

CITY HOLDING CO  
Form 10-Q  
November 05, 2008

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For The Quarterly Period Ended September 30, 2008

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 0-11733

CITY HOLDING COMPANY  
(Exact name of registrant as specified in its charter)

West Virginia  
(State or other jurisdiction of incorporation or  
organization)

55-0619957  
(I.R.S. Employer Identification No.)

25 Gatewater Road  
Charleston, West Virginia  
(Address of principal executive offices)

25313  
(Zip Code)

(304) 769-1100  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant has (1) 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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

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Non-accelerated filer

Smaller reporting company

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

Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date.

Common stock, \$2.50 Par Value – 16,182,644 shares as of November 4, 2008.

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## FORWARD-LOOKING STATEMENTS

All statements other than statements of historical fact included in this Quarterly Report on Form 10-Q, including statements in Management's Discussion and Analysis of Financial Condition and Result of Operations are, or may be deemed to be, forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Such information involves risks and uncertainties that could result in the Company's actual results differing from those projected in the forward-looking statements. Important factors that could cause actual results to differ materially from those discussed in such forward-looking statements include, but are not limited to: (1) the Company may incur additional provision for loan losses due to negative credit quality trends in the future that may lead to a deterioration of asset quality; (2) the Company may incur increased charge-offs in the future; (3) the Company may experience increases in the default rates or decreased prepayments on previously securitized loans that would result in impairment losses or lower the yield on such loans; (4) the Company may continue to benefit from strong recovery efforts on previously securitized loans resulting in improved yields on this asset; (5) the Company could have adverse legal actions of a material nature; (6) the Company may face competitive loss of customers; (7) the Company may be unable to manage its expense levels; (8) the Company may have difficulty retaining key employees; (9) changes in the interest rate environment may have results on the Company's operations materially different from those anticipated by the Company's market risk management functions; (10) changes in general economic conditions and increased competition could adversely affect the Company's operating results; (11) changes in other regulations and government policies affecting bank holding companies and their subsidiaries, including changes in monetary policies, could negatively impact the Company's operating results; (12) the Company may experience difficulties growing loan and deposit balances; (13) the current economic environment poses significant challenges for us and could adversely affect our financial condition and results of operations; and (14) the United States government's plan to purchase large amounts of illiquid, mortgage-backed and other securities from financial institutions may not be effective and/or it may not be available to us. Forward-looking statements made herein reflect management's expectations as of the date such statements are made. Such information is provided to assist stockholders and potential investors in understanding current and anticipated financial operations of the Company and is included pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances that arise after the date such statements are made.

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## City Holding Company and Subsidiaries

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## PART I, ITEM 1 – FINANCIAL STATEMENTS

## Consolidated Balance Sheets

## City Holding Company and Subsidiaries

(in thousands)

|   | September 30<br>2008<br>(Unaudited) | December 31<br>2007<br>(Note A) |
|---|-------------------------------------|---------------------------------|
| Assets  |                                     |                                 |
| Cash and due from banks   | \$ 52,206                           | \$ 64,726                       |
| Interest-bearing deposits in depository institutions  | 4,045                               | 9,792                           |
| Cash and Cash Equivalents   | 56,251                              | 74,518                          |
| Investment securities available for sale, at fair value   | 345,982                             | 382,098                         |
| Investment securities held-to-maturity, at amortized cost (approximate fair value at September 30, 2008 and December 31, 2007 - \$22,997 and \$35,198, respectively)  | 33,033                              | 34,918                          |
| Total Investment Securities   | 379,015                             | 417,016                         |
| Gross loans   | 1,777,731                           | 1,767,021                       |
| Allowance for loan losses   | (18,879)                            | (17,581)                        |
| Net Loans   | 1,758,852                           | 1,749,440                       |
| Bank owned life insurance   | 69,660                              | 64,467                          |
| Premises and equipment  | 59,574                              | 54,635                          |
| Accrued interest receivable   | 9,733                               | 11,254                          |
| Net deferred tax asset  | 41,173                              | 20,633                          |
| Intangible assets   | 57,600                              | 58,238                          |
| Other assets  | 33,707                              | 32,566                          |
| Total Assets  | \$ 2,465,565                        | \$ 2,482,767                    |
| Liabilities   |                                     |                                 |
| Deposits:   |                                     |                                 |
| Noninterest-bearing   | \$ 316,205                          | \$ 314,231                      |
| Interest-bearing:   |                                     |                                 |
| Demand deposits   | 404,593                             | 397,510                         |
| Savings deposits  | 359,644                             | 350,607                         |
| Time deposits   | 912,184                             | 927,733                         |
| Total Deposits  | 1,992,626                           | 1,990,081                       |
| Short-term borrowings   | 140,726                             | 161,916                         |
| Long-term debt  | 21,075                              | 4,973                           |
| Other liabilities   | 26,226                              | 31,803                          |
| Total Liabilities   | 2,180,653                           | 2,188,773                       |
| Shareholders' Equity  |                                     |                                 |
| Preferred stock, par value \$25 per share: 500,000 shares authorized; none issued   | -                                   | -                               |
| Common stock, par value \$2.50 per share: 50,000,000 shares authorized; 18,499,282 shares issued at September 30, 2008 and December 31, 2007, less 2,316,638 and 2,292,357 shares in treasury, respectively | 46,249                              | 46,249                          |
| Capital surplus   | 102,831                             | 103,390                         |

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|   |              |              |
|---|--------------|--------------|
| Retained earnings                                   | 231,789      | 224,386      |
| Cost of common stock in treasury                    | (81,480)     | (80,664)     |
| Accumulated other comprehensive (loss) income:      |              |              |
| Unrealized loss on securities available-for-sale    | (20,631)     | (1,783)      |
| Unrealized gain on derivative instruments           | 8,128        | 4,390        |
| Underfunded pension liability                       | (1,974)      | (1,974)      |
| Total Accumulated Other Comprehensive (Loss) Income | (14,477)     | 633          |
| Total Shareholders' Equity                          | 284,912      | 293,994      |
| Total Liabilities and Shareholders' Equity          | \$ 2,465,565 | \$ 2,482,767 |

See notes to consolidated financial statements.

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Consolidated Statements of Income (Unaudited)  
 City Holding Company and Subsidiaries  
 (in thousands, except earnings per share data)

|  | Three Months Ended<br>September 30 |               | Nine Months Ended<br>September 30 |                |
|--|------------------------------------|---------------|-----------------------------------|----------------|
|  | 2008                               | 2007          | 2008                              | 2007           |
| <b>Interest Income</b>                                     |                                    |               |                                   |                |
| Interest and fees on loans                                 | \$ 30,254                          | \$ 32,721     | \$ 91,662                         | \$ 96,131      |
| Interest on investment securities:                         |                                    |               |                                   |                |
| Taxable  | 5,850                              | 6,024         | 18,034                            | 19,709         |
| Tax-exempt   | 371                                | 415           | 1,151                             | 1,270          |
| Interest on deposits in depository institutions            | 47                                 | 171           | 163                               | 401            |
| Interest on federal funds sold                             | -                                  | 266           | -                                 | 815            |
| <b>Total Interest Income</b>                               | <b>36,522</b>                      | <b>39,597</b> | <b>111,010</b>                    | <b>118,326</b> |
| <b>Interest Expense</b>                                    |                                    |               |                                   |                |
| Interest on deposits                                       | 9,446                              | 13,190        | 31,980                            | 38,978         |
| Interest on short-term borrowings                          | 478                                | 1,758         | 2,286                             | 4,965          |
| Interest on long-term debt                                 | 317                                | 426           | 1,070                             | 1,383          |
| <b>Total Interest Expense</b>                              | <b>10,241</b>                      | <b>15,374</b> | <b>35,336</b>                     | <b>45,326</b>  |
| <b>Net Interest Income</b>                                 | <b>26,281</b>                      | <b>24,223</b> | <b>75,674</b>                     | <b>73,000</b>  |
| Provision for loan losses                                  | 2,350                              | 1,200         | 5,083                             | 3,700          |
| <b>Net Interest Income After Provision for Loan Losses</b> | <b>23,931</b>                      | <b>23,023</b> | <b>70,591</b>                     | <b>69,300</b>  |
| <b>Non-interest Income</b>                                 |                                    |               |                                   |                |
| Investment securities (losses) gains                       | (27,467)                           | (1)           | (27,465)                          | 45             |
| Service charges  | 11,993                             | 11,192        | 34,536                            | 32,681         |
| Insurance commissions                                      | 1,025                              | 1,127         | 3,231                             | 2,971          |
| Trust and investment management fee income                 | 640                                | 523           | 1,721                             | 1,529          |
| Bank owned life insurance                                  | 767                                | 596           | 2,193                             | 1,877          |
| Gain on sale of retail credit card merchant agreements     | -                                  | -             | -                                 | 1,500          |
| VISA IPO Gain  | -                                  | -             | 3,289                             | -              |
| Other income   | 284                                | 377           | 1,250                             | 1,252          |
| <b>Total Non-interest Income</b>                           | <b>(12,758)</b>                    | <b>13,814</b> | <b>18,755</b>                     | <b>41,855</b>  |
| <b>Non-interest Expense</b>                                |                                    |               |                                   |                |
| Salaries and employee benefits                             | 9,538                              | 9,307         | 28,418                            | 27,275         |
| Occupancy and equipment                                    | 1,800                              | 1,600         | 5,098                             | 4,762          |
| Depreciation   | 1,110                              | 1,160         | 3,330                             | 3,339          |
| Professional fees  | 435                                | 416           | 1,229                             | 1,204          |
| Postage, delivery, and statement mailings                  | 636                                | 641           | 1,908                             | 1,988          |
| Advertising  | 821                                | 801           | 2,081                             | 2,533          |
| Telecommunications   | 496                                | 438           | 1,354                             | 1,352          |
| Bankcard expenses  | 717                                | 623           | 1,978                             | 1,737          |
| Insurance and regulatory                                   | 354                                | 364           | 1,025                             | 1,132          |
| Office supplies  | 527                                | 472           | 1,488                             | 1,369          |
| Reposessed asset losses (gains), net of expenses           | 314                                | (47)          | 437                               | (52)           |

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|  |           |         |         |         |
|--|-----------|---------|---------|---------|
| Loss on early extinguishment of debt     | -         | -       | 1,208   | -       |
| Other expenses                           | 2,498     | 2,256   | 8,352   | 6,514   |
| Total Non-interest Expense               | 19,246    | 18,031  | 57,906  | 53,153  |
| (Loss) Income Before Income Taxes        | (8,073)   | 18,806  | 31,440  | 58,002  |
| Income tax (benefit) expense             | (5,516)   | 6,092   | 7,580   | 19,735  |
| Net (Loss) Income                        | (2,557)   | 12,714  | 23,860  | 38,267  |
| Basic (loss) earnings per common share   |           |         |         |         |
|  | \$ (0.16) | \$ 0.76 | \$ 1.48 | \$ 2.24 |
| Diluted (loss) earnings per common share |           |         |         |         |
|  | \$ (0.16) | \$ 0.76 | \$ 1.47 | \$ 2.24 |
| Dividends declared per common share      |           |         |         |         |
|  | \$ 0.34   | \$ 0.31 | \$ 1.02 | \$ 0.93 |
| Average common shares outstanding:       |           |         |         |         |
| Basic                                    |           |         |         |         |
|  | 16,142    | 16,714  | 16,130  | 17,057  |
| Diluted                                  |           |         |         |         |
|  | 16,195    | 16,767  | 16,189  | 17,116  |

See notes to consolidated financial statements.



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## Consolidated Statements of Changes in Shareholders' Equity (Unaudited)

City Holding Company and Subsidiaries

Nine Months Ended September 30, 2008 and 2007

(in thousands)

|  | Common<br>Stock | Capital<br>Surplus | Retained<br>Earnings | Treasury<br>Stock | Accumulated<br>Other<br>Comprehensive<br>(Loss) | Total<br>Shareholders'<br>Equity |
|--|-----------------|--------------------|----------------------|-------------------|---|----------------------------------|
| Balances at December 31,<br>2006   | \$ 46,249       | \$ 104,043         | \$ 194,213           | \$ (33,669)       | \$ (5,529)                                      | \$ 305,307                       |
| Comprehensive income:  |                 |                    |                      |                   |   |                                  |
| Cumulative effect of adopting<br>FIN 48  |                 |                    | (125)                |                   |   | (125)                            |
| Net income   |                 |                    | 38,267               |                   |   | 38,267                           |
| Other comprehensive gains,<br>net of deferred income taxes<br>of \$755:        |                 |                    |                      |                   |   |                                  |
| Unrealized gains on<br>available-for-sale securities of<br>\$138, net of taxes |                 |                    |                      |                   | 83  | 83                               |
| Net unrealized gain on<br>interest rate floors of \$1,750,<br>net of taxes     |                 |                    |                      |                   | 1,050   | 1,050                            |
| Total comprehensive income   |                 |                    |                      |                   |   | 39,400                           |
| Cash dividends declared<br>(\$0.93 per share)                                  |                 |                    | (15,703)             |                   |   | (15,703)                         |
| Issuance of stock awards, net  |                 | (430)              |                      | 802               |   | 372                              |
| Exercise of 7,300 stock<br>options   |                 | (141)              |                      | 295               |   | 154                              |
| Excess tax benefit on<br>stock-based compensation                              |                 | 3                  |                      |                   |   | 3                                |
| Purchase of 1,017,000<br>treasury shares                                       |                 |                    |                      | (37,688)          |   | (37,688)                         |
| Balances at September 30,<br>2007  | \$ 46,249       | \$ 103,475         | \$ 216,652           | \$ (70,260)       | \$ (4,396)                                      | \$ 291,720                       |

|                               | Common<br>Stock | Capital<br>Surplus | Retained<br>Earnings | Treasury<br>Stock | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Total<br>Shareholders'<br>Equity |
|-------------------------------|-----------------|--------------------|----------------------|-------------------|--|----------------------------------|
| Balances at December 31, 2007 | \$ 46,249       | \$ 103,390         | \$ 224,386           | \$ (80,664)       | \$ 633   | \$ 293,994                       |
| Comprehensive income:         |                 |                    |                      |                   |  |                                  |
| Net income                    |                 |                    | 23,860               |                   |  | 23,860                           |

Other comprehensive loss, net  
of deferred income taxes of  
\$10,073:

|  |           |            |            |             |             |    |          |
|--|-----------|------------|------------|-------------|-------------|----|----------|
| Unrealized losses on<br>available-for-sale securities of<br>\$31,413, net of taxes |           |            |            |             | (18,848)    |    | (18,848) |
| Net unrealized gain on interest<br>rate floors of \$6,230, net of<br>taxes         |           |            |            |             | 3,738       |    | 3,738    |
| Total comprehensive income   |           |            |            |             |             |    | 8,750    |
| Cash dividends declared (\$1.02<br>per share)                                      |           |            | (16,457)   |             |             |    | (16,457) |
| Issuance of stock awards, net  | (81)      |            |            | 491         |             |    | 410      |
| Exercise of 66,254 stock<br>options  | (744)     |            |            | 2,410       |             |    | 1,666    |
| Excess tax benefit on<br>stock-based compensation                                  | 266       |            |            |             |             |    | 266      |
| Purchase of 104,960 treasury<br>shares   |           |            |            | (3,717)     |             |    | (3,717)  |
| Balances at September 30,<br>2008  | \$ 46,249 | \$ 102,831 | \$ 231,789 | \$ (81,480) | \$ (14,477) | \$ | 284,912  |

See notes to consolidated financial statements.

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Consolidated Statements of Cash Flows (Unaudited)  
City Holding Company and Subsidiaries  
(in thousands)

|   | Nine Months Ended<br>September 30 |               |
|---|-----------------------------------|---------------|
|   | 2008                              | 2007          |
| <b>Operating Activities</b>   |                                   |               |
| Net income  | \$ 23,860                         | \$ 38,267     |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                   |               |
| Amortization and accretion  | (1,012)                           | (1,754)       |
| Provision for loan losses   | 5,083                             | 3,700         |
| Depreciation of premises and equipment  | 3,330                             | 3,339         |
| Deferred income tax benefit   | (10,467)                          | (472)         |
| Net periodic employee benefit cost  | 36                                | 177           |
| Gain on sale of credit card merchant agreements                                   | -                                 | (1,500)       |
| Loss on early extinguishment of debt  | 1,208                             | -             |
| Loss on disposal of premises and equipment  | 125                               | -             |
| Realized investment securities losses (gains)                                     | 27,465                            | (45)          |
| Proceeds from bank-owned life insurance   | -                                 | 205           |
| Increase in value of bank-owned life insurance                                    | (2,193)                           | (1,878)       |
| Decrease in accrued interest receivable   | 1,521                             | 82            |
| Increase in other assets  | (4,226)                           | (1,658)       |
| Decrease in other liabilities   | (5,561)                           | (2,980)       |
| <b>Net Cash Provided by Operating Activities</b>                                  | <b>39,169</b>                     | <b>35,483</b> |
| <b>Investing Activities</b>   |                                   |               |
| Proceeds from maturities and calls of securities held-to-maturity                 | 1,467                             | 11,458        |
| Proceeds from sale of money market and mutual fund securities available-for-sale  | 781,757                           | 753,770       |
| Purchases of money market and mutual fund securities available-for-sale           | (781,623)                         | (775,703)     |
| Proceeds from sales of securities available-for-sale                              | 2,823                             | 1,811         |
| Proceeds from maturities and calls of securities available-for-sale               | 45,619                            | 70,218        |
| Purchases of securities available-for-sale  | (71,470)                          | (12,085)      |
| Net increase in loans   | (11,615)                          | (41,388)      |
| Sales of premises and equipment   | 340                               | 15            |
| Purchases of premises and equipment   | (8,734)                           | (10,226)      |
| Proceeds from sale of credit card merchant agreements                             | -                                 | 1,650         |
| Investment in bank-owned life insurance   | (3,000)                           | -             |
| Redemption of VISA stock  | 2,334                             | -             |
| Proceeds from sale of derivative instrument                                       | 5,669                             | -             |
| <b>Net Cash Used in Investing Activities</b>                                      | <b>(36,433)</b>                   | <b>(480)</b>  |
| <b>Financing Activities</b>   |                                   |               |
| Net increase (decrease) in noninterest-bearing deposits                           | 1,974                             | (21,219)      |
| Net increase in interest-bearing deposits   | 571                               | 18,677        |
| Net (decrease) increase in short-term borrowings                                  | (4,631)                           | 3,184         |
| Proceeds from long-term debt  | 16,495                            | -             |
| Repayment of long-term debt   | (79)                              | (135)         |

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|  |           |           |
|--|-----------|-----------|
| Redemption of trust preferred securities                       | (17,569)  | -         |
| Purchases of treasury stock                                    | (3,717)   | (37,688)  |
| Proceeds from exercise of stock options                        | 1,666     | 154       |
| Excess tax benefits from stock-based compensation arrangements | 266       | 3         |
| Dividends paid   | (15,979)  | (15,484)  |
| Net Cash Used in Financing Activities                          | (21,003)  | (52,508)  |
| Decrease in Cash and Cash Equivalents                          | (18,267)  | (17,505)  |
| Cash and cash equivalents at beginning of period               | 74,518    | 110,448   |
| Cash and Cash Equivalents at End of Period                     | \$ 56,251 | \$ 92,943 |

See notes to consolidated financial statements.

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## Notes to Consolidated Financial Statements (Unaudited)

September 30, 2008

## Note A – Basis of Presentation

The accompanying consolidated financial statements, which are unaudited, include all of the accounts of City Holding Company (“the Parent Company”) and its wholly-owned subsidiaries (collectively, “the Company”). All material intercompany transactions have been eliminated. The consolidated financial statements include all adjustments that, in the opinion of management, are necessary for a fair presentation of the results of operations and financial condition for each of the periods presented. Such adjustments are of a normal recurring nature. The results of operations for the three and nine months ended September 30, 2008 are not necessarily indicative of the results of operations that can be expected for the year ending December 31, 2008. The Company’s accounting and reporting policies conform with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Such policies require management to make estimates and develop assumptions that affect the amounts reported in the consolidated financial statements and related footnotes. Actual results could differ from management’s estimates.

The consolidated balance sheet as of December 31, 2007 has been derived from audited financial statements included in the Company’s 2007 Annual Report to Shareholders. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with U.S. generally accepted accounting principles have been omitted. These financial statements should be read in conjunction with the financial statements and notes thereto included in the 2007 Annual Report of the Company.

## Note B –Previously Securitized Loans

Between 1997 and 1999, the Company completed six securitization transactions involving approximately \$760 million in 125% of fixed rate, junior-lien underlying mortgages. The Company retained a financial interest in each of the securitizations until 2004. Principal amounts owed to investors were evidenced by securities (“Notes”). During 2003 and 2004, the Company exercised its early redemption options on each of those securitizations. Once the Notes were redeemed, the Company became the beneficial owner of the mortgage loans and recorded the loans as assets of the Company within the loan portfolio. The table below summarizes information regarding delinquencies, net credit recoveries, and outstanding collateral balances of previously securitized loans for the dates presented:

| ( in thousands)   | As of and for the Nine<br>Months Ended<br>September 30, |           | As of and for<br>the Year<br>Ended<br>December 31, |
|---|---|-----------|--|
|   | 2008  | 2007      | 2007   |
| Previously Securitized Loans:                             |   |           |  |
| Total principal amount of loans outstanding               | \$ 19,812   | \$ 25,947 | \$ 24,062  |
| Discount  | (15,292)  | (17,630)  | (17,170)   |
| Net book value  | \$ 4,520  | \$ 8,317  | \$ 6,892   |
| Principal amount of loans between 30 and 89 days past due | \$ 558  | \$ 865    | \$ 1,099   |
| Principal amount of loans 90 days and above past due      | 40  | 176       | 76   |
| Net credit recoveries during the period                   | 334   | 2,506     | 2,938  |



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The Company accounts for the difference between the carrying value and the total expected cash flows from these loans as an adjustment of the yield earned on the loans over their remaining lives. The discount is accreted to income over the period during which payments are probable of collection and are reasonably estimable. Additionally, the collectibility of previously securitized loans is evaluated over the remaining lives of the loans. An impairment charge on previously securitized loans would be provided through the Company's provision for loan losses if the discounted present value of estimated future cash flows declines below the recorded value of previously securitized loans. No such impairment charges were recorded for the three and nine months ended September 30, 2008 and 2007, or for the year ending December 31, 2007.

As of September 30, 2008, the Company reported a book value of previously securitized loans of \$4.5 million whereas the actual contractual outstanding balance of previously securitized loans at September 30, 2008 was \$19.8 million. The difference ("the discount") between the book value and the expected total cash flows from previously securitized loans is being accreted into interest income over the estimated remaining life of the loans.

For the three months ended September 30, 2008 and 2007, the Company recognized \$1.3 million and \$1.9 million, respectively, of interest income from its previously securitized loans. During the first nine months of 2008 and 2007, the Company recognized \$4.3 million and \$5.5 million, respectively, of interest income from its previously securitized loans.

## Note C –Derivative Instruments

The Company utilizes interest rate floors to mitigate exposure to interest rate risk. As of September 30, 2008, the Company has entered into six interest rate floor contracts with a total notional amount of \$400 million, which are designated as cash flow hedges. The objective of these interest rate floors is to protect the overall cash flows from the Company's portfolio of \$400 million of variable-rate loans outstanding from the risk of a decrease in those cash flows.

The notional amounts and estimated fair values of interest rate floor derivative positions outstanding at period end are presented in the following table. The estimated fair values of the interest rate floors on variable-rate loans are based on quoted market prices.

| (in thousands)                              | September 30, 2008 |                      | December 31, 2007 |                      |
|---|--------------------|----------------------|-------------------|----------------------|
|   | Notional Value     | Estimated Fair Value | Notional Value    | Estimated Fair Value |
| Interest rate floors on variable-rate loans | \$ 400,000         | \$ 11,171            | \$ 500,000        | \$ 11,362            |

The weighted-average strike rates for interest rate floors outstanding at September 30, 2008 range from 6.00% to 7.75%.

Interest rate contracts involve the risk of dealing with counterparties and their ability to meet contractual terms. These counterparties must have an investment grade credit rating and be approved by the Company's Asset and Liability Committee.

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For cash flow hedges, the effective portion of the gain or loss on the derivative hedging instrument is reported in other comprehensive income, while the ineffective portion (indicated by the excess of the cumulative change in the fair value of the derivative over that which is necessary to offset the cumulative change in expected future cash flows on the hedge transaction) is recorded in current earnings as other income or other expense. The Company recognized the increase in market value of \$3.7 million, net of taxes, in Other Comprehensive Income for the nine months ended September 30, 2008 on these derivative instruments.

During the third quarter of 2008, the Company sold an interest rate floor with a notional value of \$100 million, and a strike rate of 8.00%, that matured June 2011 in order to mitigate its risk associated with the counterparty of this interest rate floor. The gain from this sale of \$4.2 million will be recognized over the remaining life of the hedged loans.

## Note D – Short-term borrowings

The components of short-term borrowings are summarized below:

| ( in thousands)   | September 30,<br>2008 | December 31,<br>2007 |
|---|-----------------------|----------------------|
| Security repurchase agreements                                    | \$ 128,958            | \$ 119,554           |
| Short-term advances   | 11,768                | 25,526               |
| Junior subordinated debentures owed to City Holding Capital Trust | -                     | 16,836               |
| Total short-term borrowings                                       | \$ 140,726            | \$ 161,916           |

The junior subordinated debentures owed to City Holding Capital Trust were fully redeemed during the first quarter of 2008 and as a result, the Company incurred a loss of \$1.2 million. Securities sold under agreement to repurchase were sold to corporate and government customers as an alternative to available deposit products. The underlying securities included in repurchase agreements remain under the Company's control during the effective period of the agreements.

## Note E – Long-Term Debt

The components of long-term debt are summarized below:

| (dollars in thousands)  | Maturity | September 30,<br>2008 | Weighted<br>Average<br>Interest Rate |
|---|----------|-----------------------|--------------------------------------|
| FHLB Advances   | 2009     | \$ 3,010              | 6.05%                                |
| FHLB Advances   | 2010     | 1,000                 | 5.98%                                |
| FHLB Advances   | 2011     | 570                   | 4.45%                                |
| Junior subordinated debentures owed to City Holding Capital Trust III | 2038 (a) | 16,495                | 6.31%                                |
| Total long-term debt  |          | \$ 21,075             |                                      |

(a) Junior Subordinated Debentures owed to City Holding Capital Trust III are redeemable prior to maturity at the option of the Company (i) in whole at any time or in part from time-to-time, at declining redemption prices ranging



from 103.525% to 100.00% on June 15, 2013, and thereafter, or (ii) in whole, but not in part, at any time within 90 days following the occurrence and during the continuation of certain pre-defined events.

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The Company formed a statutory business trust, City Holding Capital Trust III (“Capital Trust III”), under the laws of Delaware. Capital Trust III was created for the exclusive purpose of (i) issuing trust-preferred capital securities (“Capital Securities”), which represent preferred undivided beneficial interests in the assets of the trust, (ii) using the proceeds from the sale of the Capital Securities to acquire junior subordinated debentures (“Debentures”) issued by the Company, and (iii) engaging in only those activities necessary or incidental thereto. The trust is considered a variable interest entity for which the Company is not the primary beneficiary. Accordingly, the accounts of the trusts are not included in the Company’s consolidated financial statements.

The Capital Securities issued by the statutory business trust qualify as Tier 1 capital for the Company under the Federal Reserve Board guidelines. In March 2005, the Federal Reserve Board issued a final rule that allows the inclusion of trust preferred securities issued by unconsolidated subsidiary trusts in Tier 1 capital, but with stricter limits. Under ruling, after a five-year transition period, the aggregate amount of trust preferred securities and certain other capital elements would be limited to 25% of Tier 1 capital elements, net of goodwill. The amount of trust preferred securities and certain other elements in excess of the limit could be included in Tier 2 capital, subject to restrictions. The Company expects to continue to include all of its \$16 million in trust preferred securities in Tier 1 capital. The trust preferred securities could be redeemed without penalty if they were no longer permitted to be included in Tier 1 capital.

## Note F – Employee Benefit Plans

The Company accounts for share-based compensation in accordance with SFAS No. 123R, “Share-Based Payment.” A summary of the Company’s stock option activity and related information is presented below for the nine months ended September 30:

|                                | 2008     |                                    | 2007    |                                    |
|--------------------------------|----------|------------------------------------|---------|------------------------------------|
|                                | Options  | Weighted-Average<br>Exercise Price | Options | Weighted-Average<br>Exercise Price |
| Outstanding at January 1       | 305,909  | \$ 32.05                           | 271,709 | \$ 30.51                           |
| Granted                        | 11,500   | 40.88                              | 47,500  | 39.34                              |
| Exercised                      | (66,254) | 25.15                              | (7,300) | 21.17                              |
| Forfeited                      | -        | -                                  | (3,000) | 34.45                              |
| Outstanding at<br>September 30 | 251,155  | \$ 34.23                           | 308,909 | \$ 32.05                           |

Additional information regarding stock options outstanding and exercisable at September 30, 2008, is provided in the following table:

| Ranges<br>of<br>Exercise<br>Prices | No. of<br>Options<br>Outstanding | Weighted-Average<br>Exercise<br>Price | Weighted-Average                             |   | No. of<br>Options<br>Currently<br>Exercisable | Weighted-Average  |  | Aggregate<br>Intrinsic<br>Value of<br>Options<br>Currently<br>Exercisable<br>(in<br>thousands) |
|------------------------------------|----------------------------------|---------------------------------------|--|---|---|---|--|--|
|                                    |                                  |                                       | Remaining<br>Contractual<br>Life<br>(Months) | Aggregate<br>Intrinsic<br>Value (in<br>thousands) |   | Exercise<br>Price of<br>Options<br>Currently<br>Exercisable | Remaining<br>Contractual<br>Life<br>(Months) |  |
| \$ 13.30 -<br>28.00                | 2,100                            | \$ 13.30                              | 40   | \$ 61   | 2,100   | \$ 13.30  | 40   | \$ 61  |
| \$ 33.90                           | 150,555                          | 31.70                                 | 70   | 1,588   | 112,180                                       | 31.66   | 68   | 1,188  |

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|            |         |       |    |          |         |       |    |          |
|------------|---------|-------|----|----------|---------|-------|----|----------|
| 35.36 -    |         |       |    |          |         |       |    |          |
| \$ \$40.88 | 98,500  | 38.52 | 97 | 367      | 38,750  | 36.88 | 87 | 208      |
|            | 251,155 |       |    | \$ 2,016 | 153,030 |       |    | \$ 1,457 |

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Proceeds from stock option exercises totaled \$1.7 million and \$0.2 million during the nine months ended September 30, 2008 and September 30, 2007, respectively. Shares issued in connection with stock option exercises are issued from available treasury shares. If no treasury shares are available, new shares are issued from available authorized shares. During the nine months ended September 30, 2008 and September 30, 2007 all shares issued in connection with stock option exercises and restricted stock awards were issued from available treasury stock.

The total intrinsic value of stock options exercised was \$1.1 million and \$0.1 million during the nine months ended September 30, 2008 and September 30, 2007, respectively.

Stock-based compensation expense totaled \$0.2 million for both the nine months ended September 30, 2008 and September 30, 2007. Unrecognized stock-based compensation expense related to stock options totaled \$0.6 million at September 30, 2008. At such date, the weighted-average period over which this unrecognized expense was expected to be recognized was 1.8 years.

The fair value of the options is estimated at the date of grant using a Black-Scholes option-pricing model. The following weighted average assumptions were used to estimate the fair value of options granted during the three months ended September 30:

|                         | 2008      | 2007      |
|-------------------------|-----------|-----------|
| Risk-free interest rate | 3.14%     | 4.38%     |
| Expected dividend yield | 3.33%     | 3.15%     |
| Volatility factor       | 52.89%    | 39.06%    |
| Expected life of option | 8.0 years | 5.8 years |

The Company records compensation expense with respect to restricted shares in an amount equal to the fair market value of the common stock covered by each award on the date of grant. The restricted shares awarded become fully vested after various periods of continued employment from the respective dates of grant. The Company is entitled to an income tax deduction in an amount equal to the taxable income reported by the holders of the restricted shares when the restrictions are released and the shares are issued. Compensation is being charged to expense over the respective vesting periods.

Restricted shares are forfeited if officers and employees terminate prior to the lapsing of restrictions. The Company records forfeitures of restricted stock as treasury share repurchases and any compensation cost previously recognized is reversed in the period of forfeiture. Recipients of restricted shares do not pay any cash consideration to the Company for the shares, have the right to vote all shares subject to such grant and receive all dividends with respect to such shares, whether or not the shares have vested. Unrecognized stock-based compensation expense related to non-vested restricted shares was \$1.2 million at September 30, 2008. At September 30, 2008, this unrecognized expense is expected to be recognized over 3.4 years based on the weighted average-life of the restricted shares.

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A summary of the Company's restricted shares activity and related information is presented below for the nine months ended September 30:

|                             | 2008              |                               | 2007              |                               |
|-----------------------------|-------------------|-------------------------------|-------------------|-------------------------------|
|                             | Restricted Awards | Average Market Price at Grant | Restricted Awards | Average Market Price at Grant |
| Outstanding at January 1    | 31,818            |                               | 15,600            |                               |
| Granted                     | 8,825             | \$ 39.00                      | 17,150            | \$ 39.16                      |
| Forfeited/Vested            | (4,300)           |                               | (1,266)           |                               |
| Outstanding at September 30 | 36,343            |                               | 31,484            |                               |

The Company provides retirement benefits to its employees through the City Holding Company 401(k) Plan and Trust ("the 401(k) Plan"), which is intended to be compliant with Employee Retirement Income Security Act (ERISA) section 404(c). Any employee who has attained age 21 is eligible to participate beginning the first day of the month following employment. Unless specifically chosen otherwise, every employee is automatically enrolled in the 401(k) Plan and may make before-tax contributions of between 1% and 15% of eligible pay up to the dollar limit imposed by Internal Revenue Service regulations. The first 6% of an employee's contribution is matched 50% by the Company. The employer matching contribution is invested according to the investment elections chosen by the employee. Employees are 100% vested in both employee and employer contributions and the earnings they generate. The Company's total expense associated with the retirement benefit plan approximated \$0.5 million for the nine month periods ended September 30, 2008 and September 30, 2007.

The Company also maintains a defined benefit pension plan ("the Defined Benefit Plan") that covers approximately 300 current and former employees. The Defined Benefit Plan was frozen in 1999 subsequent to the Company's acquisition of the plan sponsor. The Defined Benefit Plan maintains an October 31 year-end for purposes of computing its benefit obligations. The Company made contributions of \$1.3 million to the Defined Benefit Plan during the nine months ended September 30, 2007 while no such contribution was made during the nine months ended September 30, 2008.

The following table presents the components of the net periodic pension cost of the Defined Benefit Plan:

| (in thousands)                   | Three months ended<br>September 30, |        | Nine months ended<br>September 30, |        |
|----------------------------------|-------------------------------------|--------|------------------------------------|--------|
|                                  | 2008                                | 2007   | 2008                               | 2007   |
| Components of net periodic cost: |                                     |        |                                    |        |
| Interest cost                    | \$ 166                              | \$ 164 | 498                                | \$ 492 |
| Expected return on plan assets   | (217)                               | (185)  | (651)                              | (555)  |
| Net amortization and deferral    | 63                                  | 80     | 189                                | 240    |
| Net Periodic Pension Cost        | \$ 12                               | \$ 59  | 36                                 | \$ 177 |



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## Note G – Commitments and Contingencies

The Company is a party to certain financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. The Company has entered into agreements with its customers to extend credit or provide a conditional commitment to provide payment on drafts presented in accordance with the terms of the underlying credit documents. The Company also provides overdraft protection to certain demand deposit customers that represent an unfunded commitment. Overdraft protection commitments, which are included with other commitments below, are uncollateralized and are paid at the Company's discretion. Conditional commitments generally include standby and commercial letters of credit. Standby letters of credit represent an obligation of the Company to a designated third party contingent upon the failure of a customer of the Company to perform under the terms of the underlying contract between the customer and the third party. Commercial letters of credit are issued specifically to facilitate trade or commerce. Under the terms of a commercial letter of credit, drafts will be drawn when the underlying transaction is consummated, as intended, between the customer and a third party. The funded portion of these financial instruments is reflected in the Company's balance sheet, while the unfunded portion of these commitments is not reflected in the balance sheet. The table below presents a summary of the contractual obligations of the Company resulting from significant commitments:

| ( in thousands)               | September 30,<br>2008 | December 31,<br>2007 |
|-------------------------------|-----------------------|----------------------|
| Commitments to extend credit: |                       |                      |
| Home equity lines             | \$ 132,345            | \$ 135,255           |
| Commercial real estate        | 41,252                | 47,529               |
| Other commitments             | 199,864               | 163,332              |
| Standby letters of credit     | 17,941                | 16,243               |
| Commercial letters of credit  | 290                   | 215                  |

Loan commitments and standby and commercial letters of credit have credit risks essentially the same as that involved in extending loans to customers and are subject to the Company's standard credit policies. Collateral is obtained based on management's credit assessment of the customer. Management does not anticipate any material losses as a result of these commitments.

## Note H – Total Comprehensive Income

The following table sets forth the computation of total comprehensive income:

| (in thousands)   | Nine months ended<br>September 30, |           |
|--|------------------------------------|-----------|
|  | 2008                               | 2007      |
| Net income   | \$ 23,860                          | \$ 38,267 |
| Unrealized security (losses) gains arising during the period | (34,644)                           | 138       |
| Reclassification adjustment for losses included in income    | 3,231                              | -         |
|  | (31,413)                           | 138       |
| Unrealized gains on interest rate floors                     | 6,230                              | 1,750     |

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|   |          |           |
|---|----------|-----------|
| Other comprehensive (loss) income before income taxes | (25,183) | 1,888     |
| Tax effect  | 10,073   | (755)     |
| Total comprehensive income                            | \$ 8,750 | \$ 39,400 |



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## Note I – Earnings per Share

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

| (in thousands, except per share data)        | Three months ended<br>September 30, |           | Nine months ended<br>September 30, |           |
|--|-------------------------------------|-----------|------------------------------------|-----------|
|  | 2008                                | 2007      | 2008                               | 2007      |
| Net (loss) income                            | \$ (2,557)                          | \$ 12,714 | \$ 23,860                          | \$ 38,267 |
| Average shares outstanding                   | 16,142                              | 16,714    | 16,130                             | 17,057    |
| Effect of dilutive securities:               |                                     |           |                                    |           |
| Employee stock options                       | 53                                  | 53        | 59                                 | 59        |
| Shares for diluted (loss) earnings per share | 16,195                              | 16,767    | 16,189                             | 17,116    |
| Basic (loss) earnings per share              | \$ (0.16)                           | \$ 0.76   | \$ 1.48                            | \$ 2.24   |
| Diluted (loss) earnings per share            | \$ (0.16)                           | \$ 0.76   | \$ 1.47                            | \$ 2.24   |

Options to purchase 89,750 shares of common stock at an exercise price between \$36.25 and \$39.34 per share were outstanding during the third quarter of 2007, but were not included in the computation of diluted earnings per share because the options' exercise price was greater than the average market price of the common shares and therefore, the effect would have been anti-dilutive. No shares were anti-dilutive at September 30, 2008.

## Note J – Fair Value Measurements

Effective January 1, 2008, the Company adopted Statement of Financial Accounting Standard No. 157, (“SFAS No. 157”), “Fair Value Measurements”, which defines fair value, establishes a framework for measuring fair value under accounting principles generally accepted in the United States, and enhances disclosures about fair value measurements. In accordance with Financial Accounting Standards Board Staff Position No. 157-2, “Effective Date of FASB Statement No. 157,” the Company has delayed application of SFAS No. 157 for non-financial assets and non-financial liabilities until January 1, 2009.

SFAS No. 157 defines fair value as the exchange price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

SFAS 157 establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy established by SFAS No. 157 is as follows:

Level 1: Quoted prices (unadjusted) or identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Company used the following methods and significant assumptions to estimate fair value for assets and liabilities recorded at fair value.

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**Securities Available for Sale.** Securities available for sale are reported at fair value utilizing Level 1, Level 2, and Level 3 inputs. The fair value of securities available for sale is determined by obtaining quoted prices on nationally recognized securities exchanges or matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities. Securities available for sale measured at fair value using Level 3 inputs are comprised of income notes with a total book value of \$0.3 million for which there is not an active market. The Company uses multiple input factors to determine the fair value of these securities that include the structure of the income note in relation to the current level of deferrals and/or defaults, changes in credit ratings of the debtors within the underlying securities, financial conditions of the debtors within the underlying securities, and broker quotes for securities with similar structure and credit risk.

**Derivatives.** Derivatives are reported at fair value utilizing Level 2 inputs. The Company obtains dealer quotations to value its interest rate floors and customer interest rate swaps.

**Previously Securitized Loans.** Previously securitized loans are reported at fair value utilizing Level 3 inputs. The Company utilizes an internal valuation model that calculates the present value of estimated future cash flows. The internal valuation model incorporates assumptions such as loan prepayment and default rates. Using cash flow modeling techniques that incorporate these assumptions, the Company estimated total future cash collections expected to be received from these loans and determined the yield at which the resulting discount would be accreted into income.

**Impaired Loans.** Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with SFAS No. 114, "Accounting by Creditors for Impairment of a Loan," (SFAS No. 114). The fair value of impaired loans is estimated using one of several methods, including collateral value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At September 30, 2008, substantially all of the impaired loans were evaluated based on the fair value of the collateral. In accordance with SFAS No. 157, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the impaired loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the impaired loan as nonrecurring Level 3.

The following table presents assets and liabilities measured at fair value on a recurring basis,

(in thousands)

| September 30, 2008                       | Total      | Level 1  | Level 2    | Level 3 |
|--|------------|----------|------------|---------|
| Assets:                                  |            |          |            |         |
| Investment Securities Available for Sale | \$ 336,552 | \$ 8,850 | \$ 327,435 | \$ 267  |
| Derivatives (Interest Rate Floors)       | 11,171     | -        | 11,171     | -       |
| Previously Securitized Loans             | 4,520      | -        | -          | 4,520   |

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The table below presents a reconciliation and income statement classification of gains and losses for all assets measured at fair value on a recurring basis for Level 3 assets for the nine months ended September 30, 2008.

| (in thousands)                          | Previously<br>Securitized<br>Loans | Investment<br>Securities<br>Available for<br>Sale |
|---|------------------------------------|---|
| Beginning balance, January 1, 2008      | \$ 6,892                           | \$ -  |
| Principal Receipts and Recoveries (net) | (2,372)                            | -   |
| Transfers into Level 3                  | -                                  | 267   |
| Ending Balance, September 30, 2008      | \$ 4,520                           | \$ 267  |

The Company may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with accounting principles generally accepted in the United States. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. At September 30, 2008, the Company has \$13.1 million of impaired loans that are measured at fair value on a nonrecurring basis. These assets are considered to be measured at Level 2 in the fair value measurement hierarchy.

Effective January 1, 2008, the Company adopted the provisions of SFAS No. 159, (“SFAS No. 159”) "The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of FASB Statement No. 115." SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value at specified election dates. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings at each subsequent reporting date. The fair value option (i) is applicable on an instrument by instrument basis, with certain exceptions, (ii) is irrevocable (unless a new election date occurs), and (iii) is applied only to entire instruments and not to portions of instruments. The Company has not elected to account for any of its assets at fair value and therefore adoption of SFAS No. 159 on January 1, 2008 did not effect its financial statements.

#### Note K– Recent Accounting Pronouncements

In December 2007, the FASB issued Statement No. 141 (revised 2007) (“SFAS No. 141R”), “Business Combinations.” SFAS No. 141R will significantly change how the acquisition method will be applied to business combinations. SFAS No. 141R requires an acquirer, upon initially obtaining control of another entity, to recognize the assets, liabilities and any non-controlling interest in the acquiree at fair value as of the acquisition date. Contingent consideration is required to be recognized and measured at fair value on the date of acquisition rather than at a later date when the amount of that consideration may be determinable beyond a reasonable doubt. This fair value approach replaces the cost-allocation process required under SFAS No. 141 whereby the cost of an acquisition was allocated to the individual assets acquired and liabilities assumed based on their estimated fair value. SFAS No. 141R requires acquirers to expense acquisition-related costs as incurred rather than allocating such costs to the assets acquired and liabilities assumed, as was previously the case under SFAS No. 141. Under SFAS No. 141R, the requirements of SFAS No. 146, “Accounting for Costs Associated with Exit or Disposal Activities,” would have to be met in order to accrue for a restructuring plan in purchase accounting. Pre-acquisition contingencies are to be recognized at fair value, unless it is a non-contractual contingency that is not likely to materialize, in which case, nothing should be recognized in purchase accounting and, instead, that contingency would be subject to the probable and estimable recognition criteria of SFAS No. 5, “Accounting for Contingencies.” Reversals of deferred income tax valuation allowances and income tax contingencies will be recognized in earnings subsequent to the measurement period. The allowance for loan losses of an acquiree will not be permitted to be recognized by the acquirer. Additionally, SFAS No. 141(R) will require new and modified disclosures surrounding subsequent changes to acquisition-related contingencies, contingent consideration, noncontrolling interests, acquisition-related transaction costs, fair values and cash flows not expected to

be collected for acquired loans, and an enhanced goodwill rollforward. The Company will be required to prospectively apply SFAS No. 141(R) to all business combinations completed on or after January 1, 2009. Early adoption is not permitted. The Company is currently evaluating SFAS No. 141 (R) and has not determined the impact it will have on our financial statements.

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In December 2007, the FASB issued SFAS No. 160 ("SFAS No. 160"), "Noncontrolling Interest in Consolidated Financial Statements, an amendment of ARB Statement No. 51." SFAS No. 160 clarifies that a non-controlling interest in a subsidiary, which is sometimes referred to as minority interest will be recharacterized as a "noncontrolling interest" and should be reported as a component of equity. Among other requirements, SFAS No. 160 requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the non-controlling interest. It also requires disclosure, on the face of the consolidated income statement, of the amounts of consolidated net income attributable to the parent and to the non-controlling interest. SFAS No. 160 is effective for the Company on January 1, 2009 and is not expected to have a significant impact on the Company's financial statements.

In March 2008, the FASB issued SFAS No. 161, ("SFAS No. 161"), "Disclosures About Derivative Instruments and Hedging Activities, an Amendment of FASB Statement No. 133." SFAS No. 161 applies to all derivative instruments and related hedged items accounted for under SFAS No. 133. SFAS No. 161 amends SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," to amend and expand the disclosure requirements of SFAS No. 133 to provide greater transparency about (i) how and why an entity uses derivative instruments, (ii) how derivative instruments and related hedge items are accounted for under SFAS No. 133 and its related interpretations, and (iii) how derivative instruments and related hedged items affect an entity's financial position, results of operations and cash flows. To meet those objectives, SFAS No. 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of gains and losses on derivative instruments and disclosures about credit-risk-related contingent features in derivative agreements. SFAS No. 161 is effective for the Company on January 1, 2009 and is not expected to have a significant impact on the Company's financial statements.

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Item 2 – Management’s Discussion and Analysis of Financial Condition and Results of Operations

Critical Accounting Policies

The accounting policies of the Company conform with U.S. generally accepted accounting principles and require management to make estimates and develop assumptions that affect the amounts reported in the financial statements and related footnotes. These estimates and assumptions are based on information available to management as of the date of the financial statements. Actual results could differ significantly from management’s estimates. As this information changes, management’s estimates and assumptions used to prepare the Company’s financial statements and related disclosures may also change. The most significant accounting policies followed by the Company are presented in Note One to the audited financial statements included in the Company’s 2007 Annual Report to Shareholders. The information included in this Quarterly Report on Form 10-Q, including the Consolidated Financial Statements, Notes to Consolidated Financial Statements, and Management’s Discussion and Analysis of Financial Condition and Results of Operations, should be read in conjunction with the financial statements and notes thereto included in the 2007 Annual Report of the Company. Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions, and estimates underlying those amounts, management has identified the determination of the allowance for loan losses, income taxes, and previously securitized loans to be the accounting areas that require the most subjective or complex judgments and, as such, could be most subject to revision as new information becomes available.

Pages 26 - 30 of this Quarterly Report on Form 10-Q provide management’s analysis of the Company’s allowance for loan losses and related provision. The allowance for loan losses is maintained at a level that represents management’s best estimate of probable losses in the loan portfolio. Management’s determination of the adequacy of the allowance for loan losses is based upon an evaluation of individual credits in the loan portfolio, historical loan loss experience, current economic conditions, and other relevant factors. This determination is inherently subjective as it requires material estimates including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant change. The allowance for loan losses related to loans considered to be impaired is generally evaluated based on the discounted cash flows using the impaired loan’s initial effective interest rate or the fair value of the collateral for certain collateral dependent loans.

The Company is subject to federal and state income taxes in the jurisdictions in which it conducts business. In computing the provision for income taxes, management must make judgments regarding interpretation of laws in those jurisdictions. Because the application of tax laws and regulations for many types of transactions is susceptible to varying interpretations, amounts reported in the financial statements could be changed at a later date upon final determinations by taxing authorities. On a quarterly basis, the Company estimates its annual effective tax rate for the year and uses that rate to provide for income taxes on a year-to-date basis.

The Company adopted Financial Accounting Standards Board (“FASB”) Interpretation No. 48, “Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement 109” (“FIN 48”) effective January 1, 2007. FIN 48 clarifies the accounting and disclosure for uncertain tax positions by requiring that a tax position meet a "probable recognition threshold" for the benefit of the uncertain tax position to be recognized in the financial statements. A tax position that fails to meet the probable recognition threshold will result in either reduction of a current or deferred tax asset or receivable, or recording a current or deferred tax liability. FIN 48 also provides guidance on measurement, derecognition of tax benefits, classification, interim period accounting disclosure, and transition requirements in accounting for uncertain tax positions. The cumulative effect of adopting FIN 48 was an increase in tax reserves and a decrease of \$0.1 million to the January 1, 2007 retained earnings balance. The Company includes interest and penalties related to income tax liabilities in income tax expense. The amount of unrecognized tax benefits could change over the next twelve months as a result of various factors. However, management cannot currently estimate the range of possible change.





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The Company is currently open to audit under the statute of limitations by the Internal Revenue Service for the years ended December 31, 2005 through 2007. The Company and its subsidiaries state income tax returns are open to audit under the statute of limitations for the year ended December 31, 2007. A tax examination by the State of West Virginia for the years 2004 through 2006 was completed during the third quarter of 2008. The final results of this examination did not have a material impact on the Company's financial statements.

The Company's effective income tax rate is based upon the expected tax rate for the year ending December 31, 2008, excluding impairment losses and the realization of previously unrecognized tax positions. Excluding the impact of these items, the Company's effective income tax rate for the nine months ended September 30, 2008 was 33.4% and for the third quarter of 2008 was 33.9% compared to 33.8% for the year ended December 31 2007, and 33.4% for the quarter ended September 30, 2007.

Note B, beginning on page 8 of this Quarterly Report on Form 10-Q, and page 30 provide management's analysis of the Company's previously securitized loans. The carrying value of previously securitized loans is determined using assumptions with regard to loan prepayment and default rates. Using cash flow modeling techniques that incorporate these assumptions, the Company estimated total future cash collections expected to be received from these loans and determined the yield at which the resulting discount would be accreted into income. If, upon periodic evaluation, the estimate of the total probable collections is increased or decreased but is still greater than the sum of the original carrying amount less subsequent collections plus the discount accreted to date, and it is probable that collection will occur, the amount of the discount to be accreted is adjusted accordingly and the amount of periodic accretion is adjusted over the remaining lives of the loans. If, upon periodic evaluation, the discounted present value of estimated future cash flows declines below the recorded value of previously securitized loans, an impairment charge would be provided through the Company's provision for loan losses. Please refer to Note B of Notes to Consolidated Financial Statements, on pages 8 - 9 for further discussion.

On a quarterly basis, the Company performs a review of investment securities to determine if any unrealized losses are other than temporarily impaired. Management considers the following, amongst other things, in its determination of the nature of the unrealized losses, (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, and (iii) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. As a result of this review and recent events regarding Freddie Mac and Fannie Mae, the Company recognized \$27.5 million of other than temporary impairment charges during the quarter ended September 30, 2008. These impairment charges were related to agency preferreds (\$21.1 million compared to a book value of \$22.7 million), pooled bank trust preferreds (\$4.3 million compared to a book value of \$22.3 million), income notes (\$1.1 million compared to a book value of \$2.0 million), and corporate debt securities (\$1.0 million compared to a book value of \$24.6 million). At September 30, 2008, the Company's portfolio of perpetual callable preferred securities, preferred securities, and trust preferred securities primarily invested in regional banks have a total book value of \$134.2 million and unrealized losses of \$43.0 million. The Company continues to actively monitor the market values of these investments along with the financial strength of the issuers behind these securities, as well as our entire investment portfolio. Based on the market information available the Company believes that the recent declines in market value are temporary and that the Company has the ability and intent to hold these securities until the temporary losses recover or the securities are called or mature. The Company cannot guarantee that such securities will recover and if additional information becomes available in the future to suggest that the losses are other than temporary, the Company may need to record impairment charges in future periods.

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Financial Summary

Nine Months Ended September 30, 2008 vs. 2007

The Company reported consolidated net income of \$23.9 million, or \$1.47 per diluted common share, for the nine months ended September 30, 2008, compared to \$38.3 million, or \$2.24 per diluted common share for the first nine months of 2007. Return on average assets ("ROA") was 1.27% and return on average equity ("ROE") was 10.3% for the first nine months of 2008, compared to 2.03% and 16.8%, respectively, for the first nine months of 2007.

The Company's net interest income for the first nine months of 2008 increased \$2.7 million compared to the first nine months of 2007 (see Net Interest Income). The Company recorded a provision for loan losses of \$5.1 million for the first nine months of 2008 while \$3.7 million was recorded for the first nine months of 2007 (see Allowance and Provision for Loan Losses). The Company recorded \$27.5 million of investment impairment losses in the first nine months of 2008 that were primarily related to actions taken by the federal government in relation to the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC) (see Non-Interest Income and Expense). As further discussed under the caption Non-Interest Income and Expense, excluding investment impairment losses, non-interest income increased \$4.4 million from the nine months ended September 30, 2007, to the nine months ended September 30, 2008. During the first nine months of 2008, the Company recognized a gain of \$3.3 million in connection with Visa's successful initial public offering ("IPO"). During the first nine months of 2007, the Company recognized a gain of \$1.5 million from the sale of its existing merchant processing agreements (see Non-Interest Income). Non-interest expense for the nine months ended September 30, 2008 increased \$4.8 million from the nine months ended September 30, 2007. 2008 included a loss of \$1.2 million as a result of the Company fully redeeming \$16.0 million of 9.15% Trust Preferred Securities during 2008 that had been issued in 1998 (see Non-Interest Expense).

Three Months Ended September 30, 2008 vs. 2007

The Company reported consolidated net loss of \$(2.6) million, or \$(0.16) per diluted common share, for the three months ended September 30, 2008, compared to net income of \$12.7 million, or \$0.76 per diluted common share for the third quarter of 2007. Return on average assets ("ROA") was (0.41)% and return on average equity ("ROE") was (3.3)% for third quarter of 2008, compared to 2.03% and 17.2%, respectively, for the third quarter of 2007.

The Company's net interest income for the third quarter of 2008 increased \$2.1 million compared to the third quarter of 2007 (see Net Interest Income). The Company recorded a provision for loan losses of \$2.35 million for the third quarter of 2008 while \$1.2 million was recorded for the third quarter of 2007 (see Allowance and Provision for Loan Losses). As further discussed under the caption Non-Interest Income and Expense, the Company recorded \$27.5 million of investment impairment losses in the third quarter of 2008 that were primarily related to actions taken by the federal government in relation to FNMA and FHLMC. Excluding investment impairment losses, non-interest income increased \$0.9 million from quarter ended September 30, 2007, to the quarter ended September 30, 2008, primarily due to increases in service fees of \$0.8 million. Non-interest expenses increased \$1.2 million from the quarter ended September 30, 2007 (see Non-Interest Expense).

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## Net Interest Income

## Nine Months Ended September 30, 2008 vs. 2007

The Company's tax equivalent net interest income increased \$2.6 million, or 3.5%, from \$73.7 million during the first nine months of 2007 to \$76.3 million during the first nine months of 2008. This increase is primarily attributable to interest expense on deposits and other interest bearing liabilities decreasing more quickly than interest income from loans and investments as a result of rate declines in the Federal Funds rate during 2008. As a result of the Company's positioning of its balance sheet, interest sensitive liabilities have repriced to lower levels at a faster rate than interest sensitive assets. Additionally, the Company's interest rate floors with a total notional value of \$500 million have diminished the impact of falling rates on the Company's interest income from variable rate loans. Partially offsetting the reduction in interest expense from falling market rates was a decrease of \$1.2 million in interest income from Previously Securitized Loans from the nine months ended September 30, 2007 as the balances of these loans have decreased 52.3%. The decrease in average balances was partially mitigated by an increase in the yield on these loans from 63.9% for the nine months ended September 30, 2007 to 105.1% for the nine months ended September 30, 2008. The yield on the previously securitized loans has increased due to improved cash flows as net default rates have been less than previously estimated. The default rates have decreased as a result of the Company's assumption of the servicing of all of the pool balances during the second quarter of 2005. Subsequent to our assumption of the servicing of these loans, the Company has averaged net recoveries, but does not believe that continued net recoveries can be sustained indefinitely. During the nine months ended September 30, 2008, the Company sold an interest rate floor with a notional value of \$100 million that matured in June 2011 in order to mitigate its risk associated with the counterparty of this interest rate floor. The gain from this sale will be recognized over the remaining life of the hedged loans.

## Three Months Ended September 30, 2008 vs. 2007

The Company's tax equivalent net interest income increased \$2.0 million, or 8.3%, from \$24.5 million during the third quarter of 2007 to \$26.5 million during the third quarter of 2008. This increase is primarily attributable to interest expense on deposits and other interest bearing liabilities decreasing more quickly than interest income from loans and investments as a result of rate declines in the Federal Funds rate during 2008. As a result of the Company's positioning of its balance sheet, interest sensitive liabilities have repriced to lower levels at a faster rate than interest sensitive assets. Additionally, the Company's interest rate floors with a total notional value of \$500 million during the quarter diminished the impact of falling rates on the Company's interest income from variable rate loans. Partially offsetting these increases from falling market rates was a decrease of \$0.6 million in interest income from Previously Securitized Loans from the third quarter of 2007, as the balances of these loans have decreased 48.2%. The decrease in average balances was partially mitigated by an increase in the yield on these loans to 110.3% for the third quarter of 2008 from 82.9% for the third quarter of 2007 and 93.2% for the three months ended December 31, 2007. The yield on the previously securitized loans has increased due to improved cash flows, as net default rates have been less than previously estimated. The default rates have decreased as a result of the Company's assumption of the servicing of all of the pool balances during the third quarter of 2005. Subsequent to our assumption of the servicing of these loans, the Company has averaged net recoveries, but does not believe that continued net recoveries can be sustained indefinitely. During the quarter, the Company sold an interest rate floor with a notional value of \$100 million that matured in June 2011 in order to mitigate its risk associated with the counterparty of this interest rate floor. The gain from this sale will be recognized over the remaining life of the hedged loans.

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Table One

Average Balance Sheets and Net Interest Income  
(in thousands)

|   | Nine months ended September 30, |                |                |                     |                |                |
|---|---------------------------------|----------------|----------------|---------------------|----------------|----------------|
|   | 2008                            |                |                | 2007                |                |                |
|   | Average<br>Balance              | Interest       | Yield/<br>Rate | Average<br>Balance  | Interest       | Yield/<br>Rate |
| <b>Assets</b>   |                                 |                |                |                     |                |                |
| Loan portfolio (1):                                   |                                 |                |                |                     |                |                |
| Residential real estate                               | \$ 604,798                      | \$ 28,187      | 6.23%          | \$ 596,585          | \$ 27,144      | 6.08%          |
| Home equity   | 359,101                         | 19,520         | 7.26           | 328,036             | 19,091         | 7.78           |
| Commercial, financial, and<br>agriculture             | 705,819                         | 35,563         | 6.73           | 672,331             | 38,119         | 7.58           |
| Loans to depository institutions                      | 1,551                           | 35             | 3.01           | 56,410              | 2,271          | 5.38           |
| Installment loans to individuals                      | 52,277                          | 4,014          | 10.26          | 45,596              | 3,967          | 11.63          |
| Previously securitized loans                          | 5,521                           | 4,343          | 105.08         | 11,583              | 5,539          | 63.94          |
| <b>Total loans</b>                                    | <b>1,729,067</b>                | <b>91,662</b>  | <b>7.08</b>    | <b>1,710,541</b>    | <b>96,131</b>  | <b>7.51</b>    |
| Securities:   |                                 |                |                |                     |                |                |
| Taxable   | 436,440                         | 18,034         | 5.52           | 482,484             | 19,709         | 5.46           |
| Tax-exempt (2)  | 36,253                          | 1,771          | 6.53           | 39,789              | 1,954          | 6.57           |
| <b>Total securities</b>                               | <b>472,693</b>                  | <b>19,805</b>  | <b>5.60</b>    | <b>522,273</b>      | <b>21,663</b>  | <b>5.55</b>    |
| Deposits in depository<br>institutions                |                                 |                |                |                     |                |                |
|   | 8,981                           | 163            | 2.42           | 12,823              | 401            | 4.18           |
| Federal funds sold                                    | -                               | -              | -              | 20,832              | 814            | 5.22           |
| <b>Total interest-earning assets</b>                  | <b>2,210,741</b>                | <b>111,630</b> | <b>6.74</b>    | <b>2,266,469</b>    | <b>119,009</b> | <b>7.02</b>    |
| Cash and due from banks                               | 58,293                          |                |                | 50,668              |                |                |
| Bank premises and equipment                           | 56,217                          |                |                | 47,555              |                |                |
| Other assets  | 191,625                         |                |                | 170,137             |                |                |
| Less: allowance for loan losses                       | (18,240)                        |                |                | (16,114)            |                |                |
| <b>Total assets</b>                                   | <b>\$ 2,498,636</b>             |                |                | <b>\$ 2,518,715</b> |                |                |
| <b>Liabilities</b>                                    |                                 |                |                |                     |                |                |
| Interest-bearing demand<br>deposits                   |                                 |                |                |                     |                |                |
|   | \$ 412,417                      | \$ 1,979       | 0.64%          | \$ 423,222          | \$ 3,777       | 1.19%          |
| Savings deposits                                      | 361,465                         | 2,796          | 1.03           | 340,490             | 4,259          | 1.67           |
| Time deposits   | 910,187                         | 27,204         | 3.99           | 922,958             | 30,942         | 4.48           |
| Short-term borrowings                                 | 136,644                         | 2,286          | 2.23           | 158,250             | 4,965          | 4.19           |
| Long-term debt  | 21,663                          | 1,070          | 6.60           | 25,368              | 1,383          | 7.29           |
| <b>Total interest-bearing liabilities</b>             | <b>1,842,376</b>                | <b>35,335</b>  | <b>2.56</b>    | <b>1,870,288</b>    | <b>45,326</b>  | <b>3.24</b>    |
| Noninterest-bearing demand<br>deposits                |                                 |                |                |                     |                |                |
|   | 322,344                         |                |                | 314,744             |                |                |
| Other liabilities                                     | 26,213                          |                |                | 29,803              |                |                |
| Stockholders' equity                                  | 307,703                         |                |                | 303,880             |                |                |
| <b>Total liabilities and<br/>stockholders' equity</b> | <b>\$ 2,498,636</b>             |                |                | <b>\$ 2,518,715</b> |                |                |
| Net interest income                                   |                                 | \$ 76,295      |                |                     | \$ 73,683      |                |
| Net yield on earning assets                           |                                 |                | 4.61%          |                     |                | 4.35%          |

- (1) For purposes of this table, non-accruing loans have been included in average balances and loan fees, which are immaterial, have been included in interest income.
- (2) Computed on a fully federal tax-equivalent basis assuming a tax rate of approximately 35%.

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## Table Two

Rate Volume Analysis of Changes in Interest Income and Interest Expense  
(in thousands)

|  | Nine months ended September 30, 2008 vs. 2007 |            |            |
|--|---|------------|------------|
|  | Increase (Decrease) Due to Change In:         |            |            |
|  | Volume  | Rate       | Net        |
| Interest-earning assets:               |   |            |            |
| Loan portfolio                         |   |            |            |
| Residential real estate                | \$ 373  | \$ 670     | \$ 1,043   |
| Home equity                            | 1,811   | (1,382)    | 429        |
| Commercial, financial, and agriculture | 1,900   | (4,456)    | (2,556)    |
| Loans to depository institutions       | (2,211)                                       | (25)       | (2,236)    |
| Installment loans to individuals       | 582   | (535)      | 47         |
| Previously securitized loans           | (2,902)                                       | 1,706      | (1,196)    |
| Total loans                            | (447)   | (4,022)    | (4,469)    |
| Securities:                            |   |            |            |
| Taxable                                | (1,881)                                       | 206        | (1,675)    |
| Tax-exempt (1)                         | (174)   | (9)        | (183)      |
| Total securities                       | (2,055)                                       | 197        | (1,858)    |
| Deposits in depository institutions    | (120)   | (118)      | (238)      |
| Federal funds sold                     | (815)   | 1          | (814)      |
| Total interest-earning assets          | \$ (3,437)                                    | \$ (3,942) | \$ (7,379) |
| Interest-bearing liabilities:          |   |            |            |
| Demand deposits                        | \$ (97)                                       | \$ (1,701) | \$ (1,798) |
| Savings deposits                       | 263   | (1,726)    | (1,463)    |
| Time deposits                          | (429)   | (3,309)    | (3,738)    |
| Short-term borrowings                  | (678)   | (2,001)    | (2,679)    |
| Long-term debt                         | (202)   | (111)      | (313)      |
| Total interest-bearing liabilities     | \$ (1,143)                                    | \$ (8,848) | \$ (9,991) |
| Net Interest Income                    | \$ (2,294)                                    | \$ 4,906   | \$ 2,612   |

(1) Fully federal taxable equivalent using a tax rate of 35%.

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Table Three

Average Balance Sheets and Net Interest Income  
(in thousands)

|   | Three months ended September 30, |               |                |                     |               |                |
|---|----------------------------------|---------------|----------------|---------------------|---------------|----------------|
|   | 2008                             |               |                | 2007                |               |                |
|   | Average<br>Balance               | Interest      | Yield/<br>Rate | Average<br>Balance  | Interest      | Yield/<br>Rate |
| <b>Assets</b>   |                                  |               |                |                     |               |                |
| Loan portfolio (3):                                   |                                  |               |                |                     |               |                |
| Residential real estate                               | \$ 613,771                       | \$ 9,393      | 6.09%          | \$ 598,954          | \$ 9,272      | 6.14%          |
| Home equity   | 373,445                          | 6,644         | 7.08           | 334,363             | 6,547         | 7.77           |
| Commercial, financial, and<br>agriculture             | 708,665                          | 11,622        | 6.52           | 679,104             | 12,776        | 7.46           |
| Loans to depository institutions                      | -                                | -             | -              | 60,000              | 820           | 5.42           |
| Installment loans to individuals                      | 53,521                           | 1,270         | 9.44           | 47,626              | 1,379         | 11.49          |
| Previously securitized loans                          | 4,781                            | 1,325         | 110.25         | 9,220               | 1,927         | 82.92          |
| <b>Total loans</b>                                    | <b>1,754,183</b>                 | <b>30,254</b> | <b>6.86</b>    | <b>1,729,267</b>    | <b>32,721</b> | <b>7.51</b>    |
| Securities:   |                                  |               |                |                     |               |                |
| Taxable   | 407,754                          | 5,850         | 5.71           | 442,696             | 6,024         | 5.40           |
| Tax-exempt (4)  | 34,653                           | 571           | 6.56           | 38,810              | 639           | 6.53           |
| <b>Total securities</b>                               | <b>442,407</b>                   | <b>6,421</b>  | <b>5.77</b>    | <b>481,506</b>      | <b>6,663</b>  | <b>5.49</b>    |
| Deposits in depository<br>institutions                |                                  |               |                |                     |               |                |
|   | 8,981                            | 47            | 2.08           | 15,184              | 171           | 4.47           |
| Federal funds sold                                    | -                                | -             | -              | 20,870              | 266           | 5.06           |
| <b>Total interest-earning assets</b>                  | <b>2,205,571</b>                 | <b>36,722</b> | <b>6.62</b>    | <b>2,246,827</b>    | <b>39,821</b> | <b>7.03</b>    |
| Cash and due from banks                               | 54,572                           |               |                | 51,149              |               |                |
| Bank premises and equipment                           | 57,923                           |               |                | 50,333              |               |                |
| Other assets  | 195,217                          |               |                | 171,478             |               |                |
| Less: allowance for loan losses                       | (18,158)                         |               |                | (16,563)            |               |                |
| <b>Total assets</b>                                   | <b>\$ 2,495,125</b>              |               |                | <b>\$ 2,503,224</b> |               |                |
| <b>Liabilities</b>                                    |                                  |               |                |                     |               |                |
| Interest-bearing demand<br>deposits                   |                                  |               |                |                     |               |                |
|   | \$ 414,022                       | \$ 654        | 0.63%          | \$ 410,907          | \$ 1,136      | 1.10%          |
| Savings deposits                                      | 362,550                          | 862           | 0.95           | 347,055             | 1,523         | 1.74           |
| Time deposits   | 887,884                          | 7,929         | 3.55           | 923,937             | 10,530        | 4.52           |
| Short-term borrowings                                 | 142,290                          | 477           | 1.33           | 165,965             | 1,758         | 4.20           |
| Long-term debt  | 21,089                           | 316           | 5.96           | 21,871              | 426           | 7.73           |
| <b>Total interest-bearing liabilities</b>             | <b>1,827,835</b>                 | <b>10,238</b> | <b>2.23</b>    | <b>1,869,735</b>    | <b>15,373</b> | <b>3.26</b>    |
| Noninterest-bearing demand<br>deposits                |                                  |               |                |                     |               |                |
|   | 331,919                          |               |                | 309,553             |               |                |
| Other liabilities                                     | 24,677                           |               |                | 28,092              |               |                |
| Stockholders' equity                                  | 310,694                          |               |                | 295,844             |               |                |
| <b>Total liabilities and<br/>stockholders' equity</b> | <b>\$ 2,495,125</b>              |               |                | <b>\$ 2,503,224</b> |               |                |
| Net interest income                                   |                                  | \$ 26,484     |                |                     | \$ 24,448     |                |
| Net yield on earning assets                           |                                  |               | 4.78%          |                     |               | 4.32%          |

- (3) For purposes of this table, non-accruing loans have been included in average balances and loan fees, which are immaterial, have been included in interest income.
- (4) Computed on a fully federal tax-equivalent basis assuming a tax rate of approximately 35%.



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Table Four  
Rate Volume Analysis of Changes in Interest Income and Interest Expense  
(in thousands)

|  | Three months ended September 30, 2008 vs. 2007 |            |            |
|--|--|------------|------------|
|  | Increase (Decrease) Due to Change In:          |            |            |
|  | Volume   | Rate       | Net        |
| Interest-earning assets:               |  |            |            |
| Loan portfolio                         |  |            |            |
| Residential real estate                | \$ 226   | \$ (105)   | \$ 121     |
| Home equity                            | 756  | (659)      | 97         |
| Commercial, financial, and agriculture | 549  | (1,703)    | (1,154)    |
| Loans to depository institutions       | (809)  | (11)       | (820)      |
| Installment loans to individuals       | 168  | (277)      | (109)      |
| Previously securitized loans           | (915)  | 313        | (602)      |
| Total loans                            | (25)   | (2,442)    | (2,467)    |
| Securities:                            |  |            |            |
| Taxable                                | (467)  | 293        | (174)      |
| Tax-exempt (1)                         | (68)   | -          | (68)       |
| Total securities                       | (535)  | 293        | (242)      |
| Deposits in depository institutions    | (69)   | (55)       | (124)      |
| Federal funds sold                     | (262)  | (4)        | (266)      |
| Total interest-earning assets          | \$ (891)                                       | \$ (2,208) | \$ (3,099) |
| Interest-bearing liabilities:          |  |            |            |
| Demand deposits                        | \$ 8   | \$ (490)   | \$ (482)   |
| Savings deposits                       | 67   | (728)      | (661)      |
| Time deposits                          | (405)  | (2,196)    | (2,601)    |
| Short-term borrowings                  | (247)  | (1,034)    | (1,281)    |
| Long-term debt                         | (15)   | (95)       | (110)      |
| Total interest-bearing liabilities     | \$ (592)                                       | \$ (4,543) | \$ (5,135) |
| Net Interest Income                    | \$ (299)                                       | \$ 2,335   | \$ 2,036   |

(1) Fully federal taxable equivalent using a tax rate of 35%.

#### Allowance and Provision for Loan Losses

Management systematically monitors the loan portfolio and the adequacy of the allowance for loan losses (“ALLL”) on a quarterly basis to provide for probable losses inherent in the portfolio. Management assesses the risk in each loan type based on historical trends, the general economic environment of its local markets, individual loan performance, and other relevant factors. Individual credits are selected throughout the year for detailed loan reviews, which are utilized by management to assess the risk in the portfolio and the adequacy of the allowance. Due to the nature of commercial lending, evaluation of the adequacy of the allowance as it relates to these loan types is often based more upon specific credit review, with consideration given to the potential impairment of certain credits and historical loss rates, adjusted for general economic conditions and other inherent risk factors. Conversely, due to the homogeneous nature of the real estate and installment portfolios, the portions of the allowance allocated to those portfolios are primarily based on prior loss history of each portfolio, adjusted for general economic conditions and other inherent risk factors.



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In evaluating the adequacy of the allowance for loan losses, management considers both quantitative and qualitative factors. Quantitative factors include actual repayment characteristics and loan performance, cash flow analyses, and estimated fair values of underlying collateral. Qualitative factors generally include overall trends within the portfolio, composition of the portfolio, changes in pricing or underwriting, seasoning of the portfolio, and general economic conditions.

The allowance not specifically allocated to individual credits is generally determined by analyzing potential exposure and other qualitative factors that could negatively impact the adequacy of the allowance. Loans not individually evaluated for impairment are grouped by pools with similar risk characteristics and the related historical loss rates are adjusted to reflect current inherent risk factors, such as unemployment, overall economic conditions, concentrations of credit, loan growth, classified and impaired loan trends, staffing, adherence to lending policies, and loss trends.

Determination of the allowance for loan losses is subjective in nature and requires management to periodically reassess the validity of its assumptions. Differences between actual losses and estimated losses are assessed such that management can timely modify its evaluation model to ensure that adequate provision has been made for risk in the total loan portfolio.

As a result of the Company's quarterly analysis of the adequacy of the ALLL, the Company recorded a provision for loan losses of \$5.1 million in the first nine months of 2008 and \$3.7 million in the first nine months of 2007. The provision for loan losses recorded during the first nine months of 2008 reflects the difficulties of certain commercial borrowers of the Company during the year, the downgrade of their related credits, and management's assessment of the impact of these difficulties on the ultimate collectability of the loans. Changes in the amount of the provision and related allowance are based on the Company's detailed methodology and are directionally consistent with changes in the growth, composition, and quality of the Company's loan portfolio. The Company believes its methodology for determining its ALLL adequately provides for probable losses inherent in the loan portfolio at September 30, 2008.

The Company had net charge-offs of \$3.8 million for the first nine months of 2008. Net charge-offs on commercial and residential loans were \$2.0 and \$0.8 million, respectively, for the nine months ended September 30, 2008. Charge-offs for commercial and residential loans were primarily related to five specific credits that had been appropriately considered in establishing the allowance for loan losses in prior periods. In addition, depository accounts net charge-offs were \$1.0 million for the first nine months of 2008. While charge-offs on depository accounts are appropriately taken against the ALLL, the revenue associated with depository accounts is reflected in service charges.

The Company's ratio of non-performing assets to total loans and other real estate owned improved slightly from 1.20% at June 30, 2008 to 0.99% at September 30, 2008. This decrease was due to the sale of an upscale residence in Southern West Virginia during the quarter that had previously been reported as other real estate owned. Based on our analysis, the Company believes that the allowance allocated to impaired loans, after considering the value of the collateral securing such loans, is adequate to cover losses that may result from these loans at September 30, 2008. The Company's ratio of non-performing assets to total loans and other real estate owned is 92 basis points lower than that of our peer group (bank holding companies with total assets between \$1 and \$5 billion), which reported average non-performing assets as a percentage of loans and other real estate owned of 1.91% for the most recently reported quarter ended June 30, 2008.

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The allowance allocated to the commercial loan portfolio (see Table Seven) increased \$1.2 million, or 11.2% from \$11.1 million at December 31, 2007 to \$12.3 at September 30, 2008. This increase was attributable to recent trends in the quality of the Company's commercial portfolio.

The allowance allocated to the residential real estate portfolio (see Table Seven) increased \$0.5 million, or 13.7% from \$3.6 million at December 31, 2007 to \$4.1 million at September 30, 2008. This increase was primarily due to difficulties experienced by a specific residential real estate loan customer during the nine months ended September 30, 2008.

The allowance allocated to the consumer loan portfolio (see Table Seven) decreased \$0.1 million, or 40.3% from \$0.3 million at December 31, 2007 to \$0.2 million at September 30, 2008. This decline was primarily due to a modest decline in losses experienced during the nine months ended September 30, 2008.

The allowance allocated to overdraft deposit accounts (see Table Seven) decreased \$0.3 million, or 11.9% from \$2.5 million at December 31, 2007 to \$2.2 million at September 30, 2008. This decline was attributable to declines in losses experienced during the nine months ended September 30, 2008.

As previously discussed, the carrying value of the previously securitized loans incorporates an assumption for expected cash flows to be received over the life of these loans. To the extent that the present value of expected cash flows is less than the carrying value of these loans, the Company would provide for such losses through the provision for loan losses.

Based on the Company's analysis of the adequacy of the allowance for loan losses and in consideration of the known factors utilized in computing the allowance, management believes that the allowance for loan losses as of September 30, 2008, is adequate to provide for probable losses inherent in the Company's loan portfolio. Future provisions for loan losses will be dependent upon trends in loan balances including the composition of the loan portfolio, changes in loan quality and loss experience trends, and recoveries of previously charged-off loans, among other factors.

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Table Five  
Analysis of the Allowance for Loan Losses

| (in thousands)                               | Nine months ended<br>September 30, |           | Year ended<br>December 31, |
|--|------------------------------------|-----------|----------------------------|
|  | 2008                               | 2007      | 2007                       |
| Balance at beginning of period               | \$ 17,581                          | \$ 15,405 | \$ 15,405                  |
| <b>Charge-offs:</b>                          |                                    |           |                            |
| Commercial, financial, and agricultural      | (1,991)                            | (155)     | (514)                      |
| Real estate-mortgage                         | (987)                              | (803)     | (1,006)                    |
| Installment loans to individuals             | (214)                              | (235)     | (343)                      |
| Overdraft deposit accounts                   | (2,372)                            | (2,851)   | (3,789)                    |
| Total charge-offs                            | (5,564)                            | (4,044)   | (5,652)                    |
| <b>Recoveries:</b>                           |                                    |           |                            |
| Commercial, financial, and agricultural      | 24                                 | 208       | 231                        |
| Real estate-mortgage                         | 144                                | 52        | 87                         |
| Installment loans to individuals             | 251                                | 319       | 416                        |
| Overdraft deposit accounts                   | 1,360                              | 1,340     | 1,744                      |
| Total recoveries                             | 1,779                              | 1,919     | 2,478                      |
| Net charge-offs                              | (3,785)                            | (2,125)   | (3,174)                    |
| Provision for loan losses                    | 5,083                              | 3,700     | 5,350                      |
| Balance at end of period                     | \$ 18,879                          | \$ 16,980 | \$ 17,581                  |
| <b>As a Percent of Average Total Loans:</b>  |                                    |           |                            |
| Net charge-offs (annualized)                 | (0.29)%                            | (0.17)%   | (0.18)%                    |
| Provision for loan losses (annualized)       | 0.39%                              | 0.29%     | 0.31%                      |
| <b>As a Percent of Non-Performing Loans:</b> |                                    |           |                            |
| Allowance for loan losses                    | 134.95%                            | 86.88%    | 104.49%                    |

Table Six  
Non-Performing Assets

| (in thousands)  | As of September 30, |           | As of<br>December 31, |
|---|---------------------|-----------|-----------------------|
|   | 2008                | 2007      | 2007                  |
| Non-accrual loans                                     | \$ 13,709           | \$ 18,896 | \$ 16,437             |
| Accruing loans past due 90 days or more               | 141                 | 566       | 314                   |
| Previously securitized loans past due 90 days or more | 40                  | 176       | 76                    |
| Total non-performing loans                            | 13,890              | 19,638    | 16,827                |

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|  |           |           |           |
|--|-----------|-----------|-----------|
| Other real estate, excluding property associated with previously securitized loans | 3,332     | 1,091     | 4,163     |
| Other real estate associated with previously securitized loans                     | 417       | 405       | -         |
| Total other real estate owned  | 3,749     | 1,496     | 4,163     |
| Total non-performing assets  | \$ 17,639 | \$ 21,134 | \$ 20,990 |

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## Table Seven

## Allocation of the Allowance For Loan Losses

| (in thousands)                         | As of September 30, |           | As of                |
|--|---------------------|-----------|----------------------|
|  | 2008                | 2007      | December 31,<br>2007 |
| Commercial, financial and agricultural | \$ 12,343           | \$ 10,417 | \$ 11,097            |
| Real estate-mortgage                   | 4,098               | 3,793     | 3,605                |
| Installment loans to individuals       | 207                 | 354       | 347                  |
| Overdraft deposit accounts             | 2,231               | 2,416     | 2,532                |
| Allowance for Loan Losses              | \$ 18,879           | \$ 16,980 | \$ 17,581            |

## Previously Securitized Loans

As of September 30, 2008, the Company reported a carrying value of previously securitized loans of \$4.5 million, while the actual outstanding contractual balance of these loans was \$19.8 million. The Company accounts for the difference between the carrying value and the total expected cash flows of previously securitized loans as an adjustment of the yield earned on these loans over their remaining lives. The discount is accreted to income over the period during which payments are probable of collection and are reasonably estimable. If, upon periodic evaluation, the estimate of the total probable collections is increased or decreased but is still greater than the sum of the original carrying amount less subsequent collections plus the discount accreted to date, and it is probable that collection will occur, the amount of the discount to be accreted is adjusted accordingly and the amount of periodic accretion is adjusted over the remaining lives of the loans. If, upon periodic evaluation, the discounted present value of estimated future cash flows declines below the recorded value of previously securitized loans, an impairment charge would be provided through the Company's provision for loan losses.

During the nine months ended September 30, 2008 and for the year ended December 31, 2007, the Company has experienced net recoveries on these loans primarily due to increased collection efforts. Subsequent to our assumption of the servicing of these loans during 2005, the Company has averaged net recoveries, but does not believe that the trend of net recoveries can be sustained indefinitely.

During the first nine months of 2008 and 2007, the Company recognized \$4.3 million and \$5.5 million, respectively, of interest income on its previously securitized loans. Cash receipts for the three and nine months ended September 30, 2008 and 2007 are summarized in the following table:

| (in thousands)           | Three months ended<br>September 30, |          | Nine months ended<br>September 30, |           |
|--------------------------|-------------------------------------|----------|------------------------------------|-----------|
|                          | 2008                                | 2007     | 2008                               | 2007      |
| Principal receipts       | \$ 1,390                            | \$ 3,038 | \$ 4,584                           | \$ 9,894  |
| Interest income receipts | 678                                 | 899      | 2,204                              | 2,987     |
| Total cash receipts      | \$ 2,068                            | \$ 3,937 | \$ 6,788                           | \$ 12,881 |

Based on current cash flow projections, the Company believes that the carrying value of previously securitized loans will approximate:

|        |                       |
|--------|-----------------------|
| As of: | Estimated<br>Balance: |
|--------|-----------------------|

|                      |             |
|----------------------|-------------|
| December 31,<br>2008 | \$5 million |
| December 31,<br>2009 | 4 million   |
| December 31,<br>2010 | 3 million   |
| December 31,<br>2011 | 2 million   |



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## Non-Interest Income and Non-Interest Expense

Nine Months Ended September 30, 2008 vs. 2007

Non-Interest Income: During the first nine months of 2008, the Company recorded \$27.5 million of investment impairment losses. The charges deemed to be other than temporary were related to agency preferreds (\$21.1 million compared to a book value of \$22.7 million), pooled bank trust preferreds (\$4.3 million compared to a book value of \$22.3 million), income notes (\$1.1 million compared to a book value of \$2.0 million), and corporate debt securities (\$1.0 million compared to a book value of \$24.6 million). The impairment charges for the agency preferred securities were due to the actions of the federal government to place Freddie Mac and Fannie Mae into conservatorship and the suspension of dividends on such preferred securities. The impairment charges related to the pooled bank trust preferred securities and income notes were based on the Company's quarterly review of its investment securities for indications of losses considered to be other than temporary. Based on management's assessment of the securities the Company owns, the seniority position of the securities within the pools, the level of defaults and deferred payments within the pools, and a review of the financial strength of the banks within the respective pools, management concluded that an impairment charge of \$4.3 million and \$1.1 million on the pooled bank trust preferred securities and the income notes, respectively, was necessary at September 30, 2008. The \$1.0 million impairment charge for corporate debt securities was due to Lehman Brothers Holdings bankruptcy filing. The Company had acquired this security as the result of an acquisition of a bank in 2005.

In addition, the Company recognized a \$3.3 million gain in connection with Visa's successful initial public offering ("IPO") completed in March 2008. The Company received approximately \$2.3 million on the partial redemption of its equity interest in Visa. The Company's remaining Class B shares will be converted to Class A shares on the third anniversary of Visa's IPO or upon Visa's settlement of certain litigation matters, whichever is later. The unconverted Class B shares are not reflected in the Company's balance sheet at September 30, 2008 as the Company has no historical basis in these shares. Visa also escrowed a portion of the proceeds from the IPO to satisfy approximately \$1.0 million of liabilities that represented the Company's proportionate share of legal judgments and settlements related to Visa litigation with American Express and Discover Financial Services.

Exclusive of investment impairment losses, investment gains, the gain from the Visa IPO, and the gain from the sale of the Company's merchant credit card portfolio in the first nine months of 2007, non-interest income increased \$2.6 million to \$42.9 million in the first nine months of 2008 as compared to \$40.3 million in the first nine months of 2007. The largest source of non-interest income is service charges from depository accounts, which increased \$1.8 million, or 5.7%, from \$32.7 million during the first nine months of 2007 to \$34.5 million during the first nine months of 2008. In addition, insurance commission revenues increased \$0.3 million, or 8.8%, during the first nine months of 2008 to \$3.2 million and bank owned life insurance revenues increased \$0.3 million, or 16.8%, during the first nine months of 2008 to \$2.2 million.

Non-Interest Expense: During the first nine months of 2008, the Company fully redeemed \$16.0 million of 9.15% trust preferred securities that had been issued in 1998. As a result of this redemption, the Company incurred charges of \$1.2 million to fully amortize issuance costs incurred in 1998 and for the early redemption premium. Excluding the loss on the early redemption of the trust preferred securities, non-interest expenses increased \$3.5 million from \$53.2 million in the first nine months of 2007 to \$56.7 million in the first nine months of 2008. Salaries and employee benefits increased \$1.1 million, or 4.2%, from the first nine months of 2007 due in part to additional staffing for new retail locations. Other expenses also include increased charitable contributions of approximately \$1.0 million during 2008.



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Three Months Ended September 30, 2008 vs. 2007

Non-Interest Income: During the third quarter of 2008, the Company recorded \$27.5 million of investment impairment losses. The charges deemed to be other than temporary were related to agency preferreds (\$21.1 million compared to a book value of \$22.7 million), pooled bank trust preferreds (\$4.3 million compared to a book value of \$22.3 million), income notes (\$1.1 million compared to a book value of \$2.0 million), and corporate debt securities (\$1.0 million compared to a book value of \$24.6 million). Exclusive of investment losses, non-interest income increased \$0.9 million, or 6.5%, to \$14.7 million in the third quarter of 2008 as compared to \$13.8 million in the third quarter of 2007. The largest source of non-interest income is service charges from depository accounts, which increased \$0.8 million, or 7.2%, from \$11.2 million during the third quarter of 2007 to \$12.0 million during the third quarter of 2008. Bank owned life insurance revenues increased \$0.2 million from the quarter ended September 30, 2007, as a result of the Company modifying this portfolio during 2008.

Non-Interest Expense: Non-interest expenses increased \$1.2 million from \$18.0 million in the third quarter of 2007 to \$19.2 million in the third quarter of 2008. Repossessed asset losses increased \$0.4 million from the third quarter of 2007 primarily as a result of the sale of an upper-scale residential property in Southern West Virginia. Salaries and employee benefits increased \$0.2 million, or 2.5%, from the third quarter of 2007 due in part to additional staffing for new retail locations. In addition, other expenses increased \$0.2 million from the third quarter of 2007 due to increased derivative amortization and check card expenses (higher volume) while occupancy and equipment expenses increased \$0.2 million due to higher maintenance costs associated with the Company's new core system that is used to process and accumulate data for customers and financial reporting.

Risk Management

Market risk is the risk of loss due to adverse changes in current and future cash flows, fair values, earnings or capital due to adverse movements in interest rates and other factors, including foreign exchange rates and commodity prices. Because the Company has no significant foreign exchange activities and holds no commodities, interest rate risk represents the primary risk factor affecting the Company's balance sheet and net interest margin. Significant changes in interest rates by the Federal Reserve could result in similar changes in LIBOR interest rates, prime rates, and other benchmark interest rates that could affect the estimated fair value of the Company's investment securities portfolio, interest paid on the Company's short-term and long-term borrowings, interest earned on the Company's loan portfolio and interest paid on its deposit accounts.

The Company's Asset and Liability Committee ("ALCO") has been delegated the responsibility of managing the Company's interest-sensitive balance sheet accounts to maximize earnings while managing interest rate risk. ALCO, comprised of various members of executive and senior management, is also responsible for establishing policies to monitor and limit the Company's exposure to interest rate risk and to manage the Company's liquidity position. ALCO satisfies its responsibilities through monthly meetings during which product pricing issues, liquidity measures, and interest sensitivity positions are monitored.

In order to measure and manage its interest rate risk, the Company uses an asset/liability management and simulation software model to periodically update the interest sensitivity position of the Company's balance sheet. The model is also used to perform analyses that measure the impact on net interest income and capital as a result of various changes in the interest rate environment. Such analyses quantify the effects of various interest rate scenarios on projected net interest income.

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The Company's policy objective is to avoid negative fluctuations in net income or the economic value of equity of more than 15% within a 12-month period, assuming an immediate parallel increase or decrease of 300 basis points. The Company measures the long-term risk associated with sustained increases and decreases in rates through analysis of the impact to changes in rates on the economic value of equity.

However, it is important to understand that a parallel downward shift of 100 basis points in interest rates from the current rate would result in both a 0.50% Fed Funds rate and long-term interest rates of approximately 0.50%. While it is true that short-term interest rates such as the Fed Funds rate have been at these low levels in the recent past, long-term interest rates have not reached levels as low as would be associated with this "worst-case" interest rate environment in well over 30 years. Based upon the Company's belief that the likelihood of an immediate 100 basis point decline in both long-term and short-term interest rates from current levels is remote, the Company has chosen to reflect only its risk to a decrease of 50 basis points from current rates.

The Company has entered into interest rate floors with a total notional value of \$400 million at September 30, 2008, with maturities between November 2008 and May 2011 to facilitate the management of its short-term interest rate risk. These derivative instruments provide the Company protection against the impact of declining interest rates on future income streams from certain variable rate loans. Please refer to Note C on page 9 for further discussion of the use and accounting for such derivative instruments.

The following table summarizes the sensitivity of the Company's net income to various interest rate scenarios. The results of the sensitivity analyses presented below differ from the results used internally by ALCO in that, in the analyses below, interest rates are assumed to have an immediate and sustained parallel shock. The Company recognizes that rates are volatile, but rarely move with immediate and parallel effects. Internally, the Company considers a variety of interest rate scenarios that are deemed to be possible while considering the level of risk it is willing to assume in "worst-case" scenarios such as shown by the following:

| Immediate<br>Basis Point<br>Change in<br>Interest Rates | Implied Federal<br>Funds Rate<br>Associated with<br>Change in<br>Interest Rates | Estimated<br>Increase<br>(Decrease) in<br>Net Income Over<br>12 Months | Estimated<br>Increase<br>(Decrease) in<br>Economic Value<br>of Equity |
|---|---|--|---|
| September<br>30, 2008:                                  |   |  |   |
| +300  | 4.50%   | 0.2%   | +6.1%   |
| +200  | 3.50  | 0.1  | +3.7  |
| +100  | 2.50  | -  | +1.7  |
| -100  | 0.50  | -  | -   |
| December 31,<br>2007:                                   |   |  |   |
| +300  | 6.50%   | +6.2%  | +14.4%  |
| +200  | 5.50  | +3.4   | +10.2   |
| +100  | 4.50  | +0.9   | +6.1  |
| -100  | 2.50  | +0.5   | +2.8  |
| -200  | 1.50  | +1.0   | +3.2  |

\* - Due to rate decreases in the Fed Funds rate subsequent to September 30, 2008, the Company used a base rate of 1.50% for the September 30, 2008 calculation

These estimates are highly dependent upon assumptions made by management, including, but not limited to, assumptions regarding the manner in which interest-bearing demand deposit and saving deposit accounts reprice in different interest rate scenarios, pricing behavior of competitors, prepayments of loans and deposits under alternative rate environments, and new business volumes and pricing. As a result, there can be no assurance that the results above will be achieved in the event that interest rates increase or decrease during 2008 and beyond. The results above do not necessarily imply that the Company will experience decreases in net income if market interest rates rise. The table above indicates how the Company's net income and the economic value of equity behave relative to an increase or decrease in rates compared to what would otherwise occur if rates remain stable.

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## Liquidity

The Company evaluates the adequacy of liquidity at both the Parent Company level and at City National. At the Parent Company level, the principal source of cash is dividends from City National. Dividends paid by City National to the Parent Company are subject to certain legal and regulatory limitations. Generally, any dividends in amounts that exceed the earnings retained by City National in the current year plus retained net profits for the preceding two years must be approved by regulatory authorities. During 2006 and 2007, City National received regulatory approval to pay \$146.4 million of cash dividends to the Parent Company, while generating net profits of \$104.8 million. Therefore, City National will be required to obtain regulatory approval prior to declaring any cash dividends to the Parent Company during 2008. Although regulatory authorities have approved prior cash dividends, there can be no assurance that future dividend requests will be approved.

The Parent Company used cash obtained from the dividends received primarily to: (1) pay common dividends to shareholders, (2) remit interest payments on the Company's trust-preferred securities, and (3) fund repurchase of the Company's common shares.

Over the next 12 months, the Parent Company has an obligation to remit interest payments approximating \$1.0 million on the junior subordinated debentures held by City Holding Capital Trust III. Additionally, the Parent Company anticipates continuing the payment of dividends, which are expected to approximate \$22.0 million on an annualized basis over the next 12 months based on common shareholders of record at September 30, 2008. However, interest payments on the debentures can be deferred for up to five years under certain circumstances and dividends to shareholders can, if necessary, be suspended. In addition to these anticipated cash needs, the Parent Company has operating expenses and other contractual obligations, which are estimated to require \$0.4 million of additional cash over the next 12 months. As of September 30, 2008, the Parent Company reported a cash balance of \$14.7 million and management believes that the Parent Company's available cash balance, together with cash dividends from City National will be adequate to satisfy its funding and cash needs over the next twelve months.

Excluding the interest and dividend payments discussed above, the Parent Company has no significant commitments or obligations in years after 2008 other than the repayment of its \$16.5 million obligation under the debentures held by City Holding Capital Trust III. However, this obligation does not mature until June 2038, or earlier at the option of the Parent Company. It is expected that the Parent Company will be able to obtain the necessary cash, either through dividends obtained from City National or the issuance of other debt, to fully repay the debentures at their maturity.

City National manages its liquidity position in an effort to effectively and economically satisfy the funding needs of its customers and to accommodate the scheduled repayment of borrowings. Funds are available to City National from a number of sources, including depository relationships, sales and maturities within the investment securities portfolio, and borrowings from the FHLB and other financial institutions. As of September 30, 2008, City National's assets are significantly funded by deposits and capital. Additionally, City National maintains borrowing facilities with the FHLB and other financial institutions that are accessed as necessary to fund operations and to provide contingency funding mechanisms. As of September 30, 2008, City National has the capacity to borrow an additional \$704.3 million from the FHLB and other financial institutions under existing borrowing facilities. City National maintains a contingency funding plan, incorporating these borrowing facilities, to address liquidity needs in the event of an institution-specific or systemic financial industry crisis. Also, City National maintains a significant percentage (91.3%, or \$346.0 million at September 30, 2008) of its investment securities portfolio in the highly liquid available-for-sale classification. Although it has no current intention to do so, these securities could be liquidated, if necessary, to provide an additional funding source. City National also segregates certain mortgage loans, mortgage-backed securities, and other investment securities in a separate subsidiary so that it can separately monitor the asset quality of these primarily mortgage-related assets, which could be used to raise cash through securitization transactions or obtain additional equity or debt financing if necessary.



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The Company manages its asset and liability mix to balance its desire to maximize net interest income against its desire to minimize risks associated with capitalization, interest rate volatility, and liquidity. With respect to liquidity, the Company has chosen a conservative posture and believes that its liquidity position is strong. The Company's net loan to asset ratio is 71.3% as of September 30, 2008 and deposit balances fund 80.8% of total assets. The Company has obligations to extend credit, but these obligations are primarily associated with existing home equity loans that have predictable borrowing patterns across the portfolio. The Company has significant investment security balances that totaled \$379.0 million at September 30, 2008, and that greatly exceeded the Company's non-deposit sources of borrowing which totaled \$188.0 million. Further, the Company's deposit mix has a very high proportion of transaction and savings accounts that fund 43.8% of the Company's total assets.

As illustrated in the Consolidated Statements of Cash Flows, the Company generated \$39.2 million of cash from operating activities during the first nine months of 2008, primarily from interest income received on loans and investments, net of interest expense paid on deposits and borrowings. The Company used \$36.4 million of cash in investing activities during the first nine months of 2008 primarily for the purchase of money market and mutual fund securities and to fund additional loans, net of proceeds from these securities and from maturities and calls of securities available-for-sale. The Company used \$21.0 million of cash in financing activities during the first nine months of 2008, primarily from the redemption of trust preferred stock of \$17.6 million, cash dividends paid to the Company's common stockholders of \$16.0 million, and the purchase of treasury stock of \$3.7 million. These decreases were partially offset by the proceeds from long term debt of \$16.5 million.

Capital Resources

During the first nine months of 2008, Shareholders' Equity decreased \$9.1 million, or 3.1%, from \$294.0 million at December 31, 2007 to \$284.9 million at September 30, 2008. This decrease was primarily due to unrealized losses on available-for-sale securities of \$18.8 million, dividends declared during the year of \$16.5 million, and common stock purchases of \$3.7 million. These decreases were partially offset by reported net income of \$23.9 million and unrealized gains on interest rate floors of \$3.7 million.

During August 2007, the Board of Directors authorized the Company to buy back up to 1,000,000 shares of its common shares (approximately 6% of outstanding shares) in open market transactions at prices that are accretive to the earnings per share of continuing shareholders. No time limit was placed on the duration of the share repurchase program. 104,960 shares were repurchased during the first nine months of 2008 and there can be no assurance that the Company will continue to reacquire its common shares or to what extent the repurchase program will be successful. As of September 30, 2008, the Company may repurchase an additional 437,528 shares from time to time depending on market conditions under the authorization.



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Regulatory guidelines require the Company to maintain a minimum total capital to risk-adjusted assets ratio of 8.0%, with at least one-half of capital consisting of tangible common stockholders' equity and a minimum Tier I leverage ratio of 4.0%. Similarly, City National is also required to maintain minimum capital levels as set forth by various regulatory agencies. Under capital adequacy guidelines, City National is required to maintain minimum total capital, Tier I capital, and leverage ratios of 8.0%, 4.0%, and 4.0%, respectively. To be classified as "well capitalized," City National must maintain total capital, Tier I capital, and leverage ratios of 10.0%, 6.0%, and 5.0%, respectively.

The Company's regulatory capital ratios remained strong for both City Holding and City National as illustrated in the following table:

|                   |         |                  | Actual                |                      |
|-------------------|---------|------------------|-----------------------|----------------------|
|                   | Minimum | Well-Capitalized | September 30,<br>2008 | December 31,<br>2007 |
| City Holding:     |         |                  |                       |                      |
| Total             | 8.0%    | 10.0%            | 14.1%                 | 15.1%                |
| Tier I Risk-based | 4.0     | 6.0              | 13.1                  | 14.1                 |
| Tier I Leverage   | 4.0     | 5.0              | 10.0                  | 10.3                 |
| City National:    |         |                  |                       |                      |
| Total             | 8.0%    | 10.0%            | 11.4%                 | 13.5%                |
| Tier I Risk-based | 4.0     | 6.0              | 10.3                  | 12.5                 |
| Tier I Leverage   | 4.0     | 5.0              | 7.9                   | 9.1                  |

## Item 3 – Quantitative and Qualitative Disclosure of Market Risk

The information called for by this item is provided under the caption "Risk Management" under Item 2—Management's Discussion and Analysis of Financial Condition and Results of Operations.

## Item 4 – Controls and Procedures

Pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934, the Company carried out an evaluation, with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures (as defined under Rule 13a-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based upon that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in timely alerting them to material information relating to the Company required to be included in the Company's periodic SEC filings. There has been no change in the Company's internal control over financial reporting during the quarter ended September 30, 2008 that has materially affected, or is 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 is engaged in various legal actions that it deems to be in the ordinary course of business. The Company believes that it has adequately provided for probable costs of current litigation. As these legal actions are resolved, however, the Company could realize positive and/or negative impact to its financial performance in the period in which these legal actions are ultimately decided. There can be no assurance that current actions will have immaterial results, either positive or negative, or that no material actions may be presented in the future.

Item 1A. Risk Factors.

There have been no material changes to the factors disclosed in Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2007.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds. None.

Item 3. Defaults Upon Senior Securities. None.

Item 4. Submission of Matters to a Vote of Security Holders. None.

Item 5. Other Information. None.

Item 6. Exhibits.

(a) Exhibits

31(a) Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 for Charles R. Hageboeck

31(b) Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 for David L. Bumgarner

32(a) Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 for Charles R. Hageboeck

32(b) Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 for David L. Bumgarner

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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.

City Holding Company  
(Registrant)

/s/ Charles R. Hageboeck  
Charles R. Hageboeck  
President and Chief Executive Officer  
(Principal Executive Officer)

/s/ David L. Bumgarner  
David L. Bumgarner  
Senior Vice President, Chief Financial Officer and  
Principal Accounting Officer  
(Principal Financial Officer)

Date: November 4, 2008