

CADENCE FINANCIAL CORP

Form 10-Q

May 12, 2010

[Table of Contents](#)

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

Washington, D. C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended March 31, 2010

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 1-15773

**CADENCE FINANCIAL CORPORATION**

(Exact name of registrant as specified in its charter)

Edgar Filing: CADENCE FINANCIAL CORP - Form 10-Q

**Mississippi**  
(State or other jurisdiction of  
incorporation or organization)

**64-0694775**  
(I. R. S. Employer  
Identification No.)

**301 East Main Street, P. O. Box 1187, Starkville, Mississippi**  
(Address of principal executive offices)

**39760**  
(Zip Code)

**Registrant's telephone number, including area code: (662) 323-1341**

**(Former name, former address and former fiscal year, if changed since last report): N/A**

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

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

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

Large accelerated filer  Accelerated filer   
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 practicable date:

Common Stock, \$1 Par Value 11,911,564 shares as of March 31, 2010.

**Table of Contents**

**TABLE OF CONTENTS**

**PART I. Financial Information**

<u>Item 1. Financial Statements</u>	3
<u>Consolidated Statements of Income for the Three Months Ended March 31, 2010 and 2009 (unaudited)</u>	3
<u>Consolidated Balance Sheets as of March 31, 2010 (unaudited) and December 31, 2009</u>	4
<u>Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2010 and 2009 (unaudited)</u>	5
<u>Notes to Consolidated Financial Statements (unaudited)</u>	6
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	11
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	34
<u>Item 4. Controls and Procedures</u>	36

**PART II. Other Information**

<u>Item 1. Legal Proceedings</u>	36
<u>Item 1A. Risk Factors</u>	36
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	44
<u>Item 3. Defaults Upon Senior Securities</u>	44
<u>Item 4. Reserved</u>	44
<u>Item 5. Other Information</u>	44
<u>Item 6. Exhibits</u>	45

**Table of Contents****PART I FINANCIAL INFORMATION****ITEM 1 FINANCIAL STATEMENTS****CADENCE FINANCIAL CORPORATION****CONSOLIDATED STATEMENTS OF INCOME****FOR THE THREE MONTHS ENDED MARCH 31, 2010 AND 2009****(Unaudited)**

<b>(In thousands, except per share data)</b>	<b>March 31, 2010</b>	<b>March 31, 2009</b>
<b><i>INTEREST INCOME</i></b>		
Interest and fees on loans	\$ 13,677	\$ 16,566
Interest and dividends on securities	3,713	5,058
Other interest income	151	49
<b>Total interest income</b>	<b>17,541</b>	<b>21,673</b>
<b><i>INTEREST EXPENSE</i></b>		
Interest on deposits	5,943	7,159
Interest on borrowed funds	1,350	2,194
<b>Total interest expense</b>	<b>7,293</b>	<b>9,353</b>
Net interest income	10,248	12,320
Provision for loan losses	1,621	32,761
Net interest income (loss) after provision for loan losses	8,627	(20,441)
<b><i>OTHER INCOME</i></b>		
Service charges on deposit accounts	1,832	2,005
Trust Department income	485	466
Other income	1,173	1,967
Securities gains (losses), net	(13)	63
<b>Total other income</b>	<b>3,477</b>	<b>4,501</b>
<b><i>OTHER EXPENSE</i></b>		
Salaries and employee benefits	6,606	7,069
Premises and fixed asset expense	1,865	1,884
Impairment loss on goodwill		66,542
Other expense	5,743	4,679
<b>Total other expense</b>	<b>14,214</b>	<b>80,174</b>
Income (loss) from continuing operations, before income taxes	(2,110)	(96,114)
Income tax expense (benefit)	(896)	(12,088)

Edgar Filing: CADENCE FINANCIAL CORP - Form 10-Q

Net income (loss) from continuing operations	(1,214)	(84,026)
Loss from discontinued operations, before income taxes		(30)
Income tax expense		105
Net loss from discontinued operations		(135)
Net income (loss)	(1,214)	(84,161)
Preferred stock dividend and accretion of discount	658	322
Net income (loss) applicable to common shareholders	\$ (1,872)	\$ (84,483)
Net income (loss) per share from continuing operations - basic and diluted	\$ (0.10)	\$ (7.05)
Net loss per share from discontinued operations - basic and diluted	\$	\$ (0.01)
Net income (loss) per share - basic and diluted	\$ (0.10)	\$ (7.06)
Net income (loss) applicable to common shareholders per share - basic and diluted	\$ (0.16)	\$ (7.09)
Dividends per common share	\$	\$ 0.05

**Table of Contents****CADENCE FINANCIAL CORPORATION****CONSOLIDATED BALANCE SHEETS**

(Amounts in thousands)	March 31, 2010 (Unaudited)	Dec. 31, 2009
<b>ASSETS</b>		
Cash and due from banks	\$ 21,624	\$ 17,450
Interest-bearing deposits with banks	349,318	249,460
Federal funds sold and securities purchased under agreements to resell	339	30,125
Total cash and cash equivalents	371,281	297,035
Securities available-for-sale	345,381	330,079
Securities held-to-maturity (estimated fair value of \$2,738 at March 31, 2010 and \$2,741 at December 31, 2009)	2,670	2,671
Other securities	13,223	13,313
Total securities	361,274	346,063
Loans	1,046,611	1,091,477
Less: allowance for loan losses	(42,338)	(43,422)
Net loans	1,004,273	1,048,055
Interest receivable	7,011	7,338
Premises and equipment, net	30,807	31,247
Intangible assets	1,252	1,384
Other assets	114,108	113,333
Total Assets	\$ 1,890,006	\$ 1,844,455
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Liabilities:		
Noninterest-bearing deposits	\$ 170,847	\$ 170,722
Interest-bearing deposits	1,372,807	1,329,088
Total deposits	1,543,654	1,499,810
Interest payable	1,722	2,046
Federal funds purchased and securities sold under agreements to repurchase	90,005	87,432
Subordinated debentures	30,928	30,928
Other borrowed funds	96,730	96,640
Other liabilities	8,095	7,845
Total liabilities	1,771,134	1,724,701
Shareholders Equity:		
Preferred stock \$10 par value, authorized 10,000,000 shares; issued 44,000 shares	42,205	42,097
Common stock \$1 par value, authorized 50,000,000 shares; issued 11,911,564 shares as of March 31, 2010 and 11,912,564 shares as of December 31, 2009	11,912	11,913
Surplus	95,979	95,931
Retained earnings (accumulated deficit)	(34,704)	(32,832)
Accumulated other comprehensive income	3,480	2,645

Edgar Filing: CADENCE FINANCIAL CORP - Form 10-Q

Total shareholders' equity	118,872	119,754
Total Liabilities and Shareholders' Equity	\$ 1,890,006	\$ 1,844,455

**Table of Contents****CADENCE FINANCIAL CORPORATION****CONSOLIDATED STATEMENTS OF CASH FLOWS****FOR THE THREE MONTHS ENDED MARCH 31, 2010 AND 2009****(Unaudited)**

(In thousands)	March 31, 2010	March 31, 2009
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income (loss)	\$ (1,214)	\$ (84,161)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	812	914
Deferred income taxes	(842)	(65)
Provision for loan losses	1,621	32,761
Net performance share activity	33	51
(Gains) losses on sale of securities, net	13	(63)
Impairment loss on goodwill		66,542
(Increase) decrease in interest receivable	327	486
(Increase) decrease in loans held for sale	1,021	665
(Increase) decrease in other assets	(521)	(17,807)
Increase (decrease) in interest payable	(324)	(638)
Increase (decrease) in other liabilities	340	2,944
Net cash provided by (used in) operating activities	1,266	1,629
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from maturities and calls of securities	18,637	70,247
Proceeds from sale of securities	86	10,278
Purchase of securities	(32,581)	(242,353)
(Increase) decrease in loans	41,140	20,212
(Additions) disposals of premises and equipment	(169)	(172)
Net cash provided by (used in) investing activities	27,113	(141,788)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Increase (decrease) in deposits	43,844	140,873
Issuance of preferred stock and warrants		44,000
Dividend paid on preferred stock	(550)	(220)
Dividend paid on common stock		(595)
Net change in federal funds purchased and securities sold under agreements to repurchase	2,573	(9,721)
Net change in short-term FHLB borrowings		(20,000)
Proceeds from long-term debt		35,000
Repayment of long-term debt		(13,309)
Net cash provided by (used in) financing activities	45,867	176,028
Net increase (decrease) in cash and cash equivalents	74,246	35,869
Cash and cash equivalents at beginning of period	297,035	61,233
Cash and cash equivalents at end of period	\$ 371,281	\$ 97,102
Cash paid during the period for:		
Interest	\$ 7,617	\$ 9,991



Income tax

\$

\$

5

**Table of Contents**

CADENCE FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The accompanying unaudited consolidated financial statements include the accounts of Cadence Financial Corporation (the Corporation), Cadence Bank, N.A. (Cadence or the Bank), a wholly-owned subsidiary of the Corporation, Enterprise Bancshares, Inc. (Enterprise), a wholly-owned subsidiary of the Corporation, Cadence Insurance Services of Mississippi (CISM) (formerly Galloway-Chandler-McKinney Insurance Agency, Inc. (GCM)), a wholly-owned subsidiary of Cadence, NBC Insurance Services of Alabama, Inc., a wholly-owned subsidiary of Cadence, NBC Service Corporation (NBC Service), a wholly-owned subsidiary of Cadence, and Commerce National Insurance Company (CNIC), a wholly-owned subsidiary of NBC Service. All significant intercompany accounts and transactions have been eliminated. On August 31, 2009, the Bank completed the disposition of the assets used in and liabilities arising from GCM's operations and changed its name to Cadence Insurance Services of Mississippi. See Note 11 for additional information relating to this transaction.

In the process of preparing these financial statements, management makes certain estimates and assumptions that affect the reported amounts that appear in these statements. Management believes that such estimates and assumptions are reasonable and are based on the best information available; however, actual results could differ. The results of operations in the interim statements are not necessarily indicative of results that may be expected for the full year.

In the opinion of management, all adjustments necessary for the fair presentation of the financial statements presented in this report have been made. Such adjustments were of a normal recurring nature unless otherwise disclosed in this Form 10-Q.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. It is suggested that these financial statements be read in conjunction with the financial statements and notes thereto included in the Corporation's annual report on Form 10-K for the year ended December 31, 2009.

The Corporation's management has evaluated the effect of subsequent events on these financial statements through the date the financial statements were issued.

**Note 1. Recently Issued Accounting Pronouncements**

In January 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2010-06, Improving Disclosures about Fair Value Measurements (ASC Subtopic 820-10). This guidance requires additional disclosures concerning transfers into and out of Levels 1 and 2 of the fair value measurement hierarchy and activity in Level 3 measurements. ASU No. 2010-06 also clarifies existing disclosure requirements regarding the level of disaggregation and inputs and valuation techniques. ASU No. 2010-06 is generally effective for reporting periods beginning after December 15, 2009. The Corporation adopted the guidance in ASU No. 2010-06 for the quarter ended March 31, 2010. Please refer to Note 9 of these Notes to Consolidated Financial Statements for disclosures related to the Corporation's fair value measurements.

**Note 2. Goodwill and Other Intangible Assets**

Goodwill represents the cost of acquired institutions in excess of the fair value of the net assets acquired. In accordance with FASB Accounting Standards Codification (ASC) Topic 350, Intangibles-Goodwill and Other, the Corporation did not amortize goodwill but periodically tested it for impairment using a two-step approach. The first step is to determine whether impairment could exist. If the results of the first step of testing indicate that impairment does not exist, the test is complete. If the results of the first step indicate that impairment could exist, the second step of testing must be performed. The Corporation completed its periodic impairment test in accordance with ASC 350 as of September 30, 2008. Based on the results of the first step of testing, management concluded that no impairment writedown was warranted as of September 30, 2008.

ASC Topic 350 also requires that goodwill be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Several events occurred during the first quarter of 2009 that triggered an additional test of goodwill for impairment, including the Corporation's results of operations for the three months ended March 31, 2009, the

## **Table of Contents**

changes in credit quality of the Bank's loan portfolio, and the continued general decline in the economy. The Corporation engaged an outside consultant to perform this additional goodwill impairment testing. Due primarily to the decline in the market value of the Corporation's stock and the decline in prices paid in comparable bank acquisition transactions between December 31, 2008 and March 31, 2009, the first step of the goodwill impairment test indicated that potential impairment existed and the second step of testing should be performed to determine the amount of impairment. In the second step of the test, the Corporation's balance sheet was marked to market to determine the current fair value of the goodwill that should be recorded on the balance sheet. The test concluded that the Corporation's goodwill was fully impaired as of March 31, 2009. As a result, a goodwill impairment charge of \$66.8 million (\$304,000 of which related to GCM) was recognized as of that date, and the charge eliminated all goodwill previously reflected on the Corporation's balance sheet.

Other identifiable intangible assets consist primarily of the core deposit premiums arising from acquisitions. The core deposit premiums were established using the discounted cash flow approach and are being amortized using an accelerated method over the estimated remaining life of the acquired core deposits.

### **Note 3. Performance Shares and Stock Options**

The Corporation accounts for stock options in accordance with ASC Topic 718, Compensation-Stock Compensation. This guidance requires that the fair value of equity instruments exchanged for employee services (as determined on the grant date of the award) be recognized as compensation cost over the period during which an employee is required to provide service in exchange for the award—the requisite service period (usually the vesting period). Changes in fair value during the requisite service period are recognized as compensation cost over that period.

The Corporation has one active Long Term Incentive Compensation Plan (the LTIP), which is administered by the Compensation Committee of the Board of Directors. Under the LTIP, 750,000 shares of common stock have been reserved for issuance to the Corporation's eligible employees, as well as the directors and employees of certain of the Corporation's affiliates. In 2007 and 2008, under the provisions of the LTIP, the Compensation Committee awarded performance shares of stock to certain eligible employees. No awards were granted in 2009 or in the quarter ended March 31, 2010. The shares vest in equal amounts over a four-year period after they are earned.

As of March 31, 2010, a total of 41,382 performance shares are outstanding, all of which have been earned. For the three months ended March 31, 2010 and 2009, compensation expense relating to performance shares totaled \$47,000 and \$52,000, respectively.

### **Note 4. Variable Interest Entities**

Through a business trust subsidiary, the Corporation has issued \$30.9 million in subordinated debentures that were used to support trust preferred securities. These debentures are the sole assets of the trust subsidiary. In accordance with ASC Topic 810, Consolidation, the trust subsidiary is not consolidated into the financial statements of the Corporation.

### **Note 5. Comprehensive Income**

The following tables disclose comprehensive income for the periods reported in the Consolidated Statements of Income:

**Table of Contents**

(In thousands)	Three Months Ended March 31,	
	2010	2009
Net income (loss)	\$ (1,214)	\$ (84,161)
Net change in other comprehensive income, net of tax:		
Realized (gains) losses included in net income	8	(39)
Unrealized gains (losses) on securities	827	1,507
Unrealized gains (losses) on interest rate swaps		(34)
Net change in other comprehensive income, net of tax	835	1,434
Comprehensive income (loss)	\$ (379)	\$ (82,727)
Accumulated other comprehensive income at beginning of period	\$ 2,645	\$ 237
Net change in other comprehensive income	835	1,434
Accumulated other comprehensive income at end of period	\$ 3,480	\$ 1,671

**Note 6. Defined Benefit Pension Plan**

The following table contains the components of the net periodic benefit cost of the Corporation's defined benefit pension plan for the periods indicated:

(In thousands)	Three Months Ended March 31,	
	2010	2009
Service cost	\$ 170	\$ 178
Interest cost	170	186
Expected return on assets	(200)	(225)
Net (gain)/loss recognition	90	84
Prior service cost amortization	(20)	(22)
Preliminary net periodic (benefit) cost	210	201
Immediate recognition due to settlement and curtailment		222
Net periodic (benefit) cost	\$ 210	\$ 423

The expected rate of return for 2010 and 2009 was 7.0%.

**Note 7. Investment Securities**

In accordance with ASC Topic 320, Investments—Debt and Equity Securities, for the three month period ended March 31, 2010, management reviewed the securities portfolio for securities that had unrealized losses for more than twelve months that could be considered other-than-temporary. As of March 31, 2010, approximately 8% of the number of securities in the portfolio reflected an unrealized loss.

In conducting its review for other-than-temporary impairment, management evaluated a number of factors including, but not limited to the following: the amount of the unrealized loss; the length of time in which the unrealized loss has existed; the financial condition of the issuer; rating agency changes on the issuer; and management's intent and ability to hold the security for a period of time sufficient to allow for any anticipated recovery in fair value. Based on this review, management does not believe any individual security with an unrealized loss as of March 31, 2010, is other-than-temporarily impaired.

**Note 8. Derivative Instruments**



## **Table of Contents**

In 2009, the Corporation hedged a portion of its floating rate prime based lending portfolio by entering into floating to fixed interest rate swaps. These transactions were cash flow hedges as defined by ASC Topic 815, Derivatives and Hedging, and they were accounted for under that guidance. As of March 31, 2010, the Corporation had no outstanding swaps.

For the three month period ended March 31, 2009, \$34,000 in unrealized losses (net of tax) was recorded as an adjustment to accumulated other comprehensive income for the change in fair value of the Corporation's outstanding swaps.

### **Note 9. Fair Value**

The following disclosure of the estimated fair value of financial instruments is made in accordance with ASC Topic 825, Financial Instruments. The estimated fair value amounts have been determined using available market information and appropriate valuation methodologies. However, considerable judgment is necessarily required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts that could be realized in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

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

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

**Securities** For securities held as investments, fair value equals market price, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities. The fair value of other securities, which consist of FHLB stock and Federal Reserve Bank stock, is estimated to be the carrying value, which is par.

**Loans** The fair value of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

**Deposits** The fair values of demand deposits are, as required by ASC Topic 825, equal to the carrying value of such deposits. Demand deposits include noninterest-bearing demand deposits, savings accounts, NOW accounts, and money market demand accounts. The fair value of variable rate term deposits, those repricing within six months or less, approximates the carrying value of these deposits. Discounted cash flows have been used to value fixed rate term deposits and variable rate term deposits repricing after six months. The discount rate used is based on interest rates currently being offered on comparable deposits as to amount and term.

**Federal Funds Purchased and Securities Sold Under Agreements to Repurchase** The fair value of any federal funds purchased, securities sold under agreements to repurchase and other short-term borrowings generally approximates their carrying value. The fair value of structured repurchase agreements is estimated using discounted cash flows, based on current incremental borrowing rates for similar types of arrangements.

**Subordinated Debentures** The subordinated debentures bear interest at a variable rate and the carrying value approximates the fair value.

**FHLB and Other Borrowings** The fair value of the fixed rate borrowings is estimated using discounted cash flows, based on current incremental borrowing rates for similar types of borrowing arrangements. The carrying amount of any variable rate borrowings approximates their fair values.

**Off-Balance Sheet Instruments** Fair values of off-balance sheet financial instruments are based on fees charged to enter into similar agreements. However, commitments to extend credit do not represent a significant value until such commitments are funded or closed. Management has determined that these instruments do not have a distinguishable fair value and no fair value has been assigned.

**Table of Contents**

(In thousands)	March 31, 2010		December 31, 2009	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
<b>Financial Instruments:</b>				
<b>Assets:</b>				
Cash and cash equivalents	\$ 371,281	\$ 371,281	\$ 297,035	\$ 297,035
Securities available-for-sale	345,381	345,381	330,079	330,079
Securities held-to-maturity	2,670	2,738	2,671	2,741
Other securities	13,223	13,223	13,313	1,313
Loans	1,004,273	1,004,258	1,048,055	1,049,952
<b>Liabilities:</b>				
Noninterest-bearing deposits	170,847	170,847	170,722	170,722
Interest-bearing deposits	1,372,807	1,356,440	1,329,088	1,315,583
Federal funds purchased and securities sold under agreements to repurchase	90,005	91,650	87,432	89,582
Subordinated debentures	30,928	30,928	30,928	30,928
FHLB and other borrowings	96,730	94,899	96,640	94,985

ASC Topic 820, Fair Value Measurements and Disclosures, provides guidance for using fair value to measure assets and liabilities and establishes a hierarchy to prioritize the inputs used to measure fair value. The fair value hierarchy gives the highest priority to a valuation based on quoted prices in active markets for identical assets and liabilities (Level 1), moderate priority to a valuation based on quoted prices in active markets for similar assets and liabilities and/or based on assumptions that are observable in the market (Level 2), and the lowest priority to a valuation based on assumptions that are not observable in the market (Level 3).

In accordance with the disclosure requirements of ASC 820, the following table reflects assets measured at fair value on a recurring basis as of March 31, 2010. U. S. Treasury securities are reported at fair value utilizing Level 1 inputs. Other securities classified as available-for-sale are reported at fair value using Level 2 inputs. For these securities, the Corporation obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U. S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information, and bond terms and conditions, among other things.

(In thousands)	Total	Level 1	Level 2
<b>Available-for-sale securities:</b>			
U. S. Treasury securities	\$ 319	\$ 319	\$
Obligations of other U. S. government agencies	44,929		44,929
Obligations of states and municipal subdivisions	28,604		28,604
Mortgage-backed securities	231,927		231,927
Other securities	39,602		39,602
<b>Total</b>	<b>\$ 345,381</b>	<b>\$ 319</b>	<b>\$ 345,062</b>

The following valuation methodologies are used for assets measured at fair value on a non-recurring basis and recognized in the Corporation's consolidated balance sheets, as well as the general classification of these assets within the valuation hierarchy.

**Impaired Loans** A loan is considered impaired when, based on current information, it is probable that the Corporation will not receive all amounts due in accordance with the contractual terms of the loan agreement. Once a loan has been identified as impaired, management measures impairment in accordance with ASC Topic 310, Receivables. The measurement of impaired loans is based on the present value of expected future cash flows discounted at the loan's effective interest rate or the loan's observable market price, or based on the fair value of the collateral if the loan is collateral-dependent. When management's measured value of the impaired loan is less than the recorded investment in the loan, the amount of the impairment is recorded as a specific reserve within the allowance for loan losses. Any subsequent measurement adjustments are recorded as adjustments to the allowance for loan losses. Impaired loans are classified within Level 3 of the fair value hierarchy.

**Table of Contents**

**Other Real Estate Owned** Other real estate owned ( OREO ) consists of properties acquired through foreclosure and, as held for sale property, is recorded at the lower of the outstanding loan balance or current appraisal less estimated costs to sell. Any write-down to fair value required at the time of foreclosure is charged to the allowance for loan losses. Subsequent gains or losses on other real estate resulting from the sale of the property or additional valuation allowances required due to further declines in market value are reported in other noninterest income or expenses. OREO is classified within Level 3 of the fair value hierarchy.

The following table presents the fair value measurement of assets measured at fair value on a nonrecurring basis. Fair value for these assets was determined based on the methodology discussed above, using assumptions that are not observable in the market (Level 3 inputs).

(In thousands)	Fair Value at March 31, 2010
Impaired loans	\$ 80,598
Other real estate owned	34,787

**Note 10. Preferred Stock**

On January 9, 2009, the Corporation completed the sale of \$44 million of non-voting preferred stock to the U.S. Treasury Department under the Capital Purchase Program ( CPP ). These senior preferred shares pay a cumulative annual dividend at a 5% rate for the first five years and will reset to a rate of 9% after five years if not redeemed by the Corporation prior to that time. In connection with the issuance of the senior preferred shares, the Corporation also issued to the U.S. Treasury a warrant to purchase the Corporation's common stock up to a maximum of 15% of the senior preferred amount, or \$6.6 million.

**Note 11. Discontinued Operations**

On August 31, 2009, the Bank completed the disposition of the assets used in and liabilities arising from GCM's operations to four limited liability companies established by former owners and employees of GCM. The total purchase price of the assets sold, net of liabilities assumed, was approximately \$5.5 million.

As a result of this transaction, the consolidated statement of income for the three months ended March 31, 2009, has been restated to reflect GCM's operations as discontinued operations. Summarized financial information for discontinued operations is as follows:

(In thousands)	Three Months Ended March 31, 2009
Income	\$ 1,340
Expense	1,370
Loss from discontinued operations	(30)
Income tax expense	105
Net loss from discontinued operations	\$ (135)

**ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS****Forward-Looking Information**

The following provides a narrative discussion and analysis of significant changes in our results of operations and financial condition for the three months ended March 31, 2010. Certain information included in this discussion contains forward-looking statements and information that are based on management's beliefs, expectations and conclusions, drawn from certain assumptions and information currently available. The Private Securities Litigation Act of 1995 encourages the disclosure of forward-looking information by management by providing a safe harbor for such information. This discussion includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended,



Edgar Filing: CADENCE FINANCIAL CORP - Form 10-Q

and Section 21E of the Securities Exchange Act of 1934, as amended. Although we believe that the expectations and conclusions reflected in such forward-

**Table of Contents**

looking statements are reasonable, such forward-looking statements are based on numerous assumptions (some of which may prove to be incorrect) and are subject to risks and uncertainties, which could cause the actual results to differ materially from our expectations. When used in this discussion, the words anticipate, believe, estimate, expect, objective, project, forecast, goal and similar expressions are intended to describe forward-looking statements. In addition to any assumptions and other factors referred to specifically in connection with forward-looking statements, factors that could cause our actual results to differ materially from those contemplated in any forward-looking statements include, among others, increased competition, regulatory factors, economic conditions, changing interest rates, changing market conditions (including specifically the downturn in the U. S. real estate market), availability or cost of capital, changes in accounting standards and practices, employee workforce factors, ability to achieve cost savings and enhance revenues, the assimilation of acquired operations and establishing credit practices and efficiencies therein, acts of war or acts of terrorism or geopolitical instability and other effects of legal and administrative proceedings, changes in federal, state or local laws and regulations and other factors identified in Item 1A, Risk Factors, and Item 7A, Quantitative and Qualitative Disclosures about Market Risk, of our Annual Report on Form 10-K for the year ended December 31, 2009, and that may be discussed from time to time in other reports filed with the Securities and Exchange Commission subsequent to this report. Readers are cautioned not to place undue reliance on any forward-looking statements made by or on behalf of the Corporation. Any such statement speaks only as of the date the statement was made. We undertake no obligation to update or revise any forward-looking statements, whether as a result of changes in actual results, changes in assumptions or other factors affecting such statements.

For purposes of the following discussion and analysis of the Corporation's financial condition and results of operations, the words the Corporation, we, us and our refer to the combined entities of Cadence Financial Corporation and Cadence, unless the context suggests otherwise.

**Introduction and Management Overview**

The Corporation is a bank holding company that owns Cadence. Cadence operates in the states of Mississippi, Alabama, Tennessee, Florida and Georgia. Cadence's primary business is providing traditional commercial and retail banking services to customers. Cadence also provides other financial services, including trust services, mortgage services and investment products. Our stock is traded on The NASDAQ Global Select Market (NASDAQ) under the ticker symbol of CADE.

Like most community banks, we derive most of our income from interest we receive on our loans and investments. Our primary source of funds for making these loans and investments is our deposits, on which we pay interest. Consequently, one of the key measures of our success is our amount of net interest income. Another key measure is the spread between the yield we earn on these interest-earning assets and the rate we pay on our interest-bearing liabilities.

***Summary of Quarter Ended March 31, 2010***

***Net Interest Income.*** Our net interest income declined from \$12.3 million in the first quarter of 2009 to \$10.2 million in the first quarter of 2010. For the first quarter of 2010, our net interest margin was 2.41%, compared to 2.64% for the first quarter of 2009. This 23 basis point decrease in margin resulted primarily from our intentionally building liquidity by accumulating deposits and investing in short-term assets with lower yields and our inability to decrease our cost of funding at the same rate that our yields declined on our earning assets. When comparing the first quarter of 2010 to the same quarter of 2009, we lost 53 basis points of yield on our earning assets but only reduced the cost of funds by 39 basis points. Our average earning assets declined by \$163.4 million, or 8.6% between the first quarter of 2009 and the first quarter of 2010.

***Provision for Loan Losses.*** Our provision for loan losses was \$1.6 million for the first quarter of 2010, as compared to \$32.8 million for the first quarter of 2009. We incurred \$2.7 million in net charge-offs for the first quarter of 2010, compared to \$14.4 million for the first quarter of 2009. In 2009, we experienced a significant increase in non-performing loans, mostly due to real estate construction and development loans. However, for the first quarter of 2010, our non-performing loan balance remained relatively flat compared to the fourth quarter of 2009.

***Other Income (Noninterest Income).*** Our noninterest income, exclusive of securities gains and losses, declined by \$948,000, or 21.4%, between the first quarter of 2009 and the first quarter of 2010, primarily due to lower service charges and other noninterest income.

---

**Table of Contents**

*Other Expense (Noninterest Expense).* During the first quarter of 2010, total noninterest expenses declined by \$66.0 million from the same period of 2009. This decline resulted from a \$66.5 million impairment loss on goodwill recognized in the first quarter of 2009. All of our major noninterest expense categories declined from 2009 to 2010 except our other noninterest expenses, which include higher OREO-related expenses. Other expenses in the first quarter of 2010 also included approximately \$550,000 in one-time costs related to the earnings improvement project we commissioned during this period. These costs included consulting fees and severance costs that were expensed in the first quarter of 2010.

*Net Income/(Loss).* For the first quarter of 2010, we reported a net loss applicable to common shareholders of \$1.9 million, or \$(0.16) per common share, compared to a net loss of \$84.5 million, or \$(7.09) per common share, for the first quarter of 2009.

*Loan Portfolio.* As of March 31, 2010, our loan portfolio was \$1.047 billion, distributed among commercial real estate loans, commercial and industrial loans, 1-4 family mortgages and consumer loans. As of March 31, 2010, our loan portfolio was composed of approximately 56.0% variable rate loans and 44.0% fixed rate loans. Beginning in the third quarter of 2008, we made a concerted effort to reduce our concentration in commercial real estate loans, particularly residential construction and development loans, which typically have higher yields but also higher risk. Overall, our average loan balances declined by approximately \$240.7 million, or 18.3%, from the first quarter of 2009 to the first quarter of 2010, from \$1.314 billion for the first quarter of 2009 to \$1.073 billion for the first quarter of 2010.

*Investment Portfolio.* The average balance of our investment portfolio was \$343.6 million for the first quarter of 2010, compared to \$467.8 million for the first quarter of 2009, representing a decrease of \$124.2 million, or 26.5%. However, our yield on securities only declined by 1 basis point to 4.38% over this same period.

*Federal Funds Sold and Other Interest-Bearing Assets.* Our average balances in federal funds sold and other interest-bearing assets increased significantly from the first quarter of 2009 to the first quarter of 2010, from \$108.3 million to \$309.8 million. This increase resulted from our intentionally building liquidity by accumulating deposits and investing in short-term assets. Our yields on these assets increased from 0.18% for the first quarter of 2009 to 0.20% for the first quarter of 2010.

*Deposits and Other Interest-Bearing Liabilities.* Our overall cost of funds declined by 39 basis points between the first quarter of 2009 and the first quarter of 2010. Average borrowed funds declined by \$104.0 million, or 32.8%, for the first quarter of 2010 compared to the first quarter of 2009. Average interest-bearing deposits increased slightly to \$1.343 billion for the first quarter of 2010, compared to \$1.341 billion for the first quarter of 2009.

***Outlook for the Remainder of 2010***

Our most significant challenges for 2010 are credit quality and raising capital. We have taken an aggressive stance in addressing credit issues in our loan portfolio to minimize future risks. We have increased our focus on underwriting standards and have revamped our loan policy. We also have a special assets team in place to manage workout situations and to assist in the timely disposition of defaulted assets. Our management information systems relating to loan concentrations provide us with current and detailed information about the status of the loans in our portfolio. We feel that these steps place us in the best position possible to manage credit quality; however, credit quality will remain an issue as long as current economic trends, including increasing unemployment rates and depressed real estate prices, continue.

We expect our loan portfolio balance to decline slightly during the first part of 2010, as we continue to reduce our lending exposure to commercial real estate loans and face the challenges of the current economic environment. Currently, we expect that interest rates will remain flat through the second quarter of 2010. We based our 2010 projections, budgets and goals on these expectations. If these trends move differently than expected in either direction or speed, they could have a material impact on our financial condition and results of operations. The areas of our operations most directly impacted would be the net interest margin, loan and deposit growth and the provision for loan losses.

We also expect our wholesale borrowing costs to continue to decline in 2010. We intend to use our excess liquidity to absorb maturing wholesale liabilities to reduce interest expense.

---

## **Table of Contents**

As part of an agreement entered into with the Office of the Comptroller of the Currency (the OCC) in April 2009, Cadence was required to achieve by September 30, 2009, and maintain on an ongoing basis, a Tier 1 leverage ratio of 8.0% and a total risk-based capital ratio of 12.0%. As of March 31, 2010, Cadence had a Tier 1 leverage ratio of 5.6% and a total risk-based capital ratio of 10.5%. As a result of our recent losses and Cadence's requirement for additional capital to meet these higher ratios, we have a need to raise additional capital. We are currently seeking to raise this capital through all available sources, including public or private equity offerings. It is difficult in the current economic environment for financial institutions to raise capital; however, we will continue our efforts to raise capital and meet the required capital ratios during our 2010 fiscal year. Any capital raise pursuant to a private placement that would exceed NASDAQ guidelines would require prior shareholder approval.

We will also continue our efforts to control noninterest expenses by working to achieve maximum efficiencies within our franchise. We have commissioned an earnings improvement project, which is currently in process, to look aggressively at reducing our overhead expenses during 2010 and forward. During the first quarter of 2010, we began restructuring certain operations and delivery channels to our customers and eliminated some redundant staff positions. Currently, the project is focused on noninterest income, expense control, product design and delivery, improved processing and accountability. We have established process improvement teams to focus on ongoing programs to enhance our efficiencies and improve the delivery of services to our customers. We expect that these programs will improve our product offerings, customer service, and overall profitability. These programs should be fully implemented during the second half of 2010. We continue to leverage the investments in infrastructure that we have made over the past few years and believe that they will continue to have a positive impact on our costs going forward. Reducing our efficiency ratio remains a key objective. However, our noninterest expenses for 2010 will continue to be negatively affected by significant FDIC insurance premiums and costs associated with OREO.

We remain focused on our strategy to build future earnings and understand that improved asset quality and margin growth are the keys to achieving that strategy. We are managing our credit problems aggressively and refining our risk management processes in order to enhance our future earnings. Additionally, we plan to raise capital to meet our capital ratio requirements imposed by the OCC.

### **Critical Accounting Policies and Other Accounting Issues**

Our accounting and financial reporting policies conform to United States generally accepted accounting principles and to general practices within the banking industry. Note A of the Notes to Consolidated Financial Statements in our annual report contains a summary of our accounting policies. Management is of the opinion that Note A, read in conjunction with all other information in our annual report on Form 10-K for the year ended December 31, 2009, and the information in this quarterly report, including this Management's Discussion and Analysis, should be sufficient to provide the reader with the information needed to understand our financial condition and results of operations.

*Critical Accounting Policies.* We believe that the areas of the financial statements that require the most difficult, subjective and complex judgments, and therefore contain the most critical accounting estimates, are as follows:

the provision for loan losses and the resulting allowance for loan losses;

the liability and expense relating to our pension and other postretirement benefit plans;

issues relating to other-than-temporary impairment losses in the investment portfolio; and

income taxes.

*Provision/Allowance for Loan Losses.* Our allowance for loan losses is established through charges to earnings in the form of a provision for loan losses. The allowance for loan losses is maintained at a level that we believe is adequate to absorb all probable losses on loans inherent in the loan portfolio as of the reporting date. Events that are not within our control, such as changes in economic factors, could change subsequent to the reporting date and could cause our allowance for loan losses to be over or understated. The amount of the allowance is affected by loan charge-offs, which decrease the allowance; recoveries on loans previously charged off, which increase the allowance; and the provision for loan losses charged to earnings, which increases the allowance. In determining the provision for loan losses, we monitor fluctuations in the allowance resulting from actual charge-offs and recoveries and periodically review the size and composition of the loan portfolio in light of



---

**Table of Contents**

current and anticipated economic conditions. If actual losses exceed the amount of the allowance for loan losses, our earnings could be adversely affected.

The allowance for loan losses represents management's estimate of the amount necessary to provide for losses inherent in the loan portfolio in the normal course of business. Due to the uncertainty of risks in the loan portfolio, the allowance necessary to absorb loan losses is an estimate, based on management's judgment, using the information available at the reporting date. The allowance for loan losses is also subject to regulatory examinations and determination by the regulatory agencies as to its adequacy.

The allowance for loan losses is comprised of the following three components: specific reserves, general reserves and unallocated reserves. Generally, all loans that are identified as impaired are reviewed on a quarterly basis in order to determine whether a specific reserve is required. A loan is considered impaired when, based on current information, it is probable that we will not receive all amounts due in accordance with the contractual terms of the loan agreement. Once a loan has been identified as impaired, management measures impairment in accordance with ASC Topic 310, Receivables. The measurement of impaired loans is based on the present value of expected future cash flows discounted at the loan's effective interest rate or the loan's observable market price, or based on the fair value of the collateral if the loan is collateral-dependent. When management's measured value of the impaired loan is less than the recorded investment in the loan, the amount of the impairment is recorded as a specific reserve. These specific reserves are determined on an individual loan basis based on our current evaluation of our loss exposure for each credit, given the payment status, financial condition of the borrower and value of any underlying collateral. Loans for which specific reserves are provided are excluded from the general reserve and unallocated reserve calculations described below. Changes in specific reserves from period to period are the result in changes in the circumstances of individual loans such as charge-offs, pay-offs, changes in collateral values or other factors.

We also maintain a general reserve for each loan type in the loan portfolio. Within each loan type, the portfolio is further segmented by risk ratings and by delinquency status. In determining the amount of the general reserve portion of our allowance for loan losses, we consider factors such as our historical loan loss experience, the growth, composition and diversification of our loan portfolio, current delinquency levels, adverse situations that may affect the borrower's ability to repay, estimated value of the underlying collateral, the results of recent regulatory examinations and general economic conditions. Through the second quarter of 2009, general reserves for these loans were based upon three-year historical loss rates. Beginning in the third quarter of 2009, general reserves for these loans are based upon historical loss rates from the most recent three years (twelve quarters), with the more recent quarters receiving the most weight. Management believes that this method of weighting the latest quarters is more representative of the current economic cycle. We use this information to set the general reserve portion of the allowance for loan losses at a level we deem prudent.

Because there are additional risks of losses that cannot be quantified precisely or attributed to particular loans or types of loans, including general economic and business conditions and credit quality trends, we have established an unallocated portion of the allowance for loan losses based on our evaluation of these risks. The unallocated portion of our allowance is determined based on various factors, including general economic conditions of our market area, the growth, composition and diversification of our loan portfolio, types of collateral securing our loans, the experience level of our lending officers and staff, the quality of our credit risk management and the results of independent third party reviews of our classification of credits. The unallocated portion of the allowance for loan losses was \$2.0 million, or 4.6% of the total allowance, as of March 31, 2010, and \$2.7 million, or 6.3% of the total allowance, as of December 31, 2009.

Based on an evaluation of the loan portfolio, management presents a quarterly review of the allowance for loan losses to Cadence's executive committee and our full Board of Directors, indicating any change in the allowance for loan losses since the last review and any recommendations as to adjustments in the allowance for loan losses. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available or as events change. The allowance for loan losses was \$42.3 million as of March 31, 2010, compared to \$43.4 million as of December 31, 2009.

---

**Table of Contents**

*Pension and Other Postretirement Benefit Plans.* Another area that requires subjective and complex judgments is the liability and expense relating to our pension and other postretirement benefit plans. We maintain several benefit plans for our employees. They include a defined benefit pension plan, a defined contribution pension plan, a 401(k) plan and a deferred compensation plan. We make all contributions to these plans when they are due.

The defined benefit pension plan is the only plan that requires multiple assumptions to determine the liability under the plan. This plan has been frozen to new participants for several years. Management evaluates, reviews with the plan actuaries, and updates as appropriate the assumptions used in the determination of pension liability, including the discount rate, the expected rate of return on plan assets, and increases in future compensation. Actual experience that differs from the assumptions could have a significant effect on our financial position and results of operations. The discount rate and the expected rate of return on the plan assets have a significant impact on the actuarially computed present value of future benefits that is recorded on the financial statements as a liability, together with the corresponding pension expense.

In selecting the expected rate of return, management, in consultation with the plan trustees, selected a rate based on assumptions compared to recent returns and economic forecasts. We consider the current allocation of the portfolio and the probable rates of return of each investment type. In selecting the appropriate discount rate, management, with the assistance of actuarial consultants, performs an analysis of the plan's projected benefit cash flows against discount rates from a national Pension Discount Curve (a yield curve used to measure pension liabilities). Based on the analysis, in 2009, management used a discount rate of 6.25% and an expected rate of return of 7.0%. From a historical perspective, the plan's rate of return for 2009 was 23.8%. Additionally, our philosophy has been to fund the plan annually to the maximum amount deductible under the Internal Revenue Service ( IRS ) rules. As of December 31, 2009, the plan had a current accumulated benefit obligation of approximately \$10.5 million, and plan assets with a fair value of approximately \$12.1 million.

ASC Topic 715, Compensation-Retirement Benefits, requires us to recognize the funded status of the plan (defined as the difference between the fair value of plan assets and the projected benefit obligation) on the balance sheet and to recognize in other comprehensive income any gains or losses and prior service costs or benefits not included as components of periodic benefit cost. Detailed information on our pension plan and the related impacts of these changes on the amounts recorded in our financial statements can be found in Note M (Employee Benefits) of the Notes to Consolidated Financial Statements in our December 31, 2009 Form 10-K (audited).

*Other-Than-Temporary Impairment of Investment Securities.* A third area that requires subjective and complex judgments on the part of management is the review of the investments in the investment portfolio for other-than-temporary impairments. ASC Topic 320, Investments Debt and Equity Securities, requires us to review our investment portfolio and determine if it has impairment losses that are other-than-temporary. In making its determination, management considers the following items:

the length of time and extent to which the current market value is less than cost;

evidence of a forecasted recovery;

financial condition and the industry environment of the issuer, including whether the issuer is a government or government-backed agency (all of the mortgage-backed securities and collateralized mortgage obligations in our portfolio are issued by government-backed agencies);

downgrades of the securities by rating agencies;

whether there has been a reduction or elimination of dividends or interest payments;

whether we have the intent or ability to hold the securities for a period of time sufficient to allow for anticipated recovery of fair value; and

## Edgar Filing: CADENCE FINANCIAL CORP - Form 10-Q

interest rate trends that may impact recovery and realization.

As of March 31, 2010, our investment portfolio included certain securities that were impaired by definition, but based on our review and consideration of the criteria listed above, we determined that none of the impairments were other-than-temporary.

*Income Taxes.* The calculation of our income tax provision is complex and requires the use of estimates and judgment in its determination. We are subject to the income tax laws of the various jurisdictions where we conduct business, and we estimate income tax expense based on amounts expected to be owed to these various tax



**Table of Contents**

jurisdictions. We assess the appropriate tax treatment of transactions and filing positions after considering statutes, regulations, judicial precedent and other pertinent information, and we maintain tax accruals consistent with our evaluation. Changes in the estimate of accrued taxes occur periodically due to changes in tax rates, interpretations of tax laws, the status of examinations by the taxing authorities, and newly enacted statutory, judicial, and regulatory guidance that could affect the relative merits of the tax positions. These changes, when they occur, impact accrued taxes and can materially affect our operating results. For additional information, see Note J (Income Taxes) of the Notes to Consolidated Financial Statements in our December 31, 2009 Form 10-K (audited).

*Other Accounting Issues.* We own NBC Capital Corporation (MS) Statutory Trust I (the Trust), which was organized under the laws of the State of Connecticut for the purpose of issuing trust preferred securities (TPSS). In accordance with ASC Topic 810, Consolidation, the Trust, which is considered a variable interest entity, is not consolidated into our financial statements because the only activity of the variable interest entity is the issuance of TPSSs.

**Comparison of Results of Operations for the Quarters Ended March 31, 2010 and 2009*****Net Income/(Loss)***

For the first quarter of 2010, we reported a net loss of \$1.9 million, or \$(0.16) per common share, compared to a net loss of \$84.5 million, or \$(7.09) per common share, for the first quarter of 2009.

***Net Interest Income***

Net interest income, the primary source of our earnings, represents income generated from earning assets, less the interest expense of funding those assets. Changes in net interest income may be divided into two components: (1) the change in average earning assets (volume component) and (2) the change in the net interest spread (rate component). Net interest spread represents the difference between yields on earning assets and rates paid on interest-bearing liabilities. Net interest margin is net interest income divided by average earning assets.

Net interest income decreased by \$2.1 million, or 16.8%, from \$12.3 million for the first quarter of 2009 to \$10.3 million for the first quarter of 2010. Between the first quarter of 2009 and the first quarter of 2010, the net interest margin declined from 2.64% to 2.41%. During this period, we lost 53 basis points of yield on our earning assets while only decreasing our cost of funds by 39 basis points.

The declining yield on earning assets is mostly attributable to changes in mix and volumes. Average earning assets declined from \$1.890 billion in the first quarter of 2009 to \$1.726 billion in the first quarter of 2010. This decline is primarily due to a \$240.7 million decrease in average loan balances from the first quarter of 2009 to the first quarter of 2010 and a \$124.2 million decrease in average investment securities during the same period. These declines were partially offset by a \$201.4 million increase in federal funds sold and other interest-bearing assets, as we intentionally built liquidity by accumulating deposits and investing in short-term assets.

The decrease in our cost of funds from the first quarter of 2009 to the first quarter of 2010 was impacted by rates and volumes. While our average interest-bearing deposits only increased by \$2.0 million from the first quarter of 2009 to the first quarter of 2010, our deposit cost declined by 37 basis points. However, our average balance of other borrowings declined by \$104.0 million over this period, and our cost of other borrowings declined by 23 basis points.

The following table shows, for the periods indicated, an analysis of net interest income, including the average amount of earning assets and interest-bearing liabilities outstanding during the period, the interest earned or paid on such amounts, the average yields/rates paid and the net yield on earning assets on both a book and tax equivalent basis:

**Table of Contents**

(Dollars in thousands)	Average Balance	
	Quarter Ended 3/31/10	Quarter Ended 3/31/09
<b>EARNING ASSETS:</b>		
Net loans	\$ 1,073,061	\$ 1,313,743
Federal funds sold and other interest-bearing assets	309,757	108,311
Securities:		
Taxable	339,922	362,826
Tax-exempt	3,694	104,967
<b>Totals</b>	<b>1,726,434</b>	<b>1,889,847</b>
<b>INTEREST-BEARING LIABILITIES:</b>		
Interest-bearing deposits	1,342,590	1,340,621
Borrowed funds, federal funds purchased and securities sold under agreements to repurchase and other interest-bearing liabilities	213,228	317,254
<b>Totals</b>	<b>1,555,818</b>	<b>1,657,875</b>
Net amounts	\$ 170,616	\$ 231,972



**Table of Contents**

The following table sets forth the effects of changing rates and volumes on our net interest income. Information is provided with respect to (i) effects on interest income attributable to changes in volume (changes in volume multiplied by prior rate); and (ii) effects on interest income attributable to changes in rate (changes in rate multiplied by prior volume). The change in interest due to both rate and volume has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of change to each.

(In thousands)	Quarter Ended March 31, 2010 Over Quarter Ended March 31, 2009		
	Total	Rate	Volume
<b>Earning assets:</b>			
Loans	\$ (2,889)	\$ 128	\$ (3,017)
<b>Securities:</b>			
Taxable	(369)	(116)	(253)
Tax exempt	(976)	294	(1,270)
Federal funds sold and other	102	6	96
<b>Total earning assets</b>	<b>\$ (4,132)</b>	<b>\$ 312</b>	<b>\$ (4,444)</b>
<b>Interest-bearing liabilities:</b>			
Interest-bearing deposits	\$ (1,216)	\$ (1,227)	\$ 11
Borrowed funds, federal funds purchased and securities sold under agreements to repurchase	(844)	(169)	(675)
<b>Total interest-bearing liabilities</b>	<b>\$ (2,060)</b>	<b>\$ (1,396)</b>	<b>\$ (664)</b>

- (1) Change in volume is the change in volume times the previous period's rate.
- (2) Change in rate is the change in rate times the previous period's balance.
- (3) The change in interest due to both rate and volume has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of change to each.

**Provision for Loan Losses**

We use our provision for loan losses to replenish the allowance for loan losses on our balance sheet. Based on our evaluation of the risk exposure contained in the loan portfolio, management believes that the level of the allowance is adequate. The Board of Directors reviews and approves management's evaluation. This is an ongoing process through which we review and determine the amount of the provision on a quarterly basis. The provision for loan losses declined from \$32.8 million during the first quarter of 2009 to \$1.6 million in the first quarter of 2010. We were able to reduce our provision for loan losses for the first quarter of 2010 because of a significant decrease in net charge-offs, as well as slight declines in our nonperforming and classified loans. We incurred \$2.7 million in net charge-offs for the first quarter of 2010, compared to \$14.4 million for the first quarter of 2009. Our allowance for loan losses was \$42.3 million as of March 31, 2010, compared to \$43.4 million at December 31, 2009.

**Other Income (Noninterest Income)**

Other income refers to our noninterest income, which includes various service charges, fees and commissions. One of our strategic objectives has been, and continues to be, to increase the level of our other income. Our other income, exclusive of securities gains and losses, decreased by \$948,000, or 21.4%, from the first quarter of 2009 to the first quarter of 2010. The following table presents for the periods indicated the major categories of noninterest income and the changes in the first quarter of 2010 compared to the first quarter of 2009:

**Table of Contents**

(In thousands)	Quarter Ended March 31,		
	2010	2009	Change
Service charges on deposit accounts	\$ 1,832	\$ 2,005	\$ (173)
Trust Department income	485	466	19
Other income	1,173	1,967	(794)
Total other income	\$ 3,490	\$ 4,438	\$ (948)

Our service charges on deposit accounts declined 8.6% from the first quarter of 2009 to the first quarter of 2010 primarily due to fewer insufficient funds fees charged in 2010. We believe that the decline in fees has resulted from our customers becoming better stewards of their funds and the increased use of electronic banking that provides our customers with real-time feedback on account balances. The 40.4% decrease in other noninterest income resulted primarily from insurance proceeds from a bank owned life insurance policy of approximately \$645,000 received in the first quarter of 2009, and \$150,000 from the first quarter 2009 reversal of an accrual that was established at the time of our most recent acquisition.

We recognized \$13,000 in net securities losses during the first quarter of 2010, compared to \$63,000 in net securities gains during the first quarter of 2009.

**Other Expense (Noninterest Expense)**

Noninterest expense represents ordinary overhead expenses and, from time to time, any impairments to goodwill or other intangibles. These expenses declined by \$66.0 million during the first quarter of 2010, compared with the first quarter of 2009. The following table presents for the periods indicated the major categories of noninterest expense and the changes in the first quarter of 2010 compared to the first quarter of 2009:

(In thousands)	Quarter Ended March 31,		
	2010	2009	Change
Salaries and employee benefits	\$ 6,606	\$ 7,069	\$ (463)
Premises and fixed asset expense	1,865	1,884	(19)
Impairment loss on goodwill		66,542	(66,542)
Other expense	5,743	4,679	1,064
Total other expense	\$ 14,214	\$ 80,174	\$ (65,960)

Salaries and employee benefits declined by 6.5% from the first quarter of 2009 to the first quarter of 2010. This decrease resulted mostly from certain staff reductions that were made in the first quarter of 2010, as a result of our ongoing earnings improvement project. As our customers continue to embrace our electronic banking services, the transaction volume in our branches has been reduced. We also combined some redundant positions and eliminated others, as we restructured our operations and delivery of services to our customers. We expect salaries and employee benefits expenses to decline further in the second quarter of 2010, as the first quarter 2010 expenses include severance packages related to the staff reductions.

In accordance with the provisions of ASC Topic 350 and based on the results of a third party analysis, we recognized a \$66.5 million impairment loss on goodwill as of March 31, 2009. This impairment charge eliminated all goodwill from our balance sheet, including approximately \$304,000 relating to GCM Insurance (reflected in discontinued operations on the consolidated statement of income). Other noninterest expenses increased by 22.8%, due to three main factors. Expenses relating to OREO increased from \$562,000 for the first quarter of 2009, to \$1.2 million for the first quarter of 2010. We also incurred \$250,000 in losses on letters of credit in the first quarter of 2010. Finally, other noninterest expenses for the first quarter of 2010 included consulting fees related to our earnings improvement project.

Changes in our income tax expense have generally paralleled changes in income. The income tax benefits for the first quarters of 2009 and 2010 resulted from the losses recognized for the periods, as well as the tax benefits of our tax-exempt income.

**Table of Contents****Financial Condition as of March 31, 2010****Summary**

Total assets were \$1.890 billion as of March 31, 2010, compared to \$1.844 billion as of December 31, 2009. Our loan portfolio balance was \$1.047 billion as of March 31, 2010, compared to \$1.091 billion as of December 31, 2009, a decrease of \$44.9 million, or 4.1%. Our investment portfolio balance was \$361.3 million as of March 31, 2010, compared to \$346.1 million as of December 31, 2009, an increase of \$15.2 million, or 4.4%. Total deposits were \$1.544 billion as of March 31, 2010, compared to \$1.500 billion as of December 31, 2009, an increase of \$43.8 million, or 2.9%. Shareholders' equity remained relatively flat at \$118.9 million as of March 31, 2010, compared to \$119.8 million as of December 31, 2009.

**Loan Portfolio**

Historically, our lending focus has been distributed among commercial real estate, commercial and industrial loans, 1-4 family mortgages and consumer loans. Total commercial, financial and agricultural loans, which consist primarily of short-term loans for working capital purposes, inventories, seasonal loans, lines of credit and equipment loans, accounted for 16.2% of our loan portfolio as of March 31, 2010, compared to 17.0% as of December 31, 2009. Total real estate loans, which are secured by commercial real estate, one-to-four family residential properties and multi-family dwelling units, accounted for 73.5% of our loan portfolio as of March 31, 2010, compared to 72.7% as of December 31, 2009. Total consumer loans, which consist of home improvement, mobile home, automobile and unsecured personal loans, made up 1.8% of our loan portfolio as of March 31, 2010 and December 31, 2009.

Total loans were \$1.047 billion as of March 31, 2010, a decrease of \$44.9 million, or 4.1%, compared to total loans of \$1.091 billion as of December 31, 2009. The majority of the decline in loans occurred in commercial real estate loans due primarily to payoffs and chargedowns.

The following table summarizes our loan portfolio by type of loan and type of customer as of the dates indicated:

(Dollars in thousands)	As of March 31, 2010		As of December 31, 2009	
	Amount	Percent	Amount	Percent
<b>Commercial:</b>				
Commercial	\$ 169,230	16.2%	\$ 185,466	17.0%
Commercial real estate	590,794	56.4%	612,706	56.1%
Real estate construction	29,094	2.7%	30,000	2.8%
<b>Total commercial</b>	<b>789,118</b>	<b>75.3%</b>	<b>828,172</b>	<b>75.9%</b>
<b>Consumer:</b>				
Residential real estate	82,110	7.9%	83,744	7.7%
Home equity lines	66,936	6.4%	67,185	6.2%
Other consumer loans	18,807	1.8%	20,177	1.8%
<b>Total consumer</b>	<b>167,853</b>	<b>16.1%</b>	<b>171,106</b>	<b>15.7%</b>
<b>Other</b>	<b>89,640</b>	<b>8.6%</b>	<b>92,199</b>	<b>8.4%</b>
<b>Total loans</b>	<b>\$ 1,046,611</b>	<b>100.0%</b>	<b>\$ 1,091,477</b>	<b>100.0%</b>

The contractual maturity ranges of our loan portfolio and the amount of such loans with fixed and variable interest rates in each maturity range classified by borrower type as of March 31, 2010, are summarized in the following table:

**Table of Contents**

(In thousands)	As of March 31, 2010			Total
	One Year or Less	After One Through Five Years	After Five Years	
<b>Commercial:</b>				
Commercial	\$ 54,295	\$ 111,712	\$ 3,223	\$ 169,230
Commercial real estate	153,787	331,634	105,373	590,794
Real estate construction	14,197	3,723	11,174	29,094
<b>Total commercial</b>	<b>222,279</b>	<b>447,069</b>	<b>119,770</b>	<b>789,118</b>
<b>Consumer:</b>				
Residential real estate	10,647	23,377	48,086	82,110
Home equity lines	2,554	14,969	49,413	66,936
Other consumer loans	4,663	10,744	3,400	18,807
<b>Total consumer</b>	<b>17,864</b>	<b>49,090</b>	<b>100,899</b>	<b>167,853</b>
<b>Other</b>	<b>80,074</b>	<b>8,350</b>	<b>1,216</b>	<b>89,640</b>
<b>Total loans</b>	<b>\$ 320,217</b>	<b>\$ 504,509</b>	<b>\$ 221,885</b>	<b>\$ 1,046,611</b>
Loans with a fixed interest rate	\$ 117,639	\$ 289,916	\$ 46,530	\$ 454,085
Loans with variable interest rate	202,578	214,593	175,355	592,526
<b>Total loans</b>	<b>\$ 320,217</b>	<b>\$ 504,509</b>	<b>\$ 221,885</b>	<b>\$ 1,046,611</b>

As of March 31, 2010, our loan portfolio was composed of approximately 44.0% fixed interest rate loans and 56.0% variable interest rate loans. Scheduled contractual principal repayments do not reflect the actual maturities of loans. The average maturity of our loans is substantially less than their average contractual term because of prepayments. The average life of mortgage loans tends to increase when the current mortgage loan rates are substantially higher than rates on existing mortgage loans and, conversely, decrease when current mortgage loans rates are substantially lower than rates on existing mortgages due primarily to refinancings of adjustable rate and fixed rate loans at lower rates.

**Higher-Risk Loans**

Our loan portfolio does not include several types of loans generally considered higher-risk, such as option adjustable-rate mortgage loans, junior lien mortgages, high loan-to-value mortgages, interest-only loans, subprime loans, and loans with teaser rates. Management believes that the highest risk loans in our portfolio are our construction and land development loans.

We entered the Memphis, Birmingham, and Middle Tennessee markets late in the most recent real estate boom cycle. Consequently, our build-up in our construction and land development portfolio and the subsequent lack of demand for residential real estate due to declines in the mortgage markets caused our loan quality to deteriorate. In mid-2008, we established a moratorium on residential construction and development lending. From March 31, 2009 to March 31, 2010, we reduced our exposure in our construction and land development portfolio by \$155.5 million, or 49.9%.

The following table reflects the composition of our construction and land development portfolio by market:

**Table of Contents**

(In thousands)	As of		As of		As of	
	March 31, 2010		December 31, 2009		March 31, 2009	
	Balance	%	Balance	%	Balance	%
Birmingham	\$ 14,363	9.2%	\$ 17,043	10.3%	\$ 22,799	7.3%
Florida	28,299	18.1%	25,600	15.4%	28,119	9.0%
Georgia	9,908	6.3%	10,820	6.5%	12,082	3.9%
Memphis	29,553	18.9%	29,816	18.0%	68,540	22.0%
Middle Tennessee	37,466	23.9%	43,420	26.1%	133,855	42.9%
Mississippi	26,548	17.0%	29,796	17.9%	34,308	11.0%
Tuscaloosa	10,256	6.6%	9,717	5.8%	12,221	3.9%
Total	\$ 156,393	100.0%	\$ 166,212	100.0%	\$ 311,924	100.0%

During 2010, we have charged off approximately \$1.3 million related to loans in this segment of our portfolio. As of March 31, 2010, our allowance for loan losses includes approximately \$17.2 million allocated to construction and land development loans.

All commercial real estate loans, exclusive of the loans discussed above, total approximately \$461.4 million as of March 31, 2010. Of this total, 53% represents owner occupied commercial real estate, and 47% represents non-owner occupied commercial real estate.

We have implemented additional risk management procedures focusing on real estate loans, so that we will reduce potential future losses. The moratorium on residential construction and development lending is continuing. We have tightened our underwriting standards for all commercial real estate loans and are not renewing certain loans to move them out of our portfolio. We are conducting builder/developer stress tests for any relationships of one million dollars or greater, and our loan officers are focusing more time on managing and reviewing existing loans, including stress testing, clearing exceptions, and collecting these loans.

We are beginning to see some positive signs in these portfolios; however, we are not ready to say that they have turned upward. We remain very proactive in monitoring these credits across our system since they represent the biggest risk to our future earnings.

***Delinquent and Nonperforming Assets***

We have several procedures that are designed to maintain the overall quality of our loan portfolio. We have established underwriting guidelines that are followed by our management and delinquency levels are monitored by our executive committee and reviewed by the board of directors for any negative or adverse trends. There can be no assurance, however, that our loan portfolio will not become subject to increasing pressures from deteriorating borrower credit due to general economic conditions.

Trends in delinquency ratios represent an indicator, among other considerations, of credit risk within the loan portfolio. Nonperforming loans include nonaccrual loans, loans past due 90 days or more, and loans renegotiated or restructured because of a debtor's financial difficulties.

We generally place loans on nonaccrual status if any of the following events occur:

the classification of a loan as nonaccrual internally or by regulatory examiners;

delinquency on principal for 90 days or more unless management is in the process of collection;

a balance remains after repossession of collateral;

notification of bankruptcy; or



## Edgar Filing: CADENCE FINANCIAL CORP - Form 10-Q

management judges that nonaccrual status is appropriate.

Cash payments received while a loan is classified as nonaccrual are recorded as a reduction of principal as long as doubt exists as to collection. We are sometimes required to revise the interest rate or repayment terms in a troubled debt restructuring.

We obtain appraisals on loans secured by real estate with principal amounts in excess of \$250,000 and may update those appraisals for loans categorized as nonperforming loans and potential problem loans. In instances where updated appraisals reflect reduced collateral values, we evaluate the borrower's overall financial condition to

**Table of Contents**

determine the need, if any, for possible writedowns or appropriate additions to the allowance for loan losses. We record real estate acquired through foreclosure at fair value at the time of acquisition, less estimated costs to sell the property.

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

	As of March 31, 2010	As of December 31, 2009	As of March 31, 2009
<b>(Dollars in thousands)</b>			
Nonaccrual loans	\$ 30,361	\$ 41,096	\$ 33,051
Accruing loans past due 90 days or more	3,734	5,582	5,774
Restructured loans	35,716	23,505	5,325
Total nonperforming loans	69,811	70,183	44,150
Other real estate	34,787	34,259	19,208
Total nonperforming assets	\$ 104,598	\$ 104,442	\$ 63,358
Nonperforming assets to total loans and other real estate	9.67%	9.28%	4.83%

The increase in nonperforming assets in 2009 was due primarily to the continued decline in the economy, resulting in continued deterioration in the construction and development sector of our loan portfolio.

As of March 31, 2010, other real estate was comprised primarily of residential real estate developments in various stages of completion.

We follow a loan review program designed to evaluate the credit risk in our loan portfolio. Through this loan review process, we maintain an internally classified watch list which helps management assess the overall quality of the loan portfolio and the adequacy of the allowance for loan losses. Loans included on the watch list that are not otherwise classified show warning elements where the present status portrays one or more deficiencies that require attention in the short term or where pertinent ratios of the loan account have weakened to a point where more frequent monitoring is warranted. These loans do not have all of the characteristics of a classified loan (substandard or doubtful) but do show weakened elements compared to those of a satisfactory credit.

In establishing the appropriate classification for specific assets, we consider, among other factors, the estimated value of the underlying collateral, the borrower's ability to repay, the borrower's repayment history and the current delinquent status. As a result of this process, loans are classified as substandard, doubtful or loss.

Loans classified as substandard are those loans with clear and defined weaknesses such as a highly leveraged position, unfavorable financial ratios, uncertain repayment sources or poor financial condition which may jeopardize the repayment of the debt as contractually agreed. They are characterized by the distinct possibility that we will sustain some losses if the deficiencies are not corrected. Loans classified as doubtful are those loans which have characteristics similar to substandard loans but with an increased risk that collection or liquidation in full is highly questionable and improbable. Loans classified as loss are those loans that are in the process of being charged off. Once a loan is deemed uncollectible as contractually agreed, the loan is charged off either partially or in-full against the allowance for loan losses.

**Allowance for Loan Losses**

The allowance for loan losses was \$42.3 million as of March 31, 2010, compared to \$43.4 million as of December 31, 2009. The following table summarizes the activity in our allowance for loan losses as of and for the periods indicated:

**Table of Contents**

(Dollars in thousands)	Quarter Ended March 31, 2010	Year Ended December 31, 2009
Average loans outstanding	\$ 1,073,061	\$ 1,237,411
Total loans outstanding at end of period	\$ 1,046,611	\$ 1,091,477
Allowance for loan losses at beginning of period	\$ 43,422	\$ 20,730
Charge-offs:		
Commercial, financial and agricultural	(846)	(8,143)
Real estate	(3,120)	(49,944)
Installment loans and other	(142)	(755)
Total charge-offs	(4,108)	(58,842)
Recoveries:		
Commercial, financial and agricultural	261	1,224
Real estate	1,049	695
Installment loans and other	93	287
Total recoveries	1,403	2,206
Net charge-offs	(2,705)	(56,636)
Provision for loan losses	1,621	79,328
Allowance for loan losses at end of period	\$ 42,338	\$ 43,422
Ratio of net charge-offs to average loans outstanding	0.25%	4.58%
Ratio of allowance for loan losses to period end loans	4.05%	3.98%
Ratio of allowance for loan losses to nonperforming loans	60.65%	61.87%

*Allocated Allowance for Loan Losses.* We use a risk rating and specific reserve methodology in the calculation and allocation of our allowance for loan losses. The following table describes the allocation of the allowance for loan losses among various categories of loans for the dates indicated. The allocation is made for analytical purposes and is not necessarily indicative of the categories in which future losses may occur. The total allowance is available to absorb losses from any segment of loans.

(In thousands)	As of March 31, 2010		As of December 31, 2009	
	Loan Balance	Allowance for Loan Losses	Loan Balance	Allowance for Loan Losses
Allocated component:				
Impaired loans	\$ 80,598	\$ 14,193	\$ 67,785	\$ 11,407
Pooled loans	966,013	26,183	1,023,692	29,275
Unallocated component		1,962		2,740
Totals	\$ 1,046,611	\$ 42,338	\$ 1,091,477	\$ 43,422

Management believes that the allowance for loan losses as of March 31, 2010, is adequate to cover losses inherent in the portfolio as of such date.

**Investment Portfolio**

The investment portfolio serves as a source of liquidity and earnings and is used to manage interest rate risk and to ensure collateral is available for pledging requirements. Our investment portfolio primarily consists of agency mortgage-backed securities, pooled government guaranteed SBA loans and taxable and non-taxable municipal securities. Securities within the portfolio are classified as held-to-maturity or

## Edgar Filing: CADENCE FINANCIAL CORP - Form 10-Q

available-for-sale. As of March 31, 2010, we had no securities classified as trading. Fair values of securities are based on quoted market prices where available. If quoted market prices are not available, estimated fair values are based on quoted market prices of comparable securities.

Securities available-for-sale are carried at fair value with unrealized holding gains and losses reported as a separate component of shareholders equity called accumulated other comprehensive income. Securities that are

**Table of Contents**

held as available-for-sale are used as a part of our asset/liability management strategy. Securities may be sold in response to interest rate changes, changes in liquidity needs, changes in tax strategies, changes in prepayment risk or changes to underlying bank funding. Available-for-sale securities were \$345.4 million as of March 31, 2010, compared to \$330.1 million as of December 31, 2009. As of March 31, 2010, \$231.9 million, or 67.2%, of the available-for-sale securities were invested in mortgage-backed securities, compared to \$227.3 million, or 68.9%, as of December 31, 2009. The remainder of the available-for-sale portfolio was invested primarily in government securities.

Securities held-to-maturity are carried at amortized historical cost. Securities that we have the intent and ability to hold until maturity or on a long-term basis are classified as held-to-maturity. Held-to-maturity securities were \$2.7 million as of March 31, 2010 and December 31, 2009. All of the securities in the held-to-maturity category were issued by state and municipal subdivisions.

The following tables summarize the amortized cost of securities classified as available-for-sale and held-to-maturity and their approximate fair values as of the dates shown:

(In thousands)	As of March 31, 2010			Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
<b>Available-for-sale:</b>				
Mortgage-backed securities	\$ 223,926	\$ 8,648	\$ 647	\$ 231,927
Other securities	110,855	2,845	246	113,454
<b>Total</b>	<b>\$ 334,781</b>	<b>\$ 11,493</b>	<b>\$ 893</b>	<b>\$ 345,381</b>
<b>Held-to-maturity:</b>				
Other securities	\$ 2,670	\$ 68	\$	\$ 2,738

  

(In thousands)	As of December 31, 2009			Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
<b>Available-for-sale:</b>				
Mortgage-backed securities	\$ 219,635	\$ 8,358	\$ 706	\$ 227,287
Other securities	101,235	2,087	530	102,792
<b>Total</b>	<b>\$ 320,870</b>	<b>\$ 10,445</b>	<b>\$ 1,236</b>	<b>\$ 330,079</b>
<b>Held-to-maturity:</b>				
Other securities	\$ 2,671	\$ 70	\$	\$ 2,741

Some of our investment securities are valued at less than their historical cost. We believe these declines resulted primarily from increases in market interest rates. Because the declines in market value are due to changes in interest rates and not credit quality, and because we have the ability and intent to hold these securities until a recovery in fair value, management believes the declines in fair value for these securities are temporary. Should the impairment of any of these securities become other-than-temporary, the cost basis of the investment will be reduced and the resulting loss recognized in net earnings in the period the other-than-temporary impairment is identified.

As of March 31, 2010, we had net unrealized gains of \$10.7 million in the investment portfolio compared to net unrealized gains of \$9.3 million as of December 31, 2009. The \$1.4 million increase in net unrealized gains is primarily attributable to changes in market interest rates from December 31, 2009 to March 31, 2010.

Mortgage-backed securities ( MBSs ) are securities that have been developed by pooling a number of real estate mortgages and are principally issued by quasi-federal agencies such as Fannie Mae and Freddie Mac. These securities are deemed to have high credit ratings, and the minimum monthly cash flows of principal and interest are guaranteed by the issuing agencies. Although investors generally assume that the federal government will support these agencies, it is under no obligation to do so. Other MBSs are issued by Ginnie Mae, which is a federal agency, and

are guaranteed by the U.S. government.

**Table of Contents**

Unlike U.S. government securities, which have a lump sum payment at maturity, MBSs provide cash flows from regular principal and interest payments and principal prepayments throughout the lives of the securities. MBSs that are purchased at a premium will generally suffer decreasing net yields as interest rates drop because homeowners tend to refinance their mortgages. Thus, the premium paid must be amortized over a shorter period. Conversely, MBSs purchased at a discount will obtain higher net yields in a decreasing interest rate environment. As interest rates rise, the opposite will generally be true. During a period of increasing interest rates, fixed rate MBSs do not tend to experience heavy prepayments of principal, and consequently the average life of this security will be lengthened. If interest rates begin to fall, prepayments will increase, thereby shortening the estimated lives of these securities.

The following table summarizes the contractual maturities of investment securities on an amortized cost basis and their weighted average yields as of March 31, 2010. This table shows the contractual maturities of the related investment securities and not the estimated average lives of the securities. The contractual maturity of an MBS is the date at which the last underlying mortgage matures. In the case of a 15-year pool of loans or a 30-year pool of loans, the maturity date of the security will be the date the last payment is due on the underlying mortgages.

(Dollars in thousands)	As of March 31, 2010									
	Due Within One Year		After One Year but Within Five Years		After Five Years but Within Ten Years		After Ten Years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
<b>Available-for-sale:</b>										
Mortgage-backed securities	\$ 1,113	3.94%	\$ 7,340	4.19%	\$ 10,836	4.98%	\$ 212,638	4.64%	\$ 231,927	4.64%
Other securities	2,290	4.33%	7,397	4.18%	24,588	3.51%	78,515	4.56%	112,790	4.30%
<b>Total</b>	<b>3,403</b>	<b>4.21%</b>	<b>14,737</b>	<b>4.19%</b>	<b>35,424</b>	<b>3.96%</b>	<b>291,153</b>	<b>4.62%</b>	<b>344,717</b>	<b>4.53%</b>
<b>Held-to-maturity:</b>										
Other securities					1,670	9.17%	1,000	9.73%	2,670	9.38%
Equity and other securities							13,887	2.16%	13,887	2.16%
<b>Total securities</b>	<b>\$ 3,403</b>	<b>4.21%</b>	<b>\$ 14,737</b>	<b>4.19%</b>	<b>\$ 37,094</b>	<b>4.20%</b>	<b>\$ 306,040</b>	<b>4.53%</b>	<b>\$ 361,274</b>	<b>4.48%</b>

Contractual maturity of an MBS is not a reliable indicator of its expected life because borrowers have the right to prepay their obligations at any time. A third party analysis of our mortgage-backed securities as of March 31, 2010 showed the estimated average lives for fixed MBSs to be 4.2 years. The average life of the total investment portfolio is 4.9 years as of March 31, 2010.

**Deposits**

Deposits are our primary source of funds, and we rely on our banking centers and branches to attract and retain those deposits. We offer a variety of products, which consist of noninterest-bearing and interest checking accounts, money market and savings accounts and certificates of deposit. Deposits are gathered from individuals, partnerships and corporations in our market areas. From time to time, we also purchase brokered deposits.

As of March 31, 2010, core deposits (which we define as all deposits other than brokered deposits, 50% of time deposits \$100,000 and greater and 50% of public funds) were \$1.229 billion, or 79.6% of total deposits, while non-core deposits, including brokered deposits, made up 20.4% of total deposits. Total deposits increased to \$1.544 billion as of March 31, 2010, compared to \$1.500 billion as of December 31, 2009, an increase of \$43.8 million, or 2.9%. Noninterest-bearing deposits remained virtually flat; however, interest-bearing deposits, primarily time deposits, increased by 3.3%.

The interest rates we pay are based on the competitive environments in each of our markets. We manage our interest expense through weekly deposit pricing reviews that compare our deposit rates with the competition and wholesale alternatives. In addition, we have at times offered special products or attractive rates so that our deposits will keep up with our need for liquidity. The average cost of deposits, including noninterest-bearing deposits, for the first quarter of 2010 was 1.59%, compared to 1.84% for the year ended December 31, 2009.

Edgar Filing: CADENCE FINANCIAL CORP - Form 10-Q

The following table presents the daily average balances and rates paid on deposits for the periods indicated:



**Table of Contents**

(Dollars in thousands)	Quarter Ended March 31, 2010		Year Ended December 31, 2009	
	Average Balance	Average Rate	Average Balance	Average Rate
Noninterest-bearing deposits	\$ 174,523		\$ 176,370	
Interest-bearing demand (1)	567,310	1.04%	562,253	1.15%
Savings	45,574	0.45%	43,887	0.43%
Time deposits	729,706	2.47%	722,293	2.91%
<b>Total</b>	<b>\$ 1,517,113</b>	<b>1.59%</b>	<b>\$ 1,504,803</b>	<b>1.84%</b>

(1) Includes money market accounts.

The following table provides the amount of our time deposits as of March 31, 2010, that are \$100,000 and greater by time remaining until maturity:

(In thousands)	As of March 31, 2010
Three months or less	\$ 49,227
Over three months through six months	111,093
Over six months through one year	163,327
Over one year	111,764
<b>Total</b>	<b>\$ 435,411</b>

While a majority of the time deposits in amounts of \$100,000 and greater will mature within one year, we expect that a significant portion of these deposits will be renewed, given that the rates we offer on time deposits are competitive in the market. If a significant portion of the time deposits were not renewed, it would have an adverse effect on our liquidity. We monitor maturities and have other available funding sources to mitigate this effect.

***Borrowings, Repurchase Agreements and Junior Subordinated Debentures***

We use borrowings to supplement deposits in funding our lending and investing activities. These borrowings are typically FHLB advances, which have terms ranging from overnight to several years. All FHLB borrowings are collateralized by investment securities or first mortgage loans. Additionally, we borrow from other financial institutions using investment securities as collateral and have issued junior subordinated debentures to a subsidiary trust. As of March 31, 2010, securities with a carrying value of \$280.1 million and loans with a carrying value of \$370.3 million were pledged as collateral.

Our borrowings and repurchase agreements were \$186.7 million as of March 31, 2010. The outstanding balance as of March 31, 2010, includes \$95.0 million in long-term FHLB advances, \$50.0 million in repurchase agreements with brokerage firms and \$41.7 million in repurchase agreements with clients and treasury tax and loan note payable.

The following table summarizes our outstanding borrowings and repurchase agreements of the dates indicated:

**Table of Contents**

<b>(Dollars in thousands)</b>	<b>As of March 31, 2010</b>	<b>As of December 31, 2009</b>
Ending balance	\$ 186,735	\$ 184,072
Average balance for the period	182,300	242,661
Maximum month-end balance during the period	186,735	293,704
Average interest rate for the period	2.48%	2.57%
Weighted average interest rate at the end of the period	2.48%	2.44%

Note: This table includes federal funds purchased, securities sold under agreements to repurchase, and other borrowed funds (primarily FHLB advances).

In addition to the borrowings and repurchase agreements discussed above, on December 20, 2003, the Corporation issued \$30.9 million of floating rate junior subordinated deferrable interest debentures to the Trust. The debentures are the sole asset of the Trust. The net proceeds received by the Corporation from the issuance of the debentures were used for our acquisition of Enterprise Bancshares, Inc. The Trust issued \$30.0 million of TPSs to investors. The Corporation's obligations under the debentures and related documents, taken together, constitute a full and unconditional guarantee by the Corporation of the Trust's obligations under the TPSs. The TPSs are redeemable at the Corporation's option on or after December 30, 2008, on any interest payment date. The TPSs must be redeemed upon maturity of the debentures in 2033. Interest on the debentures and TPSs is the three month London Interbank Offer Rate ( LIBOR ) plus 2.85% and is payable quarterly.

The Trust is a statutory business trust organized for the sole purpose of issuing trust securities and investing the proceeds in our junior subordinated debentures. The TPSs represent preferred beneficial interests in the assets of the Trust and are subject to mandatory redemption upon payment of the junior subordinated debentures held by the Trust. We own the common securities of the Trust. The Trust's ability to pay amounts due on the TPSs depends solely on our making payment on the related junior subordinated debentures. The debentures, which are the only assets of the Trust, are subordinate and junior in right of payment to all of our present and future senior indebtedness.

Under the provisions of the issue of the junior subordinated debentures, we have the right to defer payment of interest on the debentures at any time, or from time to time, for periods not exceeding five years. If interest payments on the junior subordinated debentures are deferred, the distributions on the TPSs will also be deferred. However, the interest due would continue to accrue during any such interest payment deferral period.

**Shareholders' Equity**

Shareholders' equity was \$118.9 million as of March 31, 2010, compared to \$119.8 million as of December 31, 2009. During the first quarter of 2010, we reported a net loss applicable to common shareholders of \$1.9 million. Included in this amount are the payment of \$550,000 in preferred dividends and \$108,000 of discount accretion related to the Series A preferred stock. Finally, an increase in the market value of our available-for-sale investment securities caused our accumulated other comprehensive income to increase from \$2.6 million at December 31, 2009, to \$3.5 million at March 31, 2010.

Dividends paid by the Corporation are provided from dividends received from Cadence. Under regulations controlling national banks, the payment of any dividends by a bank without prior approval from the OCC is limited to the current year's net profits (as defined by the OCC) and retained net profits of the two preceding years. At March 31, 2010, Cadence can not make dividend payments to the Corporation without prior approval of the OCC. The Federal Reserve, as primary regulator for bank holding companies, has also stated that all common stock dividends should be paid out of current earnings. As the Corporation does not generate earnings on a stand-alone basis, it does not have the capability to pay common stock dividends without receiving dividends from Cadence. The Corporation does not expect to make dividend payments in the near future.

**Table of Contents****Return on Equity and Assets**

The following table sets forth certain selected financial data for the periods indicated.

	Quarter Ended March 31,	
	2010	2009
Return on assets (net income divided by total average assets)	-0.4%	-16.7%
Return on equity (net income divided by average equity)	-6.3%	-203.8%
Equity to asset ratio (average equity divided by total average assets)	6.4%	8.2%

**Regulatory Capital**

Cadence is subject to the capital adequacy requirements of the OCC. The Corporation, as a bank holding company, is subject to the capital adequacy requirements of the Federal Reserve. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Corporation's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Corporation and Cadence must meet specific capital guidelines that involve quantitative measures of assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgment by regulators about components, risk weightings, and other related factors.

The risk-based capital requirements of the Federal Reserve and the OCC define capital and establish minimum capital requirements in relation to assets and off-balance sheet exposure, adjusted for credit risk. The risk-based capital standards currently in effect are designed to make regulatory capital requirements more sensitive to differences in risk profiles among bank holding companies and banks, to account for off-balance sheet exposure and to minimize disincentives for holding liquid assets. Assets and off-balance sheet items are assigned to broad risk categories, each with appropriate relative risk weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance sheet items.

The risk-based capital standards issued by the Federal Reserve require all bank holding companies to have a Tier 1 leverage ratio of at least 4.0% to be adequately capitalized and at least 5.0% to be well-capitalized and a total risk-based capital ratio (Tier 1 and Tier 2) of at least 8.0% of total risk-adjusted assets to be adequately capitalized and at least 10.0% to be well-capitalized. Tier 1 capital generally includes common shareholders' equity and qualifying perpetual preferred stock together with related surpluses and retained earnings, less deductions for goodwill and various other intangibles. Tier 2 capital may consist of a limited amount of intermediate-term preferred stock, a limited amount of term subordinated debt, certain hybrid capital instruments and other debt securities, perpetual preferred stock not qualifying as Tier 1 capital, and a limited amount of the general valuation allowance for loan losses.

The Federal Reserve has also adopted guidelines which supplement the risk-based capital guidelines with a minimum ratio of Tier 1 capital to average total consolidated assets (leverage ratio) of 3.0% for institutions with well diversified risk, including no undue interest rate exposure; excellent asset quality; high liquidity; good earnings; and that are generally considered to be strong banking organizations, rated composite 1 under applicable federal guidelines, and that are not experiencing or anticipating significant growth. Other banking organizations are required to maintain a leverage ratio of at least 4.0% in order to be categorized as adequately capitalized and at least 5.0% to be categorized as well-capitalized. These rules further provide that banking organizations experiencing internal growth or making acquisitions will be expected to maintain capital positions substantially above the minimum supervisory levels and comparable to peer group averages, without significant reliance on intangible assets.

Our actual capital amounts and ratios are presented in the following table. No amount was deducted from capital for interest-rate risk exposure.

**Table of Contents**

(Dollars in thousands)	Cadence Financial Corporation (Consolidated)		Cadence	
	Amount	Ratio	Amount	Ratio
<b>As of March 31, 2010</b>				
Total risk-based	\$ 122,651	11.2%	\$ 114,852	10.5%
Tier 1 risk-based	108,551	9.9	100,784	9.2
Tier 1 leverage	108,551	5.9	100,784	5.6
<b>As of December 31, 2009</b>				
Total risk-based	\$ 125,730	10.9%	\$ 117,053	10.2%
Tier 1 risk-based	110,980	9.6	102,338	8.9
Tier 1 leverage	110,980	6.3	102,338	6.0

The minimum amounts of capital and ratios as established by banking regulators are as follows:

(Dollars in thousands)	Cadence Financial Corporation (Consolidated)		Cadence	
	Amount	Ratio	Amount	Ratio
<b>As of March 31, 2010</b>				
Total risk-based	\$ 87,958	8.0%	\$ 87,756	8.0%
Tier 1 risk-based	43,979	4.0	43,878	4.0
Tier 1 leverage	73,058	4.0	72,109	4.0
<b>As of December 31, 2009</b>				
Total risk-based	\$ 92,103	8.0%	\$ 91,878	8.0%
Tier 1 risk-based	46,052	4.0	45,939	4.0
Tier 1 leverage	70,136	4.0	68,616	4.0

Cadence is subject to capital adequacy guidelines of the OCC at the bank level that are substantially similar to the Federal Reserve guidelines. Although current regulatory guidelines state that a financial institution must have a total risk-based capital ratio of 10.0%, a Tier 1 risk-based capital ratio of 6.0%, and a Tier 1 leverage ratio of 5.0% to be considered well-capitalized in accordance with the regulations, the primary regulator has the ability to impose higher ratios on financial institutions. These higher standards are imposed if the regulator believes that the risk profile on the institution is higher than they consider appropriate. As part of an agreement entered into with the OCC in April 2009, Cadence was required to achieve by September 30, 2009, and maintain on an ongoing basis, a Tier 1 leverage ratio of 8.0% and a total risk-based capital ratio of 12.0%. As of March 31, 2010, Cadence did not satisfy this regulatory requirement, as it had a Tier 1 leverage ratio of 5.6% and a total risk-based capital ratio of 10.5%. As a result of not meeting the capital ratio requirements, the OCC has broad authority to take additional adverse actions against Cadence.

As a result of recent losses experienced by the Corporation and Cadence's requirement for additional capital to meet these higher ratios, there is a need for the Corporation to raise additional capital. The Corporation is currently seeking to raise this capital through all available sources, including public or private equity offerings. However, at this time, there can be no assurance as to the availability or terms upon which this capital might be available.

**Off-Balance Sheet Arrangements**

There were no material changes to our contractual obligations during the first quarter of 2010.

In the ordinary course of our business, we enter into agreements with customers to loan money. When a loan agreement is executed, the customer can either borrow the money immediately or draw against the loan over a predetermined time period. If an unfunded commitment is drawn against, the Bank charges the customer the interest rate established in the original agreement for the amount of the draw for the time period outstanding. As of March 31, 2010, the amount of unfunded commitments outstanding was \$137.7 million.

---

## **Table of Contents**

We also provide letters of credit to our customers. A letter of credit is a contingent obligation to make a loan to the customer for up to the amount of the letter of credit and at a predetermined rate of interest. The Bank charges the customer approximately 1.5% of the face amount of a letter of credit as a fee for issuance. As of March 31, 2010, the amount of outstanding letters of credit was \$12.0 million.

The issuance of a letter of credit or a loan commitment is subject to the same credit and underwriting standards as any other loan agreement.

At any point in time, we do not know when or if these commitments will be funded. Generally, if they are funded, they are funded at various times over the commitment period. As a result, we are able to fund them out of normal cash flow. If all outstanding commitments were funded at the same time, we have the ability to fund them through our current liquidity and short-term borrowing lines.

In June 2008, the FHLB of Dallas issued a \$35 million standby letter of credit to the Bank to secure public funds.

## **Liquidity, Inflation and Asset/Liability Management**

Liquidity may be defined as our ability to meet cash flow requirements created by decreases in deposits and/or other sources of funds or increases in loan demand. We did not experience any problems with liquidity during the first quarter of 2010 and anticipate that all liquidity requirements will be met in the future. Our traditional sources of funds from deposit growth, maturing loans and investments, wholesale borrowing lines and earnings have generally allowed us to consistently generate sufficient funds to meet our daily operational liquidity needs. As the result of a \$44.9 million decrease in loans and a \$43.8 million increase in deposits as of March 31, 2010, compared to December 31, 2009, our loan/deposit ratio declined to 67.8% for the first quarter of 2010, compared to a loan/deposit ratio of 72.8% as of December 31, 2009. Our total funding sources include not only deposits, but also federal funds purchased, securities sold under agreements to repurchase and FHLB borrowings. When we include these sources of funding with deposits, our loans to total funding ratio declined to 60.5% as of March 31, 2010, from 64.9% as of December 31, 2009. Management's target loans to deposits ratio is in the range of 75-85%, and our goal is to limit wholesale funding to no more than 25% of total assets.

We offer retail repurchase agreements to accommodate excess funds of some of our larger depositors. Management believes that these repurchase agreements stabilize traditional deposit sources as opposed to risking the potential loss of these funds to alternative investment arrangements. Retail repurchase agreements, which we view as a source of funds, totaled \$40.0 million as of March 31, 2010, and \$37.4 million as of December 31, 2009. The level of retail repurchase agreement activity is limited by the availability of investment portfolio securities to be pledged against the accounts and our asset/liability funding policy. Because of the limited amount of retail repurchase agreements and the fact that the underlying securities remain under our control, we do not consider the exposure for this service material.

We believe that our traditional sources of cash flow, including retail deposits, maturing loans and investments, and the high level of cash currently carried on our balance sheet, will provide the cash to allow us to meet our future liquidity needs. At March 31, 2010, we had unused short-term borrowing lines (federal funds purchased lines) of approximately \$37.5 million from upstream correspondent banks. We also have additional borrowing capacity from the Federal Reserve under certain circumstances. As of March 31, 2010, we had \$95.0 million in outstanding FHLB borrowings. We have no additional borrowing capacity with the FHLB.

We have no plans to refinance or redeem any liabilities other than normal maturities and payments relating to the FHLB borrowings. We do not have plans at this time for any discretionary spending that would have a material impact on liquidity. Under regulations controlling bank holding companies and national banks, Cadence is limited in the amount it can lend to the Corporation, and those loans are required to be on a fully secured basis. At March 31, 2010, there were no loans between Cadence and the Corporation. The Corporation's only source of liquidity is dividends it receives from Cadence. Under regulations controlling national banks, the payment of any dividends by a bank without prior approval from the OCC is limited to the current year's net profits (as defined by the OCC) and retained net profits of the two preceding years.

Because the majority of assets and liabilities of a financial institution are monetary in nature, a financial institution differs greatly from most commercial and industrial companies, which have significant investments in

## **Table of Contents**

fixed assets or inventories. Fluctuations in interest rate and actions of the Federal Reserve to regulate the national money supply to mitigate recessionary and inflationary pressures have a greater effect on a financial institution's profitability than do higher costs for goods and services.

The primary objective of rate sensitivity management is to maintain net interest income growth while reducing exposure to adverse fluctuations in rates. The Asset/Liability Management Committee of the Board of Directors evaluates and analyzes our pricing, asset/liability maturities and growth, and balance sheet mix strategies in an effort to make informed decisions that will increase income and limit interest rate risk. The Committee uses simulation modeling as a guide for decision-making and to forecast changes in net income and the economic value of equity under assumed fluctuations in interest rate levels.

Due to the potential volatility of interest rates, our goal is to stabilize the net interest margin by maintaining a relatively neutral rate sensitive position. As of March 31, 2010, our balance sheet reflected approximately \$218.1 million more in rate sensitive liabilities than assets that were scheduled to reprice within one year. This represented 11.54% of our total assets and indicates that we are in a liability-sensitive position. This computation results from a static gap analysis that weights assets and liabilities equally. Management believes that interest rates will continue to remain flat for at least the next quarter of 2010 and that our current position places us in the correct interest rate risk posture for this rate environment. Management does not believe that it is in our best interest to speculate on changes in interest rate levels. Although earnings could be enhanced if predictions were correct, if interest rates move against predictions, then Cadence's earnings will be less than predicted.

During the first quarter of 2010, we believe we maintained a consistent and disciplined asset/liability management policy focusing on interest rate risk and sensitivity.

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

The Corporation is exposed only to U.S. dollar interest rate changes and, accordingly, we manage exposure by considering the possible changes in the net interest margin. We do not have any trading instruments nor do we classify any portion of our investment portfolio as held for trading. In 2009, we had hedged a portion of our floating rate prime based lending portfolio by entering into floating to fixed interest rate swaps; however, we had no outstanding hedges as of March 31, 2010. The transactions were cash flow hedges as defined by ASC Topic 815,

Derivatives and Hedging, and were accounted for under that guidance. These transactions were in line with our asset/liability strategy and were entered into to help protect the Corporation against an unexpected downturn in short-term interest rates. As we continue to enhance our asset/liability management, we will continue to look for opportunities to protect the Corporation from unexpected changes in interest rates. We have no exposure to foreign currency exchange rate risk, commodity price risk, and other market risks.

The following table reflects the period-end position of our interest-earning assets and interest-bearing liabilities, which can either reprice or mature within the designated time period. The interest rate sensitivity gaps can vary from day-to-day and are not necessarily a reflection of the future. In addition, certain assets and liabilities within the same designated time period may nonetheless reprice at different times and at different levels.

**Table of Contents**

(Dollars in thousands)	As of March 31, 2010			
	Three Months	Twelve Months	Five Years	Total
<b>Interest-sensitive assets:</b>				
Loans	\$ 538,962	\$ 688,465	\$ 956,736	\$ 1,004,273
Investment and mortgage-backed securities	36,873	98,460	217,640	361,274
Federal funds sold and other	339	20,506	20,506	20,506
	\$ 576,174	\$ 807,431	\$ 1,194,882	\$ 1,386,053
<b>Interest-bearing liabilities:</b>				
Deposits	\$ 344,090	\$ 852,864	\$ 1,437,299	\$ 1,543,654
Borrowed funds	72,664	172,664	192,664	217,664
	\$ 416,754	\$ 1,025,528	\$ 1,629,963	\$ 1,761,318

**Sensitivity gap:**

Dollar amount	\$ 159,420	\$ (218,097)	\$ (435,081)	\$ (375,265)
Percent of total interest-earning assets	27.67%	-27.01%	-36.41%	-27.07%

The matching of assets and liabilities may be analyzed by examining the extent to which such assets and liabilities are interest rate sensitive and by monitoring an institution's interest rate sensitivity gap. An asset or liability is said to be interest rate sensitive within a specific time period if it will mature or reprice within that time period. The interest rate sensitivity gap is defined as the difference between the amounts of interest-earning assets and interest-bearing liabilities anticipated, based upon certain assumptions, to mature or reprice within that time period. A gap is considered positive when the amount of interest rate sensitive assets maturing within a specific time frame exceeds the amount of interest rate sensitive liabilities maturing within that same time frame. During a period of falling interest rates, a negative gap would tend to result in an increase in net interest income while a positive gap would tend to adversely affect net interest income. In a rising interest rate environment, an institution with a positive gap would generally be expected, absent the effects of other factors, to experience a greater increase in the yield of its assets relative to the costs of its liabilities and thus an increase in the institution's net interest income would result.

At March 31, 2010, total interest-earning assets maturing or repricing within one year were less than interest-bearing liabilities maturing or repricing within the same time period by approximately \$218.1 million (cumulative), representing a negative cumulative one-year gap of 27.01% of earning assets. Management believes this position to be acceptable in the current interest rate environment.

Banking regulators have issued advisories concerning the management of interest rate risk (IRR). The regulators consider effective interest rate management an essential component of safe and sound banking practices. To monitor our IRR, our interest rate management practices include (a) risk management, (b) risk monitoring and (c) risk control as described below.

Risk management consists of a system in which a measurement is taken of the amount of earnings at risk when interest rates change. We first prepare a base strategy, which is the position of Cadence and its forecasted earnings based upon the current interest rate environment or most likely interest rate environment. The IRR is then measured based upon hypothetical changes in interest rates by measuring the impact such a change will have on the base strategy.

Risk monitoring consists of evaluating the base strategy and the assumptions used in its development based upon the current interest rate environment. This evaluation is performed quarterly by management or more often in a rapidly changing interest rate situation and monitored by the Asset/Liability Management Committee of Cadence's Board of Directors.

Risk control consists of setting policies and parameters regarding interest rates and performing simulations based on trends and projections. Interest rate risk is managed based upon our tolerance for interest rate exposure and the resulting effect on net interest income and the economic value of equity. A balance sheet and income statement simulation model is prepared monthly, using current month end data. A base case simulation is prepared monthly using current month growth trends, projected forward and a flat rate forecast. Two additional interest rate shock simulations are prepared, one showing rates rising 200 basis points and one showing a 200 basis point decline in rates. Our policy is that a 200 basis point shock in rates should not cause the projection of net interest income to

---

## **Table of Contents**

change by more than 15% and cause the economic value of equity to change by more than +25% and 20%. The March 2010 model reflects net interest income under this scenario increasing by 15.09% with a 200 basis point upward shock of rates and decreasing by 4.53% if rates are shocked down 200 basis points. At March 31, 2010, a 200 basis point immediate increase in interest rates would have resulted in a 6.77% increase in market value of equity, and a 200 basis point instant decrease would have resulted in a 12.13% decrease in market value of equity. At March 31, 2010, we were within policy on both of these tests, except for an immaterial deviation relating to the upward shock to net interest income.

### **ITEM 4 CONTROLS AND PROCEDURES**

#### **Disclosure Controls and Procedures**

As required by Rules 13a-15 and 15d-15 of the Exchange Act, the Corporation has evaluated, with the participation of management, including the Chief Executive Officer and the Chief Financial Officer, as of the end of the period covered by this report, the effectiveness of the design and operation of its disclosure controls and procedures. Based on such evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this report, such disclosure controls and procedures are effective in ensuring that information required to be disclosed by the Corporation, including its consolidated subsidiaries, is recorded, processed, summarized and reported, including being made known to the certifying officers by others within the Corporation and its consolidated subsidiaries as appropriate to allow timely decisions regarding disclosure, within the time periods specified in the SEC's rules and forms. From time to time, the Corporation reviews the disclosure controls and procedures, and may from time to time make changes aimed at enhancing their effectiveness and to ensure that the Corporation's system evolves with its business.

#### **Changes in Internal Controls over Financial Reporting**

There was no change in the Corporation's internal control over financial reporting during the quarter ended March 31, 2010, that has materially affected, or is reasonably likely to materially affect, the Corporation's internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **ITEM 1 LEGAL PROCEEDINGS**

In the normal course of business, the Corporation and its subsidiaries from time to time are involved in legal proceedings. There are no pending proceedings to which either the Corporation or any of its subsidiaries are a party that upon resolution are expected to have a material adverse effect upon the Corporation's or its subsidiaries' financial condition or results of operations.

### **ITEM 1A RISK FACTORS**

In addition to the other information contained in this Report on Form 10-Q, the following significant risks may affect the Corporation and Cadence and update the risk factors contained in Part I, Item A Risk Factors of our Annual Report on Form 10-K for the year ended December 31, 2009. The risk factors identified below are in addition to those contained in any other documents filed by the Corporation under the Securities Exchange Act of 1934, including without limitation, any other cautionary statements, written or oral, which may be made or otherwise addressed in connection with a forward-looking statement or contained in any of our subsequent filings with the Securities and Exchange Commission.

*The current economic environment poses significant challenges for us and our industry and could adversely affect our financial condition and results of operations.*

We are operating in a challenging and uncertain economic environment, including generally uncertain national and local conditions. Financial institutions like us continue to be affected by sharp declines in the real estate market and constrained financial markets. Dramatic declines in the housing market over the past year, including falling home prices and increasing delinquencies, foreclosures and unemployment, have resulted in



## Table of Contents

significant write-downs of asset values by many financial institutions, including us. Concerns over the stability of the financial markets and the economy and the need to protect capital have resulted in decreased lending by financial institutions to their clients and to each other. This market turmoil and tightening of credit has led to increased commercial and consumer deficiencies, lack of consumer confidence, increased market volatility and widespread reduction in general business activity. The resulting economic pressure on consumers and businesses and the lack of confidence in the financial markets may adversely affect our business, financial condition and results of operations.

Continued economic uncertainty, declines in real estate values, constrained financial markets, housing market decline and financial stress on borrowers as a result of the uncertain economic environment could continue to have an adverse effect on our borrowers or their clients, adversely affecting our financial condition and results of operations. We cannot predict when economic conditions are likely to improve. We may also face additional risks in connection with the current economic environment, including the following:

Economic conditions that negatively affect housing prices and the job market have caused, and may continue to cause, the credit quality of our loan portfolios to deteriorate, and that deterioration in credit quality has had, and could continue to have, a negative effect on our business and results of operations.

Market developments may affect consumer confidence levels and may cause adverse changes in payment patterns, causing increases in delinquencies and default rates on loans and other credit facilities.

The value of our securities portfolio may decline.

We face increased regulation of our industry, and compliance with that regulation has increased our costs and increased compliance challenges and may continue to do so.

As these conditions or similar ones continue to exist or worsen, we could experience continuing or increased adverse effects on our financial condition and results of operations.

*We are heavily regulated, and that regulation could limit or restrict our activities and adversely affect our earnings.*

We operate in a highly regulated industry and are subject to examination, supervision, and comprehensive regulation by various federal and state agencies, including the OCC, the Federal Reserve, the FDIC, and to a limited degree, the regulators in the states in which our branches are located. Our compliance with these regulations is costly and may restrict some of our activities, including payment of dividends, mergers and acquisitions, investments, loans and interest rates and locations of offices. As further discussed below, we are also subject to capitalization guidelines established by our regulators, which require us to maintain certain levels of capital to support our business.

In light of current conditions in the global financial markets and the global economy, regulators have increased their focus on the regulation of the financial services industry. In recent months, the U.S. financial regulators responding to directives of the Obama Administration and Congress have intervened on an unprecedented scale. New legislative proposals continue to be introduced in the U.S. Congress that could further substantially increase regulation of the financial services industry and impose restrictions on the operations and general ability of firms within the industry to conduct business consistent with historical practices, including with respect to compensation, interest rates and the effect of bankruptcy proceedings on consumer real property mortgages. Further, federal and state regulatory agencies may adopt changes to their regulations and/or change the manner in which existing regulations are applied. We cannot predict the substance or effect of pending or future legislation or regulation or the application of laws and regulation to us. Compliance with current and potential regulation and scrutiny may significantly increase our costs, impede the efficiency of our internal business processes, require us to increase our regulatory capital and limit our ability to pursue business opportunities in an efficient manner by requiring us to expend significant time, effort and resources to ensure compliance. Additionally, evolving regulations concerning executive compensation may impose limitations on us that affect our ability to compete successfully for executive and management talent.

---

## Table of Contents

On June 17, 2009, the Obama Administration proposed a white paper, "Financial Regulatory Reform: A New Foundation: Rebuilding Financial Supervision and Regulation," that provides recommendations for overhauling the nation's financial regulatory system in the wake of the global financial crisis. The plan urges Congress and regulators to adopt sweeping changes to financial sector regulation and oversight, dramatically increasing the federal government's role in nearly every aspect of the financial markets. The administration proposes both new substantive authorities and practices in government regulation and supervision, and a restructuring of the regulatory system, including the creation of new federal agencies, offices and councils. Congress is currently discussing a Financial Regulatory Reform Bill. It is too early to determine the impact of this and other bills in the financial industry. If any of these proposed bills become law, they may result in additional restrictions, oversight or costs that may have an adverse effect on our business, results of operations or the price of our common stock.

In addition, given the current economic and financial environment, our regulators may elect to alter standards or the interpretation of the standards used to measure regulatory compliance or to determine the adequacy of liquidity, certain risk management or other operational practices for financial services companies in a manner that impacts our ability to implement our strategy and could affect us in substantial and unpredictable ways and could have an adverse effect on our business, financial condition and results of operations. Furthermore, the regulatory agencies have extremely broad discretion in their interpretation of the regulations and laws and their interpretation of the quality of our loan portfolio, securities portfolio and other assets. If any regulatory agency's assessment of the quality of our assets differs from our assessment, we may be required to take additional charges that would have the effect of materially reducing our earnings, capital ratios and stock price.

*We have entered into a formal written agreement with the OCC that requires us to take specified actions.*

The OCC, Cadence's primary governmental regulator, reviews us annually. In this examination, the OCC reviews our business, including credit and other risks, accounting issues, operational matters, internal controls and management systems. Those reviews have required us to enhance our operational, risk management and internal control practices, planning processes, procedures and policies.

Following our most recent OCC review, we entered into an agreement with the OCC on April 17, 2009. In this agreement, we committed to enhance Cadence's existing practices and procedures in several areas, including the following: strategic planning, credit risk management, other real estate owned, criticized assets, internal loan review, internal audit, commercial real estate concentration risk management, brokered deposits, and financial subsidiaries. As a result of entering into a written agreement with the OCC, we are deemed to be in a troubled condition under applicable banking laws. Consequently, we will not be eligible for expedited processing of branch applications and other regulatory approvals, and we will be required to obtain OCC or FDIC approval before making severance payments to departing executives and adding new directors or senior executives. Cadence's regulators have considerable discretion in whether to grant required approvals, and we may not be able to obtain approvals if requested.

As of September 30, 2009, December 31, 2009, and March 31, 2010, in connection with such agreement, we did not meet certain capital ratios that were imposed upon Cadence by the OCC, although management believes we complied in all other material respects with such agreement. As a result of not meeting such capital ratios, the OCC has broad authority to take additional adverse actions against both the Corporation and Cadence. For more information see *We are required to maintain high capital levels* below.

*We are required to maintain high capital levels.*

As previously disclosed, the OCC has required Cadence to achieve as of September 30, 2009, and maintain on an ongoing basis, a Tier 1 leverage ratio of 8.0% and a total risk-based capital ratio of 12.0%. These capital ratios are higher than the regulatory capital ratios required to meet well-capitalized standards in a stable economy. As of September 30, 2009, December 31, 2009, and March 31, 2010, Cadence had a Tier 1 leverage ratio of 5.9%, 6.0%, and 5.6%, respectively, and a total risk-based capital ratio of 10.1%, 10.2%, and 10.5%, respectively, and, therefore, was not in compliance with the OCC's mandated capital ratios. Because Cadence is not in compliance with the written agreement with the OCC, the OCC has available a broad range of adverse actions, including imposing a consent order and taking control of Cadence. Management has been taking action and implementing programs to comply with the requirements of the OCC and believes that it has complied in all material respects with the agreement with the OCC with the exception of such ratios. The OCC may determine,

---

**Table of Contents**

however, in its sole discretion, to take additional enforcement action as discussed above, any of which could further limit the Corporation's and Cadence's businesses and negatively affect their ability to implement their business plan, the Corporation's ability to pay dividends on its common stock and preferred stock, the value of the Corporation's common stock and preferred stock, and the financial condition and results of operations of both the Corporation and Cadence.

*Our loan portfolio is highly concentrated in commercial real estate in certain geographic areas.*

Commercial real estate and farm loans totaled \$590.8 million as of March 31, 2010. Additionally, construction and development loans totaled \$156.4 million as of March 31, 2010. Our construction and development loan portfolio includes residential and non-residential construction and development loans. Our residential construction and development portfolio consists mainly of loans for the construction, development, and improvement of residential lots, homes, and subdivisions. Our non-residential construction and development portfolio consists mainly of loans for the construction and development of office buildings, hotels, and other non-residential commercial properties. Our commercial real estate and farm loan portfolio consists primarily of loans secured by office buildings, retail centers, warehouses, farm land and other commercial properties located primarily in our Mississippi, Memphis, Florida, Tuscaloosa, and Nashville market areas. The regional economic conditions in areas in which we conduct our business have an impact on the demand for our products and services as well as the ability of our customers to repay loans, the value of the collateral securing loans and the stability of our deposit funding sources.

Commercial real estate loans are typically larger than residential real estate loans and consumer loans and depend on sales, in the case of construction and development loans, and cash flows, in the case of other commercial real estate loans, from the property to service the debt. Sales and cash flows have been and may continue to be adversely affected by general economic conditions, and a further deterioration in the markets where our collateral is located could increase the likelihood of default. Because our loan portfolio contains a significant number of commercial real estate loans with relatively large balances, the deterioration of a few of these loans has caused and could continue to cause increases in our non-performing loan balances. An increase in non-performing loans could result in a loss of earnings from these loans, an increase in the provision for loan losses and an increase in charge-offs, all of which could have a material adverse effect on our financial condition and results of operations.

*The level of our commercial real estate loan portfolio has subjected us to additional regulatory scrutiny.*

The concentration of residential construction and development in our commercial real estate loan portfolio is a primary factor that led to our agreement with the OCC. The FDIC, the Federal Reserve and the OCC have promulgated joint guidance on sound risk management practices for financial institutions like Cadence with concentrations in commercial real estate lending. Under the guidance, management should employ heightened risk management practices including board and management oversight and strategic planning, enhancement of underwriting standards, risk assessment and monitoring through market analysis and stress testing. While we believe we have implemented and are continuing to implement policies and procedures with respect to our commercial real estate loan portfolio consistent with this guidance and with the requirements of the OCC agreement, the OCC could require us to implement additional policies and procedures consistent with their interpretation of the guidance that could result in additional costs to us or restrict our business in a manner that could have a material adverse effect on our results of operations.

*Our allowance for loan losses may not be adequate to cover actual losses.*

If our allowance for loan losses is not sufficient to cover actual loan losses, our earnings could decrease. Management maintains an allowance for loan losses based upon, among other things:

historical experience;

repayment capacity of borrowers;

an evaluation of local, regional and national economic conditions;

regular reviews of delinquencies and loan portfolio quality;



**Table of Contents**

collateral evaluations;

current trends regarding the volume and severity of problem loans;

the existence and effect of concentrations of credit;

results of regulatory examinations; and

from time to time, the advice of consultants.

Based on those factors, management makes various assumptions and judgments about the ultimate collectibility of the respective loan portfolios. The determination of the appropriate level of the allowance for loan losses inherently involves a high degree of subjectivity and requires management to make significant estimates of current credit risks and future trends, all of which may undergo material changes. Quarterly, our Board of Directors reviews the allowance for loan losses. In addition, the OCC periodically reviews our allowance for loan losses and may require an increase in the provision for possible loan losses or the recognition of further loan charge-offs. The OCC judgments may differ from those of our management. The amount of future loan losses is susceptible to changes in economic, operating and other conditions, which may be beyond our control, including changes in interest rates, and these losses may exceed current estimates. Federal regulatory agencies, as an integral part of their examination process, review our loans and allowance for loan losses. There can be no assurance that we will not need to increase our allowance for loan losses or that regulators will not require an increase in our allowance. Either of these occurrences could materially and adversely affect our financial condition and results of operations.

*We are subject to restrictions on executive compensation as a result of our participation in the CPP.*

Under the terms of the CPP, the U.S. Treasury has imposed specified standards for executive compensation and corporate governance for the period during which the U.S. Treasury holds any equity or warrants issued pursuant to the CPP. These standards generally apply to our chief executive officer, chief financial officer, chief operating officer, and the two next most highly compensated senior executive officers. The standards include:

ensuring that incentive compensation for senior executives does not encourage unnecessary and excessive risks that threaten our value;

required clawback of any bonus or incentive compensation paid to a senior executive based on statements of earnings, gains or other criteria that are later proven to be materially inaccurate;

prohibition on making golden parachute payments to senior executives; and

an agreement not to deduct for tax purposes executive compensation in excess of \$500,000 for each senior executive.

Under the ARRA, further compensation restrictions, including significant limitations on incentive compensation, have been imposed on our senior executive officers and most highly compensated employees. Those restrictions, and any future restrictions on executive compensation that may be adopted, could adversely affect our ability to hire and retain senior executive officers.

*Competition in the banking industry is intense and may adversely affect our profitability.*

The banking business is highly competitive, and we experience competition from many other financial institutions in our markets. We compete with commercial banks, credit unions, savings and loan associations, mortgage banking firms, consumer finance companies, securities brokerage firms, insurance companies, money market funds, and other mutual funds, as well as other regional, super-regional, national and international

## Edgar Filing: CADENCE FINANCIAL CORP - Form 10-Q

financial institutions that operate offices in our markets and elsewhere. Moreover, this highly competitive industry could become even more competitive as a result of legislative, regulatory and technological changes and continued consolidation. Many of our competitors have fewer regulatory constraints, and some have lower cost structures. In recent years, competition has intensified as a result of consolidation efforts. During the first quarter of 2010,

---

**Table of Contents**

competition continued to intensify as the challenges of the financial crises of 2009 and market disruption led to further redistribution of deposits and certain banking assets to stronger financial institutions. We expect this trend to continue. The competitive landscape was also affected by the conversion of traditional investment banks to bank holding companies during the financial crises due to the access it provides to government-sponsored sources of liquidity.

We compete with these institutions both in attracting deposits and in making loans. Price competition for loans might result in us originating fewer loans, or earning less on our loans, and price competition for deposits might result in a decrease in our total deposits or higher rates on our deposits. We have to attract our client base from other existing financial institutions and from new residents. Many of our competitors are well-established, larger financial institutions. We may face a competitive disadvantage as a result of our smaller size and inability to spread our marketing costs across a broader market. Our ability to compete successfully depends on a number of factors, including, among other things, concentrating our marketing efforts in our communities with local advertisements, personal contacts, and greater flexibility and responsiveness in working with local clients. Failure to perform in any of these areas could significantly weaken our competitive position, which could adversely affect our growth and profitability, which could materially and adversely affect our financial condition and results of operations.

*Operating results may require us to raise additional capital, but that capital may not be available or may be dilutive.*

As part of an agreement entered into with the OCC in April 2009, Cadence was required to achieve by September 30, 2009, and maintain on an ongoing basis, a Tier 1 leverage ratio of 8.0% and a total risk-based capital ratio of 12.0%. As of March 31, 2010, Cadence had a Tier 1 leverage ratio of 5.6% and a total risk-based capital ratio of 10.5%. As a result of our recent losses and Cadence's requirement for additional capital to meet these higher ratios, we have a need to raise additional capital. We are currently seeking to raise this capital through all available sources, including public or private equity offerings. Our ability to raise capital will depend on conditions in the capital markets, which are outside of our control, and on our financial performance. Accordingly, we cannot be assured of our ability to raise capital when needed or on favorable terms. If we cannot raise additional capital when needed, we could be subject to increased regulatory supervision and the imposition of restrictions on our growth and business. Any additional capital that we generate in the future, whether through exchange offers, underwritten offerings of common stock, or other public or private transactions, would be dilutive to our common shareholders and may reduce the market price of our common stock. Our inability to raise capital could materially and adversely affect our business, financial condition, or results of operations.

*Liquidity needs could adversely affect our results of operations and financial condition.*

Cadence's primary sources of funds are client deposits, maturing or called securities and loan repayments. While scheduled loan repayments are a relatively stable source of funds, they are subject to the ability of borrowers to repay the loans. The ability of borrowers to repay loans can be adversely affected by a number of factors outside of our control, including changes in economic conditions, adverse trends or events affecting business industry groups, reductions in real estate values or markets, business closings or lay-offs, inclement weather, natural disasters and international instability. Additionally, deposit levels may be affected by a number of factors, including rates paid by competitors, general interest rate levels, returns available to clients on alternative investments, financial condition or regulatory status of Cadence, actions by the OCC and general economic conditions. Accordingly, we may be required from time to time to rely on secondary sources of liquidity to meet withdrawal demands or otherwise fund operations. Those sources may include federal funds lines of credit from correspondent banks and the Federal Reserve discount window.

Our financial flexibility will be constrained if we continue to incur losses and are unable to maintain our access to funding or if adequate financing is not available at acceptable interest rates. We may seek additional debt in the future. Additional borrowings, if sought, may not be available to us or, if available, may not be available on reasonable terms. If additional financing sources are unavailable, or are not available on reasonable terms, our financial condition, results of operations, growth and future prospects could be materially adversely affected. Finally, if we are required to rely more heavily on more expensive funding sources to support future growth, our revenues may not increase proportionately to cover our costs. In addition, we may be required to slow or discontinue capital expenditures or make other investments or liquidate assets should those sources not be adequate. Until Cadence maintains a Tier 1 leverage ratio of 8.0% and a total risk-based capital ratio of 12.0%

---

**Table of Contents**

established by the OCC, Cadence is expecting to continue to reduce its loan portfolio and the interest income related thereto.

*The preferred stock sold to the U. S. Treasury may impact net income available to our common shareholders, and the warrant may be dilutive to our common shareholders.*

On January 9, 2009, we completed the sale of \$44 million of non-voting preferred stock to the U. S. Treasury under the CPP. These senior preferred shares pay a cumulative annual dividend at a 5% rate for the first five years and will reset to a rate of 9% after five years if not redeemed by us prior to that time. In connection with the issuance of the senior preferred shares, we also issued to the U. S. Treasury a warrant to purchase our common stock up to a maximum of 15% of the senior preferred amount, or \$6.6 million. Such capital has increased our equity and the number of dilutive outstanding common shares. In addition, the dividends declared and the accretion of discount on the senior preferred shares reduces the net income available to our common shareholders and earnings per common share. The senior preferred shares will also receive preferential treatment in the event of our liquidation, dissolution or winding up. Additionally, the ownership interest of our existing common shareholders will be diluted to the extent the warrant we issued to the U. S. Treasury is exercised.

*We may not be permitted to repurchase the U. S. Treasury's CPP investment if and when we request approval to do so.*

While it is our plan to repurchase the securities sold to the U. S. Treasury, in whole or in part, as soon as is practicable, we must establish to our regulators' satisfaction that we have satisfied all of the conditions to repurchase and must obtain the approval of the Federal Reserve and the U. S. Treasury. There can be no assurance that we will be able to repurchase the U. S. Treasury's investment in our non-voting preferred stock. In addition to limiting our ability to return capital to our shareholders, the U. S. Treasury's investment could limit our ability to retain key executives and other key employees, and limit our ability to develop business opportunities.

*If we are unable to repurchase the U. S. Treasury's investment after five years, the cost of this capital will increase substantially.*

If we are unable to redeem the senior preferred shares sold to the U. S. Treasury prior to January 9, 2014, the cost of this capital will increase substantially on that date, from 5.0% per annum to 9.0% per annum. Depending on our financial condition at the time, this increase in the annual dividend rate on the senior preferred shares could have a material negative effect on our liquidity.

*We face litigation and legal liability risks.*

We have been named, from time to time, as a defendant in various legal actions, including arbitrations and other litigation arising in connection with our activities. Threatened legal actions could include claims for substantial compensatory and/or punitive damages or claims for indeterminate amounts of damages. We are also subject to risk from potential employee misconduct, including non-compliance with policies and improper use or disclosure of confidential information. We maintain reserves for certain claims if deemed appropriate based upon our assessment of the claims. Whether any particular claims and legal actions are founded or unfounded, if such claims and legal actions are not resolved in our favor they may result in significant financial liability and/or adversely affect how the market perceives us and our products and services, as well as impact customer demand for those products and services. Any financial liability for which we have not adequately maintained reserves, and/or any reputation damage from such claims and legal actions, could materially and adversely affect our business, financial condition or results of operations.

*Actions of the U.S. Treasury, the Federal Reserve and other governmental and regulatory bodies for the purpose of stabilizing the financial markets may not achieve the intended effect.*

Recent legislative and regulatory initiatives to address difficult market and economic conditions may not stabilize the U.S. banking system. On October 3, 2008, President Bush signed into law the Emergency Economic Stabilization Act in response to the current crisis in the financial sector and on February 17, 2009, President Obama signed into law the ARRA. The U.S. Treasury and banking regulators have implemented a number of programs under this legislation to address capital and liquidity issues in the banking system. There can be no assurance, however, as to the actual impact that the Emergency Economic Stabilization Act or the ARRA will have



---

**Table of Contents**

on the financial markets, including the extreme levels of volatility and limited credit availability currently being experienced. The failure of the Emergency Economic Stabilization Act or the ARRA to help stabilize the financial markets and a continuation or worsening of current financial market conditions could have a material adverse effect on our business, financial condition, results of operations, access to credit or the value of our securities.

These programs and measures also subject participating financial institutions, like us, to additional restrictions, oversight and costs that may have an adverse effect on our business, financial condition, results of operations or the price of our common stock. In particular, the ARRA amended the executive compensation provisions of the Emergency Economic Stabilization Act, under which TARP was established. These amendments apply not only to future participants under TARP, but also apply retroactively to companies like us that are current TARP participants. The full effect of these amendments is uncertain and difficult to predict. The ARRA directs the Secretary of the U.S. Treasury to adopt standards that implement the amended provisions of the Emergency Economic Stabilization Act and directs the SEC to issue rules in connection with some of the amended provisions. While the U.S. Treasury has adopted interim final rules, the full effect of the new standards and rules is not fully known.

*Changes in monetary policy and interest rates could adversely affect our profitability.*

Our results of operations are affected by credit policies of monetary authorities, particularly the Federal Reserve. Our profitability depends to a significant extent on our net interest income. Net interest income is the difference between income generated from interest-earning assets and interest expense on funding those assets. Our net interest income has declined in recent periods due to a decline in interest rates and a reduction in interest earning assets. Interest rates are highly sensitive to many factors that are beyond our control, including general economic conditions and policies of various governmental and regulatory agencies. Changes in monetary policy, including changes in interest rates, could influence not only the interest we receive on loans and securities and the interest we pay on deposits and borrowings, but those changes could also affect our ability to originate loans and obtain deposits, and the average duration of our mortgage-backed securities portfolio.

Our net interest income will be adversely affected if market interest rates change such that the interest we pay on deposits and borrowings increases faster than the interest earned on loans and investments. Changes in interest rates could also adversely affect the income of some of our noninterest income sources. For example, declines in security values could further reduce our trust and investment income.

In light of changing conditions in the national economy and in the financial markets, particularly the uncertain economic environment, the continuing threat of terrorist acts and the current military operations in the Middle East, we cannot predict possible future changes in interest rates, which may negatively affect our deposit levels, our loan demand and our business and earnings. Furthermore, the actions of the United States and other governments in response to ongoing economic crisis may result in currency fluctuations, exchange controls, market disruption and other adverse effects.

*We may be required to pay significantly higher FDIC premiums in the future.*

Recent insured institution failures, as well as deterioration in banking and economic conditions, have significantly increased the loss provisions of the FDIC, resulting in a decline in the designated reserve ratio to historical lows. The FDIC expects a higher rate of insured institution failures in the next few years compared to recent years. Therefore, the reserve ratio may continue to decline. Additionally, the Emergency Economic Stabilization Act temporarily increased the limit on FDIC coverage to \$250,000 through December 31, 2009, which was extended to December 13, 2013 on May 20, 2009. These developments will cause the premiums assessed on us by the FDIC to increase and materially increase other expenses. Our FDIC insurance related costs totaled approximately \$4.3 million for 2009 and approximately \$887,000 for the first quarter of 2010. We anticipate that 2010 costs will remain high and are unable to predict the impact of FDIC insurance costs in future periods if the economic crisis continues.

*We are a bank holding company and depend on our subsidiaries for dividends, distributions and other payments.*

The Corporation is a company separate and apart from Cadence, and we must provide for our own liquidity. Substantially all of our revenues are obtained from dividends declared and paid by Cadence. Cadence's ability to declare and pay dividends is limited by its obligations to maintain sufficient capital and by other general

## **Table of Contents**

restrictions on its dividends that are applicable to our subsidiaries that are regulated by various regulatory authorities. Under regulations controlling national banks, the payment of dividends by a bank without prior approval from the OCC is limited in amount to the current year's net profit and the retained net earnings of the two preceding years. At March 31, 2010, without approval from the OCC, Cadence does not have the ability to pay dividends to the Corporation. The Federal Reserve has issued policy statements generally requiring insured banks and bank holding companies to pay dividends only out of current operating earnings.

*Our inability to hire or retain key professionals, management and staff could adversely affect our revenues and net income.*

We rely on key personnel to manage and operate our business, including major revenue generating functions such as the loan and deposit portfolios. The loss of key staff may adversely affect our ability to maintain and manage these portfolios effectively, which could negatively affect our revenues.

The ARRA has imposed significant limitations on executive compensation for recipients, like us, of funds under the CPP, which may make it more difficult for us to retain and recruit key personnel. Our success depends to a significant degree upon our ability to attract and retain qualified management, loan origination, finance, administrative, marketing and technical personnel and upon the continued contributions of our management and personnel. In particular, our success has been and continues to be highly dependent upon the abilities of our key executives, including our chairman and chief executive officer, our president and chief operating officer and chief financial officer.

*An interruption or breach in security with respect to our information systems, as well as information systems of our outsourced service providers, could have a material adverse effect on our financial condition and results of operations.*

We rely heavily on communications and information systems to conduct our business. Any failure, interruption or breach in security with respect to our information system, as well as information systems of our outsourced service providers, could damage our reputation, result in a loss of client business, subject us to additional regulatory scrutiny, or expose us to civil litigation, any of which could result in failures or disruptions in our client relationship management, general ledger, deposit, loan and other systems resulting in a material adverse effect on our financial condition and results of operations.

*We have a significant deferred tax asset and cannot assure that it will be fully realized.*

We had net deferred tax assets of \$31.4 million as of March 31, 2010, including a valuation allowance of \$651,000 relating to our state operating loss carryforwards. We have not established a valuation allowance against our federal net deferred tax assets because we believe that it is more likely than not that all of these assets will be realized. In evaluating the need for a valuation allowance, we estimated future taxable income based on management approved forecasts. This process required significant judgment by management about matters that are by nature uncertain. If future events differ significantly from our current forecasts, we may need to adjust our valuation allowance, which could have a material adverse effect on our results of operations and financial condition.

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

Not applicable

## **ITEM 3 DEFAULTS UPON SENIOR SECURITIES**

Not applicable

## **ITEM 4 RESERVED**

## **ITEM 5 OTHER INFORMATION**

Not applicable

**Table of Contents**

**ITEM 6 EXHIBITS**

- 11 Statement re computation of earnings per share
- 31.1 Certificate pursuant to Rule 13a-14(a) or 15d-14(a) of Securities Exchange Act of 1934 as adopted pursuant to section 302 of Sarbanes-Oxley Act of 2002-Principal Executive Officer
- 31.2 Certificate pursuant to Rule 13a-14(a) or 15d-14(a) of Securities Exchange Act of 1934 as adopted pursuant to section 302 of Sarbanes-Oxley Act of 2002-Principal Financial Officer
- 32.1 Certificate pursuant to 18 U.S.C., Section 1350 as adopted pursuant to section 906 of Sarbanes-Oxley Act of 2002 Chief Executive Officer
- 32.2 Certificate pursuant to 18 U.S.C., Section 1350 as adopted pursuant to section 906 of Sarbanes-Oxley Act of 2002 Chief Financial Officer

**Table of Contents**

**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.

CADENCE FINANCIAL CORPORATION  
Registrant

Date: May 12, 2010

/s/ Richard T. Haston  
Richard T. Haston  
Executive Vice President and Chief Financial Officer

(on behalf of the Registrant and as  
principal financial officer)

**Table of Contents**

EXHIBIT INDEX:

<b>Exhibit</b>	<b>Description</b>	<b>Page</b>
11	Statement re computation of earnings per share	47
31.1	Certificate pursuant to Rule 13a-14(a) or 15d-14(a) of Securities Exchange Act of 1934 as adopted pursuant to section 302 of Sarbanes-Oxley Act of 2002-Principal Executive Officer	48
31.2	Certificate pursuant to Rule 13a-14(a) or 15d-14(a) of Securities Exchange Act of 1934 as adopted pursuant to section 302 of Sarbanes-Oxley Act of 2002-Principal Financial Officer	49
32.1	Certificate pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of Sarbanes-Oxley Act of 2002 Chief Executive Officer	50
32.2	Certificate pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of Sarbanes-Oxley Act of 2002 Chief Financial Officer	51