UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2009

OR

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

For transition period from to

Commission File Number 0 -10537

OLD SECOND BANCORP, INC.

(Exact name of Registrant as specified in its charter)

Delaware	**36-3143493**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

37 South River Street, Aurora, Illinois 60507

(Address of principal executive offices) (Zip Code)

(630) 892-0202

(Registrant s telephone number, including area code)

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

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

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

Large accelerated filer o	Accelerated filer x
Non-accelerated filer (do not check if a smaller reporting company)	Smaller reporting company o

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock as of the latest practicable date: As of August 6, 2009, the Registrant had outstanding 13,824,561 shares of common stock, $1.00 par value per share.

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OLD SECOND BANCORP, INC.

Form 10-Q Quarterly Report

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

Old Second Bancorp, Inc. and Subsidiaries

Consolidated Balance Sheets

(In thousands, except share data)

	(Unaudited) June 30, 2009	December 31, 2008
Assets		
Cash and due from banks	$ 43,198	$ 66,099
Interest bearing deposits with financial institutions	3,241	809
Federal funds sold	37,284	5,497
Short-term securities available-for-sale	3,176	809
Cash and cash equivalents	86,899	73,214
Securities available-for-sale	246,318	405,577
Federal Home Loan Bank and Federal Reserve Bank stock	13,044	13,044
Loans held-for-sale	23,161	23,292
Loans	2,212,977	2,271,114
Less: allowance for loan losses	74,551	41,271
Net loans	2,138,426	2,229,843
Premises and equipment, net	60,557	62,522
Other real estate owned	15,590	15,212
Mortgage servicing rights, net	1,725	1,374
Goodwill		59,040
Core deposit and other intangible assets, net	7,238	7,821
Bank-owned life insurance (BOLI)	49,228	48,754
Accrued interest and other assets	78,051	44,912
Total assets	$ 2,720,237	$ 2,984,605
Liabilities		
Deposits:		
Non-interest bearing demand	$ 315,599	$ 318,092
Interest bearing:		
Savings, NOW, and money market	938,215	928,204
Time	1,095,463	1,140,832
Total deposits	2,349,277	2,387,128
Securities sold under repurchase agreements	26,801	46,345
Federal funds purchased		28,900
Other short-term borrowings	11,175	169,383
Junior subordinated debentures	58,378	58,378
Subordinated debt	45,000	45,000
Notes payable and other borrowings	500	23,184
Accrued interest and other liabilities	21,845	33,191
Total liabilities	2,512,976	2,791,509

Stockholders Equity				
Preferred stock, $1.00 par value; authorized 300,000 shares at June 30, 2009; series B, 5% cumulative perpetual, 73,000 shares issued and outstanding at June 30, 2009, $1,000.00 liquidation value		68,619		
Common stock, $1.00 par value; authorized 20,000,000 shares; issued 18,373,008 at June 30, 2009 and 18,304,331 at December 31, 2008; outstanding 13,824,561 at June 30, 2009 and 13,755,884 at December 31, 2008		18,373		18,304
Additional paid-in capital		63,956		58,683
Retained earnings		152,442		213,031
Accumulated other comprehensive loss		(1,330)		(2,123)
Treasury stock, at cost, 4,548,447 shares at June 30, 2009 and December 31, 2008		(94,799)		(94,799)
Total stockholders equity		207,261		193,096
Total liabilities and stockholders equity	$	2,720,237	$	2,984,605

See accompanying notes to consolidated financial statements.

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Old Second Bancorp, Inc. and Subsidiaries

Consolidated Statements of Operations

(In thousands, except share data)

	(unaudited) Three Months Ended June 30, 2009	2008	(unaudited) Year to Date June 30, 2009	2008
Interest and Dividend Income				
Loans, including fees	$ 29,834	$ 34,257	$ 59,948	$ 68,562
Loans held-for-sale	305	184	617	408
Securities, taxable	2,173	4,197	5,969	8,926
Securities, tax exempt	1,416	1,513	2,847	2,997
Dividends from Federal Reserve Bank and Federal Home Loan Bank stock	57	17	113	34
Federal funds sold	1	55	3	84
Interest bearing deposits with financial institutions	2	7	4	11
Total interest and dividend income	33,788	40,230	69,501	81,022
Interest Expense				
Savings, NOW, and money market deposits	1,546	3,504	3,392	8,314
Time deposits	9,062	11,431	18,763	23,755
Securities sold under repurchase agreements	17	202	115	538
Federal funds purchased	31	193	73	1,163
Other short-term borrowings	74	612	221	1,401
Junior subordinated debentures	1,072	1,072	2,144	2,137
Subordinated debt	309	477	799	792
Notes payable and other borrowings	3	211	114	454
Total interest expense	12,114	17,702	25,621	38,554
Net interest and dividend income	21,674	22,528	43,880	42,468
Provision for loan losses	47,500	1,900	56,925	2,800
Net interest and dividend (expense) income after provision for loan losses	(25,826)	20,628	(13,045)	39,668
Non-interest Income				
Trust income	1,846	2,190	3,735	4,372
Service charges on deposits	2,173	2,313	4,285	4,368
Secondary mortgage fees	469	232	878	515
Mortgage servicing income	134	143	271	295
Net gain on sales of mortgage loans	2,710	1,768	5,196	3,713
Securities gains, net	1,391	1,075	1,314	1,383
Increase in cash surrender value of bank owned life insurance	347	333	474	620
Debit card interchange income	635	618	1,211	1,169
Net interest rate swap (losses) gains	(957)	148	(567)	148
Other income	1,232	1,283	2,399	2,380
Total non-interest income	9,980	10,103	19,196	18,963
Non-interest Expense				
Salaries and employee benefits	9,676	11,572	20,561	23,195
Occupancy expense, net	1,645	1,559	3,160	2,997
Furniture and equipment expense	1,742	1,585	3,482	3,371
FDIC insurance	2,421	310	3,238	612
	291	296	583	496

Amortization of core deposit and other intangible asset								
Advertising expense		242		636		674		1,008
Impairment of goodwill		57,579				57,579		
Other real estate expense		2,983				3,879		5
Other expense		3,929		4,133		8,681		8,568
Total non-interest expense		80,508		20,091		101,837		40,252
(Loss) Income before income taxes		(96,354)		10,640		(95,686)		18,379
(Benefit) provision for income taxes		(37,928)		3,318		(38,244)		5,493
Net (loss) income	$	(58,426)	$	7,322	$	(57,442)	$	12,886
Preferred stock dividends and accretion		1,235				2,036		
Net (loss) income available to common stockholders	$	(59,661)	$	7,322	$	(59,478)	$	12,886
Basic (loss) earnings per share	$	(4.29)	$	0.53	$	(4.29)	$	0.96
Diluted (loss) earnings per share		(4.29)		0.53		(4.29)		0.95
Dividends declared per share		0.04		0.16		0.08		0.32

See accompanying notes to consolidated financial statements.

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Old Second Bancorp, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

(In thousands)

	(Unaudited) Six Months Ended June 30, 2009	2008
Cash flows from operating activities		
Net (loss) income	$ (57,442)	$ 12,886
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation	2,491	2,243
Amortization of leasehold improvement	91	86
Amortization and recovery of mortgage servicing rights, net	(33)	368
Provision for loan losses	56,925	2,800
Provision for deferred tax expense	37,259	
Originations of loans held-for-sale	(284,811)	(193,457)
Proceeds from sales of loans held-for-sale	289,376	206,708
Net gain on sales of mortgage loans	(5,196)	(3,713)
Change in current income taxes payable	(42,042)	474
Increase in cash surrender value of bank-owned life insurance	(474)	(620)
Change in accrued interest receivable and other assets	(26,706)	4,623
Change in accrued interest payable and other liabilities	(10,086)	(6,195)
Net premium amortization on securities	390	327
Securities gains, net	(1,314)	(1,383)
Impairment of goodwill	57,579	
Amortization of core deposit and other intangible assets	583	496
Stock based compensation	526	505
Gain on sale of other real estate owned	(293)	
Write-down of other real estate owned	3,412	
Net cash provided by operating activities	20,235	26,148
Cash flows from investing activities		
Proceeds from maturities and pre-refunds including pay down of securities available-for-sale	100,743	159,258
Proceeds from sales of securities available-for-sale	202,040	61,819
Purchases of securities available-for-sale	(141,450)	(80,876)
Net change in loans	28,689	(39,925)
Investment in other real estate owned	(1,933)	
Proceeds from sales of other real estate owned	4,067	
Cash paid for acquisition, net of cash and cash equivalents retained		(38,735)
Net purchases of premises and equipment	(617)	(3,056)
Net cash provided by investing activities	191,539	58,485
Cash flows from financing activities		
Net change in deposits	(37,851)	10,881
Net change in securities sold under repurchase agreements	(19,544)	(8,455)
Net change in federal funds purchased	(28,900)	(143,900)
Net change in other short-term borrowings	(163,342)	21,052
Proceeds from the issuance of preferred stock	68,245	
Proceeds from the issuance of common stock warrants	4,755	
Proceeds from the issuance of subordinated debt		45,000
Proceeds from junior subordinated debentures		979
Proceeds from notes payable and other borrowings	2,240	3,882

Repayment of note payable		(19,790)		(3,000)
Proceeds from exercise of stock options		55		54
Tax benefit from stock options exercised				25
Tax benefit from dividend equivalent payment		6		
Dividends paid		(3,963)		(3,865)
Net cash used in financing activities		(198,089)		(77,347)
Net change in cash and cash equivalents		13,685		7,286
Cash and cash equivalents at beginning of period		73,214		64,739
Cash and cash equivalents at end of period	$	86,899	$	72,025

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Old Second Bancorp, Inc. and Subsidiaries

Consolidated Statements of Cash Flows - Continued

(In thousands)

	(Unaudited) Six Months Ended June 30, 2009	2008
Supplemental cash flow information		
Income taxes paid	$ 2,330	$ 7,282
Interest paid for deposits	22,753	32,165
Interest paid for borrowings	3,506	6,564
Non-cash transfer of loans to other real estate	5,631	608
Non-cash transfer of notes payable to other short-term borrowings	5,134	
Change in dividends declared not paid	(1,190)	372
Non-cash transfer related to deferred taxes on goodwill	1,461	
2008 Acquisition of HeritageBanc, Inc.		
Non-cash assets acquired:		
Securities available-for-sale		$ 43,971
Federal Home Loan Bank and Federal Reserve Bank stock		1,470
Loans, net		283,552
Premises and equipment		11,567
Goodwill		56,884
Core deposit and other intangible asset		8,917
Other assets		1,403
Total non-cash assets acquired		$ 407,764
Liabilities assumed:		
Deposits		294,355
Federal funds purchased		17,100
Advances from the Federal Home Loan Bank		9,331
Other liabilities		5,243
Total liabilities assumed		326,029
Net non-cash assets acquired		$ 81,735
Cash and cash equivalents acquired		$ 5,718
Stock issuance in lieu of cash paid in acquisition		$ 43,000

See accompanying notes to consolidated financial statements.

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Old Second Bancorp, Inc. and Subsidiaries

Consolidated Statements of Changes in

Stockholders Equity

(In thousands, except share data)

	Common Stock	Preferred Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders Equity
Balance, December 31, 2007	$ 16,695	$	$ 16,114	$ 209,867	$ 1,971	$ (94,758)	$ 149,889
Comprehensive income:							
Net income				12,886			12,886
Change in net unrealized gain on securities available-for-sale net of $1,314 tax effect					(1,997)		(1,997)
Total comprehensive income							10,889
Dividends declared, $.31 per share				(4,237)			(4,237)
Purchase of Heritage	1,564		41,436				43,000
Change in restricted stock	27		(27)				
Stock options exercised	5		49				54
Tax effect of stock options exercised			25				25
Stock based compensation			505				505
Balance, June 30, 2008	$ 18,291	$	$ 58,102	$ 218,516	$ (26)	$ (94,758)	$ 200,125
Balance, December 31, 2008	$ 18,304	$	$ 58,683	$ 213,031	$ (2,123)	$ (94,799)	$ 193,096
Comprehensive loss:							
Net loss				(57,442)			(57,442)
Change in net unrealized gain on securities available-for-sale net of $452 tax effect					793		793
Total comprehensive income							(56,649)
Dividends Declared, $.08 per share				(1,111)			(1,111)
Change in restricted stock	63		(63)				
Stock options exercised	6		49				55
Tax effect of dividend equivalent payments			6				6
Stock based compensation			526				526
Preferred dividends declared (5% per preferred share)		374		(2,036)			(1,662)
Issuance of preferred stock		68,245					68,245
Issuance of stock warrants			4,755				4,755

Balance, June 30, 2009	$ 18,373	$ 68,619	$ 63,956	$ 152,442	$ (1,330)	$ (94,799)	$ 207,261

See accompanying notes to consolidated financial statements.

Old Second Bancorp, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(Table amounts in thousands, except per share data, unaudited)

Note 1 Summary of Significant Accounting Policies

The accounting policies followed in the preparation of the interim financial statements are consistent with those used in the preparation of the annual financial information. The interim financial statements reflect all normal and recurring adjustments, which are necessary, in the opinion of management, for a fair statement of results for the interim period presented. Results for the period ended June 30, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009. These interim financial statements should be read in conjunction with the audited financial statements and notes included in Old Second Bancorp, Inc. s (the Company) annual report on Form 10-K for the year ended December 31, 2008. Unless otherwise indicated, amounts in the tables contained in the notes are in thousands. Certain items in prior periods have been reclassified to conform to the current presentation.

The Company s consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States and follow general practices within the banking industry. Application of these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the financial statements. Future changes in information may affect these estimates, assumptions, and judgments, which, in turn, may affect amounts reported in the financial statements.

All significant accounting policies are presented in Note A to the consolidated financial statements included in the Company s annual report on Form 10-K for the year ended December 31, 2008. These policies, along with the disclosures presented in the other financial statement notes and in this discussion, provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined.

In December 2007, the Federal Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 141 (revised 2007), *Business Combinations* (FAS No. 141(R)), which broadens the guidance of SFAS No. 141, extending its applicability to all transactions and other events in which one entity obtains control over one or more other businesses. It broadens the fair value measurement and recognition of assets acquired, liabilities assumed, and interests transferred as a result of business combinations. FAS No. 141(R) expands on required disclosures to improve the statement users abilities to evaluate the nature and financial effects of business combinations. FAS No. 141(R) is effective for fiscal years beginning on or after December 15, 2008. In April 2009, the FASB issued Staff Position (FSP) 141(R)-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies*. This FSP amends the guidance in FAS No. 141(R) and is effective for fiscal years beginning on or after December 15, 2008. The provisions of FAS No. 141(R) and FSP 141(R)-1 will only impact the Company if we are party to a business combination closing on or after January 1, 2009.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interest in Consolidated Financial Statements, an amendment of ARB No. 51* (FAS No. 160), which requires that a noncontrolling interest in a subsidiary be reported separately within equity and the amount of consolidated net income specifically attributable to the noncontrolling interest be identified in the consolidated financial statements. It also calls for consistency in the manner of reporting changes in the parent s ownership interest and requires fair value measurement of any noncontrolling equity investment retained in a deconsolidation. FAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. The impact of adoption was not material.

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In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities, an amendment of SFAS No. 133* (FAS No. 161). FAS No. 161 amends and expands the disclosure requirements of SFAS No. 133 for derivative instruments and hedging activities. FAS No. 161 requires qualitative disclosure about objectives and strategies for using derivative and hedging instruments, quantitative disclosures about fair value amounts of the instruments and gains and losses on such instruments, as well as disclosures about credit-risk features in derivative agreements. FAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The Company adopted the provisions of FAS No. 161 on January 1, 2009 and the impact on our financial statements is outlined in Note 16.

In June 2008, the FASB issued FASB Staff Position (FSP) EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities.* (FSP EITF 03-6-1). FSP EITF 03-6-1 provides that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. FSP EITF 03-6-1 became effective on January 1, 2009. All previously reported earnings per share data have been retrospectively adjusted to conform with the provisions of FSP EITF 03-6-1. The provisions of FSP EITF 03-6-1 did not have a material impact upon the Company s earnings per share calculations.

In April 2009, the FASB issued FSP 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments.* The FSP requires a public entity to provide disclosures about fair value of financial instruments in interim financial information. FSP 107-1 and Accounting Principles Bulletin (APB) 28-1 was effective for interim and annual financial periods ending after June 15, 2009, and the impact upon adoption was not material to the Company s financial condition or results of operations.

In April 2009, the FASB issued FSP FAS 115-2, FAS124-2 and EITF 99-20-2, *Recognition and Presentation of Other-Than-Temporary-Impairment.* The FSP (i) changes existing guidance for determining whether an impairment is other than temporary to debt securities and (ii) replaces the existing requirement that the entity s management assert it has both the intent and ability to hold an impaired security until recovery with a requirement that management assert: (a) it does not have the intent to sell the security; and (b) it is more likely than not it will not have to sell the security before recovery of its cost basis. Under FSP FAS 115-2, FAS 124-2 and EITF 99-20-2, declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses to the extent the impairment is related to credit losses. The amount of impairment related to other factors is recognized in other comprehensive income. FAS 115-2, FAS 124-2 and EITF 99-20-2 was effective for interim and annual periods ending after June 15, 2009, and the impact upon adoption was not material to the Company s financial condition or results of operations.

In April 2009, the FASB issued FSP FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly.* The FSP affirms the objective of fair value when a market is not active, clarifies and includes additional factors for determining whether there has been a significant decrease in market activity, eliminates the presumption that all transactions are distressed unless proven otherwise, and requires an entity to disclose a change in valuation technique. The FSP was effective for interim and annual periods ending after June 15, 2009 and the impact upon adoption was not material to the Company s financial condition or results of operations.

In May 2009, the FASB issued Statement No. 165, *Subsequent Events* (FAS No. 165). FAS 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or available to be issued. FAS 165 is effective for interim or annual periods ending after June 15, 2009. Management adopted the provisions of FAS 165 and this change is reflected in Note 19 - Subsequent Events.

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In June 2009, the FASB issued Statement No. 166, *Accounting for Transfers of Financial Assets, an amendment of FASB Statement No. 140* (FAS No. 166). FAS 166 amends the derecognition accounting and disclosure guidance relating to FAS 140. FAS 166 eliminates the exemption from consolidation for qualifying special-purpose entities (QSPE s), it also requires a transferor to evaluate all existing QSPEs to determine whether it must be consolidated in accordance with FAS 167. FAS 166 is effective as of the beginning of the first annual reporting period that begins after November 15, 2009. Management is currently assessing the impact of FAS 166 on our financial condition, results of operations, and disclosures.

In June 2009, the FASB issued Statement No. 167, *Amendments to FASB Interpretation No. 46(R)* (FAS 167). FAS 167 amends the consolidation guidance applicable to variable interest entities. The amendments to the consolidation guidance affect all entities currently within the scope of FAS 167, as well as QSPE s that are currently excluded from the scope of FAS 167. FAS 167 is effective as of the beginning of the first annual reporting period that begins after November 15, 2009. Management is currently assessing the impact of FAS 167 on our financial condition, results of operations, and disclosures.

In June 2009, the FASB issued Statement No. 168, *FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles a replacement of FASB Statement No. 162* (FAS 168). FAS 168 will officially become the single source of authoritative nongovernmental U.S. generally accepted accounting principles (GAAP). FAS 168 does not change current GAAP, but is intended to simplify user access to all authoritative GAAP by providing all the authoritative literature related to a particular topic in one place. All existing accounting standard documents will be superseded and all other accounting literature not included in the FAS 168 will be considered nonauthoritative. FAS 168 is effective for interim or annual reporting periods ending after September 15, 2009.

Note 2 Business Combination

Old Second Acquisition, Inc., was formed as part of the November 5, 2007 Agreement and Plan of Merger between the Company, Old Second Acquisition, Inc., a wholly-owned subsidiary of the Company, and HeritageBanc, Inc. (Heritage), located in Chicago Heights. The parties consummated the merger on February 8, 2008, at which time Old Second Acquisition, Inc. was merged with and into Heritage with Heritage as the surviving corporation as a wholly-owned subsidiary of the Company. Additionally, the parties merged Heritage Bank, a wholly-owned subsidiary of Heritage, with and into Old Second National Bank, with Old Second National Bank as the surviving bank (the Bank). After the completion of the merger transaction, Heritage was dissolved and is no longer an existing subsidiary. The purchase price was paid through a combination of cash and approximately 1.6 million shares of the Company s common stock totaling $86.0 million, excluding transaction costs. The final accounting for the transaction generated $55.4 million in goodwill and $8.9 million in intangible assets subject to amortization.

The business combination was accounted for under the purchase method of accounting. Accordingly, the results of operations of Heritage have been included in the Company s results of operations since the date of acquisition. Under this method of accounting, the purchase price was allocated to the respective assets acquired and liabilities assumed based on their estimated fair values, net of applicable income tax effects. The excess cost over fair value of net assets acquired was recorded as goodwill. The following table summarizes the allocation of the purchase price.

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Purchase Price of Heritage (in thousands):		
Market value (market value per share of $27.50) of the Company s common stock issued	$	43,000
Cash paid		43,000
Transaction costs		1,557
Total purchase price	$	87,557
Allocation of the purchase price		
Historical net assets of Heritage as of February 8, 2008	$	24,390
Fair market value adjustments as of February 8, 2008		
Real estate		529
Equipment		(134)
Artwork		(30)
Loans		(122)
Goodwill		55,449
Core deposit intangible and other intangible assets		8,917
Time deposits		(1,111)
FHLB advances		(331)
Total purchase price	$	87,557

The Company decreased the goodwill attributable to the Heritage transaction by $1.4 million in the first quarter of 2009 along with an offsetting decrease to deferred tax liabilities. In addition, the Company recorded a goodwill impairment charge of $57.6 million in the second quarter of 2009, which primarily resulted from the goodwill that was attributable to Heritage. See Note 6 in these Notes to Consolidated Financial Statements and Item 2 of this quarterly report for additional information on the goodwill impairment charge.

The following is the unaudited pro forma consolidated results of operations of the Company as though Heritage had been acquired as of the beginning of the periods indicated.

		Three Months Ended June 30, 2008		**Six Months Ended June 30, 2008**
Net interest income after provision	$	20,554	$	40,795
Noninterest income		10,103		19,181
Noninterest expense		20,068		45,849
Income before income taxes		10,589		14,127
Income taxes		3,508		4,249
Net income	$	7,081	$	9,878
Per common share information				
Earnings	$	0.52	$	0.72
Diluted earnings	$	0.51	$	0.71
Average common shares issued and outstanding		13,742,576		13,741,381
Average diluted common shares outstanding		13,856,956		13,870,457

Included in the pro forma results of operations for the six months ended June 30, 2008 were one-time pretax merger costs of $3.9 million.

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Note 3 Securities

Securities available-for-sale are summarized as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2009:				
U.S. Treasury	$ 1,498	$ 47	$	$ 1,545
U.S. government agencies	18,760	495		19,255
U.S. government agency mortgage-backed	38,489	1,573	(48)	40,014
States and political subdivisions	146,670	3,139	(1,462)	148,347
Collateralized mortgage obligations	28,411	762	(39)	29,134
Collateralized debt obligations	17,809		(6,698)	11,111
Equity securities	99		(11)	88
	$ 251,736	$ 6,016	$ (8,258)	$ 249,494
December 31, 2008:				
U.S. Treasury	$ 1,496	$ 72	$	$ 1,568
U.S. government agencies	95,290	1,178	(113)	96,355
U.S. government agency mortgage-backed	86,062	1,396	(208)	87,250
States and political subdivisions	150,313	2,939	(1,659)	151,593
Collateralized mortgage obligations	58,684	711	(125)	59,270
Collateralized debt obligations	17,834		(7,567)	10,267
Equity securities	99		(16)	83
	$ 409,778	$ 6,296	$ (9,688)	$ 406,386

Recognition of other-than-temporary impairment was not necessary in the quarter ended June 30, 2009 or the year ended December 31, 2008. The changes in fair values related to interest rate fluctuations and other market factors and were generally not related to credit quality deterioration although the amount of deferrals and defaults in the pooled collateralized debt obligation increased from December 31, 2008. An increase in rates will generally cause a decrease in the fair value of individual securities while a decrease in rates typically results in an increase in fair value. In addition to the impact of rate changes upon pricing, uncertainty in the financial markets in the periods presented has resulted in reduced liquidity for certain investments, particularly the collateralized debt obligations (CDO), which also impacted market pricing for the periods presented. In the case of the CDO fair value measurement, management included a risk premium adjustment as of June 30, 2009, to reflect an estimated amount that a market participant would demand because of uncertainty in cash flows. Management made that adjustment because the level of market activity for the CDO security has continued to decrease and information on orderly transaction sales was not generally available. Accordingly, management designated this security as a level 3 security as described in note 15 of this quarterly report. Management does not have the intent to sell the above securities and it is more likely than not the Company will not have to sell the securities before recovery of its cost basis.

Below is additional information as it relates to the collateralized debt obligation, Trapeza 2007-13A, which is backed by a pool of trust preferred securities issued by trusts sponsored by multiple financial institutions. This collateralized debt obligation was rated AAA at the time of purchase by the Company.

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	Amortized Cost	Fair Value	Gross Unrealized Loss	S&P Credit Rating (1)	Number of Banks in Issuance	Issuance Deferrals & Defaults Amount	Issuance Deferrals & Defaults Collateral %	Issuance Excess Subordination Amount	Issuance Excess Subordination Collateral %
June 30, 2009									
Class A1	$ 9,382	$ 5,662	$ (3,720)	BB+	63	$ 86,000	11.5%	$ 296,938	39.6%
Class A2A	8,427	5,449	(2,978)	BB-	63	86,000	11.5%	199,938	26.7%
	$ 17,809	$ 11,111	$ (6,698)						
December 31, 2008									
Class A1	$ 9,478	$ 4,657	$ (4,821)	AAA	63	$ 37,500	5.0%	$ 340,917	45.5%
Class A2A	8,356	5,610	(2,746)	AAA	63	37,500	5.0%	243,917	32.5%
	$ 17,834	$ 10,267	$ (7,567)						

(1) Moody s credit rating for class A1 and A2A were A1 and Baa2, respectively, as of June 30, 2009. The Moody s credit ratings at December 31, 2008 for class A1 and A2A were both Aaa. The Fitch ratings for class A1 and A2A were AA and A, respectively, as of June 30, 2009. The Fitch ratings at December 31, 2008 for class A1 and A2A were both AAA.

In addition to other equity securities, which are recorded at estimated market value, the Bank owns the stock of the Federal Reserve Bank of Chicago (FRB) and the Federal Home Loan Bank of Chicago (FHLBC). Both of these entities require the Bank to invest in their non-marketable stock as a condition of membership. The value of the stock in each of those entities was recorded at cost in the amounts of $3.8 million and $9.3 million, respectively, at June 30, 2009, and at December 31, 2008. The FHLBC is a governmental sponsored entity that has been under a regulatory order for a prolonged period that generally requires approval prior to redeeming or paying dividends on that common stock. The Bank continues to utilize the various products and services of the FHLBC and management considers this stock to be a long-term investment. FHLBC members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLBC stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value.

Note 4 Loans

Major classifications of loans were as follows:

	June 30, 2009	December 31, 2008
Commercial and industrial	$ 211,773	$ 244,019
Real estate - commercial	952,561	929,576
Real estate - construction	341,350	373,704
Real estate - residential	684,495	701,221
Installment	16,502	19,116
Overdraft	3,104	761
Lease financing receivables	4,823	4,396
	2,214,608	2,272,793
Net deferred loan fees and costs	(1,631)	(1,679)
	$ 2,212,977	$ 2,271,114

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Note 5 Allowance for Loan Losses

Changes in the allowance for loan losses as of June 30 are summarized as follows:

	2009	2008
Balance at beginning of period	$ 41,271	$ 16,835
Addition resulting from acquisition		3,039
Provision for loan losses	56,925	2,800
Loans charged-off	(23,880)	(1,267)
Recoveries	235	176
Balance at end of period	$ 74,551	$ 21,583

Note 6 Goodwill and Intangibles

Goodwill and other intangible assets are reviewed for potential impairment on an annual basis as of September 30 and February 28, respectively, or more often if events or circumstances indicate that they may be impaired, in accordance with SFAS No. 142, Goodwill and Other Intangible Assets and SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. Goodwill is tested for impairment at the reporting unit level and an impairment loss is recorded to the extent that the carrying amount of goodwill exceeds its implied fair value. As of June 30, 2009, the Company s market capitalization continued to be less than its stockholders common equity as the Company s stock continued to trade at a price below its book value. Consistent with prior quarters, the Company considered this and other factors, including the items outlined in the process described below. The Company employs general industry practices in evaluating the impairment of its goodwill using a two-step process that begins with an estimation of the fair value of the reporting unit. The first step includes a screen for potential impairment. The second step, if necessary, measures the amount of impairment, if any. Significant judgment is applied when goodwill is assessed for impairment. This judgment includes developing cash flow projections, selecting appropriate discount rates, identifying relevant market comparables, incorporating general economic and market conditions and selecting an appropriate control premium.

The first step of the analysis as of June 30, 2009 was to determine if there was a potential impairment. The Company used both an income and market approach as part of this analysis. The income approach was based on discounted cash flows, which were derived from internal forecasts and economic expectations for the reporting unit. The key assumptions used to determine fair value under the income approach included the cash flow period, terminal values based on a terminal growth rate and the discount rate. The discount rates used in the income approach evaluated at June 30, 2009 ranged from 17.5% to 22.5% to attempt to incorporate discount rates a market participant might employ in its valuation of Old Second National Bank. The market approach calculated the change of control price a market participant could reasonably be expected to pay for the Bank by adding a change of control premium. The results of the first step of the analysis indicated that the Bank s carrying value exceeded its fair value, which indicated that an impairment existed and required that the Company perform the second step of the analysis to determine the amount of the impairment, if any. The second step of the analysis involves a valuation of all of the assets of the Bank as if it had just been acquired and comparing that valuation with the carrying amount of goodwill. The results of the second step of the analysis determined that goodwill was impaired, which resulted in the pre-tax impairment charge of $57.6 million. This was a total impairment and no goodwill remains as a result of this impairment charge. See the management discussion in Item 2 for additional information related to this noninterest expense. The portion of the goodwill intangible asset charge that was attributable to Heritage was tax deductible and had an associated $22.0 million deferred tax asset, and although not anticipated, there can be no guarantee that a valuation allowance against this deferred tax asset will not be necessary in future periods.

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Management also performed an annual review of the core deposit and other intangible assets. Based upon these reviews, management determined there was no impairment of the core deposit and other intangible assets as of June 30, 2009. No assurance can be given that future impairment tests will not result in a charge to earnings. The core deposit and other intangible assets related to Heritage were $8.9 million at acquisition.

The following table presents the changes in the carrying amount of goodwill and other intangibles during the first six months ended June 30, 2009, and the year ended December 31, 2008 (in thousands):

	June 30, 2009		**December 31, 2008**	
	Goodwill	**Core Deposit and Other Intangibles**	**Goodwill**	**Core Deposit and Other Intangibles**
Balance at beginning of period	$ 59,040	$ 7,821	$ 2,130	$
Addition resulting from acquisition			56,910	8,917
Amortization / adjustments (1)	(1,461)	(583)		(1,096)
Impairment	(57,579)			
Balance at end of period	$	$ 7,238	$ 59,040	$ 7,821

(1) The $1.46 million adjustment to goodwill was recorded in the first quarter of 2009.

The following table presents the estimated future amortization expense for core deposit and other intangibles as of June 30, 2009 (in thousands):

	Amount
For the rest of 2009	$ 583
2010	1,130
2011	847
2012	780
2013	732
Thereafter	3,166
Total	$ 7,238

Note 7 Mortgage Servicing Rights

Changes in capitalized mortgage servicing rights as of June 30, summarized as follows:

	2009	**2008**
Balance at beginning of period	$ 1,973	$ 2,569
Additions	318	86

Amortization		(512)		(449)
Balance at end of period		1,779		2,206
Changes in the valuation allowance for servicing assets were as follows:				
Balance at beginning of period		(599)		(87)
Provisions for impairment		(254)		(475)
Recovery credited to expense		799		556
Balance at end of period		(54)		(6)
Net balance	$	1,725	$	2,200

Note 8 Deposits

Major classifications of deposits as of June 30, 2009 and December 31, 2008, were as follows:

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		2009		2008
Non-interest bearing demand	$	315,599	$	318,092
Savings		160,697		109,991
NOW accounts		382,473		274,888
Money market accounts		395,045		543,325
Certificates of deposit of less than $100,000		644,208		696,240
Certificates of deposit of $100,000 or more		451,255		444,592
	$	2,349,277	$	2,387,128

Note 9 Borrowings

The following table is a summary of borrowings as of June 30, 2009 and December 31, 2008:

		2009		2008
Securities sold under repurchase agreements	$	26,801	$	46,345
Federal funds purchased				28,900
FHLB advances		5,077		167,018
Treasury tax and loan		6,098		2,365
Junior subordinated debentures		58,378		58,378
Subordinated debt		45,000		45,000
Notes payable and other borrowings		500		23,184
	$	141,854	$	371,190

The Company enters into sales of securities under agreements to repurchase (repurchase agreements) which generally mature within 1 to 90 days from the transaction date. These repurchase agreements are treated as financings and they were secured by securities with a carrying amount of $30.3 and $48.5 million at June 30, 2009 and December 31, 2008, respectively. The securities sold under agreements to repurchase consisted of U.S. government agencies and mortgage-backed securities during the two-year reporting period.

The Company s borrowings at the FHLBC require the Bank to be a member and invest in the stock of the FHLBC and are generally limited to the lesser of 35% of total assets or 60% of the book value of certain mortgage loans. In addition, these borrowings were collateralized by FHLBC stock of $9.3 million and loans totaling $377.3 million at June 30, 2009. FHLBC stock of $9.3 million and loans totaling $318.4 million were pledged as of December 31, 2008. The Company also established borrowing privileges at the FRB in 2009 that were supported by $110.3 million of pledged loans as of June 30, 2009. This new borrowing facility with the FRB was unused as of June 30, 2009.

The Bank is a Treasury Tax & Loan (TT&L) depository for the FRB and, as such, we accept TT&L deposits. The Company is allowed to hold these deposits for the FRB until they are called. The interest rate is the federal funds rate less 25 basis points. Securities with a face value greater than or equal to the amount borrowed are pledged as a condition of borrowing TT&L deposits. As of June 30, 2009 and December 31, 2008, TT&L deposits were $6.1 million and $2.4 million, respectively.

On January 31, 2008, the Company entered into a $75.5 million credit facility with Bank of America, N.A. (the Lender), which was comprised of a $30.5 million senior debt facility and $45.0 million of subordinated debt. The senior debt facility included a $500,000 term loan with a maturity of March 31, 2018, and a revolving loan with a maturity of March 31, 2010. The loans replaced a $30.0 million revolving line of credit facility previously held with Marshall & Ilsley Bank. At June 30, 2009, no balance was outstanding on that revolving line. The subordinated debt matures on March 31, 2018.

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The interest rate on the senior debt facility resets quarterly, and is based on, at the Company s option, either the Lender s prime rate or three-month LIBOR plus 90 basis points. The interest rate on the subordinated debt resets quarterly, and is equal to three-month LIBOR plus 150 basis points. The senior debt is secured with all of the issued and outstanding shares of Old Second National Bank. The proceeds of the $45.0 million of subordinated debt were used primarily to finance the acquisition of Heritage including transaction costs. The $30.5 million senior debt facility is for general corporate purposes and was primarily used in the past to repurchase common stock.

The credit facility agreement contains usual and customary provisions regarding acceleration of the senior debt upon the occurrence of an event of default by the Company under the agreement, as described therein. The agreement also contains certain customary representations and warranties and financial and negative covenants. At June 30, 2009, the Company did not comply with two of the financial covenants contained within that credit agreement and additional details related to that noncompliance are discussed in Item 2 of this quarterly report under the heading, *Deposits and Borrowings*. The agreement provides that upon an event of default as the result of the Company s failure to comply with a financial covenant, the Lender may (i) terminate all commitments to extend further credit, (ii) increase the interest rate on the Senior Debt by 200 basis points, (iii) declare the Senior Debt immediately due and payable and (iv) exercise all of its rights and remedies at law, in equity and/or pursuant to any or all collateral documents, including foreclosing on the collateral. As illustrated in the above table, the total outstanding principal amount of the Senior Debt is $500,000. Because the Subordinated Debt is treated as Tier 2 capital for regulatory capital purposes, the Agreement does not provide the Lender with any rights of acceleration or other remedies with regard to the Subordinated Debt upon an event of default caused by the Company s breach of a financial covenant.

In its notice to the Company, the Lender indicated that after the 30 day period lapses following the notice, the Lender will not extend any additional credit or make additional disbursements to or for the benefit of the Company. The Lender also indicated that it is not presently exercising any of its other rights or remedies under the Agreement and that it reserves all of its rights and remedies available to the Lender. The Company and the Lender are in discussions regarding the potential resolution of the issues, including a change in the covenants.

Note 10 Junior Subordinated Debentures

The Company completed the sale of $27.5 million of cumulative trust preferred securities by its unconsolidated subsidiary, Old Second Capital Trust I in June 2003. An additional $4.1 million of cumulative trust preferred securities was sold in July 2003. The costs associated with the issuance of the cumulative trust preferred securities are being amortized over 30 years. The trust-preferred securities can remain outstanding for a 30-year term but, subject to regulatory approval, can be called in whole or in part by the Company. The stated call period commenced on June 30, 2008 and can be exercised by the Company from time to time hereafter. Cash distributions on the securities are payable quarterly at an annual rate of 7.80%. The Company issued a new $32.6 million subordinated debenture to the trust in return for the aggregate net proceeds of this trust preferred offering. The interest rate and payment frequency on the debenture are equivalent to the cash distribution basis on the trust preferred securities.

The Company issued an additional $25.0 million of cumulative trust preferred securities through a private placement completed by an additional unconsolidated subsidiary, Old Second Capital Trust II, in April 2007. Although nominal in amount, the costs associated with that issuance are being amortized over 30 years. These trust preferred securities also mature in 30 years, but subject to the aforementioned regulatory approval, can be called in whole or in part on a quarterly basis commencing June 15, 2017. The quarterly cash distributions on the securities are fixed at 6.77% through June 15, 2017 and float at 150 basis points over three-month LIBOR thereafter. The Company issued a new $25.8 million subordinated debenture to the trust in return for the aggregate net proceeds of this trust preferred offering. The interest rate and payment frequency on the debenture are equivalent to the cash distribution basis on

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the trust preferred securities. The proceeds from this trust preferred offering were used to finance the common stock tender offer in May 2007.

Both of the debentures issued by Old Second Bancorp, Inc. are recorded on the Consolidated Balance Sheets as junior subordinated debentures and the related interest expense for each issuance is included in the Consolidated Statements of Income.

Note 11 Long-Term Incentive Plan

The Long-Term Incentive Plan (the Incentive Plan) authorizes the issuance of up to 1,908,332 shares of the Company s common stock, including the granting of qualified stock options (Incentive Stock Options), nonqualified stock options, restricted share rights (restricted stock and restricted stock units), and stock appreciation rights. Total shares issuable under the plan were 516,751 at June 30, 2009 and 664,277 at December 31, 2008. Stock based awards may be granted to selected directors and officers or employees at the discretion of the board of directors. All stock options were granted for a term of ten years. Restricted share rights vest three years from the grant date. Awards under the Incentive Plan become fully vested upon a merger or change in control of the Company. Compensation expense is recognized over the vesting period of the options based on the fair value of the options at the grant date.

Total compensation cost that has been charged against income for those plans was $277,000 in the second quarter of 2009 and $526,000 in the first half of 2009. The total income tax benefit was $97,000 in the second quarter of 2009 and $184,000 in the first half of 2009. Total compensation cost that has been charged against income for those plans was $253,000 in the second quarter of 2008 and $505,000 in the first half of 2008. The total income tax benefit was $88,000 in the second quarter of 2008 and $177,000 in the first half of 2008.

There were no stock options exercised or granted during the second quarter of 2009. There were 5,500 stock options exercised during the second quarter of 2008. There were no stock options granted during the second quarter of 2008. Total unrecognized compensation cost related to nonvested stock options granted under the Incentive Plan was $374,000 as of June 30, 2009, and is expected to be recognized over a weighted-average period of 1.17 years. Total unrecognized compensation cost related to nonvested stock options granted under the Incentive Plan was $708,000 as of June 30, 2008, and was expected to be recognized over a weighted-average period of 2.12 years.

A summary of stock option activity in the Incentive Plan is as follows:

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	Shares		Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)		Aggregate Intrinsic Value
Beginning outstanding at January 1, 2009	722,132	$	24.03			
Granted	16,500		7.49			
Exercised	(5,334)		10.13			
Canceled	(13,000)		29.12			
Expired						
Ending outstanding at June 30, 2009	720,298	$	23.66	5.05	$	
Exercisable at end of period	617,136	$	23.46	4.49	$	
Beginning outstanding at January 1, 2008	740,798	$	23.67			
Granted						
Exercised	(5,500)		9.85			
Expired						
Ending outstanding at June 30, 2008	735,298	$	23.78	5.81	$	231,354
Exercisable at end of period	592,966	$	22.70	5.02	$	231,354

A summary of changes in the Company s nonvested options in the Incentive Plan is as follows:

	June 30, 2009		
	Shares		Weighted Average Grant Date Fair Value
Nonvested at January 1, 2009	86,662	$	6.45
Granted	16,500		2.01
Vested			
Nonvested at June 30, 2009	103,162	$	5.74

A summary of stock option activity as of June 30 is as follows:

	Three Months Ended June 30,				Six Months Ended June 30,			
		2009		2008		2009		2008
Intrinsic value of options exercised	$		$	63,560	$	673	$	63,560
Cash received from option exercises				54,195		54,033		54,195
Tax benefit realized from option exercises				25,262		268		25,262
Weighted average fair value of options granted	$		$		$	2.01	$	

Restricted stock was granted beginning in 2005 under the Incentive Plan. Restricted stock units were granted beginning in 2009 under the Incentive Plan. No shares were issued during either the second quarter of 2009 or the second quarter of 2008. These share rights are subject to forfeiture until certain restrictions have lapsed, including employment for a specific period. These share rights vest after a three-year period. Compensation expense is recognized over the vesting period of the shares based on the market value of the shares at issue date. Awards under the Incentive Plan become fully vested upon a merger or change in control of the Company.

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A summary of changes in the Company s nonvested shares of restricted share rights is as follows:

	June 30, 2009		June 30, 2008	
	Shares	Weighted Average Grant Date Fair Value	Shares	Weighted Average Grant Date Fair Value
Nonvested at January 1	53,311	$ 28.49	46,065	$ 30.09
Granted	133,724	7.49	27,254	27.75
Vested				
Forfeited	(2,698)	29.29		
Nonvested at June 30	184,337	$ 13.24	73,319	$ 29.22

Total unrecognized compensation cost of restricted share rights was $1.3 million as of June 30, 2009, which is expected to be recognized over a weighted-average period of 2.86 years. Total unrecognized compensation cost of restricted share rights was $1.0 million as of June 30, 2008, which was expected to be recognized over a weighted-average period of 2.00 years. There were no restricted share rights vested at June 30, 2009 or June 30, 2008.

Note 12 Earnings Per Share

The (loss) earnings per share is included below as of June 30 (in thousands except for share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Basic (loss) earnings per share:				
Weighted-average common shares outstanding	13,824,561	13,742,576	13,808,266	13,414,758
Weighted-average common shares less stock based awards	13,707,907	13,669,257	13,707,583	13,341,589
Weighted-average common shares stock based awards	184,337	73,319	150,791	73,169
Net (loss) income	$ (58,426)	$ 7,322	$ (57,442)	$ 12,886
Dividends and accretion of discount on preferred shares	1,235		2,036	
Net (loss) income available to common shareholders	(59,661)	7,322	(59,478)	12,886
Common stock dividends	(548)	(2,188)	(1,097)	(4,215)
Un-vested share-based payment awards	(7)	(11)	(14)	(22)
Undistributed (Loss) Earnings	(60,216)	5,123	(60,589)	8,649
Basic (loss) earnings per share common undistributed earnings	(4.33)	0.37	(4.37)	0.64
Basic (loss) earnings per share common distributed earnings	0.04	0.16	0.08	0.32
Basic (loss) earnings per share	$ (4.29)	$ 0.53	$ (4.29)	$ 0.96
Diluted (loss) earnings per share:				
Weighted-average common shares outstanding	13,824,561	13,742,576	13,808,266	13,414,758
Dilutive effect of restricted shares (1)	83,164	31,078	76,461	29,532
Dilutive effect of stock options		83,302		99,544

Diluted average common shares outstanding	13,907,725	13,856,956	13,884,727	13,543,834
Net (loss) income available to common stockholders	$ (59,661)	$ 7,322	$ (59,478)	$ 12,886
Diluted (loss) earnings per share	$ (4.29)	$ 0.53	$ (4.29)	$ 0.95
Number of antidilutive options excluded from the diluted earnings per share calculation	1,576,637	475,000	1,576,637	475,000

(1) Includes the common stock equivalents for restricted share rights that are dilutive.

Note 13 Other Comprehensive Income

The following table summarizes the related income tax effect for the components of Other Comprehensive Income (Loss) as of June 30:

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	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Unrealized holding (losses) gains on available-for-sale securities arising during the period				
U.S. Treasury	$ (11)	$ (276)	$ (25)	$ 130
U.S. government agencies	(225)	(1,461)	(255)	(19)
U.S. government agency mortgage-backed	(218)	(1,195)	920	(221)
States and political subdivisions	(220)	(2,277)	368	(1,389)
Collateralized mortgage obligations	(113)	(1,037)	582	(428)
Collateralized debt obligations	5,470	513	869	(8)
Equity securities	8	8	5	7
	4,691	(5,725)	2,464	(1,928)
Related tax (expense) benefit	(1,866)	2,262	(973)	766
Holding gains (losses) after tax	$ 2,825	$ (3,463)	$ 1,491	$ (1,162)
Less: Reclassification adjustment for the net gains and losses realized during the period				
Realized gains (losses) by security type:				
U.S. Treasury	$	$	$	$ 95
U.S. government agencies	372	117	315	334
U.S. government agency mortgage-backed	583	572	583	572
States and political subdivisions	(5)	(14)	(29)	(18)
Collateralized mortgage obligations	441	201	445	201
Collateralized debt obligations	0	199	0	199
Equity securities	0	0	0	0
Net realized gains	1,391	1,075	1,314	1,383
Income tax expense on net realized gains	(552)	(426)	(521)	(548)
Net realized gains after tax	839	649	793	835
Other comprehensive income (loss) on available-for-sale	1,986	(4,112)	698	(1,997)
Changes in fair value of derivatives used for cashflow hedges arising during the period			158	
Related tax expense			(63)	
Other comprehensive income on cashflow hedges			95	
Total other comprehensive income (loss)	$ 1,986	$ (4,112)	$ 793	$ (1,997)

Note 14 Retirement Plans

The Company maintains tax-qualified contributory and non-contributory profit sharing plans covering substantially all full-time and regular part-time employees. The expense of these plans was $816,000 and $1.3 million in the first six months of 2009 and 2008, respectively, as the Company eliminated the profit sharing contribution and lowered the amount of the 401K match in 2009. Management had increased the discretionary plan expense in 2008, in part to accommodate the additional permanent employees from Heritage.

Note 15 Fair Value Option and Fair Value Measurements

In September 2006, the FASB issued Statement No. 157, Fair Value Measurements. This statement defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The statement establishes a fair value hierarchy about the assumptions

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used to measure fair value and clarifies assumptions about risk and the effect of a restriction on the sale or use of an asset. The standard is effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued FASB Staff Position (FSP) FAS 157-2, Effective Date of FASB Statement No. 157. This FSP delays the effective date of SFAS No. 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008 and interim periods within those fiscal years. As disclosed in the Company s 2008 Annual Report, the impact of adoption was not material.

In February 2007, the FASB issued Statement No. 159, The Fair Value Option for Financial Assets and Financial Liabilities. The standard provides companies with an option to report selected financial assets and liabilities at fair value and establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. The new standard was effective for the Company on January 1, 2008. As of April 1, 2009, the Company elected the fair value option for the loans held-for-sale. The Company did not elect the fair value option for any other financial assets or financial liabilities.

Fair Value Measurement

Statement 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Statement 157 also establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

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

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

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

The Company uses the following methods and significant assumptions to estimate fair value:

- Investment securities available-for-sale are valued primarily by a third party pricing agent and both the market and income valuation approaches are implemented using the following types of inputs:

- U.S. treasuries are priced using the market approach and utilizing live data feeds from active market exchanges for identical securities.

- Government-sponsored agency debt securities are primarily priced using available market information through processes such as benchmark curves, market valuations of like securities, sector groupings and matrix pricing.

- Other government-sponsored agency securities, mortgage-backed securities and some of the actively traded REMICs and CMOs are primarily priced using available market information including benchmark yields, prepayment speeds, spreads and volatility of similar securities.

- Other inactive government-sponsored agency securities are primarily priced using consensus pricing and dealer quotes.

- State and political subdivisions are largely grouped by characteristics, i.e., geographical data and source of revenue in trade dissemination systems. Because some securities are not traded daily and due to other grouping limitations, active market quotes are often obtained using benchmarking for like securities.

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- Collateralized debt obligations are collateralized by trust preferred security issuances of other financial institutions. Uncertainty in the financial markets in the periods presented has resulted in reduced liquidity for these investment securities, which continued to affect market pricing in the period presented. To reflect an appropriate fair value measurement, management included a risk premium adjustment to provide an estimate of the amount that a market participant would demand because of uncertainty in cash flows. Management made that adjustment because the level of market activity for the CDO security has continued to decrease and information on orderly sale transactions was not generally available.

- Marketable equity securities are priced using available market information.

- Residential mortgage loans eligible for sale in the secondary market are carried at fair market value. The fair value of loans held for sale is determined using quoted secondary market prices.

- Lending related commitments to fund certain residential mortgage loans (interest rate locks) to be sold in the secondary market and forward commitments for the future delivery of mortgage loans to third party investors are considered derivatives. Fair values are estimated based on observable changes in mortgage interest rates from the date of the commitment and do not typically involve significant judgments by management.

- The fair value of mortgage servicing rights is based on a valuation model that calculates the present value of estimated net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income to derive the resultant value. The Company is able to compare the valuation model inputs, such as the discount rate, prepayment speeds, weighted average delinquency and foreclosure/bankruptcy rates to widely available published industry data for reasonableness.

- Interest rate swap positions, both assets and liabilities, are valued by means of Bloomberg pricing models using an income approach based upon readily observable market parameters such as interest rate yield curves.

- The credit valuation reserve on customer interest rate swap positions was determined based upon management s estimate of the amount of credit risk exposure, including available collateral protection and/or by utilizing an estimate related to a probability of default as indicated in the Bank credit policy.

Assets and Liabilities Measured at Fair Value on a Recurring Basis:

The tables below present the balance of assets and liabilities at June 30, 2009 and December 31, 2008, respectively, measured at fair value on a recurring basis:

	June 30, 2009			
	Level 1	Level 2	Level 3	Total
Assets:				
Investment securities available-for-sale	$ 1,581	$ 236,750	$ 11,163	$ 249,494
Loans held-for-sale		23,161		23,161
Other assets (Interest rate swap agreements)		3,051		3,051
Other assets (Interest rate swap credit valuation)			(1,537)	(1,537)
Other assets (Forward loan commitments to investors)		(39)		(39)
Total	$ 1,581	$ 262,923	$ 9,626	$ 274,130
Liabilities:				
Other liabilities (Interest rate swap agreements)	$	$ 3,051	$	$ 3,051
Other liabilities (Interest rate lock commitments to borrowers)		(482)		(482)
Other liabilities (Risk Participation Agreement)			29	29
Total	$	$ 2,569	$ 29	$ 2,598

	December 31, 2008			
	Level 1	Level 2	Level 3	Total
Assets:				
Investment securities available for sale	$ 22,779	$ 383,555	$ 52	$ 406,386
Other assets (Interest rate swap agreements)		4,860		4,860
Other assets (Forward loan commitments to investors)		(148)		(148)
Total	$ 22,779	$ 388,267	$ 52	$ 411,098
Liabilities:				
Other liabilities (Interest rate swap agreements)	$	$ 5,018	$	$ 5,018
Other liabilities (Interest rate lock commitments to borrowers)		(148)		(148)
Other liabilities (Risk Participation Agreement)			26	26
Total	$	$ 4,870	$ 26	$ 4,896

The changes in Level 3 assets and liabilities measured at fair value on a recurring basis are summarized as follows:

	June 30, 2009		
	Investment securities available for sale	Interest Rate Swap Valuation	Risk Participation Agreement
Beginning balance January 1, 2009	$ 52	$	$ (26)
Total gains or losses (realized/unrealized)			
Included in earnings			