EAGLE BANCORP INC
Form 10-Q
August 08, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended June 30, 2012

OR

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

For the transition period from to

Commission File Number 0-25923

Eagle Bancorp, Inc.

(Exact name of registrant as specified in its charter)

Maryland	**52-2061461**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
7815 Woodmont Avenue, Bethesda, Maryland	**20814**
(Address of principal executive offices)	(Zip Code)

(301) 986-1800

(Registrant s telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

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 (§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 x 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 definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o	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 July 31, 2012, the registrant had 20,811,218 shares of Common Stock outstanding.

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EAGLE BANCORP, INC.

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Item 1 Financial Statements (Unaudited)

EAGLE BANCORP, INC.

Consolidated Balance Sheets (Unaudited)

(dollars in thousands, except per share data)

	June 30, 2012	December 31, 2011	June 30, 2011
Assets			
Cash and due from banks	$ 6,998	$ 5,374	$ 33,950
Federal funds sold	19,854	21,785	42,955
Interest bearing deposits with banks and other short-term investments	122,639	205,252	10,202
Investment securities available for sale, at fair value	338,933	313,811	250,019
Federal Reserve and Federal Home Loan Bank stock	10,950	10,242	9,748
Loans held for sale	102,767	176,826	25,489
Loans	2,319,237	2,056,256	1,948,476
Less allowance for credit losses	(34,079)	(29,653)	(27,475)
Loans, net	2,285,158	2,026,603	1,921,001
Premises and equipment, net	13,634	12,320	10,395
Deferred income taxes	16,836	14,673	13,689
Bank owned life insurance	13,936	13,743	13,543
Intangible assets, net	3,978	4,145	4,070
Other real estate owned	4,438	3,225	3,434
Other assets	22,776	23,256	15,221
Total Assets	$ 2,962,897	$ 2,831,255	$ 2,353,716
Liabilities and Shareholders Equity			
Liabilities			
Deposits:			
Noninterest bearing demand	$ 773,119	$ 688,506	$ 436,880
Interest bearing transaction	95,827	80,105	67,458
Savings and money market	1,197,974	1,068,370	819,004
Time, $100,000 or more	239,287	332,470	380,766
Other time	207,804	222,644	236,726
Total deposits	2,514,011	2,392,095	1,940,834
Customer repurchase agreements	97,704	103,362	136,897
Long-term borrowings	49,300	49,300	49,300
Other liabilities	11,612	19,787	9,658
Total Liabilities	2,672,627	2,564,544	2,136,689
Shareholders Equity			
Preferred stock, par value $.01 per share, shares authorized 1,000,000, Series A, $1,000 per share liquidation preference, shares issued and outstanding 23,235 at June 30, 2011			23,235
Preferred stock, par value $.01 per share, shares authorized 1,000,000, Series B, $1,000 per share liquidation preference, shares issued and outstanding 56,600 at June 30, 2012 and December 31, 2011	56,600	56,600	
	203	197	197

Common stock, par value $.01 per share; shares authorized 50,000,000, shares issued and outstanding 20,591,233, 19,952,844 and 19,849,042, respectively						
Warrant		946		946		946
Additional paid in capital		140,572		132,670		131,225
Retained earnings		86,556		71,423		58,209
Accumulated other comprehensive income		5,393		4,875		3,215
Total Shareholders Equity		290,270		266,711		217,027
Total Liabilities and Shareholders Equity	$	2,962,897	$	2,831,255	$	2,353,716

See notes to consolidated financial statements.

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EAGLE BANCORP, INC.

Consolidated Statements of Operations (Unaudited)

(dollars in thousands, except per share data)

	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011
Interest Income				
Interest and fees on loans	$ 63,356	$ 51,894	$ 32,633	$ 27,279
Interest and dividends on investment securities	3,544	3,285	1,850	1,665
Interest on balances with other banks and short-term investments	215	36	78	17
Interest on federal funds sold	28	77	14	35
Total interest income	67,143	55,292	34,575	28,996
Interest Expense				
Interest on deposits	6,408	8,508	2,940	4,397
Interest on customer repurchase agreements	182	321	86	171
Interest on long-term borrowings	1,069	1,063	535	534
Total interest expense	7,659	9,892	3,561	5,102
Net Interest Income	59,484	45,400	31,014	23,894
Provision for Credit Losses	8,413	5,331	4,443	3,215
Net Interest Income After Provision For Credit Losses	51,071	40,069	26,571	20,679
Noninterest Income				
Service charges on deposits	1,914	1,421	935	672
Gain on sale of loans	6,723	2,807	2,584	1,106
Gain on sale of investment securities	301	591	148	591
Increase in the cash surrender value of bank owned life insurance	194	201	97	100
Other income	1,321	1,106	677	724
Total noninterest income	10,453	6,126	4,441	3,193
Noninterest Expense				
Salaries and employee benefits	20,713	15,072	10,289	7,761
Premises and equipment expenses	4,979	4,043	2,469	2,052
Marketing and advertising	843	981	557	747
Data processing	2,207	1,601	951	912
Legal, accounting and professional fees	2,242	2,139	1,141	1,003
FDIC insurance	1,068	1,343	579	600
Other expenses	5,047	4,067	2,551	1,858
Total noninterest expense	37,099	29,246	18,537	14,933
Income Before Income Tax Expense	24,425	16,949	12,475	8,939
Income Tax Expense	9,009	6,059	4,692	3,185
Net Income	15,416	10,890	7,783	5,754
Preferred Stock Dividends and Discount Accretion	283	1,203	142	883
Net Income Available to Common Shareholders	$ 15,133	$ 9,687	$ 7,641	$ 4,871
Earnings Per Common Share				
Basic	$ 0.75	$ 0.49	$ 0.38	$ 0.25
Diluted	$ 0.73	$ 0.48	$ 0.37	$ 0.24

See notes to consolidated financial statements.

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EAGLE BANCORP, INC.

Consolidated Statements of Comprehensive Income (Unaudited)

(dollars in thousands)

	Six Months Ended June 30,		Three Months Ended June 30,	
	2012	**2011**	**2012**	**2011**
Net Income	$ 15,416	$ 10,890	$ 7,783	$ 5,754
Other comprehensive income, net of tax:				
Net unrealized gain on securities available for sale	699	1,512	585	1,275
Reclassification adjustment for net gains included in net income	(181)	(355)	(89)	(355)
Net change in unrealized gains on securities	518	1,157	496	920
Comprehensive Income	$ 15,934	$ 12,047	$ 8,279	$ 6,674

See notes to consolidated financial statements.

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EAGLE BANCORP, INC.

Consolidated Statements of Changes in Shareholders Equity (Unaudited)

(dollars in thousands, except per share data)

	Preferred Stock	Common Stock	Warrant	Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders Equity
Balance, January 1, 2012	$ 56,600	$ 197	$ 946	$ 132,670	$ 71,423	$ 4,875	$ 266,711
Net Income					15,416		15,416
Net change in other comprehensive income						518	518
Stock-based compensation				1,627			1,627
Common stock issued 638,389 shares under purchase and equity compensation plans		6		6,248			6,254
Tax benefits related to non-qualified stock compensation				27			27
Preferred stock:							
Preferred stock dividends					(283)		(283)
Discount accretion							
Balance, June 30, 2012	**$ 56,600**	**$ 203**	**$ 946**	**$ 140,572**	**$ 86,556**	**$ 5,393**	**$ 290,270**
Balance, January 1, 2011	$ 22,582	$ 197	$ 946	$ 130,382	$ 48,551	$ 2,058	$ 204,716
Net Income					10,890		10,890
Net change in other comprehensive income						1,157	1,157
Stock-based compensation				473			473
Common stock issued 73,069 shares under purchase and equity compensation plans				308			308
Tax benefits related to non-qualified stock compensation				62			62
Preferred stock:							
Preferred stock dividends					(579)		(579)
Discount accretion	653				(653)		
Balance, June 30, 2011	**$ 23,235**	**$ 197**	**$ 946**	**$ 131,225**	**$ 58,209**	**$ 3,215**	**$ 217,027**

See notes to consolidated financial statements.

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EAGLE BANCORP, INC.

Consolidated Statements of Cash Flows (Unaudited)

(dollars in thousands)

	Six Months Ended June 30,	
	2012	**2011**
Cash Flows From Operating Activities:		
Net Income	$ 15,416	$ 10,890
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for credit losses	8,413	5,331
Depreciation and amortization	1,564	1,213
Gains on sale of loans	(6,723)	(2,807)
Origination of loans held for sale	(562,628)	(183,081)
Proceeds from sale of loans held for sale	643,410	240,970
Net increase in cash surrender value of BOLI	(194)	(201)
(Increase) decrease in deferred income taxes	(2,163)	782
Net (gain) loss on sale of other real estate owned	(82)	39
Net gain on sale of investment securities	(301)	(591)
Stock-based compensation expense	1,627	473
Excess tax benefit from stock-based compensation	(27)	(62)
Decrease (increase) in other assets	480	(927)
Decrease in other liabilities	(8,175)	(1,314)
Net cash provided by operating activities	90,617	70,715
Cash Flows From Investing Activities:		
(Decrease) increase in interest bearing deposits with other banks and short term investments	(1,671)	1,450
Purchases of available for sale investment securities	(62,764)	(124,856)
Proceeds from maturities of available for sale securities	22,908	37,408
Proceeds from sale/call of available for sale securities	15,553	67,225
Purchases of federal reserve and federal home loan bank stock	(1,168)	(883)
Proceeds from redemption of federal reserve and federal home loan bank stock	460	663
Net increase in loans	(266,918)	(277,642)
Proceeds from sale of other real estate owned	837	5,327
Bank premises and equipment acquired	(2,878)	(2,104)
Net cash used in investing activities	(295,641)	(293,412)
Cash Flows From Financing Activities:		
Increase in deposits	121,770	214,036
(Decrease) increase in customer repurchase agreements	(5,658)	39,313
Payment of dividends on preferred stock	(283)	(579)
Issuance of common stock	5,489	
Proceeds from exercise of stock options	759	308
Excess tax benefit from stock-based compensation	27	62
Net cash provided by financing activities	122,104	253,140
Net (Decrease) Increase In Cash and Cash Equivalents	(82,920)	30,443
Cash and Cash Equivalents at Beginning of Period	232,411	46,462
Cash and Cash Equivalents at End of Period	$ 149,491	$ 76,905
Supplemental Cash Flows Information:		
Interest paid	$ 7,880	$ 9,789
Income taxes paid	$ 7,250	$ 5,580
Non-Cash Investing Activities		
Transfers from loans to other real estate owned	$ 2,905	$ 2,060

See notes to consolidated financial statements.

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EAGLE BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Summary of Significant Accounting Policies

Basis of Presentation

The Consolidated Financial Statements include the accounts of Eagle Bancorp, Inc. and its subsidiaries (the Company), EagleBank (the Bank), Eagle Commercial Ventures, LLC (ECV), Eagle Insurance Services, LLC, and Bethesda Leasing, LLC, with all significant intercompany transactions eliminated.

The consolidated financial statements of the Company included herein are unaudited. The consolidated financial statements reflect all adjustments, consisting of normal recurring accruals that in the opinion of management, are necessary to present fairly the results for the periods presented. The amounts as of and for the year ended December 31, 2011 were derived from audited consolidated financial statements. Certain information and note disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP) have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. There have been no significant changes to the Company s Accounting Policies as disclosed in the Company s Annual Report on Form 10-K for the year ended December 31, 2011. The Company believes that the disclosures are adequate to make the information presented not misleading. Certain reclassifications have been made to amounts previously reported to conform to the current period presentation.

These statements should be read in conjunction with the audited consolidated financial statements and related notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2011. Operating results for the three and six months ended June 30, 2012 are not necessarily indicative of the results of operations to be expected for the remainder of the year, or for any other period.

Nature of Operations

The Company, through the Bank, conducts a full service community banking business, primarily in Montgomery County, Maryland; Washington, DC; and Arlington and Fairfax Counties in Virginia. The primary financial services offered by the Bank include real estate, commercial and consumer lending, as well as traditional deposit and repurchase agreement products. The Bank is also active in the origination and sale of residential mortgage loans and the origination of small business loans. The guaranteed portion of small business loans, guaranteed by the Small Business Administration (SBA), is typically sold to third party investors in a transaction apart from the loan s origination. The Bank offers its products and services through sixteen branch offices and various electronic capabilities, including remote deposit services. Eagle Insurance Services, LLC, a subsidiary of the Bank, offers access to insurance products and services through a referral program with a third party insurance broker. Eagle Commercial Ventures, LLC, a direct subsidiary of the Company, provides subordinated financing for the acquisition, development and construction of real estate projects, where the primary financing is provided by the Bank or others. These transactions involve higher levels of risk, together with commensurate higher returns. Refer to Higher Risk Lending Revenue Recognition below.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts in the financial statements and accompanying notes. Actual results may differ from those estimates and such differences could be material to the financial statements.

Cash Flows

For purposes of reporting cash flows, cash and cash equivalents include cash and due from banks, federal funds sold, and interest bearing deposits with other banks which have an original maturity of three months or less.

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Loans Held for Sale

The Company engages in sales of residential mortgage loans and the guaranteed portion of Small Business Administration loans originated by the Bank. Loans held for sale are carried at the lower of aggregate cost or fair value. Fair value is derived from secondary market quotations for similar instruments. Gains and losses on sales of these loans are recorded as a component of noninterest income in the Consolidated Statements of Operations.

The Company s current practice is to sell residential mortgage loans on a servicing released basis, and, therefore, it has no intangible asset recorded for the value of such servicing as of June 30, 2012, December 31, 2011, and June 30, 2011. The sale of the guaranteed portion of SBA loans on a servicing retained basis gives rise to an Excess Servicing Asset, which is computed on a loan by loan basis with the unamortized amount being included in Other assets in the Statement of Financial Condition. This Excess Servicing Asset is being amortized on a straight-line basis (with adjustment for prepayments) as an offset to servicing fees collected and is included in other noninterest income in the Consolidated Statement of Operations.

The Company enters into commitments to originate residential mortgage loans whereby the interest rate on the loan is determined prior to funding (i.e. rate lock commitments). Such rate lock commitments on mortgage loans to be sold in the secondary market are considered to be derivatives. The period of time between issuance of a loan commitment and closing and sale of the loan generally ranges from 15 to 60 days. The Company protects itself from changes in interest rates through the use of best efforts forward delivery commitments, whereby the Company commits to sell a loan at a premium at the time the borrower commits to an interest rate with the intent that the buyer has assumed the interest rate risk on the loan. As a result, the Company is not exposed to losses on loans sold nor will it realize gains, related to rate lock commitments due to changes in interest rates.

The market values of rate lock commitments and best efforts contracts are not readily ascertainable with precision because rate lock commitments and best efforts contracts are not actively traded. Because of the high correlation between rate lock commitments and best efforts contracts, no gain or loss should occur on the rate lock commitments.

Investment Securities

The Company has no securities classified as trading, nor are any investment securities classified as held to maturity. Marketable equity securities and debt securities not classified as held to maturity or trading are classified as available-for-sale. Securities available-for-sale are acquired as part of the Company s asset/liability management strategy and may be sold in response to changes in interest rates, current market conditions, loan demand, changes in prepayment risk and other factors. Securities available-for-sale are carried at fair value, with unrealized gains or losses being reported as accumulated other comprehensive income, a separate component of shareholders equity, net of deferred income tax. Realized gains and losses, using the specific identification method, are included as a separate component of noninterest income in the Consolidated Statements of Operations.

Premiums and discounts on investment securities are amortized/accreted to the earlier of call or maturity based on expected lives, which lives are adjusted based on prepayment assumptions and call optionality if any. Declines in the fair value of individual available-for-sale securities below their cost that are other-than-temporary in nature result in write-downs of the individual securities to their fair value. Factors affecting the

determination of whether other-than-temporary impairment has occurred include a downgrading of the security by a rating agency, a significant deterioration in the financial condition of the issuer, or a change in management s intent and ability to hold a security for a period of time sufficient to allow for any anticipated recovery in fair value. Management systematically evaluates investment securities for other-than-temporary declines in fair value on a quarterly basis. This analysis requires management to consider various factors, which include (1) duration and magnitude of the decline in value, (2) the financial condition of the issuer or issuers and (3) structure of the security.

The entire amount of an impairment loss is recognized in earnings only when (1) the Company intends to sell the debt security, or (2) it is more likely than not that the Company will have to sell the security before recovery of its amortized cost basis, or (3) the Company does not expect to recover the entire amortized cost basis of the security. In all other situations, only the portion of the impairment loss representing the credit loss must be

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recognized in earnings, with the remaining portion being recognized in shareholders equity as comprehensive income, net of deferred taxes.

Loans

Loans are stated at the principal amount outstanding, net of unamortized deferred costs and fees. Interest income on loans is accrued at the contractual rate on the principal amount outstanding. It is the Company s policy to discontinue the accrual of interest when circumstances indicate that collection is doubtful. Deferred fees and costs are being amortized on the interest method over the term of the loan.

Management considers loans impaired when, based on current information, it is probable that the Company will not collect all principal and interest payments according to contractual terms. Loans are evaluated for impairment in accordance with the Company s portfolio monitoring and ongoing risk assessment procedures. Management considers the financial condition of the borrower, cash flow of the borrower, payment status of the loan, and the value of the collateral, if any, securing the loan. Generally, impaired loans do not include large groups of smaller balance homogeneous loans such as residential real estate and consumer type loans which are evaluated collectively for impairment and are generally placed on nonaccrual when the loan becomes 90 days past due as to principal or interest. Loans specifically reviewed for impairment are not considered impaired during periods of minimal delay in payment (ninety days or less) provided eventual collection of all amounts due is expected. The impairment of a loan is measured based on the present value of expected future cash flows discounted at the loan s effective interest rate, or the fair value of the collateral if repayment is expected to be provided solely by the collateral. In appropriate circumstances, interest income on impaired loans may be recognized on the cash basis.

Higher Risk Lending Revenue Recognition

The Company has occasionally made higher risk acquisition, development, and construction (ADC) loans that entail higher risks than ADC loans made following normal underwriting practices (higher risk loan transactions). These higher risk loan transactions are currently made through the Company s subsidiary, ECV. This activity is limited as to individual transaction amount and total exposure amounts based on capital levels and is carefully monitored. The loans are carried on the balance sheet at amounts outstanding and meet the loan classification requirements of the Accounting Standards Executive Committee (AcSEC) guidance reprinted from the CPA Letter, Special Supplement, dated February 10, 1986 (also referred to as Exhibit 1 to AcSEC Practice Bulletin No. 1). Additional interest earned on certain of these higher risk loan transactions (as defined in the individual loan agreements) is recognized as realized under the provisions contained in AcSEC s guidance reprinted from the CPA Letter, Special Supplement, dated February 10, 1986 (also referred to as Exhibit 1 to AcSEC Practice Bulletin No.1) and Staff Accounting Bulletin No. 101 (Revenue Recognition in Financial Statements). Such additional interest is included as a component of noninterest income. ECV recorded no additional interest on higher risk transactions during 2012 and 2011 (although normal interest income was recorded). ECV had three higher risk lending transactions outstanding at June 30, 2012 and four such transactions outstanding at December 31, 2011, amounting to $3.7 million and $2.3 million, respectively.

Allowance for Credit Losses

The allowance for credit losses represents an amount which, in management s judgment, is adequate to absorb probable losses on existing loans and other extensions of credit that may become uncollectible. The adequacy of the allowance for credit losses is determined through careful and continuous review and evaluation of the loan portfolio and involves the balancing of a number of factors to establish a prudent level of

allowance. Among the factors considered in evaluating the adequacy of the allowance for credit losses are lending risks associated with growth and entry into new markets, loss allocations for specific credits, the level of the allowance to nonperforming loans, historical loss experience, economic conditions, portfolio trends and credit concentrations, changes in the size and character of the loan portfolio, and management s judgment with respect to current and expected economic conditions and their impact on the existing loan portfolio. Allowances for impaired loans are generally determined based on collateral values. Loans or any portion thereof deemed uncollectible are charged against the allowance, while recoveries are credited to the allowance. Management adjusts the level of the allowance through the provision for credit losses, which is recorded as a current period operating expense. The allowance for credit losses consists of allocated and unallocated components.

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The components of the allowance for credit losses represent an estimation done pursuant to Accounting Standards Codification (ASC) Topic 450, *Contingencies,* or ASC Topic 310, *Receivables.* Specific allowances are established in cases where management has identified significant conditions or circumstances related to a specific credit that management believes indicate the probability that a loss may be incurred. For potential problem credits for which specific allowance amounts have not been determined, the Company establishes allowances according to the application of credit risk factors. These factors are set by management and approved by the appropriate Board Committee to reflect its assessment of the relative level of risk inherent in each risk grade. A third component of the allowance computation, termed a nonspecific or environmental factors allowance, is based upon management s evaluation of various environmental conditions that are not directly measured in the determination of either the specific allowance or formula allowance. Such conditions include general economic and business conditions affecting key lending areas, credit quality trends (including trends in delinquencies and nonperforming loans expected to result from existing conditions), loan volumes and concentrations, specific industry conditions within portfolio categories, recent loss experience in particular loan categories, duration of the current business cycle, bank regulatory examination results, findings of outside review consultants, and management s judgment with respect to various other conditions including credit administration and management and the quality of risk identification systems. Executive management reviews these environmental conditions quarterly, and documents the rationale for all changes.

Management believes that the allowance for credit losses is adequate; however, determination of the allowance is inherently subjective and requires significant estimates. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions. Evaluation of the potential effects of these factors on estimated losses involves a high degree of uncertainty, including the strength and timing of economic cycles and concerns over the effects of a prolonged economic downturn in the current cycle. In addition, various regulatory agencies, as an integral part of their examination process, and independent consultants engaged by the Bank periodically review the Bank s loan portfolio and allowance for credit losses. Such review may result in recognition of adjustments to the allowance based on their judgments of information available to them at the time of their examination.

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation and amortization computed using the straight-line method for financial reporting purposes. Premises and equipment are depreciated over the useful lives of the assets, which generally range from five to seven years for furniture, fixtures and equipment, to three to five years for computer software and hardware, and to ten to forty years for buildings and building improvements. Leasehold improvements are amortized over the terms of the respective leases, which may include renewal options where management has the positive intent to exercise such options, or the estimated useful lives of the improvements, whichever is shorter. The costs of major renewals and betterments are capitalized, while the costs of ordinary maintenance and repairs are expensed as incurred. These costs are included as a component of premises and equipment expenses on the Consolidated Statements of Operations.

Other Real Estate Owned (OREO)

Assets acquired through loan foreclosure are held for sale and are initially recorded at the lower of cost or fair value less estimated selling costs when acquired, establishing a new cost basis. The new basis is supported by recent appraisals. Costs after acquisition are generally expensed. If the fair value of the asset declines, a write-down is recorded through expense. The valuation of foreclosed assets is subjective in nature and may be adjusted in the future because of changes in economic conditions or review by regulatory examiners.

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Goodwill and Other Intangible Assets

Goodwill and other intangible assets are subject to impairment testing at least annually, or when events or changes in circumstances indicate the assets might be impaired. Intangible assets (other than goodwill) are amortized to expense using accelerated or straight-line methods over their respective estimated useful lives. The Company s testing of potential goodwill impairment (which is performed annually) at December 31, 2011, resulted in no impairment being recorded.

Customer Repurchase Agreements

The Company enters into agreements under which it sells securities subject to an obligation to repurchase the same securities. Under these arrangements, the Company may transfer legal control over the assets but still retain effective control through an agreement that both entitles and obligates the Company to repurchase the assets. As a result, securities sold under agreements to repurchase are accounted for as collateralized financing arrangements and not as a sale and subsequent repurchase of securities. The agreements are entered into primarily as accommodations for large commercial deposit customers. The obligation to repurchase the securities is reflected as a liability in the Company s Consolidated Statement of Condition, while the securities underlying the securities sold under agreements to repurchase remain in the respective assets accounts and are delivered to and held as collateral by third party trustees.

Marketing and Advertising

Marketing and advertising costs are generally expensed as incurred.

Income Taxes

The Company employs the liability method of accounting for income taxes as required by ASC Topic 740, *Income Taxes*. Under the liability method, deferred tax assets and liabilities are determined based on differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities (i.e., temporary timing differences) and are measured at the enacted rates that will be in effect when these differences reverse. The Company utilizes statutory requirements for its income tax accounting, and avoids risks associated with potentially problematic tax positions that may incur challenge upon audit, where an adverse outcome is more likely than not. Therefore, no provisions are made for either uncertain tax positions nor accompanying potential tax penalties and interest for underpayments of income taxes in the Company s tax reserves. In accordance with ASC Topic 740, the Company may establish a reserve against deferred tax assets in those cases where realization is less than certain, although no such reserves exist at either June 30, 2012 or December 31, 2011.

Transfer of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity. In certain cases, the recourse to the Bank to repurchase assets may exist but is deemed immaterial based on the specific facts and circumstances.

Earnings per Common Share

Basic net income per common share is derived by dividing net income available to common shareholders by the weighted-average number of common shares outstanding during the period measured. Diluted earnings per common share is computed by dividing net income available to common shareholders by the weighted-average number of common shares outstanding during the period measured including the potential dilutive effects of common stock equivalents.

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Stock-Based Compensation

In accordance with ASC Topic 718, *Compensation,* the Company records as compensation expense an amount equal to the amortization (over the remaining service period) of the fair value (computed at the date of grant) of any outstanding fixed stock option grants and restricted stock awards which vest subsequent to December 31, 2005. Compensation expense on variable stock option grants (i.e. performance based grants) is recorded based on the probability of achievement of the goals underlying the performance grant. Refer to Note 6 for a description of stock-based compensation awards, activity and expense.

New Authoritative Accounting Guidance

In December 2011, the FASB issued ASU 2011-11, *Balance Sheet (Topic 210) - Disclosures about Offsetting Assets and Liabilities.* ASU 2011-11 amends Topic 210, Balance Sheet, to require an entity to disclose both gross and net information about financial instruments, such as sales and repurchase agreements and reverse sale and repurchase agreements and securities borrowing/lending arrangements, and derivative instruments that are eligible for offset in the statement of financial position and/or subject to a master netting arrangement or similar agreement. ASU 2011-11 is effective for annual and interim periods beginning on January 1, 2013, and is not expected to have a significant impact on the Company s consolidated financial statements.

In December 2011, the FASB issued ASU No. 2011-12 *Comprehensive Income (Topic 220) - Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05.* ASU 2011-12 defers changes in ASU No. 2011-05 that relate to the presentation of reclassification adjustments to allow the FASB time to redeliberate whether to require presentation of such adjustments on the face of the financial statements to show the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income. ASU 2011-12 allows entities to continue to report reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before ASU No. 2011-05. All other requirements in ASU No. 2011-05 are not affected by ASU No. 2011-12. ASU 2011-12 is effective for annual and interim periods beginning after December 15, 2011 and did not have a significant impact on the Company s consolidated financial statements.

2. Cash and Due from Banks

Regulation D of the Federal Reserve Act requires that banks maintain noninterest reserve balances with the Federal Reserve Bank based principally on the type and amount of their deposits. During 2012, the Bank maintained balances at the Federal Reserve (in addition to vault cash) to meet the reserve requirements as well as balances to partially compensate for services. Late in 2008, the Federal Reserve in connection with the Emergency Economic Stabilization Act of 2008 began paying a nominal amount of interest on balances held, which interest on excess reserves was increased under provisions of the Dodd Frank Wall Street Reform and Consumer Protection Act passed in July 2010. Additionally, the Bank maintains interest bearing balances with the Federal Home Loan Bank of Atlanta and noninterest bearing balances with six domestic correspondent banks as compensation for services they provide to the Bank.

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3. Investment Securities Available for Sale

Amortized cost and estimated fair value of securities available for sale are summarized as follows:

June 30, 2012	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
(dollars in thousands)				
U. S. Government agency securities	$ 92,196	$ 1,738	$	$ 93,934
Residential mortgage backed securities	166,081	2,990	167	168,904
Municipal bonds	71,261	4,685	195	75,751
Other equity investments	407		63	344
	$ 329,945	$ 9,413	$ 425	$ 338,933

December 31, 2011	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
(dollars in thousands)				
U. S. Government agency securities	$ 102,283	$ 1,547	$ 77	$ 103,753
Residential mortgage backed securities	145,451	2,767	240	147,978
Municipal bonds	57,548	4,227	2	61,773
Other equity investments	404		97	307
	$ 305,686	$ 8,541	$ 416	$ 313,811

Gross unrealized losses and fair value by length of time that the individual available for sale securities have been in a continuous unrealized loss position are as follows:

	Less than 12 Months		12 Months or Greater		Total	
June 30, 2012	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
(dollars in thousands)						
Residential mortgage backed securities	$ 38,920	$ 167	$	$	$ 38,920	$ 167
Municipal bonds	14,137	195			14,137	195
Other equity investments			115	63	115	63
	$ 53,057	$ 362	$ 115	$ 63	$ 53,172	$ 425

	Less than 12 Months		12 Months or Greater		Total	
December 31, 2011	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
(dollars in thousands)						
U. S. Government agency securities	$ 25,313	$ 77	$	$	$ 25,313	$ 77
	35,017	240			35,017	240

Residential mortgage backed securities											
Municipal bonds		510		2						510		2
Other equity investments						81		97		81		97
	$	60,840	$	319	$	81	$	97	$	60,921	$	416

The unrealized losses that exist are generally the result of changes in market interest rates and interest spread relationships since original purchases. The weighted average duration of debt securities, which comprise

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99.9% of total investment securities, is relatively short at 3.5 years. The gross unrealized loss on other equity investments represents common stock of one local banking company owned by the Company, and traded on a broker bulletin board exchange. The estimated fair value is determined by broker quoted prices. The unrealized loss is deemed a result of generally weak valuations for many smaller community bank stocks. The individual banking company is profitable, has good financial trends and has a satisfactory capital position. If quoted prices are not available, fair value is measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security s credit rating, prepayment assumptions and other factors such as credit loss assumptions. The Company does not believe that the investment securities that were in an unrealized loss position as of June 30, 2012 represent an other-than-temporary impairment for the reasons noted. The Company does not intend to sell the investments and it is more likely than not that the Company will not have to sell the securities before recovery of its amortized cost basis, which may be maturity. In addition, at June 30, 2012, the Company held $10.9 million in equity securities in a combination of Federal Reserve Bank (FRB) and Federal Home Loan Bank (FHLB) stocks which are required to be held for regulatory purposes and are not marketable.

The amortized cost and estimated fair value of investments available for sale by contractual maturity are shown in the table below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	June 30, 2012		**December 31, 2011**	
(dollars in thousands)	**Amortized Cost**	**Estimated Fair Value**	**Amortized Cost**	**Estimated Fair Value**
U. S. Government agency securities maturing:				
One year or less	$ 10,019	$ 10,075	$ 15,783	$ 15,906
After one year through five years	79,305	80,695	83,638	84,740
After five years through ten years	2,872	3,164	2,862	3,107
Residential mortgage backed securities	166,081	168,904	145,451	147,978
Municipal bonds maturing:				
After one year through five years	12,033	12,596	10,089	10,539
Five years through ten years	59,228	63,155	47,459	51,234
Other equity investments	407	344	404	307
	$ 329,945	$ 338,933	$ 305,686	$ 313,811

The carrying value of securities pledged as collateral for certain government deposits, securities sold under agreements to repurchase, and certain lines of credit with correspondent banks at June 30, 2012 was $262.8 million. As of June 30, 2012 and December 31, 2011, there were no holdings of securities of any one issuer, other than the U.S. Government and U.S. Government agency securities that exceeded ten percent of shareholders equity.

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4. Loans and Allowance for Credit Losses

The Bank makes loans to customers primarily in the Washington, DC metropolitan area and surrounding communities. A substantial portion of the Bank s loan portfolio consists of loans to businesses secured by real estate and other business assets.

Loans, net of unamortized net deferred fees, at June 30, 2012, December 31, 2011, and June 30, 2011 are summarized by type as follows:

	June 30, 2012		December 31, 2011		June 30, 2011	
(dollars in thousands)	**Amount**	**%**	**Amount**	**%**	**Amount**	**%**
Commercial	$ 516,493	23%	$ 478,886	23%	$ 482,680	25%
Investment - commercial real estate (1)	932,490	40%	756,645	37%	719,450	37%
Owner occupied - commercial real estate	307,410	14%	250,174	12%	242,266	12%
Real estate mortgage - residential	48,842	2%	39,552	2%	36,794	2%
Construction - commercial and residential (1)	400,805	17%	395,267	19%	346,273	18%
Construction - C&I (owner occupied) (1)	10,501		34,402	2%	24,315	1%
Home equity	97,969	4%	97,103	5%	90,827	5%
Other consumer	4,727		4,227		5,871	
Total loans	2,319,237	100%	2,056,256	100%	1,948,476	100%
Less: Allowance for Credit Losses	(34,079)		(29,653)		(27,475)	
Net loans	$ 2,285,158		$ 2,026,603		$ 1,921,001	

(1) Includes loans for land acquisition and development.

Unamortized net deferred fees amounted to $7.2 million and $5.2 million at June 30, 2012 and December 31, 2011, respectively.

As of June 30, 2012 and December 31, 2011, the Bank serviced $28.6 million and $27.3 million, respectively, of SBA loans participations which are not reflected as loan balances on the Consolidated Balance Sheets.

Loan Origination / Risk Management

The Company s goal is to mitigate risks in the event of unforeseen threats to the loan portfolio as a result of economic downturn or other negative influences. Plans for mitigating inherent risks in managing loan assets include; carefully enforcing loan policies and procedures, evaluating each borrower s business plan during the underwriting process and throughout the loan term, identifying and monitoring primary and alternative sources for loan repayment, and obtaining collateral to mitigate economic loss in the event of liquidation. Specific loan reserves are established based upon credit and/or collateral risks on an individual loan basis. A risk rating system is employed to proactively estimate loss exposure and provide a measuring system for setting general and specific reserve allocations.

The composition of the Company s loan portfolio is heavily weighted toward commercial real estate, both owner occupied and investment real estate. At June 30, 2012, the combination of commercial real estate and real estate construction loans represent approximately 71% of the loan portfolio. The combination of owner occupied commercial real estate and owner occupied commercial real estate construction represent 14% of the loan portfolio. When owner occupied commercial real estate and owner occupied commercial construction loans are excluded, the percentage of commercial real estate and construction loans to total loans decrease to 57%. These loans are underwritten to mitigate lending risks typical of this type of loan such as declines in real estate values, changes in borrower cash flow and general economic conditions. The Bank typically requires a maximum loan to value of 80% or less and minimum cash flow debt service coverage of 1.15 to 1.00. Personal guarantees are generally required, but may be limited. In making real estate commercial mortgage loans, the Bank generally requires that interest rates adjust not less frequently than five years.

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The Company is also an active traditional commercial lender providing loans for a variety of purposes, including cash flow, equipment and account receivable financing. This loan category represents approximately 23% of the loan portfolio at June 30, 2012 and was generally variable or adjustable rate. Commercial loans meet reasonable underwriting standards, including appropriate collateral and cash flow necessary to support debt service. Personal guarantees are generally required, but may be limited. SBA loans represent 2% of the commercial loan category of loans. In originating SBA loans, the Company assumes the risk of non-payment on the uninsured portion of the credit. The Company generally sells the insured portion of the loan generating noninterest income from the gains on sale, as well as servicing income on the portion participated. SBA loans are subject to the same cash flow analyses as other commercial loans. SBA loans are subject to a maximum loan size established by the SBA.

Approximately 4% of the loan portfolio at June 30, 2012 consists of home equity loans and lines of credit and other consumer loans. These credits, while making up a smaller portion of the loan portfolio, demand the same emphasis on underwriting and credit evaluation as other types of loans advanced by the Bank.

The remaining 2% of the loan portfolio consists of longer-term residential mortgage loans. These are typically loans underwritten to the same underwriting standards as residential loans held for sale but for shorter terms, generally less than 10 years.

Loans are secured primarily by duly recorded first deeds of trust. In some cases, the Bank may accept a recorded second trust position. In general, borrowers will have a proven ability to build, lease, manage and/or sell a commercial or residential project and demonstrate satisfactory financial condition. Additionally, an equity contribution toward the project is customarily required.

Construction loans require that the financial condition and experience of the general contractor and major subcontractors be satisfactory to the Bank. Guaranteed, fixed price contracts are required whenever appropriate, along with payment and performance bonds or completion bonds for larger scale projects.

Loans intended for residential land acquisition, lot development and construction are made on the premise that the land: 1) is or will be developed for building sites for residential structures, and; 2) will ultimately be utilized for construction or improvement of residential zoned real properties, including the creation of housing. Residential development and construction loans will finance projects such as single family subdivisions, planned unit developments, townhouses, and condominiums. Residential land acquisition, development and construction loans generally are underwritten with a maximum term of 36 months, including extensions approved at origination.

Commercial land acquisition and construction loans are secured by real property where loan funds will be used to acquire land and to construct or improve appropriately zoned real property for the creation of income producing or owner user commercial properties. Borrowers are generally required to put equity into each project at levels determined by the appropriate Loan Committee. Commercial land acquisition and construction loans generally are underwritten with a maximum term of 24 months.

All construction draw requests must be presented in writing on American Institute of Architects documents and certified by the contractor, the borrower and the borrower s architect. Each draw request shall also include the borrower s soft cost breakdown certified by the borrower or its Chief Financial Officer. Prior to an advance, the Bank or its contractor inspects the project to determine that the work has been completed, to justify the draw requisition.

Commercial permanent loans are secured by improved real property which is generating income in the normal course of operation. Debt service coverage, assuming stabilized occupancy, must be satisfactory to support a permanent loan. The debt service coverage ratio is ordinarily at least 1.15 to 1.00. As part of the underwriting process, debt service coverage ratios are stress tested assuming a 200 basis point increase in interest rates from their current levels.

Commercial permanent loans generally are underwritten with a term not greater than 10 years or the remaining useful life of the property, whichever is lower. The preferred term is between 5 to 7 years, with amortization to a maximum of 25 years.

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Personal guarantees are generally received from the principals, and only in instances where the loan-to-value is sufficiently low and the debt service is sufficiently high is consideration given to either limiting or not requiring personal recourse.

The Company s loan portfolio includes loans made for real estate Acquisition, Development and Construction (ADC) purposes, including both investment and owner occupied projects. ADC loans amounted to $411.3 million at June 30, 2012. The majority of the ADC portfolio, both speculative and non speculative, includes loan funded interest reserves. ADC loans containing loan funded interest reserves represent approximately 32% of the outstanding ADC loan portfolio at June 30, 2012. The decision to establish a loan-funded interest reserve is made upon origination of the ADC loan and is based upon a number of factors considered during underwriting of the credit including: (i) the feasibility of the project; (ii) the experience of the sponsor; (iii) the creditworthiness of the borrower and guarantors; (iv) borrower equity contribution; and (v) the level of collateral protection. When appropriate, an interest reserve provides an effective means of addressing the cash flow characteristics of a properly underwritten ADC loan. The Company does not significantly utilize interest reserves in other loan products. The Company recognizes that one of the risks inherent in the use of interest reserves is the potential masking of underlying problems with the project and/or the borrower s ability to repay the loan. In order to mitigate this inherent risk, the Company employs a series of reporting and monitoring mechanisms on all ADC loans, whether or not an interest reserve is provided, including: (i) construction and development timelines which are monitored on an ongoing basis which track the progress of a given project to the timeline projected at origination; (ii) a construction loan administration department independent of the lending function; (iii) third party independent construction loan inspection reports; (iv) monthly interest reserve monitoring reports detailing the balance of the interest reserves approved at origination and the days of interest carry represented by the reserve balances as compared to the then current anticipated time to completion and/or sale of speculative projects; and (v) quarterly commercial real estate construction meetings among senior Company management, which includes monitoring of current and projected real estate market conditions. If a project has not performed as expected, it is not the customary practice of the Company to increase loan funded interest reserves.

From time to time the Company may make loans for its own portfolio or through its higher risk loan affiliate, ECV. Such loans, which are made to finance projects (which may also be financed at the Bank level), may have higher risk characteristics than loans made by the Bank, such as lower priority interests and/or higher loan to value ratios. The Company seeks an overall financial return on these transactions commensurate with the risks and structure of each individual loan. Certain transactions bear current interest at a rate with a significant premium to normal market rates. Other loan transactions carry a standard rate of current interest, but also earn additional interest based on a percentage of the profits of the underlying project or a fixed accrued rate of interest.

The following table details activity in the allowance for credit losses by portfolio segment for the three and six months ended June 30, 2012 and 2011. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

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(dollars in thousands)	Commercial	Investment Commercial Real Estate	Owner occupied Commercial Real Estate	Real Estate Mortgage Residential	Construction Commercial and Residential	Home Equity	Other Consumer	Total
Three months ended June 30, 2012								
Allowance for credit losses:								
Balance at beginning of period	$ 8,537	$ 8,145	$ 2,146	$	$ 11,660	$ 1,329	$ 58	$ 31,875
Loans charged-off	(988)	(898)			(750)	(17)	(4)	(2,657)
Recoveries of loans previously charged-off	21	16			380		1	418
Net loan charged-off	(967)	(882)			(370)	(17)	(3)	(2,239)
Provision for credit losses	1,308	1,457	244		1,194	121	119	4,443
Ending balance	$ 8,878	$ 8,720	$ 2,390	$	$ 12,484	$ 1,433	$ 174	$ 34,079
Six months ended June 30, 2012								
Allowance for credit losses:								
Balance at beginning of period	$ 9,609	$ 7,304	$ 1,898	$ 399	$ 8,546	$ 1,528	$ 369	$ 29,653
Loans charged-off	(1,761)	(1,189)		(300)	(990)	(261)	(9)	(4,510)
Recoveries of loans previously charged-off	28	18			474	1	2	523
Net loan charged-off	(1,733)	(1,171)		(300)	(516)	(260)	(7)	(3,987)
Provision for credit losses	1,002	2,587	492	(99)	4,454	165	(188)	8,413
Ending balance	$ 8,878	$ 8,720	$ 2,390	$	$ 12,484	$ 1,433	$ 174	$ 34,079
For the Period Ended June 30, 2012								
Allowance for credit losses:								
Individually evaluated for impairment	$ 1,810	$ 586	$ 207	$	$ 3,619	$ 208	$ 4	$ 6,434
Collectively evaluated for impairment	7,068	8,134	2,183		8,865	1,225	170	27,645
Ending balance	$ 8,878	$ 8,720	$ 2,390	$	$ 12,484	$ 1,433	$ 174	$ 34,079

(dollars in thousands)	Commercial	Investment Commercial Real Estate	Owner occupied Commercial Real Estate	Real Estate Mortgage Residential	Construction Commercial and Residential	Home Equity	Other Consumer	Total
Three months ended June 30, 2011								
Allowance for credit losses:								
Balance at beginning of period	$ 8,553	$ 6,657	$ 2,189	$ 161	$ 6,478	$ 1,452	$ 92	$ 25,582
Loans charged-off	(1,114)	(245)		(94)			(6)	(1,459)
Recoveries of loans previously charged-off	11	126						137
Net loan charged-off	(1,103)	(119)		(94)			(6)	(1,322)
Provision for credit losses	1,600	765	(143)	298	653	56	(14)	3,215
Ending balance	$ 9,050	$ 7,303	$ 2,046	$ 365	$ 7,131	$ 1,508	$ 72	$ 27,475
Six months ended June 30, 2011								
Allowance for credit losses:								
Balance at beginning of period	$ 8,630	$ 6,668	$ 2,064	$ 115	$ 5,745	$ 1,441	$ 91	$ 24,754
Loans charged-off	(1,799)	(277)		(94)	(741)		(6)	(2,917)
Recoveries of loans previously charged-off	13	126			167	1		307
Net loan charged-off	(1,786)	(151)		(94)	(574)	1	(6)	(2,610)
Provision for credit losses	2,206	786	(18)	344	1,960	66	(13)	5,331
Ending balance	$ 9,050	$ 7,303	$ 2,046	$ 365	$ 7,131	$ 1,508	$ 72	$ 27,475

For the Period Ended June 30, 2011								
Allowance for credit losses:								
Individually evaluated for impairment	$ 2,051	$ 817	$ 65	$	$ 1,045	$ 220	$ 4	$ 4,202
Collectively evaluated for impairment	6,999	6,486	1,981	365	6,086	1,288	68	23,273
Ending balance	$ 9,050	$ 7,303	$ 2,046	$ 365	$ 7,131	$ 1,508	$ 72	$ 27,475

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The Company s recorded investments in loans as of June 30, 2012, December 31, 2011 and June 30, 2011 related to each balance in the allowance for loan losses by portfolio segment and disaggregated on the basis of the Company s impairment methodology was as follows:

(dollars in thousands)	Commercial	Investment Commercial Real Estate	Owner occupied Commercial Real Estate	Real Estate Mortgage Residential	Construction Commercial and Residential	Home Equity	Other Consumer	Total
June 30, 2012								
Recorded investment in loans:								
Individually evaluated for impairment	$ 8,345	$ 6,048	$ 2,585	$	$ 24,338	$ 417	$ 8	$ 41,741
Collectively evaluated for impairment	508,148	926,442	304,825	48,842	386,968	97,552	4,719	2,277,496
Ending balance	$ 516,493	$ 932,490	$ 307,410	$ 48,842	$ 411,306	$ 97,969	$ 4,727	$ 2,319,237
December 31, 2011								
Recorded investment in loans:								
Individually evaluated for impairment	$ 11,741	$ 9,304	$ 5,280	$ 751	$ 26,855	$ 363	$ 1,345	$ 55,639
Collectively evaluated for impairment	467,145	747,341	244,894	38,801	402,814	96,740	2,882	2,000,617
Ending balance	$ 478,886	$ 756,645	$ 250,174	$ 39,552	$ 429,669	$ 97,103	$ 4,227	$ 2,056,256
June 30, 2011								
Recorded investment in loans:								
Individually evaluated for impairment	$ 13,417	$ 9,184	$ 3,472	$	$ 21,425	$ 284	$ 8	$ 47,790
Collectively evaluated for impairment	469,263	710,266	238,794	36,794	349,163	90,543	5,863	1,900,686
Ending balance	$ 482,680	$ 719,450	$ 242,266	$ 36,794	$ 370,588	$ 90,827	$ 5,871	$ 1,948,476

At June 30, 2012, the nonperforming loans acquired in 2008 from Fidelity & Trust Financial Corporation (Fidelity) have a carrying value of $2.1 million and an unpaid principal balance of $11.8 million and were evaluated separately in accordance with ASC Topic 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality*. The various impaired loans were recorded at estimated fair value with any excess being charged-off or treated as a non-accretable discount. Subsequent downward adjustments to the valuation of impaired loans acquired will result in additional loan loss provisions and related allowance for credit losses. Subsequent upward adjustments to the valuation of impaired loans acquired will result in accretable discount.

Credit Quality Indicators

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

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

Pass:	Loans in all classes that comprise the commercial and consumer portfolio segments that are not adversely rated, are contractually current as to principal and interest, and are otherwise in compliance with the contractual terms of the loan agreement. Management believes that there is a low likelihood of loss related to those loans that are considered pass.
Watch:	Loan paying as agreed with generally acceptable asset quality; however Borrower s performance has not met expectations. Balance sheet and/or income statement has shown

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	deterioration to the point that the company could not sustain any further setbacks. Credit is expected to be strengthened through improved company performance and/or additional collateral within a reasonable period of time.
Special Mention:	Loans in the classes that comprise the commercial portfolio segment that have potential weaknesses that deserve management s close attention. If not addressed, these potential weaknesses may result in deterioration of the repayment prospects for the loan. The special mention credit quality indicator is not used for classes of loans that comprise the consumer portfolio segment. Management believes that there is a moderate likelihood of some loss related to those loans that are considered special mention.
Classified:	Classified (a) Substandard - Loans inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the bank will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard loans, does not have to exist in individual loans classified substandard.
	Classified (b) Doubtful - Loans that have all the weaknesses inherent in a loan classified substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors, which may work to the advantage and strengthening of the assets, its classification as an estimated loss is deferred until its more exact status may be determined.

The Company s credit quality indicators are periodically updated on a case-by-case basis. The following table presents by class and by credit quality indicator, the recorded investment in the Company s loans and leases as of June 30, 2012, December 31, 2011 and June 30, 2011.

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(dollars in thousands)	Pass	Watch and Special Mention	Substandard	Doubtful	Total Loans
June 30, 2012					
Commercial	$ 478,785	$ 29,363	$ 8,328	$ 17	$ 516,493
Investment - commercial real estate	921,544	4,898	6,048		932,490
Owner occupied - commercial real estate	285,057	19,768	2,585		307,410
Real estate mortgage residential	48,128		714		48,842
Construction - commercial and residential	355,534	31,434	24,338		411,306
Home equity	95,960	1,586	423		97,969
Other consumer	4,673	46	8		4,727
Total	$ 2,189,681	$ 87,095	$ 42,444	$ 17	$ 2,319,237
December 31, 2011					
Commercial	$ 438,943	$ 28,202	$ 11,704	$ 37	$ 478,886
Investment - commercial real estate	739,668	7,673	9,304		756,645
Owner occupied - commercial real estate	235,988	8,906	5,280		250,174
Real estate mortgage residential	38,801		751		39,552
Construction - commercial and residential	394,135	8,679	26,855		429,669
Home equity	96,740		363		97,103
Other consumer	2,882		1,345		4,227
Total	$ 1,947,157	$ 53,460	$ 55,602	$ 37	$ 2,056,256
June 30, 2011					
Commercial	$ 439,692	$ 29,571	$ 12,567	$ 850	$ 482,680
Investment - commercial real estate	696,964	13,302	9,184		719,450
Owner occupied - commercial real estate	233,203	5,591	3,472		242,266
Real estate mortgage residential	36,794				36,794
Construction - commercial and residential	335,897	13,266	21,425		370,588
Home equity	90,543		284		90,827
Other consumer	5,863		8		5,871
Total	$ 1,838,956	$ 61,730	$ 46,940	$ 850	$ 1,948,476

Nonaccrual and Past Due Loans

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

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The following presents by class of loan, information related to nonaccrual loans as of the periods ended June 30, 2012, December 31, 2011 and June 30, 2011.

(dollars in thousands)	June 30, 2012	December 31, 2011	June 30, 2011
Commercial	$ 3,961	$ 5,718	$ 4,649
Investment - commercial real estate	3,749	7,662	4,520
Owner occupied - commercial real estate	1,674	282	295
Real estate mortgage - residential	714	1,041	1,047
Construction - commercial and residential	22,347	17,459	20,056
Home equity	423	624	645
Other consumer	8	8	9
Total nonperforming loans (1)(2)	$ 32,876	$ 32,794	$ 31,221

(1) Excludes performing TDRs totaling $8.8 million at June 30, 2012, $13.9 million at December 31, 2011 and $3.1 million at June 30, 2011.

(2) Gross interest income that would have been recorded in 2012 if nonaccrual loans shown above had been current and in accordance with their original terms was $1.2 million, no interest was recorded on these loans for the six months ended June 30, 2012. See Note 1 to the Consolidated Financial Statements for a description of the Company s policy for placing loans on nonaccrual status.

The following table presents by class, an aging analysis and the recorded investments in loans past due as of June 30, 2012.

(dollars in thousands)	Loans 30-59 Days Past Due	Loans 60-89 Days Past Due	Loans 90 Days or More Past Due	Total Past Due Loans	Current Loans	Total Recorded Investment in Loans
June 30, 2012						
Commercial	$ 3,880	$ 6,510	$ 3,961	$ 14,351	$ 502,142	$ 516,493
Investment - commercial real estate	690	2,003	3,749	6,442	926,048	932,490
Owner occupied - commercial real estate	5,762		1,674	7,436	299,974	307,410
Real estate mortgage residential	822	107	714	1,643	47,199	48,842
Construction - commercial and residential	619	10,819	22,347	33,785	377,521	411,306
Home equity	702	29	423	1,154	96,815	97,969
Other consumer	111	25	8	144	4,583	4,727
Total	$ 12,586	$ 19,493	$ 32,876	$ 64,955	$ 2,254,282	$ 2,319,237

Impaired Loans

Loans are considered impaired when, based on current information and events, it is probable the Company will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. Impairment is

evaluated in total for smaller-balance loans of a similar nature and on an individual loan basis for other loans. If a loan is impaired, a specific valuation allowance is allocated, if necessary, so that the loan is reported net, at the present value of estimated future cash flows using the loan s existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Interest payments on impaired loans are typically applied to principal unless collectability of the principal amount is reasonably assured, in which case interest is recognized on a cash basis. Impaired loans, or portions thereof, are charged off when deemed uncollectible.

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The following table presents by class, information related to impaired loans for the periods ended June 30, 2012, and June 30, 2011.

(dollars in thousands)	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment		Interest Income Recognized	
						Quarter To Date	Year To Date	Quarter To Date	Year To Date
June 30, 2012									
Commercial	$ 5,961	$ 1,786	$ 2,365	$ 4,151	$ 1,810	$ 7,172	$ 8,346	$ 3	$ 46
Investment - commercial real estate	5,891	3,822	1,483	5,305	586	7,523	8,750	37	76
Owner occupied - commercial	1,674	1,263	204	1,467	207	976	744		
Real estate mortgage residential	714	714		714		723	829		
Construction - commercial and residential	26,988	15,723	7,646	23,369	3,619	28,001	26,271	41	83
Home equity	423	88	127	215	208	477	526		
Other consumer	8		4	4	4	8	8		
Total	$ 41,659	$ 23,396	$ 11,829	$ 35,225	$ 6,434	$ 44,880	$ 45,474	$ 81	$ 205
December 31, 2011									
Commercial	$ 10,695	$ 2,723	$ 5,923	$ 8,646	$ 2,049		$ 7,955		$ 161
Investment - commercial real estate	11,205	8,222	2,373	10,595	692		8,298		159
Owner occupied - commercial	282		192	192	90		488		6
Real estate mortgage residential	1,041	8	733	741	300		1,112		24
Construction - commercial and residential	22,812	17,407	5,086	22,493	237		22,254		14
Home equity	624	353	89	442	182		557		19
Other consumer	8		4	4	4		6		
Total	$ 46,667	$ 28,713	$ 14,400	$ 43,113	$ 3,554		$ 40,670		$ 383
June 30, 2011									
Commercial	$ 4,649	$ 2,003	$ 1,437	$ 3,440	$ 1,208	$ 5,191	$ 3,653	$	$
Investment - commercial real estate	7,861	3,662	2,199	5,861	793	7,577	5,585		
Owner occupied - commercial	295		230	230	65	295	153		
Real estate mortgage residential	1,047	1,047		1,047		1,179	1,039		
Construction - commercial and residential	21,138	6,069	13,942	20,011	1,045	21,267	17,797		
Home equity	645	187	238	425	220	471	266		
Other consumer	9		5	5	4	5	2		
Total	$ 35,644	$ 12,968	$ 18,051	$ 31,019	$ 3,335	$ 35,985	$ 28,495	$	$

Modifications

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

Loans modified in a TDR are typically already on non-accrual status and partial charge-offs have in some cases already been taken against the outstanding loan balance. As a result, loans modified in a TDR for the Company may have the financial effect of increasing the specific allowance associated with the loan. An allowance for impaired consumer and commercial loans that have been modified in a TDR is measured based on the present

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value of expected future cash flows discounted at the loan s effective interest rate, the loan s observable market price, or the estimated fair value of the collateral, less any selling costs, if the loan is collateral dependent. Management exercises significant judgment in developing these estimates.

The following table presents the TDR loan modifications by portfolio segment outstanding as of June 30, 2012 and December 31, 2011:

(dollars in thousands)	Number of Contracts		TDRs Performing to Modified Terms		TDRs Not Performing to Modified Terms		Total TDRs
June 30, 2012							
Commercial	1	$	2,000	$		$	2,000
Investment - commercial real estate	2		2,142		217		2,359
Construction - commercial and residential	2		4,641		998		5,639
Total	5	$	8,783	$	1,215	$	9,998
December 31, 2011							
Commercial	2	$	4,977	$		$	4,977
Investment - commercial real estate	2		3,543				3,543
Construction - commercial and residential	2		5,353				5,353
Total	6	$	13,873	$		$	13,873

During the first six months of 2012, two TDRs totaling approximately $1.2 million experienced defaults on their modified terms. A default is considered to have occurred once the TDR is past due 90 days or more, or it has been placed on nonaccrual. The two nonperforming TDRs were reclassified to nonperforming loans in the first quarter of 2012. The decline in TDRs was primarily due to the repayment of one loan totaling $2.8 million. Commercial and consumer loans modified in a TDR are closely monitored for delinquency as an early indicator of possible future default. If loans modified in a TDR subsequently default, the Company evaluates the loan for possible further impairment. The allowance may be increased, adjustments may be made in the allocation of the allowance, or partial charge-offs may be taken to further write-down the carrying value of the loan. There were no loans modified in a TDR during the six months ended June 30, 2012 and June 30, 2011.

5. Net Income per Common Share

The calculation of net income per common share for three months ended June 30, 2012 and 2011 was as follows.

	Six Months Ended June 30,				Three Months Ended June 30,			
(dollars and shares in thousands, except per share data)		2012		2011		2012		2011
Basic:								
Net income available to common shareholders	$	15,133	$	9,687	$	7,641	$	4,871
Average common shares outstanding		20,204		19,775		20,298		20,051
Basic net income per common share	$	0.75	$	0.49	$	0.38	$	0.25
Diluted:								
Net income available to common shareholders	$	15,133	$	9,687	$	7,641	$	4,871
Average common shares outstanding		20,204		19,775		20,298		20,051
Adjustment for common share equivalents		510		468		509		444

Average common shares outstanding-diluted	20,714	20,243	20,807	20,495
Diluted net income per common share	$ 0.73	$ 0.48	$ 0.37	$ 0.24
Anti-dilutive shares	114,577	198,043	114,472	198,124

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6. Stock-Based Compensation

The Company maintains the 1998 Stock Option Plan (1998 Plan), the 2006 Stock Plan (2006 Plan) and the 2011 Employee Stock Purchase Plan (2011 ESPP). In connection with the acquisition of Fidelity and its subsidiary Fidelity & Trust Bank (F&T Bank), the Company assumed the Fidelity 2004 Long Term Incentive Plan and 2005 Long Term Incentive Plan (the Fidelity Plans). No additional options may be granted under the 1998 Plan or the Fidelity Plans.

The 2006 Plan provides for the issuance of awards of incentive options, nonqualifying options, restricted stock and stock appreciation rights to selected key employees and members of the Board. As amended, 1,815,000 shares of common stock are subject to issuance pursuant to awards under the 2006 Plan. Option awards are made with an exercise price equal to the average of the high and low price of the Company s shares at the date of grant.

For awards that are service based, compensation expense is being recognized over the service (vesting) period based on fair value, which for stock option grants is computed using the Black Scholes model, and for restricted stock awards is based on the average of the high and low stock price of the Company s shares at the date of grant. For awards that are performance based, compensation expense is recorded based on the probability of achievement of the goals underlying the grant. No performance based awards are outstanding at June 30, 2012.

In February 2012, the Company awarded 243,767 shares of restricted stock to senior officers, directors and employees. The shares vest in five substantially equal installments beginning on the date of grant.

Below is a summary of changes in shares under option plans pursuant to our equity compensation plans for the six months ended June 30, 2012 and 2011. The information excludes restricted stock units and awards.

	Six Months Ended June 30,			
	2012		2011	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
Beginning Balance	831,393	$ 11.19	995,005	$ 10.54
Issued			1,500	13.81
Exercised	(36,204)	12.92	(57,948)	5.55
Forfeited	(1,000)	6.34	(900)	6.34
Expired	(28,223)	15.34	(9,596)	12.53
Ending Balance	765,966	$ 10.96	928,061	$ 10.84

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The following summarizes information about stock options outstanding at June 30, 2012. The information excludes restricted stock units and awards.

Outstanding:

Range of Exercise Prices			Stock Options Outstanding		Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life
$6.05	-	$8.10	287,334	$	6.52	5.70
$8.11	-	$11.07	219,150		10.14	1.85
$11.08	-	$15.43	146,726		11.91	2.47
$15.44	-	$26.86	112,756		22.64	3.42
			765,966	$	10.96	3.65

Exercisable:

Range of Exercise Prices			Stock Options Exercisable		Weighted-Average Exercise Price
$6.05	-	$8.10	153,462	$	6.67
$8.11	-	$11.07	215,900		10.14
$11.08	-	$15.43	114,826		11.88
$15.44	-	$26.86	110,077		22.78
			594,265	$	11.92

The fair value of each stock option grant is estimated on the date of grant using the Black-Scholes option pricing model with the assumptions as shown in the table below used for grants during the years ended December 31, 2011 and 2010. There were no stock options granted under the 2006 Plan during the six months ended June 30, 2012.

	Year Ended December 31,			
		2011		2010
Expected Volatility		33.61% - 36.64%		44.44%
Weighted-Average Volatility		35.60%		44.44%
Expected Dividends		0.0%		0.0%
Expected Term (In years)		6.0 - 7.5		8.5
Risk-Free Rate		1.82%		1.01%
Weighted-Average Fair Value (Grant date)	$	5.07	$	6.23

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

The total intrinsic value of outstanding stock options and outstanding exercisable stock options was $4.5 million at June 30, 2012. The total intrinsic value of stock options exercised during the six months ended June 30, 2012 and 2011 was $98 thousand and $460 thousand, respectively. The total fair value of stock options vested was $124 thousand and $137 thousand for the six months ended June 30, 2012 and 2011, respectively. Unrecognized stock-based compensation expense related to stock options totaled $293 thousand at June 30, 2012. At such date, the weighted-average period over which this unrecognized expense is expected to be recognized was 3.07 years.

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The Company has unvested restricted stock award grants of 316,676 shares under the 2006 Plan at June 30, 2012. Unrecognized stock based compensation expense related to restricted stock awards totaled $3.9 million at June 30, 2012. At such date, the weighted-average period over which this unrecognized expense was expected to be recognized was 2.83 years. The following table summarizes the unvested restricted stock awards at June 30, 2012 and 2011.

	Six Months Ended June 30,					
	2012			2011		
	Shares		Weighted-Average Grant Date Fair Value	Shares		Weighted-Average Grant Date Fair Value
Unvested at Beginning	202,555	$	11.67	114,275	$	9.20
Issued	243,767		16.83	96,162		13.91
Forfeited	(14,978)		12.37	(423)		11.99
Vested	(114,668)		12.96	(19,104)		8.83
Unvested at End	316,676	$	15.14	190,910	$	11.60

Included in salaries and employee benefits the Company recognized $1.7 million and $473 thousand in stock-based compensation expense for the six months ended June 30, 2012 and 2011, respectively. Stock-based compensation expense is recognized ratably over the requisite service period for all awards.

Approved by shareholders in May 2011, the 2011 ESPP reserved 500,000 shares of common stock for issuance to employees. Whole shares are sold to participants in the plan at 85% of the lower of the stock price at the beginning or end of each quarterly offering period. The 2011 ESPP is available to all eligible employees who have completed at least one year of continuous employment, work at least 20 hours per week and at least five months a year. Participants may contribute a minimum of $10 per pay period to a maximum of $6,250 per offering period or $25,000 annually (not to exceed more than 10% of compensation per pay period). At June 30, 2012, the 2011 ESPP had 470,321 shares remaining for issuance.

7. Fair Value Measurements

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

Level 1 — Quoted prices in active exchange markets for identical assets or liabilities; also includes certain U.S. Treasury and other U.S. government and agency securities actively traded in over-the-counter markets.

Level 2

Observable inputs other than Level 1 including quoted prices for similar assets or liabilities, quoted prices in less active markets, or other observable inputs that can be corroborated by observable market data; also includes derivative contracts whose value is determined using a pricing model with observable market inputs or can be derived principally from or corroborated by observable market data. This category generally includes certain U.S. government and agency securities, corporate debt securities, derivative instruments, and residential mortgage loans held for sale.

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Level 3 Unobservable inputs supported by little or no market activity for financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation; also includes observable inputs for single dealer nonbinding quotes not corroborated by observable market data. This category generally includes certain private equity investments, retained interests from securitizations, and certain collateralized debt obligations.

Assets and Liabilities Recorded as Fair Value on a Recurring Basis

The table below presents the recorded amount of assets and liabilities measured at fair value on a recurring basis as of June 30, 2012 and December 31, 2011.

(dollars in thousands)	Quoted Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)	Total (Fair Value)
June 30, 2012				
Investment securities available for sale:				
U. S. Government agency securities	$	$ 93,934	$	$ 93,934
Residential mortgage backed securities		168,904		168,904
Municipal bonds		75,751		75,751
Other equity investments	115		229	344
Residential mortgage loans held for sale		102,767		102,767
Total assets measured at fair value on a recurring basis as of June 30, 2012	$ 115	$ 441,356	$ 229	$ 441,700

(dollars in thousands)	Quoted Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)	Total (Fair Value)
December 31, 2011				
Investment securities available for sale:				
U. S. Government agency securities	$	$ 103,753	$	$ 103,753
Residential mortgage backed securities		147,978		147,978
Municipal bonds		61,773		61,773
Other equity investments	81		226	307
Residential mortgage loans held for sale		176,826		176,826
Total assets measured at fair value on a recurring basis as of December 31, 2011	$ 81	$ 490,330	$ 226	$ 490,637

Investment Securities Available-for-sale

Investment securities available-for-sale is recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair value is measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security s credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 investment securities include those traded on an active exchange such as the New York Stock Exchange, Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include US

government agency debt securities, mortgage backed securities issued by government sponsored entities and municipal bonds. Securities classified as Level 3 include securities in less liquid markets.

The Company s residential loans held for sale are reported on an aggregate basis at the lower of cost or fair value.

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The following is a reconciliation of activity for assets measured at fair value based on significant unobservable (non-market) information.

(dollars in thousands)	Other Equity Investments June 30, 2012	Other Equity Investments December 31, 2011
Balance, beginning of period	$ 226	$ 267
Total realized and unrealized gains and losses:		
Included in other comprehensive income	3	
Purchases		
Principal redemption		(41)
Balance, end of period	$ 229	$ 226

Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis

The Company may be required from time to time to measure certain assets at fair value on a nonrecurring basis in accordance with GAAP. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. There are no liabilities which the Company measures at fair value on a nonrecurring basis. Assets measured at fair value on a nonrecurring basis are included in the table below:

(dollars in thousands)	Quoted Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)	Total (Fair Value)
June 30, 2012				
Impaired loans:				
Commercial	$	$ 1,318	$ 2,643	$ 3,961
Investment - commercial real estate		274	3,475	3,749
Owner occupied - commercial real estate			1,674	1,674
Real estate mortgage - residential			714	714
Construction - commercial and residential		9,725	12,622	22,347
Home equity		75	348	423
Other consumer			8	8
Other real estate owned		2,280	2,158	4,438
Total assets measured at fair value on a nonrecurring basis as of June 30, 2012	$	$ 13,672	$ 23,642	$ 37,314

(dollars in thousands)	Quoted Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)	Total (Fair Value)
December 31, 2011				
Impaired loans:				
Commercial	$	$ 1,034	$ 4,684	$ 5,718
Investment - commercial real estate		384	7,278	7,662
Owner occupied - commercial real estate			282	282
Real estate mortgage - residential			1,041	1,041
Construction - commercial and residential		12,733	4,726	17,459
Home equity		214	410	624

Other consumer			8	8
Other real estate owned		1,135	2,090	3,225
Total assets measured at fair value on a nonrecurring basis as of December 31, 2011	$	$ 15,500	$ 20,519	$ 36,019

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Loans

The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan loss is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with ASC Topic 310, Receivables, the fair value of impaired loans may be estimated using one of several methods, including the collateral value, market value of similar debt, enterprise value, and liquidation value and discounted cash flows. Those impaired loans not requiring a specific allowance represent loans for which the fair value of expected repayments or collateral exceed the recorded investment in such loans. At June 30, 2012, substantially all of the impaired loans were evaluated based upon the fair value of the collateral. In accordance with ASC Topic 820, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the loan as nonrecurring Level 3.

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

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

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

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

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

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

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

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

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

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Other earning assets: The fair value of bank owned life insurance is the current cash surrender value which is the carrying value.

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

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

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

Customer repurchase agreements and federal funds purchased: The carrying amount approximates the fair values at the reporting date.

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

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

The estimated fair values of the Company s financial instruments at June 30, 2012 and December 31, 2011 are as follows:

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(dollars in thousands)	Carrying Value	Fair Value	Fair Value Measurements Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
June 30, 2012					
Assets					
Cash and due from banks	$ 6,998	$ 6,998	$	$ 6,998	$
Federal funds sold	19,854	19,854		19,854	
Interest bearing deposits with other banks	122,639	122,639		122,639	
Investment securities	338,933	338,933	115	338,589	229
Federal Reserve and Federal Home Loan Bank stock	10,950	10,950		10,950	
Loans held for sale	102,767	102,767		102,767	
Loans	2,319,237	2,314,034			2,314,034
Other earning assets	13,936	13,936		13,936	
Liabilities					
Noninterest bearing deposits	773,119	773,119		773,119	
Interest bearing deposits	1,740,892	1,744,085		1,744,085	
Borrowings	147,004	149,753		149,753	
December 31, 2011					
Assets					
Cash and due from banks	$ 5,374	$ 5,374	$	$ 5,374	$
Federal funds sold	21,785	21,785		21,785	
Interest bearing deposits with other banks	205,252	205,252		205,252	
Investment securities	313,811	313,811	81	313,504	226
Federal Reserve and Federal Home Loan Bank stock	10,242	10,242		10,242	
Loans held for sale	176,826	176,826		176,826	
Loans	2,056,256	2,056,047			2,056,047
Other earning assets	13,743	13,743		13,743	
Liabilities					
Noninterest bearing deposits	688,506	688,506		688,506	
Interest bearing deposits	1,703,589	1,707,978		1,707,978	
Borrowings	152,662	155,452		155,452	

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8. Common Stock

On April 30, 2012, Eagle Bancorp, Inc. entered into a Sales Agency Agreement (the Agreement) with Sandler O Neill + Partners, L.P. (Sandler O Neill), pursuant to which the Company may, from time to time, sell newly issued shares of its common stock, $0.01 par value per share (the Common Stock), having an aggregate sales price of up to $35,000,000, in a discretionary equity sales program conducted through Sandler O Neill as the Company s sales agent.

Sales of shares of Common Stock pursuant to the Agreement, if any, will be made by means of ordinary brokers transactions on the NASDAQ Capital Market at market prices prevailing at the time of the sale, at prices related to the prevailing market prices, or at negotiated prices. The Company also may sell shares of its common stock to Sandler O Neill, as principal for its own account, at a price agreed upon at the time of sale. If the Company sells shares of Common Stock to Sandler O Neill as principal or other than in accordance with the Agreement, the Company will enter into a separate terms agreement with Sandler O Neill.

Through August 6, 2012, the Company has sold 578,956 shares with proceeds of $9.1 million which is net of commissions of 331 thousand under the Agreement.

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

The following discussion provides information about the results of operations, and financial condition, liquidity, and capital resources of the Company and its subsidiaries as of the dates and periods indicated. This discussion and analysis should be read in conjunction with the unaudited Consolidated Financial Statements and Notes thereto, appearing elsewhere in this report and the Management Discussion and Analysis in the Company s Annual Report on Form 10-K for the year ended December 31, 2011.

This report contains forward looking statements within the meaning of the Securities Exchange Act of 1934, as amended, including statements of goals, intentions, and expectations as to future trends, plans, events or results of Company operations and policies and regarding general economic conditions. In some cases, forward- looking statements can be identified by use of such words as may, will, anticipate, believes, expects, plans, estimates, potential, continue, should, and similar words or phases. These statements are based upon current and anticipat economic conditions, nationally and in the Company s market, interest rates and interest rate policy, competitive factors and other conditions which, by their nature, are not susceptible to accurate forecast, and are subject to significant uncertainty. For details on factors that could affect these expectations, see the risk factors and other cautionary language included in the Company s Annual Report on Form 10-K for the year ended December 31, 2011 and in other periodic and current reports filed by the Company with the Securities and Exchange Commission. Because of these uncertainties and the assumptions on which this discussion and the forward looking statements are based, actual future operations and results in the future may differ materially from those indicated herein. Readers are cautioned against placing undue reliance on any such forward looking statements.

GENERAL

The Company is a growth oriented, one-bank holding company headquartered in Bethesda, Maryland. The Company provides general commercial and consumer banking services through the Bank, its wholly owned banking subsidiary, a Maryland chartered bank which is a member of the Federal Reserve System. The Company was organized in October 1997, to be the holding company for the Bank. The Bank was organized as an independent, community oriented, full service banking alternative to the super regional financial institutions, which dominate the primary market area. The Company s philosophy is to provide superior, personalized service to its customers. The Company focuses on relationship banking, providing each customer with a number of services and becoming familiar with and addressing customer needs in a proactive, personalized fashion. The Bank currently has a total of sixteen branch offices, including seven in Montgomery County, Maryland, five in Washington, DC, two in

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Arlington County, Virginia and two in Fairfax County, Virginia. The Company has announced plans to open an office in Merrifield, Virginia, which is expected to open in late 2012, and an office in Old Town Alexandria, Virginia, which is expected to open in early 2013.

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

CRITICAL ACCOUNTING POLICIES

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

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

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

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

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

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

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

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

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

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

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RESULTS OF OPERATIONS

Earnings Summary

For the six months ended June 30, 2012, the Company s net income was $15.4 million, a 42% increase over the $10.9 million for the six months ended June 30, 2011. Net income available to common shareholders was $15.1 million ($0.75 per basic common share and $0.73 per diluted common share), as compared to $9.7 million ($0.49 per basic common share and $0.48 per diluted common share) for the same six month period in 2011, a 56% increase.

For the three months ended June 30, 2012, the Company reported net income of $7.8 million, a 35% increase over the $5.8 million net income for the quarter ended June 30, 2011. Net income available to common shareholders increased 57% to $7.6 million ($0.38 per basic share and $0.37 per diluted common share), as compared to $4.9 million ($0.25 per basic share and $0.24 per diluted common share) for the same three month period in 2011.

A lower dividend rate on preferred stock accounted for a significant amount of the higher percentage increase in earnings available to common shareholders for both the three and six month periods.

For the six months ended June 30, 2012, the Company reported an annualized return on average assets (ROAA) of 1.08% as compared to 1.00% for the six months of 2011, while the annualized return on average common equity (ROAE) was 13.66% in 2012, as compared to 10.32% for the same six month period in 2011. The increase in these ratios was due to substantial increases in noninterest income and improved operating efficiency.

For the three months ended June 30, 2012, the Company reported an ROAA of 1.08% as compared to 1.01% for the three months ended June 30, 2011. The ROAE for the quarter ended June 30, 2012 was 13.52%, as compared to 10.16% for the quarter ended June 30, 2011. The higher ROAA and ROAE ratios for the second quarter of 2012 as compared to 2011 are due to an expanded net interest margin, higher levels of noninterest income and improvement in expense management.

The Company s earnings are largely dependent on net interest income, which represented 85% of total revenue (i.e. net interest income plus noninterest income) for the six months ended June 30, 2012 compared to 88% for the same period in 2011, as the Company has been successful in diversifying its revenue through noninterest sources.

The net interest margin, which measures the difference between interest income and interest expense (i.e. net interest income) as a percentage of earning assets, decreased from 4.27% for the six months ended June 30, 2011 to 4.25% for the six months ended June 30, 2012, a difference of 2 basis points. Although funding costs for both deposits and borrowings declined, it was more than offset by higher levels of lower yielding average earning assets in the first six months of 2012 as compared to the same period in 2011. Average loan yields declined by 11 basis points (from 5.81% to 5.70%), and average investment yields declined by 26 basis points (from 3.86% to 3.60%), as compared to a decline of 44 basis points (from 1.27% to 0.83%) in the cost of interest bearing liabilities. A lower mix of average loans as a percentage of total earning assets

(from 84% to 77%) during the six months ended June 30, 2012, as compared to the same period in 2011, contributed to the decline in average earning asset yields. The net interest spread was 3.97% for the six months ended June 30, 2012, as compared to 3.93% for the same period in 2011, an increase of 4 basis points. The benefit of noninterest sources funding earning assets declined by 6 basis points from 34 basis points to 28 basis points for six months ended June 30, 2012 and 2011, respectively. The combination of a 4 basis point increase in the net interest spread and a 6 basis point decline in the value of noninterest sources resulted in the 2 basis point decrease in the net interest margin.

For the three months ended June 30, 2012 and 2011, average interest bearing liabilities were 65% and 73%, respectively, of average earning assets, as more earning assets were funded by noninterest bearing sources in the most recent three month period as compared to the same three month period in 2011. Additionally, due to a lower mix of average loans in the three months ended June 30, 2012, as compared to the same period in 2011, the average rate on earning assets for the three months ended June 30, 2012 decreased by 35 basis points from 5.24% to 4.89%.

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The cost of interest bearing liabilities for the three months ended June 30, 2012 as compared to 2011 decreased by 48 basis points from 1.25% to 0.77%, resulting in an increase in the net interest spread of 13 basis points from 3.99% for the three months ended June 30, 2011 to 4.12% for the three months ended June 30, 2012. The net interest margin increased 7 basis points from 4.32% for the three months ended June 30, 2011 to 4.39% for the three months ended June 30, 2012. A higher mix of noninterest deposits in the three months ended June 30, 2012 as compared to the same quarter in 2011, and in a lower interest rate environment was the reason for the net interest margin gain being less than the net interest spread gain. The benefit of noninterest sources funding earning assets declined by 6 basis points from 33 basis points for the three months ended June 30, 2012 to 27 basis points for the same period in 2011. The combination of a 13 basis point increase in the net interest spread and a 6 basis point decline in the value of noninterest sources resulted in the 7 basis point increase in the net interest margin.

The Company believes it has effectively managed its net interest margin and net interest income over the past twelve months as average market interest rates have declined. This factor has been significant to overall earnings performance over the past twelve months as net interest income (at 85%) represents the most significant component of the Company s revenues.

In order to fund significant growth in the average balance of loans of 21% over the six months ended June 30, 2012 as compared to 2011, the Company has relied primarily upon core deposit growth, together with use of increased levels of brokered and wholesale deposits. The major component of the growth in core deposits has been growth in money market accounts and noninterest deposits primarily as a result of effectively building new and enhanced client relationships.

In terms of the average balance sheet composition or mix, loans, which generally have higher yields than securities and other earning assets, decreased from 84% of average earning assets in the first six months of 2011 to 77% of average earning assets for the same period of 2012. This higher growth of average funding sources as compared to loans has added average liquidity to the balance sheet. The decrease in average loans as a percentage of average earning assets is due to the significant growth in average deposits for the six month period ended June 30, 2012 as compared to the same period in 2011. For the first six months of 2012, as compared to the same period in 2011, average loans, excluding loans held for sale, increased $377 million, a 21% increase, while average deposits increased by $587 million, a 32% increase. The increase in average loans in the six months of 2012 as compared to the first six months of 2011 is primarily attributable to growth in loans for both income producing - commercial real estate and construction. Increases in average deposits in the first six months of 2012, as compared to the first six months of 2011, is attributable to growth in noninterest bearing demand deposits, and money market accounts. Average investment securities for the six month periods ended June 30, 2012 and 2011 amounted to 12% and 11% of average earning assets, respectively. The combination of federal funds sold and interest bearing deposits with other banks, averaged 7% of average earning assets in the first six months of 2012 as compared to 4% for the same period in 2011, as average asset liquidity was enhanced.

The provision for credit losses was $8.4 million for the first six months of 2012 as compared to $5.3 million in 2011. The higher provisioning in 2012 as compared to 2011 is attributable to higher allowance allocations for selected loan categories and higher net charge-offs in the first six months of 2012 compared to 2011. For the six months ended June 30, 2012, net charge-offs totaled $4.0 million (0.37% of average loans) compared to $2.6 million (0.29% of average loans) for the six months ended June 30, 2011. Net charge-offs in the six months ended June 30, 2012 were primarily attributable to charge-offs of commercial and industrial loans ($1.7 million), commercial real estate loans ($1.2 million), residential, home equity and consumer loans ($567 thousand), and construction loans ($516 thousand).

The provision for credit losses was $4.4 million for the three months ended June 30, 2012 as compared to $3.2 million for the three months ended June 30, 2011. The higher provisioning in the second quarter of 2012, as compared to the second quarter of 2011, is due to a higher allowance allocation for selected loan categories and higher net charge-offs. Net charge-offs of $2.2 million in the second quarter of 2012 represented 0.40% of average loans, excluding loans held for sale, as compared to $1.3 million or 0.28% of average loans, excluding loans held for sale, in the second quarter of 2011. Net charge-offs in the second quarter of 2012 were primarily attributable to charge-offs of commercial and industrial loans ($967 thousand), and commercial real estate loans ($882 thousand), , construction loans ($370 thousand), and residential,

home equity and consumer loans ($20 thousand).

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At June 30, 2012, the allowance for credit losses represented 1.47% of loans outstanding, as compared to 1.44% at December 31, 2011, and 1.41% at June 30, 2011. The allowance for credit losses was 104% of nonperforming loans at June 30, 2012, as compared to 90% at December 31, 2011, and 88% at June 30, 2011. The level of nonperforming loans at June 30, 2012 as compared to December 31, 2011 was impacted significantly by the addition of one commercial construction real estate loan in the amount of $8.4 million placed on nonaccrual in the first quarter of 2012.

Total noninterest income for the six months ended June 30, 2012 increased to $10.5 million from $6.1 million for the six months ended June 30, 2011, a 71% increase. This increase was due primarily to an increase of $4.0 million in gains on sales of residential mortgage loans for the first six months of 2012 as compared to the same period in 2011. Also contributing to the increase was $493 thousand in service charges on deposit accounts and $215 thousand in other income, primarily associated with ATM fees. Excluding investment securities gains, total noninterest income was $10.2 million for the first six months of 2012 as compared to $5.5 million for the first six months of 2011, an increase of 83%.

Total noninterest income for the three months ended June 30, 2012 increased to $4.4 million from $3.2 million for the three months ended June 30, 2011, a 39% increase. This increase was due primarily to an increase of $1.7 million in gains on sales of residential mortgage loans in the second quarter of 2012 as compared to the second quarter of 2011. Also contributing to the increase was $263 thousand in service charges on deposit accounts offset by a $443 thousand decrease of investment gains. Excluding investment securities gains, total noninterest income was $4.3 million for the second quarter of 2012 as compared to $2.6 million for the second quarter of 2011, an increase of 65%.

The efficiency ratio, which measures the ratio of noninterest expense to total revenue, was 53.06% for the first six months of 2012, as compared to 56.76% for the first six months of 2011. Total noninterest expenses were $37.1 million for the six months ended June 30, 2012, as compared to $29.2 million for the six months ended June 30, 2011, a 27% increase. Cost increases for salaries and benefits were $5.6 million primarily due to merit and benefit cost increases, increases in incentive pay, and staffing increases primarily as a result of growth in the residential lending division as well as additional lending and branch personnel. At June 30, 2012, the Company had sixteen branch offices, as compared to thirteen at June 30, 2011. Premises and equipment expenses were $936 thousand higher due primarily to the cost of three new branch offices and normal increases in leasing costs. Data processing costs increased by $606 thousand due to system enhancements and expanded customer transaction costs. FDIC insurance premiums were $275 thousand lower due to premium rate declines which took effect on April 1, 2011. Other expenses increased by $980 thousand for the six months ended June 30, 2012 compared to the same period in 2011.

Total noninterest expenses were $18.5 million for the three months ended June 30, 2012, as compared to $14.9 million for the three months ended June 30, 2011, a 24% increase. Cost increases for salaries and benefits were $2.5 million primarily due to merit and benefit cost increases, increases in incentive pay, and staffing increases primarily as a result of growth in the residential lending division as well as additional lending and branch personnel. Premises and equipment expenses were $417 thousand higher due primarily to the cost of three new branch offices and normal increases in leasing costs. Other expenses increased by $693 thousand for the quarter ended June 30, 2012 compared to the same period in 2011.

The ratio of common equity to total assets decreased from 8.23% at June 30, 2011 to 7.89% at June 30, 2012 due to an increase in balance sheet leverage. As discussed later in Capital Resources and Adequacy, the regulatory capital ratios of the Bank and Company remain above well capitalized levels.

Net Interest Income and Net Interest Margin

Net interest income is the difference between interest income on earning assets and the cost of funds supporting those assets. Earning assets are composed primarily of loans and investment securities. The cost of funds represents interest expense on deposits, customer repurchase agreements and other borrowings. Noninterest bearing deposits and capital are other components representing funding sources (refer to discussion above under Results of

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Operations). Changes in the volume and mix of assets and funding sources, along with the changes in yields earned and rates paid, determine changes in net interest income.

For the first six months of 2012, net interest income increased 31% over the same period for 2011. Average loans increased $377 million and average deposits increased by $587 million. The net interest margin was 4.25% for the six months of 2012, as compared to 4.27% for the six months of 2011. The Company has been able to maintain its loan yields in 2012 close to 2011 levels due to loan pricing practices, and has been able to reduce its funding costs while maintaining a favorable deposit mix; much of which has occurred from sales efforts to increase and deepen client relationships. The Company believes its net interest margin remains favorable to peer banking companies.

Net interest income increased 30% for the three months ended June 30, 2012 over the same period for 2011. Average loans increased $382 million and average deposits increased by $545 million. For the three months ended June 30, 2012 the net interest margin was 4.39% as compared to 4.32% for the three months ended June 30, 2011.

The tables below presents the average balances and rates of the various categories of the Company s assets and liabilities for the three and six months ended June 30, 2012 and 2011. Included in the tables is a measurement of interest rate spread and margin. Interest rate spread is the difference (expressed as a percentage) between the interest rate earned on earning assets less the interest rate paid on interest bearing liabilities. While the interest rate spread provides a quick comparison of earnings rates versus cost of funds, management believes that margin provides a better measurement of performance. Margin includes the effect of noninterest bearing sources in its calculation and is net interest income expressed as a percentage of average earning assets.

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Eagle Bancorp, Inc.

Consolidated Average Balances, Interest Yields and Rates (Unaudited)

(dollars in thousands)

	Three Months Ended June 30,					
	2012			2011		
	Average Balance	Interest	Average Yield/Rate	Average Balance	Interest	Average Yield/Rate
ASSETS						
Interest earning assets:						
Interest bearing deposits with other banks and other short-term investments	$ 129,537	$ 78	0.25%	$ 10,265	$ 17	0.66%
Loans held for sale (1)	95,734	872	3.64%	19,419	168	3.47%
Loans (1) (2)	2,246,644	31,761	5.69%	1,864,722	27,111	5.83%
Investment securities available for sale (2)	353,572	1,850	2.10%	252,096	1,665	2.65%
Federal funds sold	19,004	14	0.30%	73,635	35	0.19%
Total interest earning assets	2,844,491	34,575	4.89%	2,220,137	28,996	5.24%
Total noninterest earning assets	76,020			84,387		
Less: allowance for credit losses	32,323			26,195		
Total noninterest earning assets	43,697			58,192		
TOTAL ASSETS	$ 2,888,188			$ 2,278,329		
LIABILITIES AND SHAREHOLDERS EQUITY						
Interest bearing liabilities:						
Interest bearing transaction	$ 78,321	$ 61	0.31%	$ 61,623	$ 48	0.31%
Savings and money market	1,130,642	1,361	0.48%	816,587	2,067	1.02%
Time deposits	489,386	1,518	1.25%	600,145	2,282	1.53%
Total interest bearing deposits	1,698,349	2,940	0.70%	1,478,355	4,397	1.19%
Customer repurchase agreements	101,240	86	0.34%	103,720	171	0.66%
Other short-term borrowings	104			88		
Long-term borrowings	49,300	535	4.29%	49,300	534	4.29%
Total interest bearing liabilities	1,848,993	3,561	0.77%	1,631,463	5,102	1.25%
Noninterest bearing liabilities:						
Noninterest bearing demand	749,636			424,482		
Other liabilities	5,519			7,458		
Total noninterest bearing liabilities	755,155			431,940		
Shareholders equity	284,040			214,926		
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 2,888,188			$ 2,278,329		
Net interest income		$ 31,014			$ 23,894	
Net interest spread			4.12%			3.99%
Net interest margin			4.39%			4.32%

(1) Loans placed on nonaccrual status are included in average balances. Net loan fees and late charges included in interest income on loans totaled $1.1 million and $1.3 million for the three months ended June 30, 2012 and 2011, respectively.

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

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Eagle Bancorp, Inc.

Consolidated Average Balances, Interest Yields and Rates (Unaudited)

(dollars in thousands)

	Six Months Ended June 30,					
	2012			2011		
	Average Balance	Interest	Average Yield/Rate	Average Balance	Interest	Average Yield/Rate
ASSETS						
Interest earning assets:						
Interest bearing deposits with other banks and other short-term investments	$ 174,263	$ 215	0.25%	$ 10,329	$ 36	0.70%
Loans held for sale (1)	107,916	1,943	3.60%	19,466	373	3.86%
Loans (1) (2)	2,166,578	61,413	5.70%	1,789,714	51,521	5.81%
Investment securities available for sale (2)	346,798	3,544	2.06%	244,878	3,285	2.71%
Federal funds sold	19,063	28	0.30%	77,891	77	0.20%
Total interest earning assets	2,814,618	67,143	4.80%	2,142,278	55,292	5.20%
Total noninterest earning assets	75,978			84,224		
Less: allowance for credit losses	31,156			25,540		
Total noninterest earning assets	44,822			58,684		
TOTAL ASSETS	$ 2,859,440			$ 2,200,962		
LIABILITIES AND SHAREHOLDERS EQUITY						
Interest bearing liabilities:						
Interest bearing transaction	$ 77,583	$ 131	0.34%	$ 61,551	$ 111	0.36%
Savings and money market	1,110,134	3,033	0.55%	785,814	3,976	1.02%
Time deposits	513,964	3,244	1.27%	575,213	4,421	1.55%
Total interest bearing deposits	1,701,681	6,408	0.76%	1,422,578	8,508	1.21%
Customer repurchase agreements	102,584	182	0.36%	97,472	321	0.66%
Other short-term borrowings	52			44		
Long-term borrowings	49,300	1,069	4.29%	49,300	1,063	4.29%
Total interest bearing liabilities	1,853,617	7,659	0.83%	1,569,394	9,892	1.27%
Noninterest bearing liabilities:						
Noninterest bearing demand	719,018			411,409		
Other liabilities	7,323			8,233		
Total noninterest bearing liabilities	726,341			419,642		
Shareholders equity	279,482			211,926		
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 2,859,440			$ 2,200,962		
Net interest income		$ 59,484			$ 45,400	
Net interest spread			3.97%			3.93%
Net interest margin			4.25%			4.27%

(1) Loans placed on nonaccrual status are included in average balances. Net loan fees and late charges included in interest income on loans totaled $2.3 million and $2.0 million for the six months ended June 30, 2012 and 2011, respectively.

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

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Provision for Credit Losses

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

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

During the first six months of 2012, the allowance for credit losses increased $4.4 million, reflecting $8.4 million in provision for credit losses and $4.0 million in net charge-offs during the period. The provision for credit losses was $8.4 million for the six months ended June 30, 2012 as compared to $5.3 million for the six months ended June 30, 2011. At June 30, 2012, the allowance for credit losses represented 1.47% of loans outstanding, compared to 1.44% at December 31, 2011 and 1.41% at June 30, 2011. The higher provisioning in 2012, as compared to 2011, is attributable to higher allowance allocations for selected loan categories and higher net charge-offs in the first six months of 2012 compared to 2011. Net charge-offs of $4.0 million represented 0.37% of average loans, excluding loans held for sale, in the first six months of 2012, as compared to $2.6 million or 0.29% of average loans, excluding loans held for sale, for the same period of 2011.

During the three months ended June 30, 2012, the allowance for credit losses increased $2.2 million, reflecting $4.4 million in provision for credit losses and $2.2 million in net charge-offs during the period. The provision for credit losses was $4.4 million for the three months ended June 30, 2012 as compared to $3.2 million for the three months ended June 30, 2011. The higher provisioning in the second quarter of 2012, as compared to the second quarter of 2011, is attributable to a higher allowance allocation for selected loan categories and higher net charge-offs.

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

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

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

	Six Months Ended June 30,	
(dollars in thousands)	**2012**	**2011**
Balance at beginning of year	$ 29,653	$ 24,754
Charge-offs:		
Commercial (1)	1,761	1,799
Investment - commercial real estate	1,189	277
Owner occupied - commercial real estate		
Real estate mortgage - residential	300	94
Construction - commercial and residential	990	741
Construction - C&I (owner occupied)		
Home equity	261	
Other consumer	9	6
Total charge-offs	4,510	2,917
Recoveries:		
Commercial (1)	28	13
Investment - commercial real estate	18	126
Owner occupied - commercial real estate		
Real estate mortgage - residential		
Construction - commercial and residential	474	167
Construction - C&I (owner occupied)		
Home equity	1	1
Other consumer	2	
Total recoveries	523	307
Net charge-offs	3,987	2,610
Additions charged to operations	8,413	5,331
Balance at end of period	$ 34,079	$ 27,475
Annualized ratio of net charge-offs during the period to average loans outstanding during the period	0.37%	0.29%

(1) Includes SBA loans.

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

	June 30, 2012		December 31, 2011		June 30, 2011	
(dollars in thousands)	**Amount**	**% (1)**	**Amount**	**% (1)**	**Amount**	**% (1)**
Commercial	$ 8,878	23%	$ 9,609	23%	$ 9,050	25%
Investment - commercial real estate	8,720	41%	7,304	37%	7,303	37%
Owner occupied - commercial real estate	2,390	13%	1,898	12%	2,046	12%
Real estate mortgage - residential		2%	399	2%	365	2%
Construction - commercial and residential	12,165	17%	7,862	19%	6,663	18%
Construction - C&I (owner occupied)	319		684	2%	468	1%
Home equity	1,433	4%	1,528	5%	1,508	5%
Other consumer	174		369		72	
Unallocated						
Total loans	$ 34,079	100%	$ 29,653	100%	$ 27,475	100%

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

Nonperforming Assets

As shown in the table below, the Company s level of nonperforming assets, which are comprised of loans delinquent 90 days or more, nonaccrual loans, which includes the nonperforming portion of troubled debt restructurings and other real estate owned, totaled $37.3 million at June 30, 2012, representing 1.26% of total assets, as compared to $36.0 million of nonperforming assets, or 1.27% of total assets, at December 31, 2011 and $34.7 million of nonperforming assets, or 1.47% of total assets, at June 30, 2011. The Company had no accruing loans 90 days or more past due at June 30, 2012, December 31, 2011 or June 30, 2011. Management remains attentive to early signs of deterioration in borrowers financial conditions and to taking the appropriate action to mitigate risk. Furthermore, the Company is diligent in placing loans on nonaccrual status and believes, based on its loan portfolio risk analysis, that its allowance for credit losses, at 1.47% of total loans at June 30, 2012 is adequate to absorb potential credit losses within the loan portfolio at that date.

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

Loans are considered to have been modified in a TDR when, due to a borrower s financial difficulties, the Company makes unilateral concessions to the borrower that it would not otherwise consider. Concessions could include interest rate reductions, principal or interest forgiveness, forbearance, and other actions intended to minimize economic loss and to avoid foreclosure or repossession of collateral. Alternatively, management, from time-to-time and in the ordinary course of business, implements renewals, modifications, extensions, and/or changes in terms of

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loans to borrowers who have the ability to repay on reasonable market-based terms, as circumstances may warrant. Such modifications are not considered to be TDRs, as the accommodation of a borrower s request does not rise to the level of a concession and/or the borrower is not experiencing financial difficulty. For example: (1) adverse weather conditions may create a short term cash flow issue for an otherwise profitable retail business which suggests a temporary interest only period on an amortizing loan; (2) there may be delays in absorption on a real estate project which reasonably suggests extension of the loan maturity at market terms; or (3) there may be maturing loans to borrowers with demonstrated repayment ability who are not in a position at the time of maturity to obtain alternate long-term financing. The most common change in terms provided by the Company is an extension of an interest only term. The determination of whether a restructured loan is a TDR requires consideration of all of the facts and circumstances surrounding the change in terms, and the exercise of prudent business judgment. The Company had five TDRs totaling $10.0 at June 30, 2012, of which three loans totaling approximately $8.8 million were performing TDRs. During the second quarter of 2012, there were no defaults on restructured loans; however, during the first three months of 2012, two TDRs totaling approximately $1.2 million defaulted on their restructured loans. A default is considered to have occurred once the TDR is past due 90 days or more or it has been placed on nonaccrual. The two nonperforming TDRs were reclassified to nonperforming loans as of March 31, 2012 and remain classified as such as of June 30, 2012. Commercial and consumer loans modified in a TDR are closely monitored for delinquency as an early indicator of possible future default. If loans modified in a TDR subsequently default, the Company evaluates the loan for possible further impairment. The allowance may be increased, adjustments may be made in the allocation of the allowance, or partial charge-offs may be taken to further write-down the carrying value of the loan. There were no loans modified into a TDR during the six months ended June 30, 2012 and June 30, 2011.

Total nonperforming loans amounted to $32.9 million at June 30, 2012 (1.42% of total loans), compared to $32.8 million at December 31, 2011 (1.59% of total loans) and $31.2 million at June 30, 2011 (1.60% of total loans). The decrease in the ratio of nonperforming loans to total loans at June 30, 2012 as compared to June 30, 2011, is due to an increase in the total loan portfolio.

Included in nonperforming assets at June 30, 2012 were $4.4 million of OREO, consisting of nine foreclosed properties. The Company had eleven foreclosed properties with a net carrying value of $3.2 million at December 31, 2011 and eleven foreclosed properties with a net carrying value of $3.4 million at June 30, 2011. OREO properties are carried at the lower of cost or appraised value less estimated costs to sell. It is the Company s policy to obtain third party appraisals prior to foreclosure, and to obtain updated third party appraisals on OREO properties not less frequently than annually. Generally, the Company would obtain updated appraisals or evaluations where it has reason to believe, based upon market indications (such as comparable sales, legitimate offers below carrying value, broker indications and similar factors), that the current appraisal does not accurately reflect current value. During the first six months of 2012, four foreclosed properties with a net carrying value of $755 thousand were sold for a net gain of $82 thousand.

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

(dollars in thousands)	June 30, 2012	2011	December 31, 2011
Nonaccrual Loans:			
Commercial	$ 3,961	$ 4,649	$ 5,718
Investment - commercial real estate	3,749	4,520	7,662
Owner occupied - commercial real estate	1,674	295	282
Real estate mortgage - residential	714	1,047	1,041
Construction - commercial and residential	22,347	20,056	17,459
Construction - C&I (owner occupied)			
Home equity	423	645	624
Other consumer	8	9	8
Accrual loans-past due 90 days:			
Commercial			
Investment - commercial real estate			
Other consumer			
Total nonperforming loans (1)	32,876	31,221	32,794
Other real estate owned	4,438	3,434	3,225
Total nonperforming assets	$ 37,314	$ 34,655	$ 36,019
Coverage ratio, allowance for credit losses to total nonperforming loans	103.66%	88.00%	90.42%
Ratio of nonperforming loans to total loans	1.42%	1.60%	1.59%
Ratio of nonperforming assets to total assets	1.26%	1.47%	1.27%

(1) Excludes performing TDRs totaling $8.8 million at June 30, 2012, $13.9 million at December 31, 2011 and $3.1 million at June 30, 2011.

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

At June 30, 2012, there were $9.6 million of performing loans considered potential problem loans, defined as loans which are not included in the 90 day past due, nonaccrual or restructured categories, but for which known information about possible credit problems causes management to be uncertain as to the ability of the borrowers to comply with the present loan repayment terms which may in the future result in disclosure in the past due, nonaccrual or restructured loan categories. The $9.6 million in potential problem loans at June 30, 2012 compared to $23.5 million at December 31, 2011, and $26.2 million at June 30, 2011. The Company has taken a conservative posture with respect to risk rating its loan portfolio. Based upon their status as potential problem loans, these loans receive heightened scrutiny and ongoing intensive risk management. Additionally, the Company s loan loss allowance methodology incorporates increased reserve factors for certain loans considered potential problem loans as compared to the general portfolio. See Provision for Credit Losses for a description of the allowance methodology.

Noninterest Income

Total noninterest income includes service charges on deposits, gain on sale of loans, gain on sale of investment securities, income from bank owned life insurance (BOLI) and other income.

Total noninterest income for first six months of 2012 was $10.5 million compared to $6.1 million in 2011, a 71% increase. This increase was due primarily to an increase of $4.0 million in gains on sales of residential

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mortgage loans for the first six months of 2012 as compared to the same period in 2011. Also contributing to the increase was $493 thousand in service charges on deposit accounts and $215 thousand in other income, primarily associated with ATM fees. Excluding investment securities gains, total noninterest income was $10.2 million for the first six months of 2012 as compared to $5.5 million for the first six months of 2011, an increase of 83%.

Total noninterest income for the three months ended June 30, 2012 increased to $4.4 million from $3.2 million for the three months ended June 30, 2011, a 39% increase. This increase was due primarily to an increase of $1.7 million in gains on sales of residential mortgage loans in the second quarter of 2012 as compared to the second quarter of 2011. Also contributing to the increase was $263 thousand in service charges on deposit accounts offset by a $443 thousand decrease of investment gains. Excluding investment securities gains, total noninterest income was $4.3 million for the second quarter of 2012 as compared to $2.6 million for the second quarter of 2011, an increase of 65%.

For the six months ended June 30, 2012, service charges on deposit accounts increased to $1.9 million from $1.4 million in the same period in 2011, an increase of 35%. For the three months ended June 30, 2012, service charges on deposit accounts increased $263 thousand, an increase of 39% from the same three month period in 2011. The increase for the six and three month periods was due to growth in the number of accounts.

The Company originates residential mortgage loans on a pre-sold basis, servicing released. Sales of these mortgage loans yielded gains of $6.5 million for the six months ended June 30, 2012 compared to $2.4 million in the same period in 2011, due to the continued expansion of the residential mortgage origination and sales division and to higher refinancing volume due to lower market interest rates. For the three months ended June 30, 2012 and 2011 gains on the sales of residential mortgages were $2.6 million and $858 thousand, respectively. Loans sold are subject to repurchase in circumstances where documentation is deficient or the underlying loan becomes delinquent or pays off within a specified period following loan funding and sale. The Bank considers these potential recourse provisions to be a minimal risk, but has established a reserve under generally accepted accounting principles for possible repurchases. There were no repurchases due to fraud by the borrower during the six months ended June 30, 2012. The reserve amounted to $139 thousand at June 30, 2012 and is included in other liabilities on the Consolidated Balance Sheets. The Bank does not originate sub-prime loans and has no exposure to this market segment.

The Company is an originator of SBA loans and its current practice is to sell the insured portion of those loans at a premium. Income from this source was $258 thousand and none for the six and three months ended June 30, 2012 compared to $376 thousand and $260 thousand for the same six and three month periods in 2011. Activity in SBA loan sales to secondary markets can vary widely from quarter to quarter.

Other income totaled $1.3 million for the six months ended June 30, 2012 as compared to $1.1 million for the same period in 2011, an increase of 19%. ATM fees increased from $348 thousand for the six months ended June 30, 2011 to $467 thousand for the same period in 2012, a 34% increase. SBA servicing fees increased from $103 thousand for the six months ended June 30, 2011 to $113 thousand for the same period in 2012, a 10% increase. Noninterest loan fees decreased from $537 thousand for the six months ended June 30, 2011 to $509 thousand for the same period in 2012, a 5% decrease. Other noninterest fee income was $231 thousand for the six months ended June 30, 2012 compared to $118 thousand for the same period in 2011, a 95% increase. Other income totaled $677 thousand for the three months ended June 30, 2012 as compared to $724 thousand for the same period in 2011, a decrease of 7%. ATM fees increased from $190 thousand for the three months ended June 30, 2011 to $251 thousand for the same period in 2012, a 32% increase. SBA servicing fees decreased from $56 thousand for the three months ended June 30, 2011 to $45 thousand for the same period in 2012, a 19% decrease. Noninterest loan fees decreased from $408 thousand for the three months ended June 30, 2011 to $254 thousand for the same period in 2012, a 38% decrease. Other noninterest fee income was $127 thousand for the three months ended June 30, 2012 compared to $58 thousand for the same period in 2011, a 119% increase.

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Noninterest Expense

Total noninterest expense consists of salaries and employee benefits, premises and equipment expenses, marketing and advertising, data processing, legal, accounting and professional fees, FDIC insurance and other expenses.

Total noninterest expenses were $37.1 million for the six months ended June 30, 2012, as compared to $29.2 million for the six months ended June 30, 2011, a 27% increase. Total noninterest expenses were $18.5 million for the three months ended June 30, 2012, as compared to $14.9 million for the three months ended June 30, 2011, a 24% increase.

Salaries and employee benefits were $20.7 million for the six months ended June 30, 2012, as compared to $15.1 million for 2011, a 37% increase. Salaries and employee benefits were $10.3 million for the three months ended June 30, 2012, as compared to $7.8 million for 2011, a 33% increase. Cost increases for salaries and benefits for both the six and three month periods were primarily due to salaries, incentive compensation and benefits increases, including staffing increases primarily as a result of growth in the residential lending division as well as additional lending and branch personnel. At June 30, 2012, the Company s staff numbered 388, as compared to 338 at December 31, 2011 and 312 at June 30, 2011.

Premises and equipment expenses amounted to $5.0 million for the six months ended June 30, 2012 as compared to $4.0 million for the same period in 2011, a 23% increase. Premises and equipment expenses amounted to $2.5 million for the three months ended June 30, 2012 as compared to $2.1 million for the same period in 2011, a 20% increase. For both the six and three month periods premises and equipment expenses were higher due primarily to the cost of three new branch offices and normal increases in leasing costs. Additionally, for the six and three months ended June 30, 2012, the Company recognized $47 thousand and $24 thousand of sublease revenue as compared to $160 thousand and $89 thousand for the same period in 2011. The sublease revenue is a direct offset of premises and equipment expenses.

Marketing and advertising expenses decreased from $981 thousand for the six months ended June 30, 2011 to $843 thousand for the same period in 2012, a 14% decrease. Marketing and advertising expenses decreased from $747 thousand for the three months ended June 30, 2011 to $557 thousand for the same period in 2012, a 25% decrease. The primary reason for the decrease in both the six and three month periods were due primarily to nonrecurring special event marketing expenses in 2011.

Data processing expenses increased from $1.6 million for the six months ended June 30, 2011 to $2.2 million in the same period in 2012, a 38% increase. Data processing expenses increased from $912 thousand for the three months ended June 30, 2011 to $951 thousand in the same period in 2012, a 4% increase. The increase in expense for both the six and three month periods was due to system enhancements initiated in April 2011, new offices and expanded customer transaction costs.

Legal, accounting and professional fees increased from $2.1 million for the six months ended June 30, 2011 to $2.2 million in the same period in 2012, a 5% increase. Legal, accounting and professional fees increased from $1.0 million for the three months ended June 30, 2011 to $1.1 million in the same period in 2012, a 14% increase. The increases for both the six and three month periods were due to the Company s use of outside professional consultants.

FDIC insurance premiums were $1.1 million for the six months ended June 30, 2012, as compared to $1.3 million in 2011, a 20% decrease. FDIC insurance premiums were $579 thousand for the three months ended June 30, 2012, as compared to $600 thousand in 2011, a 4% decrease. FDIC insurance premiums were lower for both the six and three month periods in 2012 as compared to 2011 due to FDIC premium rate declines which took effect on April 1, 2011.

For the six months ended June 30, 2012, other expenses amounted to $5.0 million as compared to $4.1 million for the same period in 2011, an increase of 24%. For the three months ended June 30, 2012, other expenses amounted to $2.6 million as compared to $1.9 million for the same period in 2011, an increase of 37%. The major components of cost in this category include insurance expenses, deposit fees, telephone, director fees, OREO

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expenses and other losses. The increase for the six month period ended June 30, 2012 compared to the same period in 2011, was primarily due to an increase of $666 thousand of other losses and an increase of $434 thousand of deposit fees offset by a decrease of $149 thousand of related expenses for the operations of OREO properties. The increase for the three month period ended June 30, 2012 compared to the same period in 2011, was primarily due to $293 thousand of other losses, $211 thousand of deposit fees and $129 thousand of related expenses for the operations of OREO properties.

Income Tax Expense

The Company s ratio of income tax expense to pre-tax income (effective tax rate) increased to 36.9% for the six months ended June 30, 2012 as compared to 35.7% for the same period in 2011. For the second quarter of 2012 the effective tax rate was 37.6% compared to 35.6% for the same period in 2011. The higher effective tax rate for both the six and three month periods relates to a higher marginal tax rate resulting from a higher level of income.

FINANCIAL CONDITION

Summary

At June 30, 2012, total assets were $2.96 billion, compared to $2.83 billion at December 31, 2011, a 5% increase. As compared to June 30, 2011, total assets at June 30, 2012 increased by $609 million, a 26% increase. Total loans (excluding loans held for sale) were $2.32 billion at June 30, 2012 compared to $2.06 billion at December 31, 2011, a 13% increase. As compared to June 30, 2011, total loans at June 30, 2012 increased by $371 million, a 19% increase. Total deposits were $2.51 billion at June 30, 2012, compared to deposits of $2.39 billion at December 31, 2011, a 5% increase. As compared to June 30, 2011, total deposits at June 30, 2012 increased by $573 million, a 30% increase. Loans held for sale amounted to $102.8 million at June 30, 2012 as compared to $176.8 million at December 31, 2011 and $25.5 million at June 30, 2011. The investment portfolio totaled $338.9 million at June 30, 2012, an 8% increase from the $313.8 million balance at December 31, 2011, as excess liquidity was deployed into new investments. As compared to June 30, 2011, the investment portfolio at June 30, 2012 increased by $89 million, a 36% increase. Total borrowed funds (excluding customer repurchase agreements) were stable at $49.3 million at June 30, 2012, December 31, 2011 and June 30, 2011. Total shareholders equity increased to $290.3 million at June 30, 2012, compared to $266.7 million and $217.0 million at December 31, 2011 and June 30, 2011, respectively.

Loans, net of amortized deferred fees and costs, at June 30, 2012, December 31, 2011 and June 30, 2011 by major category are summarized below.

		June 30, 2012			December 31, 2011			June 30, 2011	
(dollars in thousands)		**Amount**	**%**		**Amount**	**%**		**Amount**	**%**
Commercial	$	516,493	23%	$	478,886	23%	$	482,680	25%
Investment - commercial real estate		932,490	40%		756,645	37%		719,450	37%
Owner occupied - commercial real estate (1)		307,410	14%		250,174	12%		242,266	12%

Real estate mortgage - residential	48,842	2%	39,552	2%	36,794	2%
Construction - commercial and residential (1)	400,805	17%	395,267	19%	346,273	18%
Construction - C&I (owner occupied) (1)	10,501		34,402	2%	24,315	1%
Home equity	97,969	4%	97,103	5%	90,827	5%
Other consumer	4,727		4,227		5,871	
Total loans	2,319,237	100%	2,056,256	100%	1,948,476	100%
Less: Allowance for Credit Losses	(34,079)		(29,653)		(27,475)	
Net loans	$ 2,285,158		$ 2,026,603		$ 1,921,001	

(1) Includes loans for land acquisition and development.

In its lending activities, the Company seeks to develop substantial relationships with clients whose businesses and individual banking needs will grow with the Bank. There has been a significant effort to grow the loan portfolio and to be responsive to the lending needs in the markets served, while maintaining sound asset quality.

Loan growth over the past six months has been favorable, with loans outstanding reaching $2.32 billion at June 30, 2012, an increase of $263 million or 13% as compared to $2.06 billion at December 31, 2011, and increased $371 million or 19% as compared to $1.95 billion at June 30, 2011. The loan growth was predominantly in the investment and owner occupied - commercial real estate segments. Traditional sources of credit for commercial real estate transactions remain constrained and the Bank has been able to capitalize on this environment and acquire significant new customers because of the Bank s ability and willingness to lend. Commercial real estate leasing in the Bank s market area has held up far better than in other markets and values have generally seen only minor declines. Meanwhile, multi-family properties in a number of sub-markets within the Bank s market area are experiencing normalized vacancy rates, indicating a balance of supply and demand. Construction loans increased year over year as demand for new construction loans have begun to return and the Bank is selectively evaluating projects. Commercial loan growth has picked up as several sizeable relationships were captured from other banks in the market. Consumer loan balances, a relatively minor focus of the Company s lending efforts, were essentially unchanged.

The Bank has a large proportion of its loan portfolio related to real estate with 73% of total loans consisting of owner occupied and investment commercial real estate, real estate mortgage, residential and commercial and residential construction loans. Real estate also serves as collateral for loans made for other purposes, resulting in 79% of loans being secured by real estate.

Deposits and Other Borrowings

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

For the six months ended June 30, 2012, noninterest bearing deposits increased $85 million as compared to December 31, 2011, while interest bearing deposits increased by $37 million during the same period. Average total deposits for the six months of 2012 were $2.42 billion, as compared to $1.83 billion for the same period in 2011, a 32% increase.

From time to time, when appropriate in order to fund strong loan demand, the Bank accepts brokered time deposits, generally in denominations of less than $100 thousand, from a regional brokerage firm, and other national brokerage networks, including the Promontory Interfinancial Network, LLC. Additionally, the Bank participates in the Certificates of Deposit Account Registry Service (CDARS), which provides for reciprocal (two-way) transactions among banks facilitated by the Promontory Interfinancial Network, LLC for the purpose of maximizing FDIC insurance. These reciprocal CDARS funds are classified as brokered deposits, although bank regulators have recognized that these reciprocal deposits have many characteristics of core deposits, At June 30, 2012, total deposits included $287.6 million of brokered deposits (excluding the CDARS two-way), which represented 11% of total deposits. At December 31, 2011, total time deposits (excluding the CDARS two-way) included $263.3 million of brokered deposits, which represented 11% of total deposits The CDARS two-way component represented $103.0 million, or 4% of total deposits and $84.2 million or 4% of total deposits at June 30, 2012 and December 31, 2011, respectively. These sources

are believed by the Company to represent a reliable and cost efficient alternative funding source for the Bank.

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At June 30, 2012, the Company had $773.1 million in noninterest bearing demand deposits, representing 31% of total deposits. This compared to $688.5 million of these deposits at December 31, 2011 or 29% of total deposits. These deposits are primarily business checking accounts on which the payment of interest was prohibited by regulations of the Federal Reserve. Since July 2011, banks are no longer prohibited from paying interest on demand deposits account, including those from businesses. To date, the Bank has elected not to pay interest on business checking accounts, nor is the payment of such interest a prevalent practice in the Bank s market area at present. It is not clear over the longer-term what effect the elimination of this prohibition will have on the Bank s interest expense, allocation of deposits, deposit pricing, loan pricing, net interest margin, ability to compete, ability to establish and maintain customer relationships, or profitability. The Bank is prepared to evaluate options in this area should competition intensify for these deposits, which is not occurring at this time. Payment of interest on these deposits could have a significant negative impact on the Company s net interest income and net interest margin, net income, and the return on assets and equity, although no such effect is currently anticipated, as the payment of interest on accounts will not permit those business checking accounts above $250,000 to receive deposit insurance, a factor deemed important.

As an enhancement to the basic noninterest bearing demand deposit account, the Bank offers a sweep account, or customer repurchase agreement, allowing qualifying businesses to earn interest on short-term excess funds which are not suited for either a certificate of deposit or a money market account. The balances in these accounts were $97.7 million at June 30, 2012 compared to $103.4 million at December 31, 2011. Customer repurchase agreements are not deposits and are not insured by the FDIC, but are collateralized by U.S. government agency securities and / or U.S. agency backed mortgage backed securities. These accounts are particularly suitable to businesses with significant fluctuation in the levels of cash flows. Attorney and title company escrow accounts are an example of accounts which can benefit from this product, as are customers who may require collateral for deposits in excess of FDIC insurance limits but do not qualify for other pledging arrangements. This program requires the Bank to maintain a sufficient investment securities level to accommodate the fluctuations in balances which may occur in these accounts.

The Bank had no outstanding balances under its federal funds purchase lines of credit provided by correspondent banks at June 30, 2012 and December 31, 2011. The Bank had $40.0 million of borrowings outstanding under its credit facility from the FHLB at June 30, 2012 and December 31, 2011. Outstanding FHLB advances are secured by collateral consisting of a blanket lien on qualifying loans in the Bank s commercial mortgage and home equity loan portfolios.

The Company has a credit facility with a regional bank, secured by a portion of the stock of the Bank, pursuant to which the Company may borrow, on a revolving basis, up to $30 million for working capital purposes, to finance capital contributions to the Bank and ECV. There were no amounts outstanding under this credit at June 30, 2012 or December 31, 2011. For additional information on this credit facility please refer to Capital Resources and Adequacy below.

The Company has issued an aggregate of $9.3 million of subordinated notes, due 2016. For additional information on the subordinated notes, please refer to Capital Resources and Adequacy below.

Liquidity Management

Liquidity is a measure of the Company s and Bank s ability to meet loan demand and to satisfy depositor withdrawal requirements in an orderly manner. The Bank s primary sources of liquidity consist of cash and cash balances due from correspondent banks, loan repayments, federal funds sold and other short-term investments, maturities and sales of investment securities, income from operations and new core deposits into the Bank. The Bank s investment portfolio of debt securities is held in an available-for-sale status which allows for flexibility, subject to holdings held as collateral for customer repurchase agreements, to generate cash from sales as needed to meet ongoing loan demand. These sources of

liquidity are considered primary and are supplemented by the ability of the Company and Bank to borrow funds, which are termed secondary sources and which are substantial. The Company s secondary sources of liquidity include a $30 million line of credit with a regional bank, secured by a portion of the stock of the Bank, against which there were no amounts outstanding at June 30, 2012. Additionally, the Bank can purchase up to $87.5 million in federal funds on an unsecured basis from its correspondents, against

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which there were no amounts outstanding at June 30, 2012 and can borrow unsecured funds under one-way CDARS brokered deposits in the amount of $442.9 million, against which there was $42.6 million outstanding at June 30, 2012. The Bank has a commitment at June 30, 2012 from the Promontory Interfinancial Network to place up to $200 million of brokered deposits from its Insured Network Deposit (IND) program with the Bank in amounts requested by the Bank, as compared to an actual balance of $94.5 million at June 30, 2012. At June 30, 2012, the Bank was also eligible to make advances from the FHLB up to $375.9 million based on collateral at the FHLB, of which $40.0 million was outstanding at June 30, 2012. The Bank may enter into repurchase agreements as well as obtain additional borrowing capabilities from the FHLB provided adequate collateral exists to secure these lending relationships. The Bank also has a back-up borrowing facility through the Discount Window at the Federal Reserve Bank of Richmond (Federal Reserve Bank). This facility, which amounts to approximately $278.0 million, is collateralized with specific loan assets identified to the Federal Reserve Bank. It is anticipated, except for periodic testing, that this facility would be utilized for contingency funding only.

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

At June 30, 2012, under the Bank s liquidity formula, it had $1.34 billion of primary and secondary liquidity sources. The amount is deemed adequate to meet current and projected funding needs.

Commitments and Contractual Obligations

Loan commitments outstanding and lines and letters of credit at June 30, 2012 are as follows:

(dollars in thousands)		
Unfunded loan commitments	$	664,620
Unfunded lines of credit		70,046
Letters of credit		44,339
Total	$	779,005

Unfunded loan commitments are agreements whereby the Bank has made a commitment and the borrower has accepted the commitment to lend to a customer as long as there is no violation of the terms or conditions established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee before the commitment period is extended. In many instances, borrowers are required to meet performance milestones in order to draw on a commitment as is the case in construction loans, or to have a required level of collateral in order to draw on a commitment, as is the case in asset based lending credit facilities. Since commitments may expire without being drawn, the total commitment amount does not necessarily represent future cash requirements.

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

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

Asset/Liability Management and Quantitative and Qualitative Disclosures about Market Risk

A fundamental risk in banking is exposure to market risk, or interest rate risk, since a bank s net income is largely dependent on net interest income. The ALCO formulates and monitors the management of interest rate risk through policies and guidelines established by it and the full Board of Directors and through review of detailed reports discussed quarterly. In its consideration of risk limits, the ALCO considers the impact on earnings and capital, the level and direction of interest rates, liquidity, local economic conditions, outside threats and other factors. Banking is generally a business of managing the maturity and repricing mismatch inherent in its asset and liability cash flows and to provide net interest income growth consistent with the Company s profit objectives. During the three months ended June 30, 2012, the Company was able to both increase its net interest income and manage its overall interest rate risk position.

The Company, through its ALCO, monitors the interest rate environment in which it operates and adjusts the rates and maturities of its assets and liabilities to remain competitive and to achieve its overall financial objectives subject to established risk limits. In the current and expected future interest rate environment, the Company has been maintaining its investment portfolio to manage the balance between yield and prepayment risk in its portfolio of mortgage backed securities should rates remain at current levels and has been managing the investment portfolio to mitigate extension risk in that same portfolio should rates increase. In the second quarter of 2012, the investment portfolio balance was essentially maintained by reinvesting cash flows from maturing mortgaged backed securities into a combination of pass-thru and structured mortgaged backed securities and high quality Municipal securities. The duration of the investment portfolio increased to 3.5 years at June 30, 2012 from 3.4 years at December 31, 2011, due substantially to a higher mix of Municipal securities. In the loan portfolio, the re-pricing duration of the portfolio was 25 months at June 30, 2012, as compared to 24 months at December 31, 2011, with fixed rate loans amounting to 43% of total loans at June 30, 2012 (40% at December 31, 2011 and 38% at June 30, 2011) and variable and adjustable rate loans at 57% of total loans at June 30, 2012 (60% at December 31, 2011 and 62% at June 30, 2011). Variable rate loans are indexed primarily to the Wall Street Journal prime interest rate, while adjustable rate loans are indexed primarily to the five year U.S. Treasury interest rate. In the deposit portfolio, since December 31, 2011, the duration of the portfolio has increased slightly to 37 months at June 30, 2012, as compared to 36 months at December 31, 2011 and 33 months at June 30, 2011. The change since December 31, 2011 was due substantially to a higher mix of noninterest bearing and money market accounts, as compared to shorter duration time deposits. The growth of core deposits, which enhance franchise value and provide a stable funding source, has been a major objective which has been met by the Company, adding liquidity and enhanced asset sensitivity to the balance sheet at June 30, 2012 as compared to June 30, 2011.

The Company has continued its emphasis on funding loans in its marketplace, and has been able to achieve favorable loan pricing, including interest rate floors on many loan originations, although competition for new loans has been increasing. A disciplined approach to loan pricing, together with loans floors existing in 48% of total loans, has resulted in less pressure on loan yields over the past twelve months, as average loan yields have declined by just 14 basis points in the second quarter of 2012 as compared to the second quarter in 2011. Subject to floor interest rates, variable and adjustable rate loans provide additional income opportunities should interest rates rise from current levels.

The net unrealized gain before tax on the investment portfolio increased to $9.0 million at June 30, 2012 from $8.1 million at December 31, 2011, with $148 thousand of realized gains recorded for the quarter ended June

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30, 2012. Gains were realized during the second quarter of 2012 to mitigate prepayment risk in pass-through mortgage back securities.

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

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

For the analysis presented below, at June 30, 2012, the simulation assumes a 50 basis point change in interest rates on money market and interest bearing transaction deposits for each 100 basis point change in market interest rates in a decreasing interest rate shock scenario with a floor of 10 basis points, and assumes a 70 basis point change in interest rates on money market and interest bearing transaction deposits for each 100 basis point change in market interest rates in an increasing interest rate shock scenario.

As quantified in the table below, the Company s analysis at June 30, 2012 shows a moderate effect on net interest income (over the next 12 months) as well as to the economic value of equity when interest rates are shocked both down 100, and 200 basis points and up 100, 200, 300, and 400 basis points due substantially to the significant level of variable rate and repriceable assets and liabilities. The repricing duration of the investment portfolio at June 30, 2012 is 3.5 years, the loan portfolio 2.1 years, the interest bearing deposit portfolio 3.1 years and the borrowed funds portfolio 1.2 years.

The following table reflects the result of simulation analysis on the June 30, 2012 asset and liabilities balances:

Change in interest rates (basis points)	Percentage change in net interest income	Percentage change in net income	Percentage change in market value of portfolio equity
+400	+5.5%	+13.3%	-3.6%
+300	+2.7%	+6.6%	-3.5%
+200	+0.1%	+0.2%	-3.2%
+100	-1.0%	-2.5%	-2.1%
0			
-100	-0.3%	-0.8%	-7.8%
-200	-0.8%	-2.0%	-10.0%

The results of simulation are within the policy limits adopted by the Company. For net interest income, the Company has adopted a policy limit of 10% for a 100 basis point change, 12% for a 200 basis point change, 18% for a 300 basis point change and 24% for a 400 basis point change. For the market value of equity, the Company has adopted a policy limit of 12% for a 100 basis point change, 15% for a 200 basis point change,

20% for a 300 basis point change and 25% for a 400% basis point change. The changes in net interest income, net income and the economic value of equity in both a higher and lower interest rate shock scenario at June 30, 2012 are not considered to be material. The negative impact of -1.0% in net interest income and -2.5% in net income given a 100 basis point increase in market interest rates reflects in large measure the impact of floor interest rates in a substantial portion of the loan portfolio.

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In the second quarter of 2012, the Company continued to manage its interest rate sensitivity position to moderate levels of risk, as indicated in the simulation results above. Except for the lower level of asset liquidity at June 30, 2012, the risk position at the end of the second quarter was similar to the interest rate risk position at December 31, 2011. As compared to December 31, 2011, the sum of federal funds sold, interest bearing deposits with banks and other short-term investments and loans held for sale declined by $159 million at June 30, 2012.

Generally speaking, the loss of economic value of portfolio equity in a lower interest rate environment is due to lower values of core deposits more than offsetting the gains in loan and investment values; while the gain of economic value of portfolio equity in a higher interest rate environment is due to higher value of core deposits more than offsetting lower values of fixed rate loans and investments. The Company believes its balance sheet is well positioned in the current interest rate environment.

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

For the second quarter of 2012, average market interest rates declined sharply as compared to the second quarter of 2011 and the yield curve flattened. The average two year U.S. Treasury rate declined by 28 basis points and the average ten year U.S. Treasury rate declined by 139 basis points. In that environment, the Company s net interest spread increased by 13 basis points for the three months ended June 30, 2012 as compared to the three months ended June 30, 2011. The Company believes that the change in the net interest spread for the three months ended June 30, 2012 as compared to the second quarter of 2011 has been consistent with its quarterly risk analysis at December 31, 2011.

GAP Position

Banks and other financial institutions earnings are significantly dependent upon net interest income, which is the difference between interest earned on earning assets and interest expense on interest bearing liabilities. This revenue represented 87% of the Company s revenue for the second quarter of 2012, as compared to 88% of the Company s revenue for the second quarter of 2011.

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

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

At June 30, 2012, the Company had a positive GAP position of approximately $351 million or 11.8% of total assets out to three months and a positive cumulative GAP position of $338 million or 11.4% of total assets out to 12 months; as compared to a positive GAP position of approximately $434 million or 15.3% of total assets out to three months and a positive cumulative GAP position of approximately $407 million or 14.4% out to 12 months at December 31, 2011. The change in the positive GAP position at June 30, 2012, as compared to December 2011, was due substantially to the lower amount of asset liquidity on the balance sheet. The change in the GAP position at June 30, 2012 as compared to December 31, 2011 is not judged material to the Company s overall interest rate risk

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position, which relies more heavily on simulation analysis which captures the full optimality within the balance sheet. The current position is within guideline limits established by the ALCO.

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

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

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

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

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

GAP Analysis

June 30, 2012

(dollars in thousands)

Repriceable in:	0-3 months	4-12 months	13-36 months	37-60 months	Over 60 months	Total Rate Sensitive	Non-sensitive	Total Assets
RATE SENSITIVE ASSETS:								
Investment securities	$ 26,696	$ 36,914	$ 95,108	$ 87,460	$ 103,705	$ 349,883		
Loans (1)(2)	1,268,050	223,994	473,837	308,507	147,616	2,422,004		
Fed funds and other short-term investments	142,493					142,493		
Other earning assets	13,936					13,936		
Total	$ 1,451,175	$ 260,908	$ 568,945	$ 395,967	$ 251,321	$ 2,928,316	$ 34,581	$ 2,962,897
RATE SENSITIVE LIABILITIES:								

Noninterest bearing demand	$ 20,656	$ 61,968	$ 165,246	$ 165,246	$ 360,003	$ 773,119		
Interest bearing transaction	67,079		14,374	14,374		95,827		
Savings and money market	838,582		179,696	179,696		1,197,974		
Time deposits	76,219	211,622	149,462	9,788		447,091		
Customer repurchase agreements and fed funds purchased	97,704					97,704		
Other borrowings			20,000	19,300	10,000	49,300		
Total	$ 1,100,240	$ 273,590	$ 528,778	$ 388,404	$ 370,003	$ 2,661,015	$ 11,612	$ 2,672,627
GAP	$ 350,935	$ (12,682)	$ 40,167	$ 7,563	$ (118,682)	$ 267,301		
Cumulative GAP	$ 350,935	$ 338,253	$ 378,420	$ 385,983	$ 267,301			
Cumulative gap as percent of total assets	11.84%	11.42%	12.77%	13.03%	9.02%			

(1) Includes loans held for sale.

(2) Non-accrual loans are included in the over 60 months category.

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

Capital Resources and Adequacy

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

The federal banking regulators have issued guidance for those institutions which are deemed to have concentrations in commercial real estate lending. Pursuant to the supervisory criteria contained in the guidance for identifying institutions with a potential commercial real estate concentration risk, institutions which have (1) total reported loans for construction, land development, and other land acquisitions which represent 100% or more of an institution s total risk-based capital; or (2) total commercial real estate loans representing 300% or more of the institution s total risk-based capital and the institution s commercial real estate loan portfolio has increased 50% or more during the prior 36 months are identified as having potential commercial real estate concentration risk. Institutions which are deemed to have concentrations in commercial real estate lending are expected to employ heightened levels of risk management with respect to their commercial real estate portfolios, and may be required to hold higher levels of capital. The Company, like many community banks, has a concentration in commercial real estate loans, and the Company has experienced significant growth in its commercial real estate portfolio in recent years. Commercial real estate loans and construction, land and land development loans represent 426% and 148%, respectively of total risk based capital. Management has extensive experience in commercial real estate lending, and has implemented and continues to maintain heightened risk management procedures, and strong underwriting criteria with respect to its commercial real estate portfolio. Nevertheless, we may be required to maintain higher levels of capital as a result of our commercial real estate concentration, which could require us to obtain additional capital, and may adversely affect shareholder returns.

The Company has a credit facility with a regional bank, pursuant to which the Company may borrow, on a revolving basis, up to $30 million for working capital purposes, to finance capital contributions to the Bank and ECV. The credit facility is secured by a first lien on a portion of the stock of the Bank, and bears interest at a floating rate equal to the Wall Street Journal Prime Rate minus 0.25% with a floor interest rate of 4.25%. Interest is payable on a monthly basis. The term of the credit facility expires on August 31, 2012, and is expected to be renewed for another one year period. There were no amounts outstanding under this credit at June 30, 2012 and December 31, 2011.

On July 14, 2011, the Company entered into and consummated a Securities Purchase Agreement (the Purchase Agreement) with the Secretary of the Treasury of the United States (the Secretary) under the Small Business Lending Fund program. Pursuant to the Purchase Agreement, the Company issued 56,600 shares of the Company s Senior Non-Cumulative Perpetual Preferred Stock, Series B (the Series B Preferred Stock), having a liquidation amount per share equal to $1,000, for a total purchase price of $56,600,000.

The Series B Preferred Stock is entitled to receive non-cumulative dividends, beginning October 1, 2011. The dividend rate, as a percentage of the liquidation amount, can fluctuate on a quarterly basis during the first ten quarters during which the Series B Preferred Stock is outstanding, based upon changes in the level of Qualified Small Business Lending or QSBL (as defined in the Purchase Agreement) by the Bank. The dividend rate for the first four dividend periods was one percent (1%). For the fifth through ninth calendar quarters, the dividend rate may be

adjusted to between one percent (1%) and five percent (5%) per annum, to reflect the amount of change if any, in the Bank s level of QSBL. If the level of the Bank s qualified small business loans declines so that the percentage increase in QSBL as compared to the baseline level is less than ten percent (10%), then the dividend rate payable on the Series B Preferred Stock would increase. For the tenth calendar quarter through four and one half years after issuance, the dividend rate will be fixed at between one percent (1%) and seven percent (7%) based upon the increase in QBSL as compared to the baseline. After four and one half years from issuance, the dividend rate will increase to nine percent (9%).

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The Series B Preferred Stock may be redeemed at any time at the Company s option, at a redemption price of 100% of the liquidation amount plus accrued but unpaid dividends to the date of redemption for the current period, subject to the approval of its federal banking regulator.

The Company has issued an aggregate of $9.3 million of subordinated notes, which bear interest at a fixed rate of 10.0% per year. The notes have a maturity of September 30, 2016 and are redeemable at the option of the Company, in whole or in part, on any interest payment date at the principal amount thereof, plus interest to the date of redemption. The notes are intended to qualify as Tier 2 capital for regulatory purposes to the fullest extent permitted. The payment of principal on the notes may only be accelerated upon the occurrence of certain bankruptcy or receivership related events relating to the Company or, to the extent permitted under capital rules to be adopted by the Federal Reserve Board pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, a major bank subsidiary of the Company.

Under current capital rules, the capital treatment of the notes must be phased out, at a rate of 20% of the original principal amount per year during the last five years of the term of the notes, commencing on October 1, 2011.

The actual capital amounts and ratios for the Company and Bank as of June 30, 2012, December 31, 2011 and June 30, 2011 are presented in the table below.

(dollars in thousands)	Company Actual Amount	Company Ratio	Bank Actual Amount	Bank Ratio	For Capital Adequacy Purposes Ratio	To Be Well Capitalized Under Prompt Corrective Action Provision Ratio *
As of June 30, 2012						
Total capital (to risk weighted assets)	$ 319,538	11.53%	$ 305,319	11.07%	8.0%	10.0%
Tier 1 capital (to risk weighted assets)	277,880	10.02%	271,183	9.83%	4.0%	6.0%
Tier 1 capital (to average assets)	277,880	9.63%	271,183	9.46%	3.0%	5.0%
As of December 31, 2011						
Total capital (to risk weighted assets)	$ 292,137	11.84%	$ 273,383	11.13%	8.0%	10.0%
Tier 1 capital (to risk weighted assets)	254,850	10.33%	243,553	9.92%	4.0%	6.0%
Tier 1 capital (to average assets)	254,850	8.21%	243,553	7.88%	3.0%	5.0%
As of June 30, 2011						
Total capital (to risk weighted assets)	$ 241,881	11.33%	$ 220,615	10.40%	8.0%	10.0%
Tier 1 capital (to risk weighted assets)	205,882	9.64%	194,094	9.15%	4.0%	6.0%
Tier 1 capital (to average assets)	205,882	9.07%	194,094	8.60%	3.0%	5.0%

* Applies to Bank only

Bank and holding company regulations, as well as Maryland law, impose certain restrictions on dividend payments by the Bank, as well as restricting extensions of credit and transfers of assets between the Bank and the Company. At June 30, 2012 the Bank could pay dividends to the parent to the extent of its earnings so long as it maintained required capital ratios.

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Item 3. Quantitative and Qualitative Disclosures about Market Risk

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

Item 4. Controls and Procedures

The Company s management, under the supervision and with the participation of the Company s Chief Executive Officer and Chief Financial Officer, evaluated as of the last day of the period covered by this report the effectiveness of the operation of the Company s disclosure controls and procedures, as defined in Rule 13a-14 under the Securities and Exchange Act of 1934. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company s disclosure controls and procedures were effective.

PART II - OTHER INFORMATION

Item 1 - Legal Proceedings

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

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

(a) *Sales of Unregistered Securities.*	None
(b) *Use of Proceeds.*	Not Applicable
(c) *Issuer Purchases of Securities.*	None
Item 3 - Defaults Upon Senior Securities	None
Item 4 - Mine Safety Disclosures	Not Applicable
Item 5 - Other Information	
(a) Required 8-K Disclosures	None
(b) *Changes in Procedures for Director Nominations*	None

Item 6 - Exhibits

Exhibit No.	Description of Exhibit
3.1	Certificate of Incorporation of the Company, as amended (1)
3.2	Articles Supplementary to the Articles of Incorporation for the Series B Preferred Stock (2)
3.3	Bylaws of the Company (3)
4.1	Warrant to Purchase Common Stock (4)
4.2	Form of Subordinated Note due 2016(5)
10.1	1998 Stock Option Plan (6)
10.2	Employment Agreement, dated September 1, 2011, between James H. Langmead and the Bank (7)

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10.3	Employment Agreement, dated September 1, 2011, between Thomas D. Murphy and the Bank (8)
10.4	Amended and Restated Employment Agreement between Ronald D. Paul and the Company (9)
10.5	Employment Agreement, dated September 1, 2011, between Susan G. Riel and the Bank (10)
10.6	Fee Agreement between Robert P. Pincus and the Company (11)
10.7	2006 Stock Plan (12)
10.8	Employment Agreement, dated September 1, 2011, among Michael T. Flynn the Company and the Bank (13)
10.9	Employment Agreement, dated September 1, 2011, between Laurence E. Bensignor and the Bank (14)
10.10	Employment Agreement, dated September 1, 2011, between the Bank and Janice Williams (15)
10.11	2012 Senior Executive Incentive Plan (16)
10.12	Eagle Bancorp, Inc. 2011 Employee Stock Purchase Plan (17)
10.13	Employment Agreement dated as of February 23, 2012, between the Bank and Antonio F. Marquez (18)
11	Statement Regarding Computation of Per Share Income See Note 5 of the Notes to Consolidated Financial Statements
21	Subsidiaries of the Registrant
31.1	Certification of Ronald D. Paul
31.2	Certification of James H. Langmead
32.1	Certification of Ronald D. Paul
32.2	Certification of James H. Langmead
101	Interactive data files pursuant to Rule 405 of Regulation S-T:

(i)	the Consolidated Statement of Financial Position at June 30, 2012, December 31, 2011and June 30, 2011
(ii)	the Consolidated Statement of Earnings for three month periods ended June 30, 2012 and 2011
(iii)	the Consolidated Statement of Comprehensive Income for three month periods ended June 30, 2012 and 2011
(iv)	the Consolidated Statement of Changes in Shareholders Equity for the three month periods ended June 30, 2012 and 2011
(v)	the Consolidated Statement of Cash Flows for the three months ended June 30, 2012 and 2011
(vi)	the Notes to the Consolidated Financial Statements

(1) Incorporated by reference to the exhibit of the same number to the Company s Current Report on Form 8-K filed on July 16, 2008.
(2) Incorporated by reference to Exhibit 3.1 to the Company s Current Report on Form 8-K filed on July 15, 2011.
(3) Incorporated by reference to Exhibit 3.2 to the Company s Current Report on Form 8-K filed on October 30, 2007.
(4) Incorporated by reference to Exhibit 4.1 to the Company s Current Report on Form 8-K filed on December 8, 2008.
(5) Incorporated by reference to Exhibit 10.1 to the Company s Current Report on Form 8-K filed on September 1, 2010.
(6) Incorporated by reference to Exhibit 10.1 to the Company s Annual Report on Form 10-KSB for the year ended December 31, 1998.
(7) Incorporated by reference to Exhibit 10.1 to the Company s Current Report on Form 8-K filed on December 23, 2011.
(8) Incorporated by reference to Exhibit 10.2 to the Company s Current Report on Form 8-K filed on December 23, 2011.
(9) Incorporated by reference to Exhibit 10.2 to the Company s Current Report on Form 8-K/A filed on December 22, 2008.
(10) Incorporated by reference to Exhibit 10.3 to the Company s Current Report on Form 8-K filed on December 23, 2011.
(11) Incorporated by reference to Exhibit 10.3 to the Company s Registration Statement on Form S-4 (Registration No. 333-150763)
(12) Incorporated by reference to Exhibit 4 to the Company s Registration Statement on Form S-8 (No. 333-135072)
(13) Incorporated by reference to Exhibit 10.6 to the Company s Current Report on Form 8-K filed on December 23, 2011
(14) Incorporated by reference to Exhibit 10.5 to the Company s Current Report on Form 8-K filed on December 23, 2011.
(15) Incorporated by reference to Exhibit 10.4 to the Company s Current Report on Form 8-K filed on December 23, 2011.
(16) Incorporated by reference to Exhibit 10.2 to the Company s Current Report on Form 8-K filed on December 23, 2011.
(17) Incorporated by reference to Exhibit 4 to the Company s Registration Statement on Form S-8 (Registration No. 333-175966).
(18) Incorporated by reference to Exhibit 10.13 to the Company s Quarterly Report on Form 10-Q for the Quarter ended March 31, 2012.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

EAGLE BANCORP, INC.

Date: August 7, 2012	By:	/s/ Ronald D. Paul Ronald D. Paul, Chairman, President and Chief Executive Officer of the Company
Date: August 7, 2012	By:	/s/ James H. Langmead James H. Langmead, Executive Vice President and Chief Financial Officer of the Company