GREEN BANKSHARES, INC.
Form 10-Q
November 06, 2008

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## UNITED STATES <br> SECURITIES AND EXCHANGE COMMISSION <br> Washington, D.C. 20549 <br> FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2008

## OR

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

## For the transition period from

$\qquad$ to $\qquad$
Commission file number 0-14289
GREEN BANKSHARES, INC.
(Exact name of registrant as specified in its charter)

Tennessee
(State or other jurisdiction of incorporation or organization)

100 North Main Street, Greeneville, Tennessee
(Address of principal executive offices)
Registrant s telephone number, including area code: (423) 639-5111
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 p NO o Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer p Non-accelerated filer o Smaller reporting company o (Do not check if a smaller reporting company)
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.) YES o NO p
As of November 06, 2008, the number of shares outstanding of the issuer s common stock was: 12,992,681.

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## PART I FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

The unaudited condensed consolidated financial statements of Green Bankshares, Inc. and its wholly owned subsidiaries are as follows:
Condensed Consolidated Balance Sheets September 30, 2008 and December 31, 2007.
Condensed Consolidated Statements of Income and Comprehensive Income For the three and nine months ended September 30, 2008 and 2007.
Condensed Consolidated Statement of Changes in Shareholders Equity For the nine months ended September 30, 2008.

Condensed Consolidated Statements of Cash Flows For the nine months ended September 30, 2008 and 2007. Notes to Condensed Consolidated Financial Statements.

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## GREEN BANKSHARES, INC. <br> CONDENSED CONSOLIDATED BALANCE SHEETS

September 30, 2008 and December 31, 2007
(Amounts in thousands, except share and per share data)

| September 30, | December 31, |
| :---: | :---: |
| 2008 | $2007 *$ |
| (Unaudited) |  |


| ASSETS |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
| Cash and due from banks | \$ | 46,168 | \$ | 65,717 |
| Federal funds sold |  | 56,751 |  |  |
| Securities available for sale |  | 292,897 |  | 235,273 |
| Securities held to maturity (with a market value of \$700 and \$1,280) |  | 757 |  | 1,303 |
| FHLB and other stock, at cost |  | 13,203 |  | 12,322 |
| Loans held for sale |  | 1,824 |  | 2,331 |
| Loans, net of unearned income |  | 2,323,076 |  | 2,356,376 |
| Allowance for loan losses |  | $(34,856)$ |  | $(34,111)$ |
| Other real estate owned and repossessed assets |  | 12,215 |  | 4,859 |
| Premises and equipment, net |  | 83,569 |  | 82,697 |
| Goodwill and other intangible assets |  | 156,117 |  | 157,827 |
| Other assets |  | 60,320 |  | 63,147 |
| Total assets | \$ | 3,012,041 | \$ | 2,947,741 |
| LIABILITIES AND SHAREHOLDERS EQUITY |  |  |  |  |
| Liabilities |  |  |  |  |
| Deposits | \$ | 2,276,198 | \$ | 1,986,793 |
| Federal funds purchased |  | 413 |  | 87,787 |
| Repurchase agreements |  | 64,929 |  | 106,738 |
| FHLB advances and notes payable |  | 229,906 |  | 318,690 |
| Subordinated debentures |  | 88,662 |  | 88,662 |
| Accrued interest payable and other liabilities |  | 25,451 |  | 36,594 |
| Total liabilities |  | 2,685,559 |  | 2,625,264 |
| Shareholders equity |  |  |  |  |
| Common stock: \$2 par, 20,000,000 shares authorized, 12,999,161 and |  |  |  |  |
| 12,931,015 shares outstanding |  | 25,998 |  | 25,862 |
| Additional paid-in capital |  | 185,631 |  | 185,170 |
| Retained earnings |  | 114,742 |  | 109,938 |
| Accumulated other comprehensive income |  | 111 |  | 1,507 |
| Total shareholders equity |  | 326,482 |  | 322,477 |
| Total liabilities and shareholders equity | \$ | 3,012,041 | \$ | 2,947,741 |

* This condensed consolidated balance sheet has been derived from the audited consolidated balance sheet, as filed in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2007.

See notes to condensed consolidated financial statements.

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## GREEN BANKSHARES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME Three and Nine Months Ended September 30, 2008 and 2007 (Amounts in thousands, except share and per share data)

| Three Months Ended | Nine Months Ended |
| :---: | :---: | :---: |
| September 30, | September 30, |
| 2007 | 2008 2007 |

Interest income

| Interest and fees on loans | $\$$ | 38,497 | $\$$ | 48,630 | $\$$ | 120,653 | $\$$ |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| Investment securities |  | 120,226 |  |  |  |  |  |
| Federal funds sold and other |  | 87 | 3,642 | 10,604 | 6,440 |  |  |
|  |  | 22 | 112 | 49 |  |  |  |
|  |  | 42,566 | 52,294 | 131,369 | 126,715 |  |  |

## Interest expense

Deposits

14,345 17,812
43,657
43,977
Borrowings
3,837
7,189
13,812
13,691
$\begin{array}{llll}18,182 & 25,001 & 57,469 & 57,668\end{array}$

Net interest income
24,384
27,293
73,900
69,047
Provision for loan losses
8,620
1,444
20,527
3,677

Net interest income after provision for loan losses

25,849
53,373
65,370

Noninterest income
Service charges and fees
Other

| 6,711 | 6,418 | 19,725 | 16,102 |
| ---: | ---: | ---: | ---: |
| 1,299 | 1,270 | 3,703 | 3,468 |
| 8,010 | 7,688 | 23,428 | 19,570 |

Noninterest expense

| Salaries and employee benefits | 10,157 | 9,753 | 29,261 | 25,683 |
| :--- | ---: | ---: | ---: | ---: |
| Occupancy and furniture and equipment expense | 3,180 | 2,852 | 9,743 | 7,574 |
| Other | 8,607 | 6,405 | 22,641 | 16,504 |
|  |  |  |  |  |
|  | 21,944 | 19,010 | 61,645 | 49,761 |


| Income before income taxes |  | 1,830 |  | 14,527 |  | 15,156 |  | 35,179 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Provision for income taxes |  | 596 |  | 5,613 |  | 5,282 |  | 13,563 |
| Net income | \$ | 1,234 | \$ | 8,914 | \$ | 9,874 | \$ | 21,616 |
| Comprehensive income | \$ | 1,547 | \$ | 11,167 | \$ | 8,478 | \$ | 21,181 |
| Per share of common stock: |  |  |  |  |  |  |  |  |
| Basic earnings | \$ | 0.10 | \$ | 0.69 | \$ | 0.76 | \$ | 1.90 |
| Diluted earnings |  | 0.10 |  | 0.69 |  | 0.76 |  | 1.89 |
| Dividends |  | 0.13 |  | 0.13 |  | 0.39 |  | 0.39 |
| Weighted average shares outstanding: |  |  |  |  |  |  |  |  |
| Basic |  | 31,774 |  | 12,921,240 |  | 31,538 |  | 62,422 |
| Diluted |  | 47,618 |  | 13,008,733 |  | 36,084 |  | 55,389 |

See notes to condensed consolidated financial statements.

# GREEN BANKSHARES, INC. <br> CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY 

For the Nine Months Ended September 30, 2008
(Amounts in thousands, except share and per share data)

|  | Common Stock |  | Additional Paid-in |  | Retained | Accumulated Other Comprehensive Income (loss) |  | Total <br> Shareholders |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Shares | Amount |  | Capital (Una | Earnings udited) |  |  |  | Equity |
| Balance, December 31, 2007 | 12,931,015 | \$ 25,862 | \$ | 185,170 | \$ 109,938 | \$ | 1,507 | \$ | 322,477 |
| Common stock transactions: |  |  |  |  |  |  |  |  |  |
| Exercise of shares under stock option plan | 759 | 2 |  | 12 |  |  |  |  | 14 |
| Issuance of restricted common shares | 67,387 | 134 |  | (134) |  |  |  |  |  |
| Compensation expense: |  |  |  |  |  |  |  |  |  |
| Stock options |  |  |  | 342 |  |  |  |  | 342 |
| Restricted stock |  |  |  | 241 |  |  |  |  | 241 |
| Dividends paid (\$.39 per share) |  |  |  |  | $(5,070)$ |  |  |  | $(5,070)$ |
| Comprehensive income: |  |  |  |  |  |  |  |  |  |
| Net income |  |  |  |  | 9,874 |  |  |  | 9,874 |
| Change in unrealized gains (losses), net of reclassification |  |  |  |  |  |  |  |  |  |
| and taxes |  |  |  |  |  |  | $(1,396)$ |  | $(1,396)$ |
| Total comprehensive income |  |  |  |  |  |  |  |  | 8,478 |
| Balance, September 30, 2008 | 12,999,161 | \$ 25,998 | \$ | 185,631 | \$ 114,742 | \$ | 111 | \$ | 326,482 |

See notes to condensed consolidated financial statements.

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See notes to condensed consolidated financial statements.

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# GREEN BANKSHARES, INC. <br> NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS 

 September 30, 2008Unaudited
(Amounts in thousands, except share and per share data)

## NOTE 1 PRINCIPLES OF CONSOLIDATION

The accompanying unaudited condensed consolidated financial statements of Green Bankshares, Inc. (the Company ) and its wholly owned subsidiary, GreenBank (the Bank ), have been prepared in accordance with accounting principles generally accepted in the United States of America for interim information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X as promulgated by the Securities and Exchange Commission ( SEC ). Accordingly, they do not include all the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine months ended September 30, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008. For further information, refer to the consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2007. Certain amounts from prior period financial statements have been reclassified to conform to the current year s presentation.

## NOTE 2 LOANS

Loans at September 30, 2008 and December 31, 2007 were as follows:

|  | September 30, <br> $\mathbf{2 0 0 8}$ | December 31, <br> $\mathbf{2 0 0 7}$ |  |  |
| :--- | ---: | ---: | ---: | ---: |
|  |  |  |  |  |
| Commercial real estate | $\$$ | $1,525,742$ | $\$$ | $1,549,457$ |
| Residential real estate | 391,550 | 398,779 |  |  |
| Commercial | 319,087 | 320,264 |  |  |
| Consumer | 91,866 | 97,635 |  |  |
| Other | 9,237 | 3,871 |  |  |
| Unearned income |  | $(14,406)$ | $(13,630)$ |  |
| Loans, net of unearned income | $\$$ | $2,323,076$ | $\$$ | $2,356,376$ |
|  |  |  |  |  |
| Allowance for loan losses | $\$$ | $(34,856)$ | $\$$ | $(34,111)$ |

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# GREEN BANKSHARES, INC. <br> NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS 

September 30, 2008
Unaudited
(Amounts in thousands, except share and per share data)
NOTE 2 LOANS (Continued)
Transactions in the allowance for loan losses and certain information about nonaccrual loans and loans 90 days past due but still accruing interest for the nine months ended September 30, 2008 and twelve months ended December 31, 2007 were as follows:

|  | September 30, <br> 2008 | December 31, <br> 2007 |  |  |
| :--- | :---: | :---: | :---: | :---: |
| Balance at beginning of year | $\$$ | 34,111 | $\$$ | 22,302 |
| Add (deduct): |  |  |  | 9,022 |
| Reserve of acquired bank |  | 20,527 | 14,483 |  |
| Provision for loan losses |  | $(22,380)$ | $(13,471)$ |  |
| Loans charged off | 2,598 | 1,775 |  |  |
| Recoveries of loans charged off | $\$$ | 34,856 | $\$$ | 34,111 |

September 30, December 31, 2008

2007
Impaired loans were as follows:

| Loans with no allowance allocated | $\$$ | 41,008 | $\$$ |  |
| :--- | ---: | ---: | ---: | ---: |
| Loans with allowance allocated |  | 16,458 | 36,267 |  |
| Amount of allowance allocated |  | 3,161 | 5,440 |  |

Nonperforming loans were as follows:

| Loans past due 90 days still on accrual | $\$$ | 54 | $\$$ | 18 |
| :--- | ---: | ---: | ---: | ---: |
| Nonaccrual loans |  | 40,687 |  | 32,060 |
| Total | $\$$ | 40,741 | $\$$ | 32,078 |

(Continued)

# GREEN BANKSHARES, INC. <br> NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS 

September 30, 2008
Unaudited
(Amounts in thousands, except share and per share data)

## NOTE 3 EARNINGS PER SHARE OF COMMON STOCK

Basic earnings per share (EPS) of common stock is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share of common stock is computed by dividing net income by the weighted average number of common shares and potential common shares outstanding during the period. Stock options and restricted common shares are regarded as potential common shares. Potential common shares are computed using the treasury stock method. For the three and nine months ended September 30, 2008, 371,205 options are excluded from the effect of dilutive securities because they are anti-dilutive; 44,910 options are similarly excluded from the effect of dilutive securities for the three and nine months ended September 30, 2007. The following is a reconciliation of the numerators and denominators used in the basic and diluted earnings per share computations for the three and nine months ended September 30, 2008 and 2007:

|  | Three Months Ended September 30, |  |  |  |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Income <br> (Numerator) | 2008 | Shares <br> (Denominator) | Income <br> (Numerator) | Shares <br> (Denominator) |  |
| Basic EPS |  |  |  |  |  |  |
| Income available to common shareholders | $\$$ | 1,234 | $12,931,774$ | $\$$ | 8,914 | $12,921,240$ |
| Effect of dilutive shares |  |  | 15,844 |  |  | 87,493 |

## Diluted EPS

Income available to common shareholders plus assumed conversions
$\begin{array}{lllll}\$ & 1,234 & 12,947,618 & \$ & 8,914\end{array} 13,008,733$

## Nine Months Ended September 30, <br> 2008 <br> 2007

|  | Income <br> (Numerator) | Shares <br> (Denominator) | Income <br> (Numerator) | Shares <br> (Denominator) |  |  |
| :--- | :---: | ---: | ---: | ---: | ---: | ---: |
| Basic EPS <br> Income available to common shareholders | $\$$ | 9,874 | $12,931,538$ | $\$$ | 21,616 | $11,362,422$ |
| Effect of dilutive shares |  | 4,546 |  | 92,967 |  |  |
| Diluted EPS |  |  |  |  |  |  |
| Income available to common shareholders <br> plus assumed conversions | $\$ \quad 9,874$ | $12,936,084$ | $\$$ | 21,616 | $11,455,389$ |  |
|  |  |  |  |  |  |  |

# GREEN BANKSHARES, INC. <br> NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS 

September 30, 2008
Unaudited
(Amounts in thousands, except share and per share data)

## NOTE 4 SEGMENT INFORMATION

The Company s operating segments include banking, mortgage banking, consumer finance, automobile lending and title insurance. The reportable segments are determined by the products and services offered, and internal reporting. Loans, investments and service charges and fees on deposits provide the revenues in the banking operation; loans and fees provide the revenues in consumer finance and mortgage banking and insurance commissions provide revenues for the title insurance company. Consumer finance, automobile lending and title insurance do not meet the quantitative threshold on an individual basis, and are therefore shown below in Other Segments . Mortgage banking operations are included in Bank. All operations are domestic.
Segment performance is evaluated using net interest income and noninterest income. Income taxes are allocated based on income before income taxes, and indirect expenses (including management fees) are allocated based on time spent for each segment. Transactions among segments are made at fair value. Information reported internally for performance assessment follows.

| Three months ended September 30, 2008 | Bank |  | Other Segments |  | Holding <br> Company |  | Eliminations |  | Totals |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Net interest income (expense) | \$ | 23,499 | \$ | 1,935 | \$ | $(1,050)$ | \$ |  | \$ | 24,384 |
| Provision for loan losses |  | 7,636 |  | 984 |  |  |  |  |  | 8,620 |
| Noninterest income |  | 7,711 |  | 485 |  | 32 |  | (218) |  | 8,010 |
| Noninterest expense |  | 20,347 |  | 1,289 |  | 526 |  | (218) |  | 21,944 |
| Income tax expense (benefit) |  | 1,002 |  | 57 |  | (463) |  |  |  | 596 |
| Segment profit (loss) | \$ | 2,225 | \$ | 90 | \$ | $(1,081)$ | \$ |  | \$ | 1,234 |
| Segment assets at September 30, 2008 |  | ,963,181 | \$ | 39,106 | \$ | 9,754 | \$ |  |  | ,012,041 |


| Three months ended September 30, 2007 | Bank |  | Other Segments |  | Holding <br> Company |  | Eliminations |  | Totals |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Net interest income (expense) | \$ | 27,454 | \$ | 1,710 | \$ | $(1,871)$ |  | \$ | \$ | 27,293 |
| Provision for loan losses |  | 961 |  | 483 |  |  |  |  |  | 1,444 |
| Noninterest income |  | 7,311 |  | 624 |  | 56 |  | (303) |  | 7,688 |
| Noninterest expense |  | 17,836 |  | 1,239 |  | 238 |  | (303) |  | 19,010 |
| Income tax expense (benefit) |  | 6,154 |  | 241 |  | (782) |  |  |  | 5,613 |
| Segment profit (loss) | \$ | 9,814 | \$ | 371 | \$ | $(1,271)$ |  | \$ | \$ | 8,914 |
| Segment assets at September 30, 2007 |  | 2,905,571 | \$ | 37,517 | \$ | 12,659 |  | \$ |  | 2,955,747 |
| Nine months ended September 30, |  | Bank |  | her ments |  | lding mpany |  | Eliminations |  | Totals |
| Net interest income (expense) | \$ | 71,647 | \$ | 5,743 |  | $(3,490)$ |  | \$ | \$ | 73,900 |


| 20,527 |  |  |  |  |  |  |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: |
| Provision for loan losses | 18,552 | 1,975 |  |  | (645) | 23,428 |
| Noninterest income | 22,315 | 1,549 | 209 |  | $(645)$ | 61,645 |
| Noninterest expense | 56,906 | 3,838 | 1,546 |  | 5,282 |  |
| Income tax expense (benefit) | 6,448 | 579 | $(1,745)$ |  |  |  |
|  |  |  |  |  |  |  |
| Segment profit (loss) | $\$ 12,056$ | $\$$ | 900 | $\$$ | $(3,082)$ | $\$$ |


| Nine months ended September 30, 2007 | Bank |  | Other Segments |  | Holding Company |  | Eliminations |  | Totals |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Net interest income (expense) | \$ | 66,988 | \$ | 4,916 | \$ | $(2,857)$ | \$ |  | \$ | 69,047 |
| Provision for loan losses |  | 2,480 |  | 1,197 |  |  |  |  |  | 3,677 |
| Noninterest income |  | 18,485 |  | 1,886 |  | 94 |  | (895) |  | 19,570 |
| Noninterest expense |  | 46,198 |  | 3,751 |  | 707 |  | (895) |  | 49,761 |
| Income tax expense (benefit) |  | 14,159 |  | 728 |  | $(1,324)$ |  |  |  | 13,563 |
| Segment profit (loss) | \$ | 22,636 | \$ | 1,126 | \$ | $(2,146)$ | \$ |  | \$ | 21,616 |

(Continued)

# GREEN BANKSHARES, INC. <br> NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS September 30, 2008 <br> Unaudited <br> (Amounts in thousands, except share and per share data) <br> <br> NOTE 4 SEGMENT INFORMATION (Continued) <br> <br> NOTE 4 SEGMENT INFORMATION (Continued) <br> Asset Quality Ratios 

As of and for the period ended September 30, 2008
Nonperforming loans as percentage of total loans, net of unearned income
Nonperforming assets as a percentage of total assets
Allowance for loan losses as a percentage of total loans, net of unearned income
Allowance for loan losses as a percentage of nonperforming loans
YTD net charge-offs to average total loans, net of unearned income
As of and for the period ended September 30, 2007
Nonperforming loans as percentage of total loans, net of unearned income
Nonperforming assets as a percentage of total assets
Allowance for loan losses as a percentage of total loans, net of unearned income
Allowance for loan losses as a percentage of nonperforming loans YTD net charge-offs to average total loans, net of unearned income

As of and for the year ended December 31, 2007
Nonperforming loans as percentage of total loans, net of unearned income
Nonperforming assets as a percentage of total assets
Allowance for loan losses as a percentage of total loans, net of unearned income
Allowance for loan losses as a percentage of nonperforming loans
Net charge-offs to average total loans, net of unearned income
Net charge-offs

Bank
Other

| $1.74 \%$ | $1.57 \%$ | $1.75 \%$ |
| ---: | ---: | ---: |
| $1.73 \%$ | $1.69 \%$ | $1.76 \%$ |
|  |  |  |
| $1.37 \%$ | $8.01 \%$ | $1.50 \%$ |
| $78.93 \%$ | $510.88 \%$ | $85.56 \%$ |
| $0.77 \%$ | $4.64 \%$ | $0.84 \%$ |

Bank
Other Total

| $0.24 \%$ | $1.40 \%$ | $0.26 \%$ |
| ---: | ---: | ---: |
| $0.22 \%$ | $1.96 \%$ | $0.26 \%$ |
|  |  |  |
| $1.32 \%$ | $8.01 \%$ | $1.45 \%$ |
| $556.73 \%$ | $573.30 \%$ | $558.18 \%$ |
|  |  |  |
| $0.02 \%$ | $2.45 \%$ | $0.07 \%$ |

Bank Other Total

| $1.35 \%$ | $1.30 \%$ | $1.36 \%$ |
| ---: | ---: | ---: |
| $1.22 \%$ | $2.11 \%$ | $1.25 \%$ |
|  |  |  |
| $1.32 \%$ | $7.96 \%$ | $1.45 \%$ |
| $98.37 \%$ | $609.80 \%$ | $106.34 \%$ |
| $0.50 \%$ | $4.14 \%$ | $0.57 \%$ |

Bank Other Total

| $\$$ | 17,950 | $\$$ | 1,832 | $\$$ | 19,782 |
| :--- | ---: | ---: | ---: | ---: | ---: |
| $\$$ | 423 | $\$$ | 875 | $\$$ | 1,298 |
| $\$$ | 10,193 | $\$$ | 1,503 | $\$$ | 11,696 |

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# GREEN BANKSHARES, INC. <br> NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS 

 September 30, 2008Unaudited
(Amounts in thousands, except share and per share data)

## NOTE 5 BUSINESS COMBINATION

On May 18, 2007, the Company acquired Civitas BankGroup, Inc. ( CVBG ), parent of Cumberland Bank. CVBG, headquartered in Franklin, Tennessee, operated 12 full-service branches in the Middle Tennessee area. The primary reason for the acquisition of CVBG, and the premium paid, was to provide accelerated entry for the Company in the Middle Tennessee area in some of the fastest growing areas in the Nashville MSA. Operating results of CVBG are included in the consolidated financial statements since the date of the acquisition.
The acquisition was accounted for under the purchase method of accounting, and accordingly, the purchase price has been allocated to the tangible and identified intangible assets purchased and the liabilities assumed based upon estimated fair values at the date of acquisition. The aggregate purchase price was $\$ 164,268$, including $\$ 45,793$ paid in cash and $3,091,495$ shares of the Company s common stock. Identified intangible assets and purchase accounting fair value adjustments are being amortized under various methods over the expected lives of the corresponding assets and liabilities. Goodwill will not be amortized and is not deductible for tax purposes, but will be reviewed for impairment on an annual basis. Identified intangible assets from the acquisition subject to amortization were $\$ 9,485$ and total goodwill from the acquisition was $\$ 112,062$.
The following table summarizes the fair value of assets acquired and liabilities assumed at the date of acquisition:

| Cash and due from banks | 21,182 |
| :--- | ---: |
| Securities | 200,081 |
| FHLB stock | 2,863 |
| Bankers Bank stock | 100 |
| Loans held for sale | 8,642 |
| Loans, net of unearned income | 631,496 |
| Allowance for loan losses | $(9,022)$ |
| Premises and equipment | 18,332 |
| Goodwill | 112,062 |
| Core deposit intangible | 8,740 |
| Mortgage servicing rights | 745 |
| Other assets | 16,369 |
| Total assets acquired | $1,011,590$ |
| Deposits | $(699,089)$ |
| Federal funds purchased | $(52,500)$ |
| Repurchase agreements | $(42,790)$ |
| FHLB advances | $(32,000)$ |
| Subordinated debentures | $(17,527)$ |
| Other liabilities | $(3,416)$ |
| Total liabilities assumed | $(847,322)$ |
| Net assets acquired | $\$ 164,268$ |

The Company also incurred $\$ 761$ in direct costs for legal, advisory and conversion cost that were capitalized into goodwill associated with the merger.

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The following table presents pro forma information as if the acquisition had occurred at the beginning of 2007 for the nine month period ending September 30, 2007. The pro forma information includes adjustments for interest income on loans and securities acquired, amortization of intangibles arising from the acquisition, depreciation expense on property acquired, interest expense on deposits assumed, and the related income tax effects. The pro forma financial information is not necessarily indicative of the results of operations as they would have been had the acquisition been effected on the assumed dates.
(Continued)

# GREEN BANKSHARES, INC. <br> NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS September 30, 2008 <br> Unaudited <br> (Amounts in thousands, except share and per share data) <br> NOTE 5 BUSINESS COMBINATION (Continued) 

|  | Nine Months <br> Ended <br> September 30, <br> $\mathbf{2 0 0 7}$ |  |
| :--- | :--- | :--- |
| Net interest income | $\$$ | 88,991 |
| Net income | $\$$ | 27,605 |
| Basic earnings per share | $\$$ | 2.08 |
| Diluted earnings per share | $\$$ | 2.06 |

## NOTE 6 BORROWINGS

In May 2007, the Company formed GreenBank Capital Trust I ( GB Trust I ), and GB Trust I issued $\$ 56,000$ of variable rate trust preferred securities. The Company issued $\$ 57,732$ of subordinated debentures to the GB Trust I in exchange for the proceeds of the sale of trust preferred securities, which debentures represent the sole asset of GB Trust I. The debentures pay interest quarterly at the three-month LIBOR plus $1.65 \%$ adjusted quarterly $(4.47 \%$ at September 30, 2008). The Company may redeem the subordinated debentures, in whole or in part, beginning June 2012 and in certain events prior to that date, at a premium. The subordinated debentures must be redeemed no later than 2037.
Also in May 2007 the Company acquired two Trusts in the CVBG acquisition, Civitas Statutory Trust I ( CS Trust I ) and Cumberland Capital Statutory Trust II ( CCS Trust II ).
In December 2005, CS Trust I issued $\$ 13,000$ of variable rate trust preferred securities, and CVBG issued $\$ 13,403$ of subordinated debentures to CS Trust I in exchange for the sale of trust preferred securities, which debentures represent the sole asset of CS Trust I. The debentures pay interest quarterly at the three-month LIBOR plus $1.54 \%$ adjusted quarterly ( $4.36 \%$ at September 30, 2008). The Company may redeem the subordinated debentures, in whole or in part, beginning March 2011 and in certain events prior to that date, at a premium. The subordinated debentures must be redeemed no later than March 2036.
In July 2001, CCS Trust II issued \$4,000 of variable rate trust preferred securities, and CVBG issued $\$ 4,124$ of subordinated debentures to CCS Trust II in exchange for the proceeds of the sale of trust preferred securities, which debentures represent the sole asset of CCS Trust II. The debentures pay interest quarterly at the three-month LIBOR plus $3.58 \%$ adjusted quarterly ( $6.38 \%$ at September 30, 2008). As of July 2007 the Company may redeem the subordinated debentures, in whole or in part at a price of $100 \%$ of face value. The subordinated debentures must be redeemed no later than July 2031.
(Continued)

# GREEN BANKSHARES, INC. <br> NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS September 30, 2008 <br> Unaudited <br> (Amounts in thousands, except share and per share data) 

## NOTE 7 FAIR VALUE DISCLOSURES

Effective January 1, 2008, the Company adopted Statement of Financial Accounting Standards ( SFAS ) No. 157, Fair Value Measurements and SFAS No. 159 The Fair Value Option for Financial Assets and Liabilities . SFAS No. 157, which was issued in September 2006, establishes a framework for using fair value. It defines fair value rules as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS No. 159, which was issued in February 2007, generally permits the measurement of selected eligible financial instruments at fair value at specified election dates. Upon adoption of SFAS No. 159 , the Company did not elect to adopt the fair value option for any financial instruments.
SFAS No. 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. SFAS No. 157 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

## Level 1

Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market, as well as certain U.S. Treasury, other U.S. Government and agency mortgage-backed debt securities that are highly liquid and are actively traded in over-the-counter markets.

## Level 2

Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments and derivative contracts whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. This category generally includes certain U.S. Government and agency mortgage-backed debt securities, corporate debt securities, derivative contracts and residential mortgage loans held-for-sale.

## Level 3

Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. This category generally includes certain private equity investments, retained residual interests in securitizations, residential mortgage servicing rights, and highly structured or long-term derivative contracts.
Following is a description of valuation methodologies used for assets and liabilities recorded at fair value.
Investment Securities Available-for-Sale
Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices of like or similar securities, if available and these securities are classified as Level 1 or Level 2. If quoted prices are not available, fair values are 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 and are classified as Level 3.
(Continued)

# GREEN BANKSHARES, INC. <br> NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS 

 September 30, 2008Unaudited
(Amounts in thousands, except share and per share data)

## NOTE 7 FAIR VALUE DISCLOSURES (Continued)

Loans Held for Sale
Loans held for sale are carried at the lower of cost or market value. The fair value of loans held for sale is based on what secondary markets are currently offering for portfolios with similar characteristics. As such, the Company classifies loans held for sale subjected to nonrecurring fair value adjustments as Level 2.

## 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 losses 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 agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with SFAS No. 114, Accounting by Creditors for Impairment of a Loan: (SFAS 114). The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At September 30, 2008, substantially all of the total impaired loans were evaluated based on either the fair value of the collateral or its liquidation value. In accordance with SFAS No. 157, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the impaired loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the impaired loan as nonrecurring Level 3.
Loan Servicing Rights
Loan servicing rights are subject to impairment testing. A valuation model, which utilizes a discounted cash flow analysis using interest rates and prepayment speed assumptions currently quoted for comparable instruments and a discount rate determined by management, is used in the completion of impairment testing. If the valuation model reflects a value less than the carrying value, loan servicing rights are adjusted to fair value through a valuation allowance as determined by the model. As such, the Company classifies loan servicing rights subjected to nonrecurring fair value adjustments as Level 3 .
Assets and Liabilities Recorded at Fair Value on a Recurring Basis
Below is a table that presents information about certain assets and liabilities measured at fair value:
September 30, 2008

| Description | Fair Value Measurement Using |  |  |  | Total <br> Carrying <br> Amount in Statement of <br> Financial Position |  | Assets/Liabilities Measured at Fair Value |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Securities available for sale | \$ | \$ | $\begin{aligned} & 292,897 \\ & \text { (Continu } \end{aligned}$ | \$ | \$ | 292,897 | \$ | 292,897 |

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## GREEN BANKSHARES, INC. <br> NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS <br> September 30, 2008 <br> Unaudited <br> (Amounts in thousands, except share and per share data) <br> NOTE 7 FAIR VALUE DISCLOSURES (Continued)

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 U.S. generally accepted accounting principles. 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. Assets measured at fair value on a nonrecurring basis are included in the table below.

September 30, 2008
$\left.\begin{array}{lllllll} & & & \text { September 30, 2008 } \\ \text { Total } \\ \text { Carrying }\end{array}\right]$

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

Green Bankshares, Inc. (the Company ) is the bank holding company for GreenBank (the Bank ), a Tennessee-chartered commercial bank that conducts the principal business of the Company. The Company is the third largest bank holding company headquartered in Tennessee based on asset size at September 30, 2008 and at that date was also the second largest NASDAQ listed bank holding company headquartered in Tennessee. The Bank currently maintains a main office in Greeneville, Tennessee and 65 full-service bank branches primarily in East and Middle Tennessee. In addition to its commercial banking operations, the Bank conducts separate businesses through its three wholly-owned subsidiaries: Superior Financial Services, Inc. ( Superior Financial ), a consumer finance company; GCB Acceptance Corporation ( GCB Acceptance ), an automobile lending company; and Fairway Title Co., a title company formed in 1998. The Bank also operates a wealth management office in Sumner County, Tennessee, and a mortgage banking operation in Knox County, Tennessee. All dollar amounts reported or discussed in Part I, Item 2 of this Quarterly Report on Form 10-Q are shown in thousands, except share and per share amounts.
On October 3, 2008 the Emergency Economic Stabilization Act was enacted into law in order to address the economic crisis which has currently frozen the credit markets. This landmark bill authorizes the Secretary of the Treasury to purchase up to $\$ 700$ billion in troubled assets from financial institutions in order to provide liquidity to the market and promote financial market stability. The troubled assets included in this program are residential and commercial mortgages, securities, obligations or other instruments related to such mortgages, and any other illiquid financial instruments determined by the Secretary to be necessary, such as car and truck loans. The bill includes a variety of taxpayer protections such as executive compensation limits, measures to prevent unjust enrichment, and a warrant provision for the government to retain an equity stake in financial institutions participating in the program. The bill also includes homeownership preservation provisions such as mortgage modification measures. In addition, the bill also includes an insurance program to guarantee troubled assets of financial institutions under the program, using risk-based premiums for such guarantees to cover anticipated claims.
Since October 3, 2008, there have been additional details surfacing almost daily concerning this legislation which may, or may not, impact the Company. The extent of these changes are currently being evaluated and the impact on the Company is unknown at this time. On October 14, 2008 Treasury announced the TARP Capital Purchase Program, pursuant to which Treasury will make direct capital investments in participating financial institutions in an attempt to stimulate credit flows in the economy. Under this revised program, healthy banks are encouraged to participate. The minimum investment for a financial institution considering participating in the Capital Purchase Program is an amount equal to $1 \%$ of its risk-weighted assets and the maximum amount is the lesser of $\$ 25$ billion or $3 \%$ of its risk-weighted assets. The application to participate in this Capital Purchase Program must be received by the institution s primary banking regulator no later than November 14, 2008 and the investment is expected to be made by December 31, 2008. The following discussion and analysis provides information that management believes is relevant to an assessment and understanding of the Company s consolidated results of operations and financial condition. This discussion should be read in conjunction with the (i) condensed consolidated financial statements and notes thereto in this Form 10-Q and (ii) the audited, consolidated financial statements and the notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2007 (the 2007 10-K ). Except for specific historical information, many of the matters discussed in this Form 10-Q may express or imply projections of revenues or expenditures, plans and objectives for future operations, growth or initiatives, expected future economic performance, or the expected outcome or impact of pending or threatened litigation. These and similar statements regarding events or results which the Company expects will or may occur in the future, are forward-looking statements that involve risks, uncertainties and other factors which may cause actual results and performance of the Company to differ materially from those expressed or implied by those statements. All forward-looking information is provided pursuant to the safe harbor established under the Private Securities Litigation Reform Act of 1995 and should be evaluated in the context of these risks, uncertainties and other factors. Forward-looking statements, which are based on assumptions and estimates and describe our future plans, strategies and expectations, are generally identifiable by the use of forward-looking terminology and words such as trends, assumptions, target, guidance, outlook, future, plans, goals, objectives, expectations, near-term, long-term, projection, may, will,
intend, estimate, anticipate, believe, potential, regular, or continue (or the negative or other deriva of these terms) or similar terminology and expressions.

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Although the Company believes that the assumptions underlying any forward-looking statements are reasonable, any of the assumptions could be inaccurate, and therefore, actual results may differ materially from those projected in or implied by the forward-looking statements. Factors and risks that may result in actual results differing from this forward-looking information include, but are not limited to, (1) unanticipated deterioration in the financial condition of borrowers resulting in significant increases in loan losses and provisions for those losses; (2) lack of sustained growth in the economy in the markets that the Bank serves; (3) increased competition with other financial institutions in the markets that the Bank serves; (4) changes in the legislative and regulatory environment; (5) the Company s failure to successfully implement its growth strategy; and (6) the loss of key personnel as well as those contained in the 2007 10-K in Part I, Item 1A thereof, which is incorporated herein by this reference, as well as other factors discussed throughout this document, including, without limitation the factors described under Critical Accounting Policies and Estimates on page 19 of this Quarterly Report on Form 10-Q, or from time to time, in the Company s filings with the Securities and Exchange Commission ( SEC ), press releases and other communications.
Readers are cautioned not to place undue reliance on forward-looking statements made in this document, since the statements speak only as of the document s date. All forward-looking statements included in this Quarterly Report on Form 10-Q are expressly qualified in their entirety by the cautionary statements in this section and to the more detailed risk factors included in the Company s 2007 10-K. The Company has no obligation and does not intend to publicly update or revise any forward-looking statements contained in or incorporated by reference into this Quarterly Report on Form 10-Q, to reflect events or circumstances occurring after the date of this document or to reflect the occurrence of unanticipated events. Readers are advised, however, to consult any further disclosures the Company may make on related subjects in its documents filed with or furnished to the SEC or in its other public disclosures.

## Growth and Business Strategy

The Company expects that, over the next five years, its growth from mergers and acquisitions, including acquisitions of both entire financial institutions and selected branches of financial institutions, will continue. De novo branching is also expected to be a method of growth, particularly in high-growth and other demographically-desirable markets.
The Company s strategic plan projects geographic expansion within a 300 -mile radius of its headquarters in Greene County, Tennessee. This could result in the Company expanding westward and eastward up to and including Nashville, Tennessee and Roanoke, Virginia, respectively, east/southeast up to and including the Piedmont area of North Carolina and western North Carolina, southward to northern Georgia and northward into eastern and central Kentucky. In particular, the Company believes the markets in and around Knoxville, Nashville and Chattanooga, Tennessee are highly desirable areas with respect to expansion and growth plans.
The Bank had historically operated under a single bank charter while conducting business under 18 bank brands. On January 23, 2007 the Bank announced that it was changing all brand names to GreenBank throughout all the communities it serves to better enhance recognition and customer convenience. The GreenBank name became effective on March 31, 2007. The Bank continues to offer local decision making through the presence of its regional executives in each of its markets, while maintaining a cost effective organizational structure in its back office and support areas.
The Bank focuses its lending efforts predominately on individuals and small to medium-sized businesses while it generates deposits primarily from individuals in its local communities. To aid in deposit generation efforts, the Bank offers its customers extended hours of operation during the week as well as on Saturday. During the first quarter of 2007, the Bank initiated Sunday banking hours from 1:00 pm to $4: 00 \mathrm{pm}$ at most branches. The Bank also offers free online banking and in early 2005 established its High Performance Checking Program which has generated a significant number of new core transaction accounts.
In addition to the Company s business model, which is summarized in the paragraphs above, the Company is continuously investigating and analyzing other lines and areas of business. These include, but are not limited to, various types of insurance and real estate activities. Conversely, the Company frequently evaluates and analyzes the profitability, risk factors and viability of its various business lines and segments and, depending upon the results of these evaluations and analyses, may conclude to exit certain segments and/or business lines. Further, in conjunction
with these ongoing evaluations and analyses, the Company may decide to sell, merge or close certain branch facilities.

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## Overview

The Company reported net income for the three and nine month periods ended September 30, 2008 of $\$ 1,234$ and $\$ 9,874$, respectively compared to net income of $\$ 8,914$ and $\$ 21,616$ for the corresponding 2007 periods. The decline in reported earnings for the periods presented was the result of deteriorating economic conditions during 2008 which impacted the Company s residential real estate construction and development loan portfolios. As a result, the Company s loan loss provision was $\$ 8,620$ during the third quarter of 2008 and $\$ 20,527$ for the nine month period ended September 30, 2008. Non-accrual loans remained relatively constant at $\$ 40,687$ at September 30, 2008 compared with $\$ 40,419$ at June 30, 2008 but have increased from $\$ 32,060$ at December 31, 2007 due to continued downward pressure on residential real estate values. Other Real Estate Owned ( OREO ) decreased to \$12,215 at September 30, 2008 from June $30 \$ 20,632$ at June 30, 2008 but has increased compared to $\$ 4,859$ at December 31, 2007. The decrease in OREO from June 30, 2008 levels reflected the Company s efforts to aggressively reduce non-performing assets through auction sales conducted throughout the third quarter of 2008.
As previously disclosed, late in the second quarter, the Company experienced the impact of further economic weaknesses in the Nashville and Knoxville markets concentrated primarily in the residential real estate construction and development segment of the loan portfolio. This segment of the portfolio totaled approximately $\$ 187$ million at June 30, 2008 and represented almost eight percent of total loans outstanding at that date. During mid-June, certain customers acknowledged liquidity concerns and as a result approximately $\$ 12$ million of loans were immediately placed on non-accrual. Additionally an intensified effort was undertaken to review this segment of the portfolio for potential impairment based upon projected future cash flows of the borrowers. As a result of this intensified effort, an additional $\$ 23$ million of current loans were identified and placed on non-accrual during the second quarter. In July 2008 the Company announced that it would conduct auctions to dispose of certain existing OREO related assets as well as accelerating efforts to convert non-earning assets to earning assets. During the third quarter, OREO assets disposed of resulted in proceeds received of $\$ 10,706$ and losses incurred on disposition of these assets of $\$ 1,942$. At September 30, 2008, of the $\$ 40.6$ million of loans on non-accrual, approximately $\$ 7.0$ million were less than 30 days past due with $\$ 4.1$ million of the $\$ 7.0$ million current.
Net interest income totaled $\$ 24,384$ during the third quarter of 2008 and declined approximately $3 \%$ from the second quarter of 2008 as a result net interest margin compression reflecting local deposit pricing competition pressure coupled with the income impact of carrying a higher average level of non-earning assets during the quarter. On a year-to-date basis, despite falling market interest rates, net interest income improved by $7 \%$ over the same period a year ago primarily as a result of a higher level of earning assets resulting from an acquisition completed in May 2007. Non-interest income totaled $\$ 8,010$ for the three months ended September 30, 2008, down slightly from the second quarter of 2008 due to further contraction in mortgage related activity coupled with reduced revenues from mutual fund and annuity sales activity. On a year-to-date basis, non-interest income was $\$ 23,428$ at September 30, 2008, up $20 \%$ over the same period a year ago reflecting the acquisition completed in May 2007 and the continued success of the Company s High Yield Checking Program.
Non-interest expenses were $\$ 21,944$ for the third quarter of 2008, up $\$ 1,804$ from the second quarter of the year, and included $\$ 2,598$ of OREO related costs during the current quarter. Non-interest expense levels for the nine months of 2008 totaled $\$ 61,645$, reflecting an increase of $24 \%$ over the same period a year ago. In addition to the impact of the incremental recurring operating costs of an acquisition completed in May 2007, the Company has incurred approximately $\$ 4,183$ of incremental expenses related to OREO losses and collection efforts.
Net charge-offs for the quarter totaled $\$ 9,115$ compared with net charge-offs of $\$ 9,595$ during the second quarter of 2008 and net charge-offs of $\$ 676$ during the third quarter of 2007. On a year to date basis, net charge-offs for 2008 have totaled $\$ 19,782$ versus $\$ 1,298$ during the same period last year. Non-performing assets were $\$ 52,956$ at September 30, 2008 compared with $\$ 61,212$ at June 30, 2008 and $\$ 36,937$ at year end 2007. The primary reason for the decrease in non-performing assets from June 30, 2008 was the reduction of OREO through auctions. At September 30, 2008 the Company s non-performing loans to total loans ratio was $1.75 \%$ compared with $1.73 \%$ at June 30, 2008 and $1.36 \%$ at December 31, 2007. Non-performing assets to total assets reflected a ratio of $1.76 \%$ at September 30, 2008 compared with $2.03 \%$ at June 30, 2008 and $1.25 \%$ at December 31, 2007. The Company s loan loss reserve to loans was $1.50 \%$ at September 30, 2008 compared with $1.51 \%$ at June 30, 2008 and $1.45 \%$ at

December 31, 2007.

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At September 30, 2008, the Company s assets totaled $\$ 3,012,041$, deposits were $\$ 2,276,198$, loans, net of unearned income, amounted to $\$ 2,323,076$ and total shareholders equity was $\$ 326,482$. The Company s annualized return on average shareholders equity for the three and nine months ended September 30, 2008 was $1.49 \%$ and $3.99 \%$, respectively, and its annualized return on average total assets was $0.16 \%$ and $0.45 \%$, respectively.

## Critical Accounting Policies and Estimates

The Company s consolidated financial statements and accompanying notes have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reported periods.
Management continually evaluates the Company s accounting policies and estimates it uses to prepare the consolidated financial statements. In general, management s estimates are based on historical experience, information from regulators and third party professionals and various assumptions that are believed to be reasonable under the existing facts and circumstances. Actual results could differ from those estimates made by management.
The Company believes its critical accounting policies and estimates include the valuation of the allowance for loan losses and the fair value of financial instruments and other accounts. Based on management s calculation, an allowance of $\$ 34,856$, or $1.50 \%$ of total loans, net of unearned income, was an adequate estimate of losses inherent in the loan portfolio as of September 30, 2008. This estimate resulted in a provision for loan losses in the income statement of $\$ 8,620$ and $\$ 20,527$, respectively, for the three and nine months ended September 30, 2008. If the economic conditions, loan mix and amount of future charge-offs differ significantly from those assumptions used by management in making its determination, the allowance for loan losses and provision for loan losses on the income statement could be materially affected.
The consolidated financial statements include certain accounting disclosures that require management to make estimates about fair values. Independent third party valuations are used for securities available for sale and securities held to maturity as well as purchase accounting adjustments resulting from acquisitions. Estimates of fair value are used in the accounting for loans held for sale, goodwill and other intangible assets. Estimates of fair values are used in disclosures regarding stock compensation, commitments, and the fair values of financial instruments. Fair values are estimated using relevant market information and other assumptions such as interest rates, credit risk, prepayments and other factors. The fair values of financial instruments are subject to change as influenced by market conditions.

## Changes in Results of Operations

Net Income. Net income for the three months ended September 30, 2008 was $\$ 1,234$, compared to $\$ 8,914$ for the same period in 2007. This decrease of $\$ 7,680$, or $86 \%$, resulted primarily from a $\$ 7,176$ increase in the provision for loan losses reflecting continued economic weaknesses in the residential real estate construction and development portfolios primarily in the Nashville and Knoxville markets during 2008. In addition, the Bank had a net loss on the sale of OREO of $\$ 1,942$ that increased noninterest expense during the third quarter of 2008 related to the liquidation of OREO properties plus $\$ 657$ of OREO/collection related costs.
Net interest income for the three months ended September 30, 2008 was $\$ 24,384$, as compared to $\$ 27,293$ for the same period in 2007. This decrease of $\$ 2,909$ in net interest income resulted primarily from the contraction of the net interest margin plus the income impact of carrying a higher level of non-performing assets. During this period the net interest margin declined by 50 basis points to $3.72 \%$ at September 30, 2008 from 4.22\% at September 30, 2007 reflecting the downward movement in market interest rates resulting from initiatives undertaken by the Federal Open Market Committee ( FOMC ) to reduce market interest rates. Non-interest income rose $4 \%$ from the third quarter of 2007 and totaled $\$ 8,010$ for the three months ended September 30, 2008. The principal driver of this increase was the ongoing success of the Company s High Performance Checking product. During the third quarter of 2008, the Company opened 3,564 net new checking accounts compared with 3,465 opened during the same period a year ago. Non-interest expenses increased $\$ 2,934$, or $15 \%$, to $\$ 21,944$ from $\$ 19,010$ for the three months ended September 30, 2008 and 2007, respectively. This change is primarily attributable to the previously mentioned net loss on sale of OREO of $\$ 1,977$ and collection-related cost of $\$ 657$.

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Net income for the nine months ended September 30, 2008 was $\$ 9,874$ compared to $\$ 21,616$ for the same period in 2007. The decrease of $\$ 11,742$ is principally a function of increased provision for loan losses incurred in 2008 versus 2007 and the increased recurring operating costs associated with an acquisition completed in May 2007.
Net Interest Income. The largest source of earnings for the Company is net interest income, which is the difference between interest income on earning assets and interest expense on deposits and other interest-bearing liabilities. The primary factors which affect net interest income are changes in volume and rates on interest-earning assets and interest-bearing liabilities, which are affected in part by management s responses to changes in interest rates through asset/liability management. During the three months ended September 30, 2008, net interest income was $\$ 24,384$, as compared to $\$ 27,293$ for the same period in 2007, representing a decrease of $11 \%$. This decrease of $\$ 2,909$ in net interest income resulted primarily from the contraction of the net interest margin plus the income impact of carrying a higher level of non-performing assets.
The Company s average balance for interest-earning assets increased $2 \%$ from $\$ 2,584,814$ for the three months ended September 30, 2007 to $\$ 2,625,820$ for the three months ended September 30, 2008.
The Company s average balance for interest-bearing liabilities increased $4 \%$ from $\$ 2,345,587$ for the three months ended September 30, 2007 to $\$ 2,450,824$ for the three months ended September 30, 2008. The Company experienced a $13 \%$ increase in average interest-bearing deposits from $\$ 1,822,380$ for the three months ended September 30, 2007 to $\$ 2,057,849$ for the three months ended September 30, 2008.
The Company s yield on loans (the largest component of interest-earning assets) decreased by 164 basis points from the third quarter of 2007 to the third quarter of 2008. Approximately one-half of the Company s loan portfolio is set at variable rates and was impacted by the result of the FOMC s action to lower market interest rates by 275 basis points during this period of time.

FOMC Meeting Date
March 21, 2007
May 9, 2007
June 28, 2007
August 7, 2007
September 18, 2007
October 31, 2007
December 11, 2007
January 22, 2008
January 30, 2008
March 18, 2008
April 30, 2008
June 25, 2008
August 6, 2008
September 16, 2008

| Beginning <br> Rate | Increase/ <br> Decrease | Ending <br> Rate |
| :---: | ---: | ---: |
| $5.25 \%$ | $0.00 \%$ | $5.25 \%$ |
| $5.25 \%$ | $0.00 \%$ | $5.25 \%$ |
| $5.25 \%$ | $0.00 \%$ | $5.25 \%$ |
| $5.25 \%$ | $0.00 \%$ | $5.25 \%$ |
| $5.25 \%$ | $(0.50 \%)$ | $4.75 \%$ |
| $4.75 \%$ | $(0.25 \%)$ | $4.50 \%$ |
| $4.50 \%$ | $(0.25 \%)$ | $4.25 \%$ |
| $4.25 \%$ | $(0.75 \%)$ | $3.50 \%$ |
| $3.50 \%$ | $(0.50 \%)$ | $3.00 \%$ |
| $3.00 \%$ | $(0.75 \%)$ | $2.25 \%$ |
| $2.25 \%$ | $(0.25 \%)$ | $2.00 \%$ |
| $2.00 \%$ | $0.00 \%$ | $2.00 \%$ |
| $2.00 \%$ | $0.00 \%$ | $2.00 \%$ |
| $2.00 \%$ | $0.00 \%$ | $2.00 \%$ |

The Company s cost of interest-bearing liabilities decreased by 128 basis points from the third quarter ended September 30, 2007 to the third quarter ended September 30, 2008. The velocity of change on fixed maturity interest-bearing liabilities is slower than the immediate change on variable rate assets. The re-pricing characteristics of this portion of interest-bearing liabilities which comprise $71 \%$ of total interest-bearing liabilities will lag behind market interest rate changes especially in a rapidly changing interest rate environment.
For the nine months ended September 30, 2008, net interest income increased by $\$ 4,853$, or $7 \%$, to $\$ 73,900$ from $\$ 69,047$ for the same period in 2007, despite the dramatic drop in market interest rates of 325 basis points, reflecting the impact of the acquisition completed during May 2007.

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The following table sets forth certain information relating to the Company s consolidated average interest-earning assets and interest-bearing liabilities and reflects the average yield on assets and average cost of liabilities for the periods indicated. These yields and costs are derived by dividing income or expense by the average daily balance of assets or liabilities, respectively, for the periods presented.

Interest-earning assets:

| Loans ${ }^{(1)(2)}$ | $\$ 2,302,465$ | $\$ 38,510$ |
| :--- | ---: | ---: |
| Investment securities (2) | 306,616 | 4,154 |
| Other short-term investments | 16,739 | 87 |
|  |  |  |
| Total interest-earning assets | $\$ 2,625,820$ | $\$ 42,751$ |
| Noninterest earning assets | 373,449 |  |

Total assets
\$ 2,999,269
\$2,906,645

## Interest-bearing liabilities:

Deposits:
Interest checking, savings and money market
Time deposits \$ 617,156

2008

## Average

Balance Interest

Three Months Ended
September 30,

| Average | Average |
| :---: | :---: |
| Rate |  |

2007

Rate
Balance

| $6.65 \%$ | $\$ 2,327,498$ |
| ---: | ---: |
| $5.39 \%$ | 255,556 |
| $2.07 \%$ | 1,760 |
| $6.48 \%$ | $\$ 2,584,814$ |
|  | 321,831 |
|  | $\$ 2,906,645$ |


| $1.38 \%$ | $\$ 701,472$ | $\$ 4,381$ | $2.48 \%$ |
| ---: | ---: | ---: | ---: |
| $3.37 \%$ | $1,120,908$ | 13,431 | $4.75 \%$ |
| $2.77 \%$ | $\$ 1,822,380$ | $\$ 17,812$ | $3.88 \%$ |

Securities sold under repurchase agreements and short-term borrowings
Notes payable
74,385 $262 \quad 1.40 \%$
1.40\%
4.37\% 286,956
$4.71 \% \quad 88,662$
\$2,450,824 \$ 18,182
2.95\%
\$2,345,587
\$ 25,001
4.23\%

## Noninterest bearing <br> liabilities:

| Demand deposits | 193,566 | 208,093 |
| :--- | ---: | ---: |
| Other liabilities | 24,698 | 33,893 |
| Total noninterest bearing |  |  |
| liabilities | 218,264 | 241,986 |
| Total liabilities | $2,669,088$ | $2,587,573$ |

Shareholders equity ..... 330,181 ..... 319,072
Total liabilities and shareholders Equity ..... \$2,999,269 ..... \$2,906,645
Net interest income ..... \$ 24,569
\$ 27,498
Interest rate spread ..... 3.53\% ..... 3.83\%
Net yield on interest-earning assets ..... 3.72\% ..... 4.22\%
12008 averageloan balancesexcludenonaccrualloans for theperiods
presented. 2007
average loan
balances include
nonaccrual
loans for the
periods
presented, as
they are not
material.
2 Fully TaxableEquivalent( FTE ) at the rateof $35 \%$. TheFTE basisadjusts for thetax benefits ofincome oncertaintax-exempt
loans andinvestmentsusing the federalstatutory rate of$35 \%$ for eachperiod
presented. The
Company
believes this measure to be the preferred industry measurement of net interest income and provides
relevant comparison between taxable and non-taxable amounts.

3 The interest
expense and average interest rates paid on the Subordinated Debentures for the three month period ended September 30, 2007 should have been \$1,655 and $7.41 \%$, respectively. The impact of this timing difference on the 2007 second and third quarter results was deemed immaterial to the overall
financial statements.

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| Nine Months Ended <br> September 30, |  |  |  |  |  |
| :--- | :--- | :---: | :---: | :---: | :---: |
| Average <br> Balance | Interest | Average | Average | Rate | Balance | Interest | Average |
| :---: |
| Rate |

## Interest-earning assets:

Loans ${ }^{(1)(2)}$
Investment securities (2)
Other short-term investments
Total interest-earning assets
Noninterest earning assets
Total assets
Interest-bearing liabilities:

Deposits:
Interest checking, savings and
money market
Time deposits
\$2,958,252
\$ 120,698
266,453
7,254
\$2,596,217
362,035
6.94\%
5.58\%
2.04\%
6.79\%
\$ 2,112,762
235,905
\$2,348,667

Total interest-bearing deposits
\$ 1,934,135
\$ 43,657
3.02\%
1.56\%
3.78\%

645,708
891,179
\$ 12,792
2.65\%
4.68\%
3.83\%

Securities sold under repurchase agreements and short-term borrowings Notes payable
Subordinated debentures
Total interest-bearing liabilities

Noninterest bearing
liabilities:
Demand deposits
188,737
178,051
Other liabilities
25,480
Total noninterest bearing liabilities

214,217
2.14\%
4.21\%
5.26\%

80,697
217,599
51,318
\$2,413,259 \$ 57,469
3.18\% \$ 1,886,501 \$ 57,668

30,522

208,573
Total liabilities
2,627,476
2,095,074
Shareholders equity
330,776
\$2,958,252

Total liabilities and shareholders Equity
Net interest income ..... \$ 74,472 ..... \$ 69,398
Interest rate spread 3.61\% ..... 3.95\%
Net yield on interest-earning assets ..... 3.83\% ..... 4.39\%
12008 averageloan balancesexcludenonaccrualloans for theperiodspresented. 2007
average loanbalances includenonaccrualloans for theperiodspresented, asthey are notmaterial.
2 Fully TaxableEquivalent( FTE ) at the rateof $35 \%$. The
FTE basis
adjusts for thetax benefits ofincome oncertaintax-exemptloans andinvestmentsusing the federalstatutory rate of$35 \%$ for eachperiodpresented. TheCompanybelieves thismeasure to bethe preferred
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industry
measurement of net interest
income and
provides
relevant
comparison
between taxable
and non-taxable amounts.

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Provision for Loan Losses. During the three and nine month periods ended September 30, 2008, loan charge-offs were $\$ 10,374$ and $\$ 22,380$, respectively and recoveries of charged-off loans were $\$ 1,259$ and $\$ 2,598$. The Company s provision for loan losses increased by $\$ 7,176$ to $\$ 8,620$ for the three months ended September 30, 2008, as compared to $\$ 1,444$ for the same period in 2007 due to deterioration in the residential real estate construction and development loan portfolio of the Bank. The Company s allowance for loan losses increased by $\$ 745$ to $\$ 34,856$ at September 30, 2008 from $\$ 34,111$ at December 31, 2007 and the reserve to outstanding loans ratio increased 5 basis points to $1.50 \%$ between these two dates and also increased from the ratio of $1.45 \%$ at September 30, 2007. Credit quality ratios have declined since September 30, 2007, principally as a result of the rapid deterioration of the residential real estate market beginning in the fourth quarter of 2007 in the Company s urban markets, primarily Nashville and Knoxville. Management continually evaluates the Company s credit policies and procedures for effective risks and controls management. The ratio of allowance for loan losses to nonperforming loans was $85.56 \%, 106.34 \%$ and $558.18 \%$ at September 30, 2008, December 31, 2007 and September 30, 2007, respectively, and the ratio of nonperforming assets to total assets was $1.76 \%, 1.25 \%$ and $0.26 \%$ at September 30, 2008, December 31, 2007 and September 30, 2007, respectively. The ratio of nonperforming loans to total loans, net of unearned interest, was $1.75 \%, 1.36 \%$ and $0.26 \%$ at September 30, 2008, December 31, 2007 and September 30, 2007, respectively. Within the Bank, the Company s largest subsidiary, the ratio of nonperforming assets to total assets was $1.73 \%, 1.22 \%$ and $0.22 \%$ at September 30, 2008, December 31, 2007 and September 30, 2007, respectively.
The Company s year-to-date ( YTD ) net charge-offs as a percentage of average loans increased from $0.07 \%$ for the nine months ended September 30, 2007 to $0.84 \%$ for the nine months ended September 30, 2008. Net charge-offs as a percentage of average loans were $0.57 \%$ for the year ended December 31, 2007.
Management believes that credit quality indicators will be driven by the current economic environment and the resiliency of residential real estate markets. Management continually evaluates the existing portfolio in light of loan concentrations, current general economic conditions and economic trends. Management believes these evaluations strongly suggest an economic slowdown in the Company s markets has and will continue to occur throughout 2008 and most likely into 2009. Based on its evaluation of the allowance for loan loss calculation and review of the loan portfolio, management believes the allowance for loan losses is adequate at September 30, 2008. However, the provision for loan losses could further increase for the entire year of 2008 if the general economic conditions continue to weaken or the residential real estate markets in Nashville or Knoxville or the financial conditions of borrowers deteriorate beyond management s current expectations.
Noninterest Income. Fee income, unrelated to interest-earning assets, consisting primarily of service charges, commissions and fees, has become an important component to the Company s total revenue stream.
Total noninterest income for the three and nine months ended September 30, 2008 was $\$ 8,010$ and $\$ 23,428$ as compared to $\$ 7,688$ and $\$ 19,570$ for the same period in 2007. Service charges, commissions and fees remain the largest component of total noninterest income and increased from $\$ 6,418$ and $\$ 16,102$ for the three and nine months ended September 30, 2007 to $\$ 6,711$ and $\$ 19,725$, respectively, for the same period in 2008. This increase primarily reflects additional service charges and NSF fees from deposit-related products stemming primarily from the continued increased volume due to the Bank s High Performance Checking Program introduced in the first quarter of 2005 and the acquisition completed in the second quarter of 2007. The Company believes that noninterest income will continue to improve over the remainder of 2008 with the introduction of this program in the former Cumberland Bank branches. In addition, other noninterest income increased by $\$ 29$ and $\$ 235$ to $\$ 1,299$ and $\$ 3,703$ for the three and nine months ended September 30, 2008, respectively, from $\$ 1,270$ and $\$ 3,468$ for the same periods in 2007.
Noninterest Expense. Control of noninterest expense is a critical aspect in enhancing income. Noninterest expense includes personnel, occupancy, and other expenses such as write-downs and net losses from sales on OREO, data processing, printing and supplies, legal and professional fees, postage, Federal Deposit Insurance Corporation assessment, etc. Total noninterest expense was $\$ 21,944$ and $\$ 61,645$ for the three and nine months ended September 30, 2008, respectively, compared to $\$ 19,010$ and $\$ 49,761$ for the same period in 2007. The $\$ 2,934$, or $15 \%$, increase in total noninterest expense for the three months ended September 30, 2008 compared to the same period of 2007 principally reflects increases previously mentioned on net loss on sale of OREO of $\$ 1,942$ and collection-related cost of $\$ 657$ during the third quarter of 2008.

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Personnel costs are the largest single component of the Company s noninterest expenses. For the three and nine months ended September 30, 2008, salaries and benefits represented $\$ 10,157$, or $46 \%$, and $\$ 29,261$, or $47 \%$, respectively, of total noninterest expense. This was an increase of $\$ 404$, or $4 \%$, and $\$ 3,578$, or $14 \%$, respectively, from the $\$ 9,753$ and $\$ 25,683$ for the three and nine months ended September 30, 2007. Including Bank branches and non-bank office locations the Company had 76 locations at September 30, 2008 and December 31, 2007, as compared to 77 at September 30, 2007 and 60 at December 31, 2006, and the number of full-time equivalent employees increased $2 \%$ from 773 at September 30, 2007 to 789 at September 30, 2008. The increase in personnel costs for the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007 are primarily the result of the acquisition completed in May 2007 and the increase in the number of de-novo branches and related staff during the third and fourth quarters of 2007.
The Company s efficiency ratio increased from 54.34\% at September 30, 2007 to $67.74 \%$ at September 30, 2008, which increase is primarily associated with the additional expense related to OREO net losses/collection cost. The efficiency ratio illustrates how much it cost the Company to generate revenue; for example, it cost the Company 67.74 cents to generate one dollar of revenue for the nine months ended September 30, 2008.
Income Taxes. The effective income tax rate for the three and nine months ended September 30, 2008 was $32.57 \%$ and $34.85 \%$, respectively, compared to $38.64 \%$ and $38.55 \%$ for the same periods in 2007 . The decrease in the effective rate for the current year is primarily attributable to the increased level of tax exempt earnings in the current year over the prior year.

## Changes in Financial Condition

Total assets at September 30, 2008 were $\$ 3,012,041$, an increase of $\$ 64,300$, or $2 \%$, from December 31, 2007. The increase in assets was primarily reflective of the $\$ 56,751$, or $100 \%$, increase in federal funds sold and the 57,624 , or $24 \%$, increase in securities available for sale. These increases were partially offset by the $\$ 33,300$, or $1 \%$, decrease in loans, net of unearned income.
Non-performing loans include non-accrual loans and loans 90 or more days past due. All loans that are 90 days past due are considered non-accrual unless they are adequately secured and there is reasonable assurance of full collection of principal and interest. Non-accrual loans that are 120 days past due without assurance of repayment are charged off against the allowance for loan losses. Nonaccrual loans and loans past due 90 days totaled $\$ 40,741$ at September 30, 2008, an increase of $\$ 8,663$ from December 31, 2007. At September 30, 2008, the ratio of the Company s allowance for loan losses to non-performing loans (which include non-accrual loans) was $85.56 \%$.
The Company maintains an investment portfolio to provide liquidity and earnings. Investments at September 30, 2008 with an amortized cost of $\$ 293,451$ had a market value of $\$ 293,597$. At year-end 2007, investments with an amortized cost of $\$ 234,098$ had a market value of $\$ 236,553$.

## Liquidity and Capital Resources

Liquidity. Liquidity refers to the ability or the financial flexibility to manage future cash flows to meet the needs of depositors and borrowers and fund operations. During the quarter ended September 30, 2008 the Company reduced its reliance on borrowed funds as deposit levels improved and invested the excess liquidity in federal funds sold and available for sale securities. Maintaining appropriate levels of liquidity allows the Company to have sufficient funds available for reserve requirements, customer demand for loans, withdrawal of deposit balances and maturities of deposits and other liabilities. The Company s liquid assets include cash and due from banks, federal funds sold, investment securities and loans held for sale. Including securities pledged to collateralize municipal deposits, these assets represented $8 \%$ of the total liquidity base at September 30, 2008 and December 31, 2007, respectively. The liquidity base is generally defined to include deposits, repurchase agreements, notes payable and subordinated debentures. The Company maintains borrowing availability with the Federal Home Loan Bank of Cincinnati ( FHLB ), which was fully utilized at September 30, 2008, in order to better optimize its funding costs. The Company also maintains federal funds lines of credit totaling $\$ 141,000$ at seven correspondent banks, of which $\$ 140,587$ was available at September 30, 2008. The Company believes it has sufficient liquidity to satisfy its current operating needs.
For the nine months ended September 30, 2008, operating activities of the Company provided $\$ 30,054$ of cash flows. Net income of $\$ 9,874$ comprised a substantial portion of the cash generated from operations. Cash flows from
operating activities were also positively affected by various non-cash items, including (i) $\$ 20,527$ in provision for loan losses, (ii) $\$ 5,264$ of depreciation and amortization and (iii) $\$ 5,031$ increase in other assets. This was offset in part by a decrease of $\$ 11,142$ in accrued interest payable and other liabilities and a deferred tax benefit of $\$ 746$.

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The Company s purchase of $\$ 136,985$ in investment securities available for sale was the primary component of the $\$ 59,233$ used in investing activities for the nine months ended September 30, 2008. In addition the Company s net increase in loans used $\$ 13,841$ in cash flows. This was offset by (i) $\$ 77,865$ in proceeds from the sale and maturities of investment securities available for sale, and (ii) $\$ 19,238$ in proceeds from the sale of other real estate. Purchases of fixed asset additions used $\$ 4,615$ in cash flows.
The net increase in deposits of $\$ 289,405$ was the primary source of cash flows provided in financing activities This was offset by the net decrease in federal funds purchased and repurchase agreements of $\$ 129,183$ and net repayments of FHLB advances and notes payable of $\$ 109,701$. In addition, dividends paid in the amount of $\$ 5,070$ further increased the total net cash used in financing activities.
Capital Resources. The Company s capital position is reflected in its shareholders equity, subject to certain adjustments for regulatory purposes. Shareholders equity, or capital, is a measure of the Company s net worth, soundness and viability. The Company continues to exhibit a strong capital position while consistently paying dividends to its shareholders. Further, the capital base of the Company allows it to take advantage of business opportunities while maintaining the level of resources deemed appropriate by management of the Company to address business risks inherent in the Company s daily operations.
Shareholders equity on September 30, 2008 was $\$ 326,482$, an increase of $\$ 4,005$, or $1 \%$, from $\$ 322,477$ on December 31, 2007. The increase in shareholders equity primarily reflects net income for the nine months ended September 30, 2008 of $\$ 9,874$ ( $\$ 0.76$ per share). This increase was offset by quarterly dividend payments during the nine months ended September 30, 2008 totaling $\$ 5,070$ ( $\$ 0.39$ per share) and the cumulative change of $\$ 1,396$ in unrealized losses, net of reclassification and taxes, on available for sale securities.
On September 18, 2002 the Company announced that its Board of Directors had authorized the repurchase of up to $\$ 2,000$ of the Company s outstanding shares of common stock beginning in October 2002. The repurchase plan has been renewed by the Board of Directors annually thereafter and will terminate on the earlier to occur of the Company s repurchase of the total authorized dollar amount or December 31, 2008. The repurchase plan is dependent upon market conditions and there is no guarantee as to the exact number of shares to be repurchased by the Company. To date, the Company has purchased 25,700 shares at an aggregate cost of approximately $\$ 538$ under this program. The Company s primary source of liquidity is dividends paid by the Bank. Applicable Tennessee statutes and regulations impose restrictions on the amount of dividends that may be declared by the Bank. Further, any dividend payments are subject to the continuing ability of the Bank to maintain its compliance with minimum federal regulatory capital requirements and to retain its characterization under federal regulations as a well-capitalized institution. Risk-based capital regulations adopted by the Board of Governors of the Federal Reserve Board ( FRB ) and the Federal Deposit Insurance Corporation (the FDIC ) require bank holding companies and banks, respectively, to achieve and maintain specified ratios of capital to risk-weighted assets. The risk-based capital rules are designed to measure Tier 1 Capital and Total Capital in relation to the credit risk of both on- and off-balance sheet items. Under the guidelines, one of four risk weights is applied to the different on-balance sheet items. Off-balance sheet items, such as loan commitments, are also subject to risk-weighting after conversion to balance sheet equivalent amounts. All bank holding companies and banks must maintain a minimum total capital to total risk-weighted assets ratio of $8.00 \%$, at least half of which must be in the form of core, or Tier 1, capital (consisting of common equity, retained earnings, and a limited amount of qualifying perpetual preferred stock and trust preferred securities, net of goodwill and other intangible assets and accumulated other comprehensive income). These guidelines also specify that bank holding companies that are experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels. At September 30, 2008, the Bank and the Company each satisfied their respective minimum regulatory capital requirements, and the Bank was well-capitalized within the meaning of federal regulatory requirements. The table below sets forth the capital position of the Bank and the Company at September 30, 2008.

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|  | Required <br> Minimum | Required to be Well |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  | Ratio | Capitalized | Bank | Company |
| Tier 1 risk-based capital | 4.00\% | 6.00\% | 10.34\% | 10.64\% |
| Total risk-based capital | 8.00\% | 10.00\% | 11.59\% | 11.89\% |
| Leverage Ratio | 4.00\% | 5.00\% | 8.77\% | 9.03\% |

The FRB has issued regulations which will allow continued inclusion of outstanding and prospective issuances of trust preferred securities as Tier 1 capital subject to stricter quantitative and qualitative limits than allowed under prior regulations. The new limits will phase in over a five-year transition period and would permit the Company s trust preferred securities to continue to be treated as Tier 1 capital.

## Off-Balance Sheet Arrangements

At September 30, 2008, the Company had outstanding unused lines of credit and standby letters of credit totaling $\$ 500,370$ and unfunded loan commitments outstanding of $\$ 16,780$. Because these commitments generally have fixed expiration dates and most will expire without being drawn upon, the total commitment level does not necessarily represent future cash requirements. If needed to fund these outstanding commitments, the Company has the ability to liquidate Federal funds sold or securities available-for-sale or, on a short-term basis, to borrow any then available amounts from the FHLB and/or purchase Federal funds from other financial institutions. At September 30, 2008, the Company had accommodations with upstream correspondent banks for unsecured Federal funds lines of \$140,587. These accommodations have various covenants related to their term and availability, and in most cases must be repaid within less than a month. The following table presents additional information about the Company s off-balance sheet commitments as of September 30, 2008, which by their terms have contractual maturity dates subsequent to September 30, 2008:

|  | Less than 1 |  |  |  | More than 5 |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | Year | 1-3 Years |  | 3-5 Years |  | Years |  | Total |  |
| Commitments to make loans fixed | \$ | 6,555 | \$ |  | \$ |  | \$ |  | \$ | 6,555 |
| Commitments to make loans variable |  | 10,225 |  |  |  |  |  |  |  | 10,225 |
| Unused lines of credit |  | 262,039 |  | 83,578 |  | 22,473 |  | 84,259 |  | 452,349 |
| Letters of credit |  | 30,207 |  | 3,199 |  | 7,721 |  | 6,894 |  | 48,021 |
| Total | \$ | 309,026 | \$ | 86,777 | \$ | 30,194 | \$ | 91,153 | \$ | 517,150 |

## Disclosure of Contractual Obligations

In the ordinary course of operations, the Company enters into certain contractual obligations. Such obligations include the funding of operations through debt issuances as well as leases for premises and equipment. The following table summarizes the Company s significant fixed and determinable contractual obligations as of September 30, 2008:

|  | Less than 1 |  |  | More than 5 |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Year |  | 3 Years |  | Years |  | ears | Total |
| Certificates of deposits | \$ 1,312,493 | \$ | 166,085 | \$ | 6,102 | \$ | 3,179 | \$ 1,487,859 |
| Repurchase agreements | 64,929 |  |  |  |  |  |  | 64,929 |
| FHLB advances and notes payable | 457 |  | 67,402 |  | 80,984 |  | 81,063 | 229,906 |


| Subordinated debentures |  |  |  |  | 88,662 | 88,662 |  |
| :--- | ---: | :---: | :---: | ---: | ---: | ---: | ---: |
| Operating lease obligations | 1,039 | 1,458 | 1,236 | 1,098 | 4,831 |  |  |
| Deferred compensation | 1,949 |  |  | 1,937 | 3,886 |  |  |
| Purchase obligations | 281 |  |  |  |  | 281 |  |
|  |  |  |  |  |  |  |  |
| Total | $\$ 1,381,148$ | $\$ 234,945$ | $\$$ | 88,322 | $\$$ | 175,939 | $\$ 1,880,354$ |

Additionally, the Company routinely enters into contracts for services. These contracts may require payment for services to be provided in the future and may also contain penalty clauses for early termination of the contract. Management is not aware of any additional commitments or contingent liabilities which may have a material adverse impact on the liquidity or capital resources of the Company.

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## Effect of New Accounting Standards

In November 2007, the Securities and Exchange Commission ( SEC ) issued Staff Accounting Bulletin No. 109, Written Loan Commitments Recorded at Fair Value Through Earnings ( SAB 109 ). SAB 109 expresses the current view of the staff that the expected net future cash flows related to the associated servicing of the loan should be included in the measurement of all written loan commitments that are accounted for at fair value through earnings. SEC registrants are expected to apply the views in Question 1 of SAB 109 on a prospective basis to derivative loan commitments issued or modified in fiscal quarters beginning after December 15, 2007. The implementation of this guidance did not have a material impact on the Company s consolidated financial statements.
In December 2007, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 141(R), Business Combinations and SFAS No. 160, Accounting and Reporting of Noncontrolling Interest in Consolidated Financial Statements, an amendment of ARB No. 51 . These new standards will significantly change the accounting for and reporting of business combination transactions and noncontrolling (minority) interests in consolidated financial statements. SFAS Nos. $141(\mathrm{R})$ and 160 are required to be adopted simultaneously and are effective for the first annual reporting period beginning on or after December 15, 2008. Earlier adoption is prohibited. We are currently evaluating the impact of adopting SFAS Nos. $141(\mathrm{R})$ and 160 on our consolidated financial statements.
In December 2007, the FASB issued SFAS No. 133 Accounting for Derivative Instruments and Hedging Activities , Implementation Issue No. E23, Hedging General: Issues Involving the Application of the Shortcut Method under Paragraph 68 ( Issue E23 ). Issue E23 amends SFAS No. 133 to explicitly permit use of the shortcut method for hedging relationships in which interest rate swaps have nonzero fair value at the inception of the hedging relationship, provided certain conditions are met. Issue E23 was effective for hedging relationships designated on or after January 1, 2008. The implementation of this guidance did not have a material impact on our consolidated financial statements.
In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133 . SFAS No. 161 expands quarterly disclosure requirements in SFAS No. 133 about an entity s derivative instruments and hedging activities. SFAS No. 161 is effective for fiscal years beginning after November 15, 2008. The Company is currently assessing the impact of SFAS No. 161 on its consolidated financial position and results of operations.
In April 2008, the FASB issued FSP No. FAS 142-3, Determination of the Useful Life of Intangible Assets. This FSP amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, Goodwill and Other Intangible Assets . The objective of this FSP is to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141(R), and other U.S. Generally Accepted Accounting Principles. This FSP applies to all intangible assets, whether acquired in a business combination or otherwise and shall be effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years and applied prospectively to intangible assets acquired after the effective date. Early adoption is prohibited. We have evaluated the new statement and have determined that it will not have a significant impact on the determination or reporting of our financial results.

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

Part II, Item 7A of the 2007 10-K is incorporated in this item of this Quarterly Report by this reference. There have been no material changes in the quantitative and qualitative market risks of the Company since December 31, 2007.
ITEM 4. CONTROLS AND PROCEDURES

## Disclosure Controls and Procedures

The Company s management, with the participation of the Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the Company s disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934 (the Exchange Act ) as of the end of the period covered by this report. Based upon this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of September 30, 2008, the Company s disclosure controls and procedures were effective for the purposes set forth in the definition thereof in Exchange Act Rule 13a-15(e).

## Internal Control Over Financial Reporting

There have been no changes in the Company s internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)) during the quarter ended September 30, 2008 that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

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## PART II OTHER INFORMATION

## Item 1. Legal Proceedings

The Company and its subsidiaries are subject to claims and suits arising in the ordinary course of business. In the opinion of management, the ultimate resolution of these pending claims and legal proceedings will not have a material adverse effect on the Company $s$ results of operations.
Item 1A. Risk Factors
There have been no material changes to our risk factors as previously disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2007.
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds
The Company made no unregistered sales of its equity securities or repurchases of its common stock during the quarter ended September 30, 2008.

## Item 3. Defaults Upon Senior Securities

None
Item 4. Submission of Matters to a Vote of Security Holders
None
Item 5. Other Information
None
Item 6. Exhibits
See Exhibit Index immediately following the signature page hereto.

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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.

Green Bankshares, Inc.
Registrant
Date: November 06, 2008
By: /s/ James E. Adams
James E. Adams
Executive Vice President, Chief Financial Officer and Secretary

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## EXHIBIT INDEX

Exhibit No. Description
31.1 Chief Executive Officer Certification Pursuant to Rule 13a-14(a)/15d-14(a)
31.2 Chief Financial Officer Certification Pursuant to Rule 13a-14(a)/15d-14(a)
32.1 Chief Executive Officer Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2 Chief Financial Officer Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

