

PEOPLES BANCORP INC

Form 10-Q

October 31, 2008

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2008

OR

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

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

Commission File Number: 0-16772

PEOPLES BANCORP INC.

(Exact name of Registrant as specified in its charter)

Ohio  
(State or other jurisdiction  
of incorporation or  
organization)

31-0987416  
(I.R.S. Employer Identification No.)

138 Putnam Street, P. O.  
Box 738, Marietta, Ohio  
(Address of principal  
executive offices)

45750  
(Zip Code)

Registrant's telephone  
number, including area  
code: (740) 373-3155

Not Applicable  
(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  No

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

Large accelerated filer       Accelerated filer       Non-accelerated filer       Smaller reporting company   
(Do not check if a smaller re-ported company)

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date: 10,425,803 common shares, without par value, at October 29, 2008.

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As used in this Quarterly Report on Form 10-Q (“Form 10-Q”), “Peoples” refers to Peoples Bancorp Inc. and its consolidated subsidiaries collectively, except where the context indicates the reference relates solely to the registrant, Peoples Bancorp Inc.

## PART I – FINANCIAL INFORMATION

## ITEM 1: FINANCIAL STATEMENTS

PEOPLES BANCORP INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS (Unaudited)

(Dollars in thousands, except share data)	September 30, 2008	December 31, 2007
<b>Assets</b>		
Cash and cash equivalents:		
Cash and due from banks	\$ 38,311	\$ 43,275
Interest-bearing deposits in other banks	1,247	1,925
Total cash and cash equivalents	39,558	45,200
Available-for-sale investment securities, at fair value (amortized cost of \$598,355 at September 30, 2008 and \$535,979 at December 31, 2007)	589,017	542,231
Other investment securities, at cost	23,996	23,232
Total investment securities	613,013	565,463
Loans, net of deferred fees and costs	1,113,610	1,120,941
Allowance for loan losses	(19,156)	(15,718)
Net loans	1,094,454	1,105,223
Loans held for sale	1,069	1,994
Bank premises and equipment, net	25,283	24,803
Bank owned life insurance	51,511	50,291
Goodwill	62,520	62,520
Other intangible assets	4,268	5,509
Other assets	28,712	24,550
Total assets	\$ 1,920,388	\$ 1,885,553
<b>Liabilities</b>		
Deposits:		
Non-interest-bearing	\$ 184,474	\$ 175,057
Interest-bearing	1,066,383	1,011,320
Total deposits	1,250,857	1,186,377
Short-term borrowings	140,461	222,541
Long-term borrowings	293,565	231,979
Junior subordinated notes held by subsidiary trust	22,487	22,460
Accrued expenses and other liabilities	15,924	19,360
Total liabilities	1,723,294	1,682,717

## Stockholders' Equity

Common stock, no par value, 24,000,000 shares authorized,		
10,963,199 shares issued at September 30, 2008 and 10,925,954		
shares issued at December 31, 2007, including	164,457	163,399
shares in treasury		
Retained earnings	56,007	52,527
Accumulated comprehensive (loss) income, net of deferred income taxes	(7,113)	3,014
Treasury stock, at cost, 638,626 shares at September 30, 2008 and		
629,206 shares at December 31, 2007	(16,257)	(16,104)
Total stockholders' equity	197,094	202,836
Total liabilities and stockholders' equity	\$ 1,920,388	\$ 1,885,553

See Notes to the Unaudited Consolidated Financial Statements

Table of ContentsPEOPLES BANCORP INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF INCOME (Unaudited)

(Dollars in thousands, except per share data)	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2008	2007	2008	2007
<b>Interest Income:</b>				
Interest and fees on loans	\$ 18,027	\$ 20,981	\$ 56,805	\$ 63,831
Interest on taxable investment securities	7,361	6,507	20,929	18,893
Interest on tax-exempt investment securities	663	704	2,115	1,818
Other interest income	12	49	61	139
<b>Total interest income</b>	<b>26,063</b>	<b>28,241</b>	<b>79,910</b>	<b>84,681</b>
<b>Interest Expense:</b>				
Interest on deposits	7,458	9,447	23,704	27,921
Interest on short-term borrowings	689	2,975	3,006	9,031
Interest on long-term borrowings	2,819	2,172	7,957	6,046
Interest on junior subordinated notes held by subsidiary trusts	495	495	1,481	1,677
<b>Total interest expense</b>	<b>11,461</b>	<b>15,089</b>	<b>36,148</b>	<b>44,675</b>
<b>Net interest income</b>	<b>14,602</b>	<b>13,152</b>	<b>43,762</b>	<b>40,006</b>
Provision for loan losses	5,996	967	14,198	2,437
<b>Net interest income after provision for loan losses</b>	<b>8,606</b>	<b>12,185</b>	<b>29,564</b>	<b>37,569</b>
<b>Other Income:</b>				
Deposit account service charges	2,761	2,562	7,431	7,375
Insurance income	2,439	2,230	7,701	7,657
Trust and investment income	1,266	1,211	3,915	3,639
Electronic banking income	994	879	2,925	2,607
Bank owned life insurance	391	418	1,220	1,237
Mortgage banking income	104	251	500	722
Net loss on investment securities	(111)	(613)	(126)	(575)
Other	187	185	570	567
<b>Total other income</b>	<b>8,031</b>	<b>7,123</b>	<b>24,136</b>	<b>23,229</b>
<b>Other Expenses:</b>				
Salaries and employee benefits	7,035	6,603	21,501	20,770
Net occupancy and equipment	1,344	1,233	4,169	3,917
Data processing and software	521	530	1,622	1,594
Electronic banking expense	638	554	1,678	1,568
Professional fees	528	469	1,594	1,714
Franchise tax	416	449	1,248	1,336
Amortization of intangible assets	390	478	1,208	1,467
Marketing	273	350	1,010	1,078

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Other	2,048	1,933	5,949	5,647
Total other expenses	13,193	12,599	39,979	39,091
Income before income taxes	3,444	6,709	13,721	21,707
Income taxes	493	1,594	3,169	5,597
Net income	\$ 2,951	\$ 5,115	\$ 10,552	\$ 16,110
Earnings per share:				
Basic	\$ 0.29	\$ 0.49	\$ 1.02	\$ 1.53
Diluted	\$ 0.28	\$ 0.49	\$ 1.02	\$ 1.52
Weighted-average number of shares outstanding:				
Basic	10,319,534	10,421,548	10,309,010	10,502,866
Diluted	10,354,522	10,483,657	10,350,008	10,573,934
Cash dividends declared	\$ 2,397	\$ 2,293	\$ 7,072	\$ 6,943

See Notes to the Unaudited Consolidated Financial Statements

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CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (Unaudited)

(Dollars in thousands, except per share data)	Common Stock		Retained Earnings	Accumulated Comprehensive Income (Loss)	Treasury Stock	Total
	Shares	Amount				
Balance, December 31, 2007	10,925,954	\$163,399	\$ 52,527	\$ 3,014	\$(16,104)	\$202,836
Net income			10,552			10,552
Other comprehensive loss, net of tax				(10,127)		(10,127)
Cash dividends declared of \$0.68 per share			(7,072)			(7,072)
Stock-based compensation expense		439				439
Purchase of treasury stock, 20,513 shares					(449)	(449)
Issuance of common stock related to stock-based compensation (reissued 10,486 treasury shares)	6,475	(113)			296	183
Tax benefit from exercise of stock options		15				15
Issuance of common stock under dividend reinvestment plan	30,770	717				717
Balance, September 30, 2008	10,963,199	\$164,457	\$ 56,007	\$ (7,113)	\$(16,257)	\$197,094

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(Dollars in thousands)	Nine Months Ended	
	2008	2007



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Net cash provided by operating activities	25,232	21,865
Cash flows from investing activities:		
Purchases of available-for-sale securities	(237,441)	(134,600)
Proceeds from sales of available-for-sale securities	64,893	151
Proceeds from maturities, calls and prepayments of available-for-sale securities	110,127	92,839
Net (increase) decrease in loans	(2,988)	23,560
Net expenditures for premises and equipment	(2,904)	(1,867)
Net proceeds from sales of other real estate owned	272	107
Business acquisitions, net of cash received	–	(1,070)
Investment in limited partnership and tax credit funds	(249)	(277)
Net cash (used in) investing activities	(68,290)	(21,157)
Cash flows from financing activities:		
Net increase in non-interest-bearing deposits	9,417	398
Net increase (decrease) in interest-bearing deposits	54,991	(50,577)
Net (decrease) increase in short-term borrowings	(82,080)	54,164
Proceeds from long-term borrowings	115,000	85,000
Payments on long-term borrowings	(53,413)	(71,378)
Cash dividends paid	(6,268)	(6,304)
Purchase of treasury stock	(449)	(10,241)
Repayment of trust preferred securities	–	(7,000)
Proceeds from issuance of common stock	203	846
Excess tax benefit for share-based payments	15	154
Net cash provided by (used in) financing activities	37,416	(4,938)
Net (decrease) in cash and cash equivalents	(5,642)	(4,230)
Cash and cash equivalents at beginning of period	45,200	39,806
Cash and cash equivalents at end of period	\$ 39,558	\$ 35,576

See Notes to the Unaudited Consolidated Financial Statements



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PEOPLES BANCORP INC. AND SUBSIDIARIES  
NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation:

The accompanying unaudited Consolidated Financial Statements of Peoples Bancorp Inc. and its subsidiaries have been prepared in accordance with accounting principles generally accepted in the United States (“US GAAP”) for interim financial information and the instructions for Form 10-Q and Article 10 of Regulation S-X. Accordingly, these financial statements do not contain all of the information and footnotes required by US GAAP for annual financial statements and should be read in conjunction with Peoples’ Annual Report on Form 10-K for the fiscal year ended December 31, 2007 (“2007 Form 10-K”).

The accounting and reporting policies followed in the presentation of the accompanying unaudited Consolidated Financial Statements are consistent with those described in Note 1 of the Notes to the Consolidated Financial Statements included in Peoples’ 2007 Form 10-K, as updated by the information contained in this report. In the opinion of management, these financial statements reflect all adjustments necessary to present fairly such information for the periods and dates indicated. Such adjustments are normal and recurring in nature. All significant intercompany accounts and transactions have been eliminated. The Consolidated Balance Sheet at December 31, 2007, contained herein has been derived from the audited Consolidated Balance Sheet included in Peoples’ 2007 Form 10-K.

The preparation of the financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Results of operations for interim periods are not necessarily indicative of the results to be expected for the full year. In addition, Peoples’ insurance commission income includes contingent performance based insurance commissions that are recognized by Peoples when received, which typically occurs during the first quarter of each year.

2. New Accounting Pronouncements:

On May 9, 2008, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards No. 162, The Hierarchy of Generally Accepted Accounting Principles (“SFAS 162”). SFAS 162 established a framework for selecting accounting principles to be used in preparing financial statements that are presented in conformity with US GAAP. SFAS 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board Auditing amendments to AU Section 411, The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles, and is not expected to have an impact on Peoples’ Consolidated Financial Statements.

On March 19, 2008, the FASB issued Statement of Financial Accounting Standards No. 161, Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133 (“SFAS 161”), which requires enhanced disclosures about an entity’s derivative and hedging activities intended to improve the transparency of financial reporting. Under SFAS 161, entities will be required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations and (c) how derivative instruments and related hedged items affect an entity’s financial position, financial performance and cash flows. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. Peoples will adopt SFAS 161 effective January 1, 2009 and adoption is not anticipated to have a material impact on Peoples’ Consolidated Financial Statements.

On February 15, 2007, the FASB issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities—including an amendment of FASB Statement No. 115 (“SFAS 159”), which

permits companies to choose to measure many financial instruments and certain other items at fair value. The objective of SFAS 159 is to improve financial reporting by providing companies with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently. Peoples adopted SFAS 159 effective January 1, 2008, as required, but has not elected to measure any permissible items at fair value. As a result, the adoption of SFAS 159 has not had any impact on Peoples' Consolidated Financial Statements.

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On September 15, 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements (“SFAS 157”), which replaces various definitions of fair value in existing accounting literature with a single definition, establishes a framework for measuring fair value and requires additional disclosures about fair value measurements upon adoption. SFAS 157 clarifies that fair value is the price that would be received to sell an asset or the price paid to transfer a liability in the most advantageous market available to the entity and emphasizes that fair value is a market-based measurement and should be based on the assumptions market participants would use. SFAS 157 also creates a three-level hierarchy under which individual fair value estimates are to be ranked based on the relative reliability of the inputs used in the valuation. This hierarchy is the basis for the disclosure requirements, with fair value estimates based on the least reliable inputs requiring more extensive disclosures about the valuation method used and the gains and losses associated with those estimates. SFAS 157 is required to be applied whenever another financial accounting standard requires or permits an asset or liability to be measured at fair value. The statement does not expand the use of fair value to any new circumstances.

On February 12, 2008, the FASB issued FASB Staff Position No. FAS 157-2, Effective Date of FASB Statement No. 157 (“FSP 157-2”). FSP 157-2 amends SFAS 157 to delay the effective date for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis, which means at least annually. For items within its scope, Peoples will be required to apply the new guidance beginning January 1, 2009. Management is still determining the impact adoption will have on Peoples’ Consolidated Financial Statements. For all other items, Peoples applied the guidance as of January 1, 2008, as required, which did not have a material impact on Peoples’ Consolidated Financial Statements.

On October 10, 2008, the FASB issued FASB Staff Position No. FAS 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active (“FSP 157-3”). FSP 157-3 clarifies the application of SFAS 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. FSP 157-3 was effective immediately upon issuance, and includes prior periods for which financial statements have not been issued. Peoples applied the guidance contained in FSP 157-3 in determining fair values at September 30, 2008, although it did not have a material impact on Peoples’ Consolidated Financial Statements.

### 3. Stock-Based Compensation:

Under the Peoples Bancorp Inc. 2006 Equity Plan (the “2006 Equity Plan”) approved by shareholders, Peoples may grant, among other awards, nonqualified stock options, incentive stock options, restricted stock awards, stock appreciation rights or any combination thereof covering up to 500,000 common shares to employees and non-employee directors. In prior years, Peoples granted nonqualified and incentive stock options to employees and nonqualified stock options to non-employee directors under the 2006 Equity Plan and predecessor plans. Since February 2007, Peoples has granted a combination of restricted common shares and stock appreciation rights (“SARs”) to be settled in common shares to employees and restricted common shares to non-employee directors subject to the terms and conditions prescribed by the 2006 Equity Plan. In general, common shares issued in connection with stock-based awards are issued from treasury shares to the extent available. If no treasury shares are available, common shares are issued from authorized but unissued common shares.

Stock Options: Under the provisions of the 2006 Equity Plan and predecessor stock option plans, the exercise price per share of any stock option granted may not be less than the fair market value of the underlying common shares on the date of grant of the stock option. The most recent stock options granted to employees and non-employee directors occurred in 2006. The stock options granted to employees will vest three years from the grant date, while the stock options granted to non-employee directors vested six months from the grant date. All stock options granted to both employees and non-employee directors expire ten years from the date of grant. The following summarizes the changes to Peoples’ stock options for the period ended September 30, 2008:

	Number of Common Shares	Weighted-Average Exercise Price	Weighted- Average Remaining Contractual Life	Aggregate Intrinsic Value
Outstanding at January 1	325,461	\$ 22.74		
Granted	—	—		
Exercised	13,064	17.36		
Forfeited	7,950	24.98		
Outstanding at September 30	304,447	22.91	4.4 years	\$ 569,000
Exercisable at September 30	261,909	22.01	4.0 years	\$ 569,000

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For the nine months ended September 30, 2008, the total intrinsic value of stock options exercised was \$61,000. The following summarizes information concerning Peoples' stock options outstanding at September 30, 2008:

Range of Exercise Prices	Outstanding			Exercisable		
	Number of Common Shares	Remaining Contractual Life	Weighted-Average Exercise Price	Number of Common Shares	Remaining Contractual Life	Weighted-Average Exercise Price
\$13.48 to \$14.92	68,603	1.1 years	\$ 14.15	68,603		\$ 14.15
\$15.45 to \$22.32	65,181	4.1 years	\$ 21.47	65,181		21.47
\$23.59 to \$27.38	77,462	4.9 years	\$ 25.18	77,462		25.18
\$27.51 to \$28.66	67,801	6.4 years	\$ 28.20	31,263		28.13
\$28.71 to \$30.00	25,400	7.5 years	\$ 29.27	19,400		29.12
Total	304,447	4.4 years	\$ 22.91	261,909		\$ 22.01

Stock Appreciation Rights: SARs granted to employees have an exercise price equal to the fair market value of Peoples' common shares on the date of grant and will be settled using common shares of Peoples. Additionally, the SARs granted will vest three years from the grant date and expire ten years from the date of grant. The following summarizes the changes to Peoples' SARs for the period ended September 30, 2008:

	Number of Common Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life	Aggregate Intrinsic Value
Outstanding at January 1	30,374	\$ 27.96		
Granted	28,170	23.85		
Exercised	—	—		
Forfeited	1,111	29.25		
Outstanding at September 30	57,433	25.92	9.0 years	\$ —
Exercisable at September 30	—	—	—	\$ —

For the nine months ended September 30, 2008, the weighted-average estimated fair value of the SARs granted was \$5.46. The following summarizes information concerning Peoples' SARs outstanding at September 30, 2008:

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Range of Exercise Prices	Outstanding			Exercisable		
	Number of Common Shares	Remaining Contractual Life	Weighted-Average Exercise Price	Number of Common Shares	Weighted-Average Exercise Price	
\$23.26 to \$23.26	5,000	8.8 years	\$ 23.26	–	\$ –	
\$23.77 to \$23.77	26,170	9.4 years	\$ 23.77	–	\$ –	
\$23.80 to \$27.99	6,000	9.2 years	\$ 26.26	–	\$ –	
\$29.25 to \$29.25	20,263	8.4 years	\$ 29.25	–	\$ –	
Total	57,433	9.0 years	\$ 25.92	–	\$ –	

Restricted Shares: Under the 2006 Equity Plan, Peoples may award restricted common shares to officers, key employees and non-employee directors. In general, the restrictions on common shares awarded to non-employee directors expire after six months, while the restrictions on common shares awarded to employees expire after three years. The following summarizes the changes to Peoples' restricted common shares for the period ended September 30, 2008:



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	Number of Common Shares	Weighted- Average Grant Date Fair Value
Outstanding at January 1	9,148	\$ 28.49
Awarded	14,069	23.72
Released	6,475	24.63
Forfeited	164	29.25
Outstanding at September 30	16,578	\$ 25.94

For the nine months ended September 30, 2008, the total intrinsic value of restricted common shares released was \$143,000.

Stock-Based Compensation: Peoples recognizes stock-based compensation expense, which is included as a component of Peoples' salaries and employee benefits costs, based on the estimated fair value of the awards on the grant date. The following summarizes the amount of stock-based compensation expense and related tax benefit recognized for the period ended September 30:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Total stock-based compensation	\$ 80,000	\$ 78,000	\$ 439,000	\$ 317,000
Recognized tax benefit	(28,000)	(27,000)	(154,000)	(111,000)
Net expense recognized	\$ 52,000	\$ 51,000	\$ 285,000	\$ 206,000

The estimated fair value of SARs granted during the nine months ended September 30, 2008 and 2007, was calculated at grant date using the Black-Scholes option pricing model with the following weighted-average assumptions:

	2008	2007
Risk-free interest rate	4.38%	4.83%
Dividend yield	3.88%	2.93%
Volatility factor of the market price of parent stock	26.3%	25.4%
Weighted-average expected life	10 years	10 years

The Black-Scholes option valuation model was originally developed for use in estimating the fair value of traded options, which have different characteristics than equity awards granted by Peoples, such as no vesting or transfer

restrictions. The model requires the input of highly subjective assumptions, including the expected stock price volatility, which can materially affect the fair value estimate. The expected volatility and expected life assumptions were based solely on historical data. The expected dividend yield is computed based on the then current dividend rate, and the risk-free interest rate is based on U.S. Treasury zero-coupon issues with a remaining term approximating the expected life of the equity awards.

Total unrecognized stock-based compensation expense related to unvested awards was \$268,000 at September 30, 2008, which will be recognized over a weighted-average period of 1.7 years.

#### 4. Employee Benefit Plans:

Peoples sponsors a noncontributory defined benefit pension plan that covers substantially all employees. The plan provides retirement benefits based on an employee's years of service and compensation. In 2003, Peoples changed the methodology used to determine the retirement benefits for employees hired on or after January 1, 2003, which has lowered accumulated benefit obligation and net costs. Peoples also has a contributory postretirement benefit plan for former employees who were retired as of December 31, 1992. The plan provides health and life insurance benefits. Peoples' policy is to fund the cost of the benefits as they are incurred. The following table details the components of the net periodic benefit cost for the plans:

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## Pension Benefits

(Dollars in thousands)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2008	2007	2008	2007
Service cost	\$ 191	\$ 212	\$ 572	\$ 635
Interest cost	195	189	586	568
Expected return on plan assets	(300)	(297)	(901)	(893)
Amortization of prior service cost	1	1	3	2
Amortization of net loss	2	40	7	120
Net periodic benefit cost	\$ 89	\$ 145	\$ 267	\$ 432

## Postretirement Benefits

(Dollars in thousands)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2008	2007	2008	2007
Interest cost	\$ 4	\$ 7	\$ 11	\$ 20
Amortization of prior service cost	(1)	–	(2)	–
Amortization of net loss	(1)	–	(3)	2
Net periodic benefit cost	\$ 2	\$ 7	\$ 6	\$ 22

## 5. Comprehensive (Loss) Income:

The components of other comprehensive (loss) income for the three and nine month periods ended September 30 were as follows:

(Dollars in thousands)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2008	2007	2008	2007
Net income	\$ 2,951	\$ 5,115	\$ 10,552	\$ 16,110
Other comprehensive (loss) income:				
Available-for-sale investment securities:				
Gross unrealized holding (loss) gain arising in the period	(8,218)	3,243	(15,715)	637

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Related tax benefit (expense)	2,876	(1,135)	5,500	(223)
Less: reclassification adjustment for net loss included in net income	(111)	(613)	(126)	(575)
Related tax benefit	39	215	44	201
Net effect on other comprehensive (loss) income	(5,270)	2,506	(10,133)	788
Amortization of unrecognized loss and service cost on defined benefit pension plan	9	41	9	122
Related tax expense	(3)	(14)	(3)	(43)
Net effect on other comprehensive (loss) income	6	27	6	79
Total other comprehensive (loss) income, net of tax	(5,264)	2,533	(10,127)	867
Total comprehensive (loss) income	\$ (2,313)	\$ 7,648	\$ 425	\$16,977

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The following details the change in the components of Peoples' accumulated other comprehensive income (loss) for the nine months ended September 30, 2008:

(Dollars in thousands)	Unrealized Gains (Loss) on Securities	Unrecognized Net Pension and Postretirement Costs	Accumulated Comprehensive Income (Loss)
Balance, December 31, 2007	\$ 4,064	\$ (1,050)	\$ 3,014
Current period change, net of tax	(10,133)	6	(10,127)
Balance, September 30, 2008	\$ (6,069)	\$ (1,044)	\$ (7,113)

## 6. Earnings Per Share:

Basic earnings per share are computed by dividing net income by the weighted-average number of common shares outstanding. Diluted earnings per share is computed by dividing net income by the weighted-average number of common shares outstanding adjusted to include the effect of potentially dilutive common shares. Potentially dilutive common shares include incremental shares issuable upon exercise of outstanding stock options, SARs and non-vested restricted common shares using the treasury stock method. The calculation of basic and diluted earnings per share was as follows:

(Dollars in thousands, except per share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Net income	\$ 2,951	\$ 5,115	\$ 10,552	\$ 16,110
Weighted-average common shares outstanding	10,319,534	10,421,548	10,309,010	10,502,866
Effect of potentially dilutive common shares	34,988	62,109	40,998	71,068
Total weighted-average diluted common shares outstanding	10,354,522	10,483,657	10,350,008	10,573,934
Earnings per Share:				
Basic	\$ 0.29	\$ 0.49	\$ 1.02	\$ 1.53
Diluted	\$ 0.28	\$ 0.49	\$ 1.02	\$ 1.52

## 7. Fair Values of Financial Instruments:

Effective January 1, 2008, Peoples adopted SFAS 157, which established a hierarchy for measuring fair value that is intended to maximize the use of observable inputs and minimize the use of unobservable inputs. This hierarchy uses three levels of inputs to measure the fair value of assets and liabilities as follows:

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

Level 2 – Observable inputs other than Level 1 including quoted prices for similar assets or liabilities, quoted prices in less active markets, or other observable inputs that can be corroborated by observable market data; also includes derivative contracts whose value is determined using a pricing model with observable market inputs or can be derived principally from or corroborated by observable market data. This category generally includes certain U.S. Government and agency securities, corporate debt securities, derivative instruments, and residential mortgage loans held for sale.

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

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Assets measured at fair value on a recurring basis comprise the following at September 30, 2008:

(Dollars in thousands)	Fair Value	Fair Value Measurements at Reporting Date		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Using Significant Other Observable Inputs (Level 2)	Using Significant Unobservable Inputs (Level 3)
Available-for-sale investment securities	\$ 589,017	\$ 3,231	\$ 575,391	\$ 10,395
Interest rate contract	1	–	1	–
<b>Total</b>	<b>\$ 589,018</b>	<b>\$ 3,231</b>	<b>\$ 575,392</b>	<b>\$ 10,395</b>

The investment securities measured at fair value utilizing Level 1 and 2 inputs are obligations of the U.S. Treasury, agencies and corporations of the U.S. government, including mortgage-backed securities, bank eligible obligations of any state or political subdivision in the U.S., bank eligible corporate obligations, including private-label mortgage-backed securities and common stocks issued by various unrelated banking holding companies. The fair values used by Peoples are obtained from an independent pricing service and represent either quoted market prices for the identical securities (Level 1 inputs) or fair values determined by pricing models that consider observable market data, such as interest rate volatilities, LIBOR yield curve, credit spreads and prices from market markers and live trading systems.

The investment securities measured at fair value using Level 3 inputs are comprised of four collateralized debt obligations, with a total book value of \$6.1 million, and two corporate obligations, with a total book value of \$3.1 million, for which there is not an active market. Peoples uses multiple input factors to determine the fair value of these securities. Those input factors are discounted cash flow analysis, structure of the security in relation to current level of deferrals and/or defaults, changes in credit ratings, financial condition of the debtors within the underlying securities, broker quotes for securities with similar structure and credit risk, interest rate movements and pricing of new issuances.

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

	Investment Securities
Balance, January 1, 2008	\$ 9,004
Transfers into Level 3	2,083
Transfers out of Level 3	(2,078)
Unrealized gain included in comprehensive income	1,386

Balance, September 30, 2008	\$	10,395
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Certain assets were measured at fair value on a non-recurring basis at September 30, 2008. Loans held for investment that are considered impaired by Peoples are measured and reported at fair value through a specific allocation of the allowance for loan losses in accordance with the provisions of FASB Statement No. 114, Accounting by Creditors for Impairment of a Loan. Management's determination of the fair value for these loans represents the estimated amount to be received from the sale of the collateral based on observable market prices and market value provided by independent, licensed or certified appraisers (Level 2 Inputs).

At September 30, 2008, impaired loans with an aggregate outstanding principal balance of \$29.1 million were measured and reported at an aggregate fair value of \$29.5 million, less estimated costs to sell of \$1.9 million (net value of \$27.6 million). For the three and nine months ended September 30, 2008, Peoples recognized losses on impaired loans of \$1.5 million and \$8.5 million, respectively, of which \$6.4 million was recognized in the second quarter and relates to a single commercial real estate loan being charged down to the fair value of the collateral of \$6.5 million, less estimated costs to sell of \$0.3 million (net value of \$6.2 million).



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

## SELECTED FINANCIAL DATA

The following data should be read in conjunction with the unaudited Consolidated Financial Statements and Management's Discussion and Analysis that follows:

SIGNIFICANT RATIOS	At or For the Three Months Ended September 30,		At or For the Nine Months Ended September 30,	
	2008	2007	2008	2007
Return on average stockholders' equity	5.82%	10.27%	6.88%	10.88%
Return on average assets	0.61%	1.09%	0.74%	1.15%
Net interest margin (a)	3.50%	3.26%	3.54%	3.29%
Efficiency ratio (b)	55.33%	57.03%	55.98%	58.06%
Average stockholders' equity to average assets	10.54%	10.60%	10.81%	10.61%
Average loans to average deposits	87.56%	92.09%	89.44%	93.04%
Dividend payout ratio	81.23%	44.83%	67.02%	43.10%
<b>ASSET QUALITY RATIOS</b>				
Nonperforming loans as a percent of total loans (c)(d)	3.21%	0.56%	3.21%	0.56%
Nonperforming assets as a percent of total assets (d)(e)	1.88%	0.34%	1.88%	0.34%
Allowance for loan losses to loans net of unearned interest (d)	1.72%	1.32%	1.72%	1.32%
Allowance for loan losses to nonperforming loans (c)(d)	53.60%	237.33%	53.60%	237.33%
Provision for loan losses to average loans	0.54%	0.09%	1.28%	0.22%
Net charge-offs as a percentage of average loans (annualized)	0.74%	0.36%	1.29%	0.27%
<b>CAPITAL RATIOS (d)</b>				
Tier I capital ratio	12.35%	11.82%	12.35%	11.82%
Total risk-based capital ratio	13.68%	13.04%	13.68%	13.04%

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Leverage ratio	8.66%	8.67%	8.66%	8.67%
Tangible capital ratio (f)	7.03%	7.20%	7.03%	7.20%

PER SHARE DATA

Earnings per share – basic \$	0.29	\$ 0.49	\$ 1.02	\$ 1.53
Earnings per share – diluted	0.28	0.49	1.02	1.52
Cash dividends declared per share	0.23	0.22	0.68	0.66
Book value per share (d)	19.09	19.25	19.09	19.25
Tangible book value per share (d) (g)	\$ 12.62	\$ 12.63	\$ 12.62	\$ 12.63
Weighted average shares outstanding – Basic	10,319,534	10,421,548	10,309,010	10,502,866
Weighted average shares outstanding – Diluted	10,354,522	10,483,657	10,350,008	10,573,934
Common shares outstanding at end of period	10,324,573	10,363,397	10,324,573	10,363,397

- (a) Fully tax-equivalent net interest income as a percentage of average earning assets.
- (b) Non-interest expense (less intangible amortization) as a percentage of fully tax-equivalent net interest income plus non-interest income (excluding gains or losses on investment securities and asset disposals).
- (c) Nonperforming loans include loans 90 days past due and accruing, renegotiated loans and nonaccrual loans.
- (d) Data presented as of the end of the period indicated.
- (e) Nonperforming assets include nonperforming loans and other real estate owned.
- (f) Tangible equity as a percentage of tangible assets, which excludes balance sheet impact of intangible assets acquired through acquisitions on both total stockholders' equity and total assets.
- (g) Tangible book value per share reflects capital calculated for banking regulatory requirements and excludes balance sheet impact of intangible assets acquired through acquisitions.

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### Forward-Looking Statements

Certain statements in this Form 10-Q which are not historical fact are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, Section 21E of the Securities Exchange Act of 1934, as amended, and the Private Securities Litigation Reform Act of 1995. Words such as “anticipate”, “estimates”, “may”, “feels”, “expects,” “believes”, “plans”, “will”, “would”, “should”, “could” and similar expressions are intended to identify these forward-looking statements but are not the exclusive means of identifying such statements. Forward-looking statements are subject to risks and uncertain-ties that may cause actual results to differ materially. Factors that might cause such a difference include, but are not limited to:

- (1) deterioration in the credit quality of Peoples’ loan portfolio could occur due to a number of factors, such as adverse changes in economic conditions that impair the ability of borrowers to repay their loans, the underlying value of the collateral could prove less valuable than otherwise assumed and assumed cash flows may be less favorable than expected, which may adversely impact the provision for loan losses;
- (2) competitive pressures among financial institutions or from non-financial institutions, which may increase significantly;
  - (3) changes in the interest rate environment, which may adversely impact interest margins;
- (4) changes in prepayment speeds, loan originations and charge-offs, which may be less favorable than expected and adversely impact the amount of interest income generated;
- (5) general economic conditions and weakening in the economy, specifically the real estate market, either national or in the states in which Peoples does business, which may be less favorable than expected;
- (6) political developments, wars or other hostilities, which may disrupt or increase volatility in securities markets or other economic conditions;
  - (7) legislative or regulatory changes or actions, which may adversely affect the business of Peoples;
- (8) adverse changes in the conditions and trends in the financial markets, which may adversely affect the fair value of securities within Peoples’ investment portfolio;
  - (9) a delayed or incomplete resolution of regulatory issues that could arise;
  - (10) Peoples’ ability to receive dividends from its subsidiaries;
- (11) changes in accounting standards, policies, estimates or procedures, which may impact Peoples’ reported financial condition or results of operations;
  - (12) Peoples’ ability to maintain required capital levels and adequate sources of funding and liquidity;
- (13) the impact of reputational risk created by these developments on such matters as business generation and retention, funding and liquidity;
- (14) the costs and effects of regulatory and legal developments, including the outcome of regulatory or other governmental inquiries and legal proceedings and results of regulatory examinations; and
- (15) other risk factors relating to the banking industry or Peoples as detailed from time to time in Peoples’ reports filed with the Securities and Exchange Commission (“SEC”), including those risk factors included in the disclosure under the heading “ITEM 1A. RISK FACTORS” of Part I of Peoples’ 2007 Form 10-K.

All forward-looking statements speak only as of the execution date of this Form 10-Q and are expressly qualified in their entirety by the cautionary statements. Although management believes the expectations in these forward-looking statements are based on reasonable assumptions within the bounds of management’s knowledge of Peoples’ business and operations, it is possible that actual results may differ materially from these projections. Additionally, Peoples undertakes no obligation to update these forward-looking statements to reflect events or circumstances after the date of this Form 10-Q or to reflect the occurrence of unanticipated events except as may be required by applicable legal requirements. Copies of documents filed with the SEC are available free of charge at the SEC’s website at [www.sec.gov](http://www.sec.gov) and/or from Peoples Bancorp’s website – [www.peoplesbancorp.com](http://www.peoplesbancorp.com) under the “Investor Relations” section.

### Business Overview

The following discussion and analysis of Peoples' unaudited Consolidated Financial Statements is presented to provide insight into management's assessment of the financial condition and results of operations.

Peoples offers diversified financial products and services through 49 financial service locations and 38 ATMs in southeastern Ohio, northwestern West Virginia and northeastern Kentucky through its financial service units – Peoples Bank, National Association ("Peoples Bank"), Peoples Financial Advisors (a division of Peoples Bank) and Peoples Insurance Agency, Inc, a subsidiary of Peoples Bank. Peoples Bank is a member of the Federal Reserve System and subject to regulation, supervision and examination by the Office of the Comptroller of the Currency.

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Peoples' products and services include traditional banking products, such as deposit accounts, lending products and trust services. Peoples also offers a complete array of insurance products and makes available custom-tailored fiduciary and wealth management services. Peoples provides services through traditional offices, ATMs and telephone and internet-based banking. Brokerage services are offered exclusively through an unaffiliated registered broker-dealer located at Peoples' offices.

This discussion and analysis should be read in conjunction with the audited Consolidated Financial Statements, and notes thereto, contained in Peoples' 2007 Form 10-K, as well as the Consolidated Financial Statements, ratios, statistics and discussions contained elsewhere in this Form 10-Q.

Critical Accounting Policies

The accounting and reporting policies of Peoples conform to US GAAP and to general practices within the financial services industry. The preparation of the financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual resu