

INTERNATIONAL BANCSHARES CORP
Form 10-Q
August 08, 2007

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

FORM 10-Q

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

For the quarterly period ended June 30, 2007

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 0-9439

INTERNATIONAL BANCSHARES CORPORATION
(Exact name of registrant as specified in its charter)

Texas
(State or other jurisdiction of
incorporation or organization)

74-2157138
(I.R.S. Employer Identification No.)

1200 San Bernardo Avenue, Laredo, Texas 78042-1359
(Address of principal executive offices)
(Zip Code)

(956) 722-7611
(Registrant's telephone number, including area code)

None
**(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

Indicate by check mark if the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

OR

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Large Accelerated Filer

Accelerated Filer

Non-accelerated filer

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.

Class	Shares Issued and Outstanding
Common Stock, \$1.00 par value	69,056,925 shares outstanding at August 1, 2007

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Condition (Unaudited)

(Dollars in Thousands)

	June 30, 2007	December 31, 2006
Assets		
Cash and due from banks	\$ 256,219	\$ 268,207
Federal funds sold	124,000	29,000
Total cash and cash equivalents	380,219	297,207
Time deposits with banks	21,951	396
Investment securities:		
Held-to-maturity (Market value of \$2,325 on June 30, 2007 and \$2,375 on December 31, 2006)	2,325	2,375
Available-for-sale (Amortized cost of \$3,810,573 on June 30, 2007 and \$4,548,236 on December 31, 2006)	3,768,993	4,488,078
Total investment securities	3,771,318	4,490,453
Loans, net of unearned discounts	5,127,584	5,034,810
Less allowance for possible loan losses	(66,938	) (64,537)
Net loans	5,060,646	4,970,273
Bank premises and equipment, net	411,340	390,323
Accrued interest receivable	54,518	57,288
Other investments	309,801	345,988
Identified intangible assets, net	34,166	34,358
Goodwill, net	283,198	282,246
Other assets	39,581	42,922
Total assets	\$ 10,366,738	\$ 10,911,454

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	June 30, 2007	December 31, 2006
Liabilities and Shareholders' Equity		
Liabilities:		
Deposits:		
Demand non-interest bearing	\$ 1,459,623	\$ 1,453,476
Savings and interest bearing demand	2,353,327	2,204,451
Time	3,326,379	3,331,991
Total deposits	7,139,329	6,989,918
Securities sold under repurchase agreements	968,396	706,335
Other borrowed funds	1,066,414	2,095,576
Junior subordinated deferrable interest debentures	242,051	210,908
Other liabilities	76,311	66,661
Total liabilities	9,492,501	10,069,398
Commitments, Contingent Liabilities and Other Tax Matters (Note 10)		
Shareholders' equity:		
Common shares of \$1.00 par value. Authorized 275,000,000 shares; issued 95,279,649 shares on June 30, 2007 and 94,846,451 shares on December 31, 2006	95,280	86,224
Surplus	142,205	138,247
Retained earnings	883,720	861,251
Accumulated other comprehensive loss	(26,780)	(40,390)
	1,094,425	1,045,332
Less cost of shares in treasury, 26,290,228 shares on June 30, 2007 and 25,643,564 shares on December 31, 2006	(220,188)	(203,276)
Total shareholders' equity	874,237	842,056
Total liabilities and shareholders' equity	\$ 10,366,738	\$ 10,911,454

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Income (Unaudited)

(Dollars in Thousands, except per share data)

	Three Months Ended		Six Months Ended	
	June 30, 2007	2006	June 30, 2007	2006
Interest income:				
Loans, including fees	\$ 112,723	\$ 97,202	\$ 221,979	\$ 187,604
Federal funds sold	821	817	1,517	2,194
Investment securities:				
Taxable	45,782	50,110	97,438	99,366
Tax-exempt	1,078	1,144	2,209	2,316
Other interest income	2,004	101	2,120	212
Total interest income	162,408	149,374	325,263	291,692
Interest expense:				
Savings deposits	13,695	10,139	26,791	19,043
Time deposits	36,236	29,421	71,273	55,620
Securities sold under repurchase agreements	10,213	7,676	18,535	15,548
Other borrowings	18,177	24,728	45,382	44,733
Junior subordinated interest deferrable debentures	4,526	5,361	8,945	10,385
Total interest expense	82,847	77,325	170,926	145,329
Net interest income	79,561	72,049	154,337	146,363
Provision for possible loan losses	1,198	82	2,559	679
Net interest income after provision for possible loan losses	78,363	71,967	151,778	145,684
Non-interest income:				
Service charges on deposit accounts	21,058	21,517	41,283	42,515
Other service charges, commissions and fees				
Banking	8,843	7,301	16,961	14,229
Non-banking	3,887	4,022	8,831	8,011
Gain (loss) on investment securities transactions, net	2,257	410	(14,910)	410
Other investments, net	4,785	7,384	10,568	11,957
Other income	6,436	6,388	10,774	10,517
Total non-interest income	47,266	47,022	73,507	87,639

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	Three Months Ended June 30, 2007		Six Months Ended June 30, 2007	
		2006		2006
Non-interest expense:				
Employee compensation and benefits	\$ 31,962	\$ 30,152	\$ 63,155	\$ 59,624
Occupancy	8,303	6,506	15,343	12,748
Depreciation of bank premises and equipment	7,813	7,061	15,369	13,805
Professional fees	2,791	2,539	5,469	5,470
Stationery and supplies	1,490	1,343	2,971	2,901
Amortization of identified intangible assets	1,320	1,216	2,529	2,433
Advertising	3,169	3,088	6,420	6,044
Other	16,581	15,816	34,242	43,553
Total non-interest expense	73,429	67,721	145,498	146,578
Income before income taxes	52,200	51,268	79,787	86,745
Minority interest in consolidated subsidiaries	(78)		
Provision for income taxes	17,688	16,610	26,553	28,112
Net income	\$ 34,590	\$ 34,658	\$ 53,234	\$ 58,633
Basic earnings per common share:				
Weighted average number of shares outstanding:	69,313,121	69,399,418	69,314,282	69,619,164
Net income	\$.50	\$.50	\$.77	\$.84
Fully diluted earnings per common share:				
Weighted average number of shares outstanding:	69,686,149	70,117,255	69,820,072	70,350,981
Net income	\$.50	\$.49	\$.76	\$.83

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income (Unaudited)

(Dollars in Thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Net income	\$ 34,590	\$ 34,658	\$ 53,234	\$ 58,633
Other comprehensive income (loss), net of tax				
Net unrealized holding (losses) gains on securities available for sale arising during period	(6,815)	(22,090)	36,207	(23,053)
Reclassification adjustment for gains (losses) on securities available for sale included in net income		38	(22,597)	38
Comprehensive income	\$ 27,775	\$ 12,606	\$ 66,844	\$ 35,618

See accompanying notes to consolidated financial statements.

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INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows (Unaudited)

(Dollars in Thousands)

	Six Months Ended	
	June 30,	
	2007	2006
Operating activities:		
Net income	\$ 53,234	\$ 58,633
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for possible loan losses	2,559	679
Amortization of loan premiums	233	692
Accretion of time deposits with banks	(32))
(Increase) decrease in loans held for sale	(9,801)	) 12,462
Depreciation of bank premises and equipment	15,369	13,805
Gain on sale of bank premises and equipment	(2,431)	) (522)
Depreciation and amortization of leased assets	1,083	1,083
Accretion of investment securities discounts	(321)	) (222)
Amortization of investment securities premiums	2,076	2,022
Investment securities transactions, net	14,910	(410)
Amortization of junior subordinated debenture discounts	215	294
Amortization of identified intangible assets	2,529	2,433
Stock based compensation expense	369	467
Earnings from affiliates and other investments	(5,038)	) (7,809)
Deferred tax benefit	(349)	) (2,823)
Decrease (increase) in accrued interest receivable	3,288	(3,133)
Net decrease in other assets	2,347	1,987
Net increase in other liabilities	3,360	17,220
Net cash provided by operating activities	83,600	96,858
Investing activities:		
Proceeds from maturities of securities	16,015	5,270
Proceeds from sales of available for sale securities	739,069	410
Purchases of available for sale securities	(484,958)	) (575,121)
Principal collected on mortgage-backed securities	470,673	405,949
Maturities of time deposits with banks	25,084	
Net increase in loans	(50,760)	) (217,729)
Purchases of other investments	(5,412)	) (1,866)
Distributions of other investments	49,187	4,771
Purchases of bank premises and equipment	(38,596)	) (40,378)
Proceeds from sale of bank premises and equipment	5,966	9,421
Adjustment to goodwill related to prior acquisition (Note 10)	5,885	
Cash paid in purchase transaction	(23,470))
Cash acquired in purchase transaction	30,772	
Net provided by (used in) investing activities	739,455	(409,273)

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	Six Months Ended June 30,	
	2007	2006
Financing activities:		
Net (decrease) increase in non-interest bearing demand deposits	\$ (23,191)	\$ 15,668
Net increase (decrease) in savings and interest bearing demand deposits	92,255	(95,896)
Net (decrease) increase in time deposits	(37,654)	74,158
Net increase (decrease) in securities sold under repurchase agreements	262,061	(92,797)
Net (decrease) increase in other borrowed funds	(1,029,409)	361,998
Proceeds of issuance of long-term debt	53,609	
Principal payments of long term-debt	(22,681)	
Purchase of treasury stock	(16,912)	(23,171)
Proceeds from stock transactions	3,992	1,038
Payment of cash dividends	(22,086)	(22,113)
Payment of cash dividends in lieu of fractional shares	(27)	
Net cash (used in) provided by financing activities	(740,043)	218,885
Increase (decrease) in cash and cash equivalents	83,012	(93,530)
Cash and cash equivalents at beginning of period	297,207	458,118
Cash and cash equivalents at end of period	\$ 380,219	\$ 364,588
Supplemental cash flow information:		
Interest paid	\$ 176,295	\$ 143,500
Income taxes paid	29,981	32,975
Adjustment to goodwill arising from prior acquisition (Note 10)	2,076	

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(Unaudited)

Note 1 Basis of Presentation

The accounting and reporting policies of International Bancshares Corporation (Corporation) and Subsidiaries (the Corporation and Subsidiaries collectively referred to herein as the Company) conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry. The consolidated financial statements include the accounts of the Corporation and its wholly-owned subsidiaries, International Bank of Commerce, Laredo (IBC), Commerce Bank, International Bank of Commerce, Zapata, International Bank of Commerce, Brownsville and the Corporation s wholly-owned non-bank subsidiaries, IBC Subsidiary Corporation, IBC Life Insurance Company, IBC Trading Company, and IBC Capital Corporation, as well as the GulfStar Group in which the Company owns a controlling interest. All significant inter-company balances and transactions have been eliminated in consolidation. The consolidated financial statements are unaudited, but include all adjustments, which, in the opinion of management, are necessary for a fair presentation of the results of the periods presented. All such adjustments were of a normal and recurring nature. It is suggested that these financial statements be read in conjunction with the financial statements and the notes thereto in the Company s latest Annual Report on Form 10-K. The consolidated statement of condition at December 31, 2006 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. Certain reclassifications have been made to make prior periods comparable.

The Company operates as one segment. The operating information used by the Company s chief executive officer for purposes of assessing performance and making operating decisions about the Company is the consolidated statements presented in this report. The Company has four active operating subsidiaries, namely, the bank subsidiaries, otherwise known as International Bank of Commerce, Laredo, Commerce Bank, International Bank of Commerce, Zapata and International Bank of Commerce, Brownsville. The Company applies the provisions of SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, in determining its reportable segments and related disclosures. None of the Company s other subsidiaries meets the 10% threshold for disclosure under SFAS No. 131.

All per share data presented has been restated to reflect the stock splits effected through stock dividends, Note 9.

On January 1, 2007, the Company changed its accounting policy related to accounting for contingencies in connection with the adoption of Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement 109. See Note 10 Commitments, Contingent Liabilities and Other Tax Matters.

Note 2 Acquisition

On March 16, 2007, the Company completed its acquisition of Southwest First Community, Inc. (Southwest Community), a bank holding company with approximately \$133 million in assets that owned State Bank & Trust in Beeville, Texas and Commercial State Bank in Sinton, Texas. The transaction was pursuant to the Agreement and Plan of Merger dated December 1, 2006 (the Merger Agreement). The Company paid consideration totaling \$23.5 million in cash.

Note 3 Loans

A summary of net loans, by loan type at June 30, 2007 and December 31, 2006 is as follows:

	June 30, 2007	December 31, 2006
	(Dollars in thousands)	
Commercial, financial and agricultural	\$ 2,305,427	\$ 2,337,573
Real estate-mortgage	751,812	785,401
Real estate-construction	1,599,838	1,404,186
Consumer	174,546	198,580
Foreign	295,965	309,144
Total loans	5,127,588	5,034,884
Unearned discount	(4)	(74)
Loans, net of unearned discount	\$ 5,127,584	\$ 5,034,810

Note 4 Allowance for Possible Loan Losses

A summary of the transactions in the allowance for possible loan losses is as follows:

	June 30, 2007	June 30, 2006
	(Dollars in Thousands)	
Balance at December 31,	\$ 64,537	\$ 77,796
Losses charged to allowance	(1,947)	(11,607)
Recoveries credited to allowance	735	668
Net losses charged to allowance	(1,212)	(10,939)
Provision charged to operations	2,559	679
Allowance acquired in acquisition (Note 2)	1,054	
Balance at June 30,	\$ 66,938	\$ 67,536

Impaired loans are those loans where it is probable that all amounts due according to contractual terms of the loan agreement will not be collected. The Company has identified these loans through its normal loan review procedures. Impaired loans are measured based on (1) the present value of expected future cash flows discounted at the loan's effective interest rate; (2) the loan's observable market price; or (3) the fair value of the collateral if the loan is collateral dependent. Substantially all of the Company's impaired loans are measured at the fair value of the collateral. In limited cases the Company may use other methods to determine the level of impairment of a loan if such loan is not collateral dependent.

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The following table details key information regarding the Company's impaired loans:

	June 30, 2007 (Dollars in Thousands)	December 31, 2006
Balance of impaired loans where there is a related allowance for loan loss	\$ 19,724	\$ 22,909
Balance of impaired loans where there is no related allowance for loan loss		
Total impaired loans	\$ 19,724	\$ 22,909
Allowance allocated to impaired loans	\$ 7,206	\$ 7,171

The impaired loans included in the table above were primarily comprised of collateral dependent commercial loans, which have not been fully charged off. The average recorded investment in impaired loans was \$21,081,000 and \$25,684,000 for June 30, 2007 and December 31, 2006, respectively. The interest recognized on impaired loans was not significant.

Management of the Company recognizes the risks associated with these impaired loans. However, management's decision to place loans in this category does not necessarily mean that losses will occur.

The bank subsidiaries charge off that portion of any loan which management considers to represent a loss as well as that portion of any other loan which is classified as a loss by bank examiners. Commercial and industrial or real estate loans are generally considered by management to represent a loss, in whole or part, when an exposure beyond any collateral coverage is apparent and when no further collection of the loss portion is anticipated based on the borrower's financial condition and general economic conditions in the borrower's industry. Generally, unsecured consumer loans are charged-off when 90 days past due.

While management of the Company considers that it is generally able to identify borrowers with financial problems reasonably early and to monitor credit extended to such borrowers carefully, there is no precise method of predicting loan losses. The determination that a loan is likely to be uncollectible and that it should be wholly or partially charged-off as a loss is an exercise of judgment. Similarly, the determination of the adequacy of the allowance for possible loan losses can be made only on a subjective basis. It is the judgment of the Company's management that the allowance for possible loan losses at June 30, 2007 was adequate to absorb probable losses from loans in the portfolio at that date.

Note 5 Stock Options

On April 1, 2005, the Board of Directors adopted the 2005 International Bancshares Corporation Stock Option Plan (the 2005 Plan). The 2005 Plan replaced the 1996 International Bancshares Corporation Key Contributor Stock Option Plan (the 1996 Plan). Under the 2005 Plan both qualified incentive stock options (ISOs) and non-qualified stock options (NQSOs) may be granted. Options granted may be exercisable for a period of up to 10 years from the date of grant, excluding ISOs granted to 10% shareholders, which may be exercisable for a period of up to only five years. As of June 30, 2007, 108,999 shares were available for future grants under the 2005 Plan.

Through June 30, 2007, the Company has granted non-qualified stock options exercisable for a total of 154,420 shares, adjusted for stock dividends, of Common Stock to certain employees of the GulfStar Group. The grants were not made under either the 1996 Plan or the 2005 Plan. The options are exercisable for a period of seven years and vest in equal increments over a period of five years. All options granted to the GulfStar Group employees had an option price of not less than the fair market value of the Common Stock on the date of grant. All options granted to the GulfStar Group employees have been exercised as of July 2007.

On January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123R, (SFAS No. 123R), Share-Based Payment, (Revised 2004). SFAS No. 123R sets accounting requirements for share-based compensation to employees and non-employee directors, including employee stock purchase plans, and requires companies to recognize in the statement of operations the grant-date fair value of stock options and other equity-based compensation.

A summary of option activity under the stock option plans for the three months ended June 30, 2007 is as follows:

	Number of options	Weighted average exercise price	Weighted average remaining contractual term (years)	Aggregate intrinsic value (\$)
Options outstanding at December 31, 2006	1,515,965	\$ 15.65		
Plus: Options granted	62,525	26.57		
Less:				
Options exercised	433,356	9.18		
Options expired				
Options forfeited	121,100	14.68		
Options outstanding at June 30, 2007	1,024,034	\$ 19.21	4.03	\$ 7,115,000
Options fully vested and exercisable at June 30, 2007	582,952	\$ 13.83	2.23	\$ 6,946,000

Stock-based compensation expense included in the consolidated statements of income for the three and six months ended June 30, 2007 was approximately \$190,000 and \$369,000, respectively. As of June 30, 2007 there was approximately \$1,755,000, of total unrecognized stock-based compensation cost related to non-vested options granted under the Company plans that will be recognized over a weighted average period of 1.8 years.

Note 6 Investment Securities

The Company classifies debt and equity securities into one of three categories: held-to maturity, available-for-sale, or trading. Such classifications are reassessed for appropriate classification at each reporting date. Securities classified as held-to-maturity are carried at amortized cost for financial statement reporting, while securities classified as available-for-sale and trading are carried at their fair value. Unrealized holding gains and losses are included in net income for those securities classified as trading, while unrealized holding gains and losses related to those securities classified as available-for-sale are excluded from net income and reported net of tax as other comprehensive income (loss) and accumulated other comprehensive income (loss) until realized, or in the case of losses, when deemed other than temporary.

In the first quarter 2007, the Company wrote down approximately \$732.0 million of investment securities to fair value, which resulted in an impairment charge of approximately \$17.0 million. The write down was a result of the Company's strategic identification of certain investment securities that were sold in the second quarter of 2007 with the proceeds used to reduce Federal Home Loan Bank (FHLB) borrowings. The investments sold were certain hybrid mortgage backed securities with a coupon re-set date that exceeded 30 months and a weighted average yield to coupon re-set that was approximately 100 basis points less than the FHLB certificate of indebtedness short term-rate. The sale of the securities facilitated a repositioning of the balance sheet to a more neutral position in terms of interest rate risk and improved the Company's operating ratios.

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A summary of the investment securities held for investment and securities available for sale as reflected on the books of the Company is as follows:

	June 30, 2007 (Dollars in Thousands)	December 31, 2006
U.S. Treasury securities		
Available-for-sale	\$ 1,308	\$ 1,268
Mortgage-backed securities		
Available-for-sale	3,662,070	4,376,284
States and political subdivisions		
Available-for-sale	90,062	95,897
Other		
Held-to-maturity	2,325	2,375
Available-for-sale	15,553	14,629
Total investment securities	\$ 3,771,318	\$ 4,490,453

Note 7 Other Borrowed Funds

Other borrowed funds include Federal Home Loan Bank borrowings, which are short or long term, variable or fixed borrowings issued by the Federal Home Loan Bank of Dallas at the market price offered at the time of funding. These borrowings are secured by mortgage-backed investment securities and a portion of the Company's loan portfolio. At June 30, 2007, other borrowed funds totaled \$1,066,414,000, a decrease of 49.1% from \$2,095,576,000 at December 31, 2006. The decrease is attributable to the pay-down of borrowings due to the Company's sale of certain identified investment securities in the second quarter 2007.

Note 8 Junior Subordinated Interest Deferrable Debentures

The Company has formed twelve statutory business trusts under the laws of the State of Delaware, for the purpose of issuing trust preferred securities. As part of the Local Financial Corporation (LFIN) acquisition, the Company acquired three additional statutory business trusts previously formed by LFIN for the purpose of issuing trust preferred securities. The twelve statutory business trusts formed by the Company and the three business trusts acquired in the LFIN transaction (the Trusts) have each issued Capital and Common Securities and invested the proceeds thereof in an equivalent amount of junior subordinated debentures (the Debentures) issued by the Company or LFIN, as appropriate. The Company has succeeded to the obligations of LFIN under the LFIN Debentures, which have an outstanding principal balance of \$20,620,000. The Debentures will mature on various dates; however the Debentures may be redeemed at specified prepayment prices, in whole or in part after the optional redemption dates specified in the respective indentures or in whole upon the occurrence of any one of certain legal, regulatory or tax events specified in respective indentures. As of August 1, 2007, the Debentures issued by four of the trusts formed by the Company and the Debentures issued by two of the trusts formed by LFIN have been redeemed by the Company. As of June 30, 2007, the principal amount of debentures outstanding totaled \$242,051,000.

On April 22, 2007, pursuant to the Indenture dated as of April 10, 2002, between the Company and Wilmington Trust Company, as Trustee, the Company redeemed all of its Floating Rate Junior Subordinated Debt Securities (the Debt Securities), issued to International Bancshares Capital Trust IV (Trust IV) at a redemption price equal to approximately \$22,681,000, which includes accrued interest to, but not including, the redemption date.

In accordance with the Amended and Restated Declaration of Trust dated as of April 10, 2002 between the Company and Wilmington Trust Company, as Institutional Trustee, the proceeds from the redemption of the Debt Securities were used to simultaneously redeem an equal amount of Trust IV Floating Rate Capital Securities and Floating Rate Common Securities issued by Trust IV.

On April 13, 2007, the Company formed International Bancshares Corporation Trust XI (Trust XI), its eleventh statutory business trust formed under the laws of the State of Delaware, for the purpose of issuing trust preferred securities. On April 19, 2007, Trust XI issued \$32,000,000 of Capital Securities. The Capital Securities accrue interest for the first five years at a fixed rate of 6.82% and subsequently at a floating rate of 1.62% over the three month LIBOR, and interest is payable quarterly beginning July 1, 2007. The Trust XI Capital Securities will mature on July 1, 2037, however, the Capital Securities may be redeemed at specified prepayment prices (a) in whole or in part on any interest payment date on or after July 1, 2012, or (b) in whole or in part within 90 days upon the occurrence of certain legal, regulatory, or tax events. The Capital Securities are subordinated and junior in right of payment to all present and future senior indebtedness of the Company. The Company has fully and unconditionally guaranteed the obligation of Trust XI with respect to the Capital Securities. The Company has the right, unless an Event of Default has occurred and is continuing, to defer payment of interest on the Capital Securities for up to twenty consecutive quarterly periods. The redemption prior to maturity of any of the Capital Securities may require the prior approval of the Federal Reserve and/or other regulatory agencies.

On June 11, 2007, the Company formed International Bancshares Corporation Trust XII (Trust XII), its twelfth statutory business trust formed under the laws of the State of Delaware, for the purpose of issuing trust preferred securities. On June 26, 2007, Trust XII issued \$20,000,000 of Capital Securities. The Capital Securities accrue interest for the first five years at a fixed rate of 6.851% and subsequently at a floating rate of 1.45% over the three month LIBOR, and interest is payable quarterly beginning September 1, 2007. The Trust XII Capital Securities will mature on September 1, 2037; however, the Capital Securities may be redeemed at specified prepayment prices (a) in whole or in part on any interest payment date on or after September 1, 2012, or (b) in whole or in part within 90 days upon the occurrence of certain legal, regulatory, or tax events. The Capital Securities are subordinated and junior in right of payment to all present and future senior indebtedness of the Company. The Company has fully and unconditionally guaranteed the obligation of Trust XII with respect to the Capital Securities. The Company has the right, unless an Event of Default has occurred and is continuing, to defer payment of interest on the Capital Securities for up to twenty consecutive quarterly periods. The redemption prior to maturity of any of the Capital Securities may require the prior approval of the Federal Reserve and/or other regulatory agencies.

The Debentures are subordinated and junior in right of payment to all present and future senior indebtedness (as defined in the respective indentures) of the Company, and are *pari passu* with one another. The interest rate payable on, and the payment terms of the Debentures are the same as the distribution rate and payment terms of the respective issues of Capital and Common Securities issued by the Trusts. The Company has fully and unconditionally guaranteed the obligations of each of the Trusts with respect to the Capital and Common Securities. The Company has the right, unless an Event of Default (as defined in the Indentures) has occurred and is continuing, to defer payment of interest on the Debentures for up to ten consecutive semi-annual periods on Trusts I, IV and LFIN Trust II and for up to twenty consecutive quarterly periods on Trusts V, VI, VII, VIII, IX, X, XI and XII and LFIN Trust III. If interest payments on any of the Debentures are deferred, distributions on both the Capital and Common Securities related to that Debenture would also be deferred. The redemption prior to maturity of any of the Debentures may require the prior approval of the Federal Reserve and/or other regulatory bodies.

For financial reporting purposes, the Trusts are treated as investments of the Company and not consolidated in the consolidated financial statements. Although the Capital Securities issued by each of the Trusts are not included as a component of shareholders' equity on the consolidated statement of condition, the Capital Securities are treated as capital for regulatory purposes. Specifically, under applicable regulatory guidelines, the Capital Securities issued by the Trusts qualify as Tier 1 capital up to a maximum of 25% of Tier 1 capital on an aggregate basis. Any amount that exceeds the 25% threshold would qualify as Tier 2 capital. For June 30, 2007, the total \$242,051,000, of the Capital Securities outstanding qualified as Tier 1 capital.

In March 2005, the Federal Reserve Board issued a final rule that would continue to allow the inclusion of trust preferred securities in Tier 1 capital, but with stricter quantitative limits. Under the final rule, after a transition period ending March 31, 2009, the aggregate amount of trust preferred securities and certain other capital elements would be limited to 25% of Tier 1 capital elements, net of goodwill, less any associated deferred tax liability. The amount of trust preferred securities and certain other elements in excess of the limit could be included in Tier 2 capital, subject to restrictions. Bank holding companies with significant international operations will be expected to limit trust preferred securities to 15% of Tier 1 capital elements, net of goodwill; however, they may include qualifying mandatory convertible preferred securities up to the 25% limit. The Company believes that substantially all of the current trust preferred securities will be included in Tier 1 capital after the five-year transition period ending March 31, 2009.

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The following table illustrates key information about each of the Capital and Common Securities and their interest rate at June 30, 2007:

	Junior Subordinated Deferrable Interest Debentures (in thousands)	Repricing Frequency	Interest Rate	Interest Rate Index	Maturity Date	Optional Redemption Date
Trust I	\$ 10,269	Fixed	10.18%	Fixed	June 2031	June 2011
Trust V	\$ 20,619	Semi-Annually	9.01%	LIBOR + 3.65	July 2032	July 2007
Trust VI	\$ 25,737	Semi-Annually	8.81%	LIBOR + 3.45	November 2032	November 2007
Trust VII	\$ 10,310	Quarterly	8.61%	LIBOR + 3.25	April 2033	April 2008
Trust VIII	\$ 25,628	Quarterly	8.41%	LIBOR + 3.05	October 2033	October 2008
Trust IX	\$ 41,238	Fixed	7.10%	Fixed	October 2036	October 2011
Trust X	\$ 34,021	Fixed	6.66%	Fixed	February 2037	February 2012
Trust XI	\$ 32,990	Fixed	6.82%	Fixed	July 2037	July 2012
Trust XII	\$ 20,619	Fixed	6.85%	Fixed	September 2037	September 2012
LFIN Trust II	\$ 10,310	Semi-Annually	9.03%	LIBOR + 3.625	July 2032	July 2007
LFIN Trust III	\$ 10,310	Quarterly	8.81%	LIBOR + 3.45	November 2032	November 2007
	\$ 242,051					

- (1) LFIN Trust II was redeemed in July 2007, pursuant to the Indenture
- (2) Trust V was redeemed in July 2007, pursuant to the Indenture
- (3) Trust IX, X, XI and XII accrue interest at a fixed rate for the first five years, then floating at LIBOR + 1.62%, 1.65%, 1.62% and 1.45% thereafter, respectively.

Note 9 Common Stock and Dividends

Cash dividends of \$.35 per share were paid on May 1, 2007 and May 1, 2006 to all holders of record on April 16, 2007 and April 17, 2006, respectively. A 10% stock dividend was paid on June 8, 2007 to all holders of record on May 21, 2007.

The Company expanded its formal stock repurchase program on May 3, 2007. Under the expanded stock repurchase program, the Company is authorized to repurchase up to \$225,000,000 of its common stock through December 2008. Stock repurchases may be made from time to time, on the open market or through private transactions. Shares repurchased in this program will be held in treasury for reissue for various corporate purposes, including employee stock option plans. As of August 1, 2007, a total of 5,680,022 shares had been repurchased under this program at a cost of \$201,292,000. Stock repurchases are reviewed quarterly at the Company's Board of Directors meetings and the Board of Directors has stated that the aggregate investment in treasury stock should not exceed \$245,973,000. In the past, the Board of Directors has increased previous caps on treasury stock once they were met, but there are no assurances that an increase of the \$245,973,000 cap will occur in the future. As of August 1, 2007, the Company has approximately \$222,265,000 invested in treasury shares, which amount has been accumulated since the inception of the Company.

Note 10 Commitments and Contingent Liabilities and Other Tax Matters

The Company is involved in various legal proceedings that are in various stages of litigation. Some of these actions allege lender liability claims on a variety of theories and claim actual and punitive damages. The Company has determined, based on discussions with its counsel that any loss in such actions, individually or in the aggregate, is remote or the damages sought, even if fully recovered, would not be considered material to the consolidated financial position or results of operations of the Company. However, many of these matters are in various stages of proceedings and further developments could cause management to revise its assessment of these matters.

The Company's lead bank subsidiary has invested in partnerships, which have entered into several lease-financing transactions. The lease-financing transactions in two of the partnerships have been examined by the Internal Revenue Service (IRS). In both partnerships, the lead bank subsidiary was the owner of a ninety-nine percent (99%) limited partnership interest. The IRS has issued separate Notice of Final Partnership Administrative Adjustments (FPAA) to the partnerships and on September 25, 2001, and January 10, 2003, the Company filed lawsuits contesting the adjustments asserted in the FPAA's.

Prior to filing the lawsuits the Company was required to deposit the estimated tax due of approximately \$4,083,000 with respect to the first FPAA and \$7,710,606 with respect to the second FPAA with the IRS pursuant to the Internal Revenue Code. If it is determined that the amount of tax due, if any, related to the lease-financing transactions is less than the amount of the deposits, the remaining amount of the deposits would be returned to the Company.

In order to curtail the accrual of additional interest related to the disputed tax benefits and because interest rates were unfavorable, on March 7, 2003, the Company submitted to the IRS a total of approximately \$13.7 million, which constitutes the interest that would have accrued based on the adjustments proposed in the FPAA's related to both of the lease-financing transactions. If it is determined that the amount of interest due, if any, related to the lease-financing transactions is less than the approximate \$13.7 million, the remaining amount of the prepaid interest would be refunded to the Company, plus interest thereon.

Beginning August 29, 2005, IBC proceeded to litigate one of the partnership tax cases in the Federal District Court in San Antonio, Texas. The case was tried over nine days beginning August 29, 2005. On March 31, 2006, the trial court rendered a judgment against the Company on the first FPAA. IBC timely filed its notice of appeal to the Fifth Circuit Court of Appeals. All appellate briefs have been filed the appeal will be argued on August 8, 2007. The other partnership tax case has been stayed by the same Court during the pendency of the appeal.

The Company, through December 31, 2005, had previously expensed approximately \$12.0 million connection with the lawsuits. Because of the above-referenced trial court judgment against the Company on the first FPAA, the uncertainty of the outcome at the appellate level, and the similarity between the two FPAA's, the Company, through December 31, 2006, has expensed an additional \$13.7 million, approximately. The resultant approximately \$25.7 million expensed is the total of the tax adjustments due and the interest due on such adjustments for both FPAA's. Management intends to continue to appeal the judgment in the first case and will continue to evaluate the merits of each lawsuit and make any appropriate revisions to the amounts, as deemed necessary.

As part of the LFIN acquisition, two tax matters were transferred to the Company. The first relates to deductions taken on amended returns filed by LFIN during 2003 for the tax years ended June 30, 1999 through December 31, 2001. The refunds requested on the amended returns amounted to approximately \$7.0 million. At December 31, 2003, LFIN had received approximately \$2.0 million of the total refund requested. Because all the refunds are under review by the IRS, LFIN had established a reserve equal to the \$2.0 million received and did not recognize any benefit for the remaining \$5.0 million. The second tax contingency reserve of \$7.0 million was resolved with the IRS in September 2006 and as a result, the second tax contingency reserve is no longer required. The reserve was applied to the goodwill acquired as part of the LFIN acquisition. During the first quarter of 2007, the Company favorably resolved the issues with the IRS on the first tax contingency for approximately \$7.0 million plus interest accrued thereon. The Company has applied the refund, including interest accrued prior to the LFIN acquisition, to the goodwill that resulted from the LFIN acquisition. The Company has booked the remaining portion of the interest accrued on the tax matter subsequent to the LFIN acquisition to earnings.

In June 2006, the Financial Accounting Standards Board issued Financial Interpretation No. 48, (FIN 48), Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109, Accounting for Income Taxes. FIN 48 addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under FIN 48, the Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. FIN 48 also provides guidance on derecognition, classification, interest and penalties on income taxes, accounting in interim periods and requires increased disclosures.

The Company adopted the provisions of FIN 48 on January 1, 2007. As a result of the implementation of FIN 48, the Company recognized no change in the liability for unrecognized tax benefits, thus, there was no change to the January 1, 2007 retained earnings balance. The total amount of unrecognized tax benefits at January 1, 2007 was \$32.5 million, of which \$11.8 million would impact the Company's effective tax rate, if recognized.

The Company recognizes interest accrued related to unrecognized tax benefits in operating expenses and penalties in income tax expense, which is consistent with the recognition of these items in prior reporting periods. As of January 1, 2007 the Company recorded no additional reserve to the existing \$13.6 million liability for the payment of interest and penalties on issues under litigation. The IRS has assessed approximately \$11.8 million plus interest of \$13.6 million on the issues under litigation. The Company does not anticipate any significant changes to the unrecognized tax benefits in the next twelve months. The Company files income tax returns in the U.S. federal jurisdiction and the State of Oklahoma. The Company is not subject to examination by any taxing authority for any tax years prior to 2003.

Note 11 Capital Ratios

The Company had a leverage ratio of 7.99% and 7.36%, risk-weighted Tier 1 capital ratio of 12.99% and 12.49% and risk-weighted total capital ratio of 14.14% and 13.61% at June 30, 2007 and December 31, 2006, respectively. The identified intangibles and goodwill of \$317,364,000 as of June 30, 2007, recorded in connection with the acquisitions made by the Company, are deducted from the sum of core capital elements when determining the capital ratios of the Company. The Company actively monitors the regulatory capital ratios to ensure that the Company's bank subsidiaries are well capitalized under the regulatory framework.

In March 2005, the Federal Reserve Board issued a final rule that would continue to allow the inclusion of trust preferred securities in Tier 1 capital, but with stricter quantitative limits. Under the final rule, after a five-year transition period ending March 31, 2009, the aggregate amount of trust preferred securities and certain other capital elements would be limited to 25% of Tier 1 capital elements, net of goodwill, less any associated deferred tax liability. The amount of trust preferred securities and certain other elements in excess of the limit could be included in Tier 2 capital, subject to restrictions. Bank holding companies with significant international operations will be expected to limit trust preferred securities to 15% of Tier 1 capital elements, net of goodwill; however, they may include qualifying mandatory convertible preferred securities up to the 25% limit.

Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations

Special Cautionary Notice Regarding Forward Looking Information

Certain matters discussed in this report, excluding historical information, include forward-looking statements, within the meaning of Section 27A of the Securities Exchange Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and are subject to the safe harbor created by these sections. Although the Company believes such forward-looking statements are based on reasonable assumptions, no assurance can be given that every objective will be reached. The words estimate, expect, intend, believe and project, as well as other words or expressions of a similar meaning are intended to identify forward-looking statements. Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date of this report. Such statements are based on current expectations, are inherently uncertain, are subject to risks and should be viewed with caution. Actual results and experience may differ materially from the forward-looking statements as a result of many factors.

Factors that could cause actual results to differ materially from any results that are projected, forecasted, estimated or budgeted by the Company in forward-looking statements include, among others, the following possibilities:

- Changes in interest rates and market prices, which could reduce the Company's net interest margins, asset valuations and expense expectations.
- Changes in the capital markets utilized by the Company and its subsidiaries, including changes in the interest rate environment that may reduce margins.
- Changes in state and/or federal laws and regulations to which the Company and its subsidiaries, as well as their customers, competitors and potential competitors, are subject, including, without limitation, changes in the accounting, tax and regulatory treatment of trust preferred securities, as well as changes in banking, tax, securities, insurance and employment laws and regulations.
- Changes in U.S. - Mexico trade, including, without limitation, reductions in border crossings and commerce resulting from the Homeland Security Programs called US-VISIT, which is derived from Section 110 of the Illegal Immigration Reform and Immigrant Responsibility Act of 1996.
- The loss of senior management or operating personnel.
- Increased competition from both within and outside the banking industry.
- Changes in local, national and international economic business conditions that adversely affect the Company's customers and their ability to transact profitable business with the Company, including the ability of its borrowers to repay their loans according to their terms or a change in the value of the related collateral.
- The timing, impact and other uncertainties of the Company's potential future acquisitions including the Company's ability to identify suitable potential future acquisition candidates, the success or failure in the integration of their operations and the Company's ability to maintain its current branch network and to enter new markets successfully and capitalize on growth opportunities.
- Changes in the Company's ability to pay dividends on its Common Stock.
- The effects of the litigation and proceedings pending with the Internal Revenue Service regarding the Company's lease financing transactions.
- Additions to the Company's loan loss allowance as a result of changes in local, national or international conditions which adversely affect the Company's customers.

- Political instability in the United States and Mexico.
- Technological changes.
- Acts of war or terrorism.
- Natural disasters.
- The effect of changes in accounting policies and practices as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standards setters.

It is not possible to foresee or identify all such factors. The Company makes no commitment to update any forward-looking statement, or to disclose any facts, events or circumstances after the date hereof that may affect the accuracy of any forward-looking statement, unless required by law.

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Overview

The Company, which is headquartered in Laredo, Texas, with more than 230 facilities and more than 380 ATMs, provides banking services for commercial, consumer and international customers of South, Central and Southeast Texas and the State of Oklahoma. The Company is one of the largest independent commercial bank holding companies headquartered in Texas. The Company, through its bank subsidiaries, is in the business of gathering funds from various sources and investing those funds in order to earn a return. The Company either directly or through a bank subsidiary owns two insurance agencies, a broker/dealer and a majority interest in an investment banking unit that owns a broker/dealer. The Company's primary earnings come from the spread between the interest earned on interest-bearing assets and the interest paid on interest-bearing liabilities. In addition, the Company generates income from fees on products offered to commercial, consumer and international customers.

The Company is very active in facilitating trade along the United States border with Mexico. The Company does a large amount of business with customers domiciled in Mexico. Deposits from persons and entities domiciled in Mexico comprise a large and stable portion of the deposit base of the Company's bank subsidiaries. The Company also serves the growing Hispanic population through the Company's facilities located throughout South, Central and Southeast Texas and the State of Oklahoma.

Expense control is an essential element in the Company's long-term profitability. As a result, one of the key ratios the Company monitors is the efficiency ratio, which is a measure of non-interest expense to net interest income plus non-interest income. The Company monitors this ratio over time to assess the Company's efficiency relative to its peers and whether the Company is being productive with its long term goals of providing superior returns to the Company's shareholders. The first quarter of 2007 was negatively affected by an impairment charge of \$13.1 million, after tax, arising from a charge on certain investment securities. This impairment charge negatively affected the efficiency ratio but does not necessarily reflect a long-term negative trend. The first quarter of 2006 was negatively affected by a \$8.9 million, net of tax expense recognized as part of the tax litigation. Additionally, the Company's efficiency ratio has been negatively impacted over the last few years because of the Company's aggressive branch expansion which has added 57 branches in 2006 and the first half of 2007. During rapid expansion periods, the Company's efficiency ratio will suffer but the long-term benefits of the expansion should be realized in future periods and the benefits should positively impact the efficiency ratio in future periods.

Results of Operations

Summary

Consolidated Statements of Condition Information

	June 30, 2007 (Dollars in Thousands)	December 31, 2006	Percent Increase (Decrease)
Assets	\$ 10,366,738	\$ 10,911,454	(5.0)%
Net loans	5,060,646	4,970,273	1.8
Deposits	7,139,329	6,989,918	2.1
Other borrowed funds	1,066,414	2,095,576	(49.1)
Junior subordinated deferrable interest debentures	242,051	210,908	14.8
Shareholders' equity	874,237	842,056	3.8

Consolidated Statements of Income Information

	Three Months Ended		Percent Increase (Decrease)	Six Months Ended		Percent Increase (Decrease)	
	June 30, (Dollars in Thousands)			June 30, (Dollars in Thousands)			
	2007	2006		2007	2006		
Interest income	\$ 162,408	\$ 149,374	8.7	% \$ 325,263	\$ 291,692	11.5	%
Interest expense	82,847	77,325	7.1	170,926	145,329	17.6	
Net interest income	79,561	72,049	10.4	154,337	146,363	5.4	
Provision for possible loan losses	1,198	82	1,361.0	2,559	679	276.9	
Non-interest income	47,266	47,022	0.5	73,507	87,639	(16.1))
Non-interest expense	73,429	67,721	8.4	145,498	146,578	(0.7))
Net income	34,590	34,658	(0.2)	) 53,234	58,633	(9.2))
Per common share (adjusted for stock dividends):							
Basic	\$.50	\$.50	0	% \$.77	\$.84	(8.3))%
Diluted	.50	.49	2.0	.76	.83	(8.4))

Net Income

Net income for the first and second quarter of 2007 declined by 0.2% as compared to the same period in 2006. Net income for the first six months of 2007 was negatively impacted by an impairment charge of \$13.1 million, after tax, on certain investments. A significant portion of the impairment charge is a result of the Company's strategic identification of certain investment securities that were sold in the second quarter of 2007 with the proceeds from the sales used to reduce Federal Home Loan Bank (FHLB) borrowings. Net income for the same period was positively affected by the sale of the securities, which generated gains of \$1.5 million, after tax. The investments sold were certain hybrid mortgage backed securities with a coupon re-set date that exceeded 30 months and a weighted average yield to coupon re-set that was approximately 100 basis points less than the FHLB certificate of indebtedness short-term rate. The sale of the securities facilitated a re-positioning of the balance sheet to a more neutral position in terms of interest rate risk and also improved operating ratios.

Net income for the first six months of 2006 was negatively impacted by a \$8.9 million, net of tax, charge to operations as a result of the loss of a IRS tax lawsuit that was litigated during the third quarter of 2005 in the Federal District Court in San Antonio, Texas and relates to certain leasing transactions previously discussed in Note 17 of the Notes to Consolidated Financial Statements set forth in the Company's 2006 Annual Report. Because of the trial court judgment, uncertainty of the outcome at the appellate level and the similarity between the litigated lawsuit and one that is pending, the Company took the \$8.9 million charge, net of tax.

Net Interest Income

	Three Months Ended		Percent Increase (Decrease)	Six Months Ended		Percent Increase (Decrease)	
	June 30, (in Thousands)			June 30, (in Thousands)			
	2007	2006		2007	2006		
Interest income:							
Loans, including fees	\$ 112,723	\$ 97,202	16.0	% \$ 221,979	\$ 187,604	18.3	%
Federal funds sold	821	817	0.5	1,517	2,194	(30.9))
Investment securities:							
Taxable	45,782	50,110	(8.6)	) 97,438	99,366	(1.9))
Tax-exempt	1,078	1,144	(5.8)	) 2,209	2,316	(4.6))
Other interest income	2,004	101	1,884.2	2,120	212	900.0	
Total interest income	162,408	149,374	8.7	325,263	291,692	11.5	
Interest expense:							
Savings deposits	13,695	10,139	35.1	26,791	19,043	40.7	
Time deposits	36,236	29,421	23.2	71,273	55,620	28.1	
Securities sold under repurchase agreements	10,213	7,676	33.1	18,535	15,548	19.2	
Other borrowings	18,177	24,728	(26.5)	) 45,382	44,733	1.5	
Junior subordinated interest deferrable debentures	4,526	5,361	(15.6)	) 8,945	10,385	(13.9))
Total interest expense	82,847	77,325	7.1	170,926	145,329	17.6	
Net interest income	\$ 79,561	\$ 72,049	(10.4)	)% \$ 154,337	\$ 146,363	5.4	%

Net interest income is the spread between income on interest earning assets, such as loans and securities, and the interest expense on liabilities used to fund those assets, such as deposits, repurchase agreements and funds borrowed. Net interest income is the Company's largest source of revenue. Net interest income is affected by both changes in the level of interest rates and changes in the amount and composition of interest earning assets and interest bearing liabilities.

As part of its strategy to manage interest rate risk, the Company strives to manage both assets and liabilities so that interest sensitivities match. One method of calculating interest rate sensitivity is through gap analysis. A gap is the difference between the amount of interest rate sensitive assets and interest rate sensitive liabilities that re-price or mature in a given time period. Positive gaps occur when interest rate sensitive assets exceed interest rate sensitive liabilities, and negative gaps occur when interest rate sensitive liabilities exceed interest rate sensitive assets. A positive gap position in a period of rising interest rates should have a positive effect on net interest income as assets will re-price faster than liabilities. Conversely, net interest income should contract somewhat in a period of falling interest rates. Management can quickly change the Company's interest rate position at any given point in time as market conditions dictate. Additionally, interest rate changes do not affect all categories of assets and liabilities equally or at the same time. Analytical techniques employed by the Company to supplement gap analysis include simulation analysis to quantify interest rate risk exposure. The gap analysis prepared by management is reviewed by the Investment Committee of the Company twice a year (see table on page 25 for the June 30, 2007 gap analysis). Management currently believes that the Company is properly positioned for interest rate changes; however if management determines at any time that the Company is not properly positioned, it will strive to adjust the interest rate sensitive assets and liabilities in order to manage the effect of interest rate changes.

Non-Interest Income

	Three Months Ended		Percent Increase (Decrease)	Six Months Ended		Percent Increase (Decrease)
	June 30, (in Thousands) 2007	2006		June 30, (in Thousands) 2007	2006	
Service charges on deposit accounts	\$ 21,058	\$ 21,517	(2.1)%	\$ 41,283	\$ 42,515	(2.9)%
Other service charges, commissions and fees						
Banking	8,843	7,301	21.1	16,961	14,229	19.2
Non-banking	3,887	4,022	(3.4)	8,831	8,011	10.2
Investment securities transactions, net	2,257	410	450.5	(14,910)	410	(3,736.6)
Other investments, net	4,785	7,384	(35.2)	10,568	11,957	(11.6)
Other income	6,436	6,388	0.8	10,774	10,517	2.4
Total non-interest income	\$ 47,266	\$ 47,022	0.5 %	\$ 73,507	\$ 87,639	(16.1)%

The decrease in investment securities transactions can be attributed to a \$17.0 million impairment charge recorded in connection with certain investment securities identified for sale in the first quarter 2007, offset by gains of \$2.3 million in the second quarter 2007, when the securities were sold. The impairment charge is a result of the Company's strategic identification of certain investment securities sold in the second quarter 2007 with the proceeds from the sales used to reduce Federal Home Loan Bank (FHLB) borrowings. The investments sold were certain hybrid mortgage backed securities with a coupon re-set date that exceeded 30 months and a weighted average yield to coupon re-set that was approximately 100 basis points less than the FHLB certificate of indebtedness short-term rate. The sale of the securities facilitated a re-positioning of the balance sheet to a more neutral position in terms of interest rate risk and improved the Company's operating ratios. As a result of this decision, the Company marked the securities to market. The increase in banking service charges, commissions and fees can be attributed to surcharge and interchange income for use of automated teller machines (ATM) and increased debit card usage by customers.

Non-Interest Expense

	Three Months Ended		Percent Increase (Decrease)	Six Months Ended		Percent Increase (Decrease)
	June 30, (in Thousands) 2007	2006		June 30, (in Thousands)		