

Childrens Place, Inc.  
Form 10-Q  
May 25, 2016  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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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 April 30, 2016

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 0-23071

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THE CHILDREN'S PLACE, INC.

(Exact name of registrant as specified in its charter)

Delaware 31-1241495  
(State or Other Jurisdiction of (I.R.S. Employer  
Incorporation or Organization) Identification Number)

500 Plaza Drive  
Secaucus, New Jersey 07094  
(Address of Principal Executive Offices) (Zip Code)

(201) 558-2400  
(Registrant's Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

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(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

The number of shares outstanding of the registrant's common stock with a par value of \$0.10 per share, as of May 23, 2016 was 18,874,098 shares.

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THE CHILDREN'S PLACE, INC. AND SUBSIDIARIES

QUARTERLY REPORT ON FORM 10-Q

FOR THE PERIOD ENDED APRIL 30, 2016

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## PART I. FINANCIAL INFORMATION

## Item 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

THE CHILDREN'S PLACE, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED BALANCE SHEETS  
 (In thousands, except par value)

	April 30, 2016 (unaudited)	January 30, 2016	May 2, 2015 (unaudited)
<b>ASSETS</b>			
Current assets:			
Cash and cash equivalents	\$ 174,801	\$ 187,534	\$ 141,282
Short-term investments	58,801	40,100	59,280
Accounts receivable	25,539	26,315	25,041
Inventories	250,280	268,831	281,059
Prepaid expenses and other current assets	31,045	43,042	38,684
Deferred income taxes	16,359	15,486	13,611
Total current assets	556,825	581,308	558,957
Long-term assets:			
Property and equipment, net	283,448	290,980	309,548
Deferred income taxes	25,527	22,230	38,178
Other assets	3,416	3,430	3,420
Total assets	\$ 869,216	\$ 897,948	\$ 910,103
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>			
<b>LIABILITIES:</b>			
Current liabilities:			
Revolving loan	\$ 25,000	\$—	\$ 11,186
Accounts payable	127,454	154,541	130,899
Income taxes payable	3,272	1,611	489
Accrued expenses and other current liabilities	95,060	118,870	104,190
Total current liabilities	250,786	275,022	246,764
Long-term liabilities:			
Deferred rent liabilities	68,321	70,250	78,506
Other tax liabilities	10,205	9,713	6,222
Other long-term liabilities	16,405	15,170	7,818
Total liabilities	345,717	370,155	339,310
<b>COMMITMENTS AND CONTINGENCIES</b>			
<b>STOCKHOLDERS' EQUITY:</b>			
Preferred stock, \$1.00 par value, 1,000 shares authorized, 0 shares issued and outstanding	—	—	—
Common stock, \$0.10 par value, 100,000 shares authorized; 18,943, 19,479 and 20,736 issued; 18,903, 19,440 and 20,700 outstanding	1,894	1,948	2,074
Additional paid-in capital	232,582	232,182	228,586
Treasury stock, at cost (40, 39, 36 shares)	(2,001	) (1,939	) (1,748
Deferred compensation	2,001	1,939	1,748
Accumulated other comprehensive loss	(15,603	) (27,485	) (12,394
Retained earnings	304,626	321,148	352,527

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Total stockholders' equity	523,499	527,793	570,793
Total liabilities and stockholders' equity	\$ 869,216	\$ 897,948	\$ 910,103

See accompanying notes to these condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands, except per share amounts)

	Thirteen Weeks Ended	
	April 30, 2016	May 2, 2015
Net sales	\$419,351	\$404,865
Cost of sales (exclusive of depreciation and amortization)	254,000	252,756
Gross profit	165,351	152,109
Selling, general and administrative expenses	109,212	114,514
Other costs (income)	68	(3 )
Depreciation and amortization	16,461	14,394
Operating income	39,610	23,204
Interest expense	(74 )	(176 )
Income before income taxes	39,536	23,028
Provision for income taxes	13,551	7,421
Net income	\$25,985	\$15,607
Earnings per common share		
Basic	\$1.35	\$0.74
Diluted	\$1.33	\$0.73
Cash dividends declared and paid per common share	\$0.20	\$0.15
Weighted average common shares outstanding		
Basic	19,200	21,012
Diluted	19,569	21,366

See accompanying notes to these condensed consolidated financial statements.

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THE CHILDREN'S PLACE, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
 (Unaudited)  
 (In thousands)

	Thirteen Weeks Ended April 30, May 2, 2016 2015	
Net income	\$25,985	\$15,607
Other Comprehensive Income:		
Foreign currency translation adjustment	11,703	5,099
Change in fair value of cash flow hedges, net of income taxes of \$(65)	179	—
Comprehensive income	\$37,867	\$20,706

See accompanying notes to these condensed consolidated financial statements.

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THE CHILDREN'S PLACE, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (Unaudited) (In thousands)

	Thirteen Weeks Ended	
	April 30, 2016	May 2, 2015
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$25,985	\$15,607
Reconciliation of net income to net cash provided by operating activities:		
Depreciation and amortization	16,461	14,394
Stock-based compensation	6,544	3,868
Excess tax benefits from stock-based compensation	(1,008)	(794)
Deferred taxes	(5,349)	(868)
Deferred rent expense and lease incentives	(2,808)	(2,655)
Other	224	190
Changes in operating assets and liabilities:		
Inventories	21,327	17,818
Prepaid expenses and other assets	1,348	2,830
Income taxes payable, net of prepayments	16,256	5,910
Accounts payable and other current liabilities	(51,807)	(42,405)
Deferred rent and other liabilities	1,122	(499)
Total adjustments	2,310	(2,211)
Net cash provided by operating activities	28,295	13,396
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Property and equipment purchases, lease acquisition and software costs	(7,084)	(10,063)
Purchase of short-term investments	(30,000)	(36,280)
Redemption of short-term investments	11,299	29,000
Change in company-owned life insurance policies	(49)	(3)
Net cash used in investing activities	(25,834)	(17,346)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Purchase and retirement of common stock, including transaction costs	(46,150)	(41,213)
Cash dividends paid	(3,803)	(3,130)
Borrowings under revolving credit facility	134,374	178,006
Repayments under revolving credit facility	(109,374)	(166,820)
Exercise of stock options	—	438
Excess tax benefits from stock-based compensation	1,008	794
Net cash used in financing activities	(23,945)	(31,925)
Effect of exchange rate changes on cash	8,751	3,866
Net decrease in cash and cash equivalents	(12,733)	(32,009)
Cash and cash equivalents, beginning of period	187,534	173,291
Cash and cash equivalents, end of period	\$174,801	\$141,282

See accompanying notes to these condensed consolidated financial statements.



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THE CHILDREN'S PLACE, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited) (In thousands)

	Thirteen Weeks Ended April 30, May 2, 2016 2015	
OTHER CASH FLOW INFORMATION:		
Net cash paid during the period for income taxes	\$2,525	\$2,422
Cash paid during the period for interest	323	343
Decrease in accrued purchases of property and equipment	(1,713 )	(3,384 )

See accompanying notes to these condensed consolidated financial statements.

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THE CHILDREN'S PLACE, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

1. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") for interim financial information and the rules and regulations of the Securities and Exchange Commission (the "SEC"). Accordingly, certain information and footnote disclosures normally included in the annual consolidated financial statements prepared in accordance with U.S. GAAP have been condensed or omitted.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments necessary to present fairly the consolidated financial position of The Children's Place, Inc. (the "Company") as of April 30, 2016 and May 2, 2015 and the results of its consolidated operations and cash flows for the thirteen weeks ended April 30, 2016 and May 2, 2015. The consolidated financial position as of January 30, 2016 was derived from audited financial statements. Due to the seasonal nature of the Company's business, the results of operations for the thirteen weeks ended April 30, 2016 and May 2, 2015 are not necessarily indicative of operating results for a full fiscal year. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended January 30, 2016.

Certain reclassifications have been made to prior period financial statements to conform to the current period presentation.

Terms that are commonly used in the Company's notes to condensed consolidated financial statements are defined as follows:

First Quarter 2016 — The thirteen weeks ended April 30, 2016.

First Quarter 2015 — The thirteen weeks ended May 2, 2015.

FASB — Financial Accounting Standards Board.

SEC — U.S. Securities and Exchange Commission.

U.S. GAAP — Generally Accepted Accounting Principles in the United States.

FASB ASC — FASB Accounting Standards Codification, which serves as the source for authoritative U.S. GAAP, except that rules and interpretive releases by the SEC are also sources of authoritative U.S. GAAP for SEC registrants.

Short-term Investments

Short-term investments consist of investments which the Company expects to convert into cash within one year, including time deposits, which have original maturities greater than 90 days. The Company classifies its investments in securities at the time of purchase as held-to-maturity and reevaluates such classifications on a quarterly basis. Held-to-maturity investments consist of securities that the Company has the intent and ability to retain until maturity. These securities are recorded at cost and adjusted for the amortization of premiums and discounts, which approximates fair value. Cash inflows and outflows related to the sale and purchase of investments are classified as investing activities in the Company's consolidated statements of cash flows. All of the Company's short-term investments are U.S. dollar denominated time deposits with banking institutions in Hong Kong that have six month maturity dates.

Stock-based Compensation

The Company generally grants time vesting stock awards ("Deferred Awards") and performance-based stock awards ("Performance Awards") to employees at management levels. The Company also grants Deferred Awards to its non-employee directors. Deferred Awards are granted in the form of a defined number of restricted stock units that require each recipient to complete a service period. Deferred Awards generally vest ratably over three years, except for those granted to non-employee directors, which generally vest after one year. Performance Awards are granted in the form of a defined range of restricted stock units which have performance criteria that must be achieved for the awards to vest (the "Target Shares") in addition to a service period requirement. For Performance Awards issued

during fiscal 2014 and 2015 (the “2014 and 2015 Performance Awards”), an employee may earn from 0% to 300% of their Target Shares based on the achievement of adjusted earnings per share for a cumulative three-fiscal year performance period and our total shareholder return (“TSR”) relative to that of companies in our peer group. The 2014 and 2015 Performance Awards cliff vest, if earned, after completion of the applicable three year performance period. The 2014 and 2015 Performance Awards grant date fair value was estimated using a Monte Carlo simulation covering the period from the valuation date through the end of the applicable performance period using our simulated stock price as well as the TSR of companies in our peer group. For Performance Awards issued during fiscal 2016

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(the “2016 Performance Awards”), an employee may earn from 0% to 200% of their Target Shares based on the achievement of adjusted earnings per share for a cumulative three-fiscal year performance period and adjusted operating margin expansion and adjusted return on invested capital achieved at the end of the performance period. The 2016 Performance Awards cliff vest, if earned, after completion of the three-year performance period. The fair value of the 2016 Performance Awards granted is based on the closing price of our common stock on the grant date. Stock-based compensation expense is recognized ratably over the related service period reduced for estimated forfeitures of those awards not expected to vest due to employee turnover. Stock-based compensation expense, as it relates to Performance Awards, is also adjusted based on the Company's estimate of adjusted earnings per share, adjusted operating margin expansion and adjusted return on invested capital as they occur.

**Deferred Compensation Plan**

The Company has a deferred compensation plan (the “Deferred Compensation Plan”), which is a nonqualified plan, for eligible senior level employees. Under the plan, participants may elect to defer up to 80% of his or her base salary and/or up to 100% of his or her bonus to be earned for the year following the year in which the deferral election is made. The Deferred Compensation Plan also permits members of the Board of Directors to elect to defer payment of all or a portion of their retainer and other fees to be earned for the year following the year in which a deferral election is made. In addition, eligible employees and directors of the Company may also elect to defer payment of any shares of Company stock that is earned with respect to stock-based awards. Directors may elect to have all or a certain portion of their fees earned for their service on the Board invested in shares of the Company’s common stock. Such elections are irrevocable. The Company is not required to contribute to the Deferred Compensation Plan, but at its sole discretion, can make additional contributions on behalf of the participants. Deferred amounts are not subject to forfeiture and are deemed invested among investment funds offered under the Deferred Compensation Plan, as directed by each participant. Payments of deferred amounts (as adjusted for earnings and losses) are payable following separation from service or at a date or dates elected by the participant at the time the deferral is elected. Payments of deferred amounts are generally made in either a lump sum or in annual installments over a period not exceeding 15.0 years. All deferred amounts are payable in the form in which they were made except for board fees invested in shares of the Company's common stock, which will be settled in shares of Company common stock. Earlier distributions are not permitted except in the case of an unforeseen hardship.

The Company has established a rabbi trust that serves as an investment to shadow the Deferred Compensation Plan liability. The assets of the rabbi trust are general assets of the Company and as such, would be subject to the claims of creditors in the event of bankruptcy or insolvency. Investments of the rabbi trust consist of mutual funds and Company common stock. The Deferred Compensation Plan liability, excluding Company common stock, is included in other long-term liabilities and changes in the balance, except those relating to payments, are recognized as compensation expense. The value of the mutual funds is included in other assets and related earnings and losses are recognized as investment income or loss, which is included in selling, general and administrative expenses. Company stock deferrals are included in the equity section of the Company’s consolidated balance sheet as treasury stock and as a deferred compensation liability. Deferred stock is recorded at fair market value at the time of deferral and any subsequent changes in fair market value are not recognized.

The Deferred Compensation Plan liability, excluding Company stock, at fair value, was approximately \$0.7 million, \$0.7 million, and \$0.5 million at April 30, 2016, January 30, 2016 and May 2, 2015, respectively. The value of the Deferred Compensation Plan assets was approximately \$0.7 million, \$0.7 million and \$0.3 million at April 30, 2016, January 30, 2016 and May 2, 2015, respectively. Company stock was \$2.0 million, \$1.9 million, and \$1.7 million at April 30, 2016, January 30, 2016 and May 2, 2015, respectively.

**Exit or Disposal Cost Obligations**

In accordance with the “Exit or Disposal Cost Obligations” topic of the FASB ASC, the Company records its exit and disposal costs at fair value to terminate an operating lease or contract when termination occurs before the end of its term and without future economic benefit to the Company. In cases of employee termination benefits, the Company recognizes an obligation only when all of the following criteria are met:

- management, having the authority to approve the action, commits to a plan of termination;

the plan identifies the number of employees to be terminated, their job classifications or functions and their locations, and the expected completion date;

the plan establishes the terms of the benefit arrangement, including the benefits that employees will receive upon termination (including but not limited to cash payments), in sufficient detail to enable employees to determine the type and amount of benefits they will receive if they are involuntarily terminated; and

actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

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During the first quarter of fiscal 2012, management approved a plan to exit its distribution center in Ontario, California (the "West Coast DC") and move the operations to its distribution center in Fort Payne, Alabama (the "Southeast DC"). The Company ceased operations at the West Coast DC in May 2012. The lease of the West Coast DC expired in March 2016.

During the third quarter of fiscal 2012, management approved a plan to close the Company's distribution center in Dayton, New Jersey ("Northeast DC") and move the operations to its Southeast DC. The Company ceased operations in the Northeast DC during the fourth quarter of fiscal 2012. The lease of the Northeast DC expires in January 2021 and the Company has subleased this facility through January 2021.

The following table provides details of the remaining accruals for the West Coast DC and Northeast DC as of April 30, 2016, of which approximately \$0.3 million was included in accrued expenses and other current liabilities and approximately \$0.3 million was included in other long-term liabilities (dollars in thousands):

	105,386	5,070	4.81%						
Total interest-bearing liabilities	641,873	19,006	2.96%	647,689	23,349	3.60%	620,685	20,276	3.27%
Demand deposits	104,954			96,475			98,622		
Other liabilities	3,511			3,084			2,520		
Total liabilities	750,338			747,248			721,827		
Stockholders equity	82,195			77,479			72,540		
Total liabilities and stockholders equity	\$ 832,533			\$ 824,727			\$ 794,367		
Net interest margin		\$ 28,042	3.61%		\$ 26,392	3.42%		\$ 25,433	3.42%

\* Computed on a fully tax-equivalent basis using a 34% rate.

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The following table summarizes changes in net interest income attributable to changes in the volume of interest-bearing assets and liabilities and changes in interest rates.

**TABLE II**  
**VOLUME AND RATE ANALYSIS\***  
(in thousands)

	2008 vs. 2007			2007 vs. 2006			2006 vs. 2005		
	Increase (Decrease) Due to Changes in:			Increase (Decrease) Due to Changes in:			Increase (Decrease) Due to Changes in:		
	Volume	Rate	Total	Volume	Rate	Total	Volume	Rate	Total
<b>EARNING ASSETS:</b>									
Loans	\$ 2,517	\$ (3,540)	\$ (1,023)	\$ 3,075	\$ 1,369	\$ 4,444	\$ 6,006	\$ 2,473	\$ 8,479
<b>Investment Securities:</b>									
Taxable	(759)	184	(575)	(801)	161	(640)	(142)	139	(3)
Tax-exempt	(522)	34	(488)	(295)	(4)	(299)	(357)	(38)	(395)
Total investment securities	(1,281)	218	(1,063)	(1,096)	157	(939)	(499)	101	(398)
Federal funds sold	(128)	(479)	(607)	561	(34)	527	27	170	197
Total earning assets	1,108	(3,801)	(2,693)	2,540	1,492	4,032	5,534	2,744	8,278
<b>INTEREST-BEARING LIABILITIES:</b>									
Interest-bearing transaction accounts	(1)	(12)	(13)	4	(1)	3	2	(0)	2
Money market deposit accounts	(159)	(1,143)	(1,302)	(20)	236	216	52	815	867
Savings accounts	(4)	(89)	(93)	(10)	3	(7)	(10)	(0)	(10)
Time deposits, \$100,000 or more	441	(1,156)	(715)	208	1,202	1,410	803	901	1,704
Other time deposits	624	(850)	(226)	1,326	210	1,536	509	1,803	2,312
Total time and savings deposits	901	(3,250)	(2,349)	1,508	1,650	3,158	1,356	3,519	4,875
Federal funds purchased, repurchase agreements and other borrowings	(43)	(1,050)	(1,093)	27	30	57	1	752	753
Federal Home Loan Bank advances	(1,007)	106	(901)	(351)	209	(142)	1,823	504	2,327
Total interest-bearing liabilities	(149)	(4,194)	(4,343)	1,184	1,889	3,073	3,180	4,775	7,955
Change in net interest income	\$ 1,257	\$ 393	\$ 1,650	\$ 1,356	\$ (397)	\$ 959	\$ 2,354	\$ (2,031)	\$ 323

\* Computed on a fully tax-equivalent basis using a 34% rate.

**Interest Sensitivity**

An important element of earnings performance and the maintenance of sufficient liquidity is proper management of the interest sensitivity gap. The interest sensitivity gap is the difference between interest sensitive assets and interest sensitive liabilities in a specific time interval. This gap can be managed by repricing assets or liabilities, which are variable rate instruments, by replacing an asset or liability at maturity or by adjusting the interest rate during the life of the asset or liability. Matching the amounts of assets and liabilities maturing in the same time interval helps to hedge interest rate risk and to minimize the impact of rising or falling interest rates on net interest income.

The Company determines the overall magnitude of interest sensitivity risk and then formulates policies governing asset generating and pricing, funding sources and pricing, and off-balance sheet commitments. These decisions are based on management's expectations regarding future interest rate movements, the state of the national and regional economy, and other financial and business risk factors. The Company uses computer simulations to measure the effect of various interest rate scenarios on net interest income. This modeling reflects interest rate changes and the related impact on net interest income and net income over specified time horizons.





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Based on scheduled maturities only, the Company was liability sensitive at the one-year timeframe as of December 31, 2008. It should be noted, however, that non-maturing deposit liabilities, which consist of interest checking, money market and savings accounts, are less interest sensitive than other market driven deposits. On December 31, 2008 non-maturing deposit liabilities totaled \$187.1 million, or 29.89%, of total interest-bearing liabilities. In a rising rate environment these deposit rates have historically lagged behind the changes in earning asset rates, thus mitigating the impact from the liability sensitivity position. The asset/liability model allows the Company to reflect the fact that non-maturing deposits are less rate sensitive than other deposits by using a decay rate. The decay rate is a type of artificial maturity that simulates maturities for non-maturing deposits over the number of months that more closely reflects historic data. Using the decay rate, the model reveals that the Company is asset sensitive.

When the Company is liability sensitive, net interest income should decrease if interest rates rise since liabilities will reprice faster than assets. Conversely, if interest rates fall, net interest income should increase, depending on the optionality (prepayment speeds) of the assets. When the Company is asset sensitive, net interest income should rise if rates rise and should fall if rates fall.

The most likely scenario represents the rate environment as management forecasts it to occur. Management uses a static test to measure the effects of changes in interest rates on net interest income. This test assumes that management takes no steps to adjust the balance sheet to respond to the shock by repricing assets/liabilities, as discussed in the first paragraph of this section.

Under the rate environment forecasted by management, rate shocks in 50 to 100 basis point increments are applied to see the impact on the Company's earnings. The rate shock model reveals that a 50 basis point decrease in rates would cause an approximate 1.87% annual decrease in net income. The rate shock model reveals that a 100 basis point rise in rates would cause an approximate 3.11% annual increase in net income and that a 200 basis point rise in rates would cause an approximate 5.86% annual increase in net income.

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As of December 31, 2008

(in thousands)	Within 3 Months	4-12 Months	1-5 Years	Over 5 Years	Total
<b>Uses of funds</b>					
Federal funds sold	\$ 17,814	\$	\$	\$	\$ 17,814
Taxable investments	8,913	20,252	55,308	921	85,394
Tax-exempt investments	500	2,104	8,474	3,583	14,661
<b>Total investments</b>	<b>27,227</b>	<b>22,356</b>	<b>63,782</b>	<b>4,504</b>	<b>117,869</b>
<b>Loans</b>					
Commercial	32,908	3,783	19,845	13,816	70,352
Tax-exempt				2,738	2,738
Consumer	2,468	2,580	26,982	8,760	40,790
Real estate	119,322	28,493	282,820	90,204	520,839
Other	1,373	547	312	501	2,733
<b>Total loans</b>	<b>156,071</b>	<b>35,403</b>	<b>329,959</b>	<b>116,019</b>	<b>637,452</b>
<b>Total earning assets</b>	<b>\$ 183,298</b>	<b>\$ 57,759</b>	<b>\$ 393,741</b>	<b>\$ 120,523</b>	<b>\$ 755,321</b>
<b>Sources of funds</b>					
Interest-bearing transaction accounts	\$ 12,902	\$	\$	\$	\$ 12,902
Money market deposit accounts	135,791				135,791
Savings accounts	38,412				38,412
Time deposits \$100,000 or more	32,591	69,934	25,237		127,762
Other time deposits	37,648	96,730	73,524		207,902
Federal funds purchased, repurchase agreements and other borrowings	33,282				33,282
FHLB advances	70,000				70,000
<b>Total interest bearing liabilities</b>	<b>\$ 360,626</b>	<b>\$ 166,664</b>	<b>\$ 98,761</b>	<b>\$</b>	<b>\$ 626,051</b>
<b>Rate sensitivity GAP</b>	<b>\$ (177,328)</b>	<b>\$ (108,905)</b>	<b>\$ 294,980</b>	<b>\$ 120,523</b>	<b>\$ 129,270</b>
<b>Cumulative GAP</b>	<b>\$ (177,328)</b>	<b>\$ (286,233)</b>	<b>\$ 8,747</b>	<b>\$ 129,270</b>	
<b>Provision for Loan Losses</b>					

The provision for loan losses is a charge against earnings necessary to maintain the allowance for loan losses at a level consistent with management's evaluation of the loan portfolio.

The provision for loan losses was \$2.4 million in 2008 as compared to \$1.0 million in 2007 and \$1.2 million in 2006.

Loans that were charged off during 2008 totaled \$1.6 million compared to \$1.0 million in 2007 and \$1.2 million in 2006. Recoveries amounted to \$463 thousand in 2008, \$381 thousand in 2007 and \$331 thousand in 2006. The Company's net loans charged off to year-end loans were 0.18% in 2008, 0.11% in 2007, and 0.15% in 2006. The allowance for loan losses, as a percentage of year-end loans, was 1.00% in 2008, 0.86% in 2007, and 0.82% in 2006.

As of December 31, 2008, nonperforming assets totaled \$14.9 million, up from \$3.2 million at year-end 2007. The December 2008 total consisted of \$3.8 million of other real estate, \$6.6 million in troubled debt restructured, \$3.5 million in loans still accruing interest but past due 90 days or more, and \$1.0 million in nonaccrual loans. The \$3.8 million of other real estate consisted of the following:

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**Other Real Estate Owned**

(in thousands)

Construction, land development, and other land	\$ 1,015
1-4 family residential properties	1,236
Nonfarm nonresidential properties	1,500
Total	\$ 3,751

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Loans still accruing interest but past due 90 days or more increased to \$3.5 million as of December 31, 2008 compared to \$623 thousand as of December 31, 2007. Although nonperforming assets as of December 31, 2008 were approximately \$11.7 million higher than December 31, 2007, \$5.3 million of this increase is due to an increase in troubled debt restructured.

Impaired loans increased to \$12.9 million from \$8.0 million as of December 31, 2007 as detailed in Note 4 of the Notes to Consolidated Financial Statements included in Item 8, Financial Statements and Supplemental Data of this report on Form 10-K. As shown in Note 4, the majority of these loans are collateralized.

### **Noninterest Income**

Noninterest income increased \$236 thousand, or 1.89%, in 2008 from 2007 compared to an increase of \$1.1 million, or 9.55%, in 2007 from 2006. Income from fiduciary activities was down slightly. The gain on disposal of premises and equipment is primarily attributed to a \$230 thousand gain on the sale of a Bank building that was no longer needed. The reduction in other operating income is attributed to the closing of the Company's in-house brokered mortgage department at the Bank in the fall of 2007.

### **Noninterest Expenses**

Noninterest expenses increased by \$2.4 million, or 9.04%, in 2008 over 2007 after increasing \$850 thousand, or 3.38%, in 2007 over 2006. \$1.1 million of this increase was in the category of salaries and employee benefits which increased by 6.97%. This increase is due to annual salary increases and an increase of 21 full-time equivalent employees over 2007.

Occupancy and equipment expense increased \$263 thousand, or 7.23%, over 2007. The increase is related to the Hilltop Branch that was opened in January 2008.

The \$428 thousand loss on write down of other real estate owned consists of two items. During the fourth quarter of 2008 the Company had a one-time write-off consisting of \$165 thousand for an undeveloped branch site as well as the establishment of a \$263 thousand valuation reserve for foreclosed property currently held as other real estate owned.

The remaining increase in noninterest expense is attributed to data processing, advertising, customer development and other costs. The majority of the data processing increase is related to increased debit card and ATM interchange costs and providing key employees with data processing devices that allow them access to their email when they are not in the office. Most of the increase in marketing and customer development costs can be attributed to the grand opening of the Hilltop Branch, the initiation of a contract related to ATMs in a chain of drug stores throughout Hampton Roads and higher contributions to non-profit organizations. Increases in foreclosed property and repossessed asset expense, FDIC insurance costs, courier expense, Federal Reserve costs and director fees account for the majority of the increase in the category titled Other.

### **Balance Sheet Review**

At December 31, 2008, the Company had total assets of \$835.0 million, an increase of 1.51% from \$822.6 million at December 31, 2007. Net loans as of December 31, 2008 were \$631.0 million, an increase of 6.59% from \$592.0 million at December 31, 2007.

Total investment securities at December 31, 2008 were \$104.8 million, a decrease of 20.48% from \$131.8 million on December 31, 2007. The Company's goal is to provide maximum return on the investment portfolio within the framework of its asset/liability objectives. The objectives include managing interest sensitivity, liquidity and pledging requirements.

During 2008, as in 2007, one of the Company's strategic goals was to restructure the balance sheet in order to improve the net interest margin. The use of proceeds from maturing lower-yielding investments to fund loan growth was part of this strategy. In addition, during 2008, the Company used funds from low-yielding maturing securities to pay down \$10.0 million of its FHLB advances.

At December 31, 2008, total deposits increased to \$646.5 million, an increase of 8.45% from \$596.2 million on December 31, 2007. Noninterest-bearing deposits increased \$27.8 million or 28.95% at year-end 2008 over 2007.

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Savings and time deposits increased \$22.6 million, or 4.51% in 2008 over 2007. In 2008, the Bank joined the Certificate of Deposit Account Registry Service network (CDARS), a service that allows member banks to share FDIC insurance coverage for their customers. As a result, a customer's deposit is fully FDIC-insured up to \$50.0 million. Only certificates of deposit can be placed through CDARS; all other account types are ineligible. Also in 2008, the Bank introduced new time deposit products to attract additional deposits.

**Investment Portfolio**

The following table sets forth a summary of the investment portfolio:

**TABLE IV**  
**INVESTMENT PORTFOLIO**

As of December 31,	2008	2007	2006
	(in thousands)		
<b>Available-for-sale securities, at fair value:</b>			
U.S. Treasury securities	\$ 400	\$ 988	\$ 981
Obligations of U.S. Government agencies	78,112	95,711	146,086
Obligations of state and political subdivisions	15,115	25,341	29,615
Mortgage-backed securities	2,453		
Money market investments	908	1,604	721
Other marketable equity securities		9	22
	\$ 96,988	\$ 123,653	\$ 177,425
<b>Held-to-maturity securities, at cost:</b>			
Obligations of U.S. Government agencies	\$ 2,600	\$ 2,300	\$ 2,700
Obligations of state and political subdivisions	467	604	732
	\$ 3,067	\$ 2,904	\$ 3,432
<b>Restricted securities:</b>			
Federal Home Loan Bank stock	4,622	5,115	7,094
Federal Reserve Bank stock	169	169	169
	\$ 4,791	\$ 5,284	\$ 7,263
<b>Total</b>	<b>\$ 104,846</b>	<b>\$ 131,841</b>	<b>\$ 188,120</b>

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The following table summarizes the contractual maturity of the investment portfolio and their weighted average yields as of December 31, 2008:

	1 year or less	1-5 years	5-10 years (in thousands)	Over 10 years	Total
U.S. Treasury securities	\$ 400	\$	\$	\$	\$ 400
Weighted average yield	0.99%				0.99%
Obligations of U.S. Government agencies	\$ 27,857	\$ 52,855	\$	\$	\$ 80,712
Weighted average yield	3.05%	3.57%			3.39%
Obligations of state and political subdivisions	\$ 2,604	\$ 8,474	\$ 3,583	\$ 921	\$ 15,582
Weighted average yield	4.65%	4.61%	4.58%	6.37%	4.72%
Mortgage-backed securities	\$	\$ 2,453	\$	\$	\$ 2,453
Weighted average yield		3.87%			3.87%
Money market investments	\$ 908	\$	\$	\$	\$ 908
Weighted average yield	3.55%				3.55%
Federal Home Loan Bank stock - restricted	\$	\$	\$	\$ 4,622	\$ 4,622
Weighted average yield				4.14%	4.14%
Federal Reserve Bank stock - restricted	\$	\$	\$	\$ 169	\$ 169
Weighted average yield				6.00%	6.00%
Total securities	\$ 31,769	\$ 63,782	\$ 3,583	\$ 5,712	\$ 104,846
Weighted average yield	3.17%	3.72%	4.58%	4.56%	3.63%

Yields are calculated on a fully tax-equivalent basis using a 34% rate.

**Loan Portfolio**

The following table shows a breakdown of total loans by type at December 31 for years 2004 through 2008:

**TABLE V**  
**LOAN PORTFOLIO**

As of December 31,	2008	2007	2006 (in thousands)	2005	2004
Commercial and other	\$ 73,086	\$ 70,741	\$ 67,697	\$ 63,224	\$ 56,231
Real estate construction	60,604	56,007	81,227	36,517	44,228
Real estate mortgage	460,235	415,492	367,808	325,677	263,096
Tax exempt	2,738	2,992	3,191	2,376	2,568
Installment loans to individuals	40,789	51,912	63,670	66,903	67,130
Total	\$ 637,452	\$ 597,144	\$ 583,593	\$ 494,697	\$ 433,253

Based on the North American Industry Classification System code, there are no categories of loans that exceed 10% of total loans other than the categories disclosed in the preceding table.

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The maturity distribution and rate sensitivity of certain categories of the Bank's loan portfolio at December 31, 2008 is presented below:

**TABLE VI**  
**MATURITY SCHEDULE OF SELECTED LOANS**

December 31, 2008	Within 1 year	1 to 5 years	After 5 years	Total
	(in thousands)			
Commercial and other	\$ 38,366	\$ 20,402	\$ 14,318	\$ 73,086
Real estate construction	50,683	9,921		60,604
<b>Total</b>	<b>\$ 89,049</b>	<b>\$ 30,323</b>	<b>\$ 14,318</b>	<b>\$ 133,690</b>
Loans due after 1 year with:				
Fixed interest rate	\$	\$ 28,722	\$ 14,318	\$ 43,040
Variable interest rate	\$	\$ 1,601	\$	\$ 1,601

The following table presents information concerning the aggregate amount of nonaccrual, past due loans and troubled debt restructured as of December 31 for the years 2004 through 2008:

**TABLE VII**  
**NONACCRUAL, PAST DUE AND TROUBLED DEBT RESTRUCTURED LOANS**

As of December 31,	2008	2007	2006	2005	2004
	(in thousands)				
Nonaccrual loans	\$ 1,045	\$ 84	\$ 458	\$ 308	\$ 402
Loans past due 90 days or more and accruing interest	3,529	623	826	935	1,122
Troubled debt restructured	6,594	1,321			1,806
Interest income that would have been recorded under original loan terms	244	79	38	66	42
Interest income recorded for the period	185	105	24	35	35

Loans are placed in nonaccrual status if principal or interest has been in default for a period of 90 days or more unless the obligation is both well secured and in the process of collection. A debt is well secured if it is secured (i) by collateral in the form of liens on or pledges of real or personal property, including securities, that have a realizable value sufficient to discharge the debt in full or (ii) by the guaranty of a financially responsible party. A debt is in the process of collection if collection of the debt is proceeding in due course either through legal action, including judgment enforcement procedures, or, in appropriate circumstances, through collection efforts not involving legal action which are reasonably expected to result in repayment of the debt or in its restoration to a current status.

Potential problem loans consist of loans that, because of potential credit problems of the borrowers, have caused management to have serious doubts as to the ability of such borrowers to comply with the loan repayment terms. At December 31, 2008 such problem loans, not included in Table VII, amounted to approximately \$4.8 million.

**Summary of Loan Loss Experience**

The determination of the balance of the Allowance for Loan Losses is based upon a review and analysis of the loan portfolio and reflects an amount which, in management's judgment, is adequate to provide for possible future losses. Management's review includes monthly analysis of past due and nonaccrual loans and detailed periodic loan by loan analyses.





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The principal factors considered by management in determining the adequacy of the allowance are the growth and composition of the loan portfolio, historical loss experience, the level of nonperforming loans, economic conditions, the value and adequacy of collateral, and the current level of the allowance.

The following table shows an analysis of the Allowance for Loan Losses for the years 2004 through 2008:

**TABLE VIII**  
**ANALYSIS OF THE ALLOWANCE FOR LOAN LOSSES**

As of December 31,	2008	2007	2006 (in thousands)	2005	2004
Balance at the beginning of period	\$ 5,130	\$ 4,784	\$ 4,448	\$ 4,303	\$ 4,832
Charge-offs:					
Commercial, financial and agricultural	190	87	223	76	468
Real estate construction					4
Real estate mortgage	401	71	69	108	327
Consumer loans	649	501	558	584	702
Other loans	347	376	345	507	229
Total charge-offs	1,587	1,035	1,195	1,275	1,730
Recoveries:					
Commercial, financial and agricultural	118	23	49	21	29
Real estate mortgage	6	89	6	9	36
Consumer loans	183	126	138	230	220
Other loans	156	143	138	110	66
Total recoveries	463	381	331	370	351
Net charge-offs	1,124	654	864	905	1,379
Provision for loan loss	2,400	1,000	1,200	1,050	850
Balance at end of period	\$ 6,406	\$ 5,130	\$ 4,784	\$ 4,448	\$ 4,303
Selected loan loss statistics					
Loans (net of unearned income):					
End of period balance	\$ 637,452	\$ 597,144	\$ 583,593	\$ 494,697	\$ 433,253
Average balance	\$ 622,883	\$ 587,645	\$ 543,136	\$ 450,053	\$ 418,781
Net charge-offs to average total loans	0.18%	0.11%	0.16%	0.20%	0.32%
Provision for loan losses to average total loans	0.39%	0.17%	0.22%	0.23%	0.20%
Provision for loan losses to net charge-offs	213.52%	152.91%	138.89%	116.02%	61.64%
Allowance for loan losses to period end loans	1.00%	0.86%	0.82%	0.90%	0.99%
Earnings to loan loss coverage*	10.53	18.56	12.54	12.10	9.17

\* Income before taxes plus provision for loan losses, divided by net charge-offs.

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The following table shows the amount of the Allowance for Loan Losses (ALL) allocated to each category at December 31 for the years 2004 through 2008. Although the ALL is allocated into these categories, the entire ALL is available to cover loan losses in any category. For example, if real estate construction loans experienced losses of \$40 thousand, the ALL could handle these losses even though only \$31 thousand is allocated to that category.

**TABLE IX**  
**ALLOCATION OF THE ALLOWANCE FOR LOAN LOSSES**

As of December 31,	2008		2007		2006		2005		2004	
	Amount	Percent of loans to Total Loans	Amount	Percent of loans to Total Loans	Amount	Percent of loans to Total Loans	Amount	Percent of loans to Total Loans	Amount	Percent of loans to Total Loans
	(in thousands)									
Commercial and other	1,467	11.9%	1,305	12.6%	1,668	12.2%	1,426	13.3%	1,207	13.6%
Real estate construction	31	9.5%	67	9.4%	55	13.9%	31	7.4%	18	10.2%
Real estate mortgage	4,318	72.2%	3,116	69.4%	2,398	63.0%	2,224	65.8%	1,957	60.7%
Consumer	590	6.4%	642	8.7%	663	10.9%	767	13.5%	1,014	15.5%
Unallocated	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	107	N/A
<b>Total Deposits</b>	<b>\$ 6,406</b>	<b>100.0%</b>	<b>\$ 5,130</b>	<b>100.0%</b>	<b>\$ 4,784</b>	<b>100.0%</b>	<b>\$ 4,448</b>	<b>100.0%</b>	<b>\$ 4,303</b>	<b>100.0%</b>

The following table shows the average balances and average rates paid on deposits for the years ended December 31, 2008, 2007 and 2006.

**TABLE X**  
**DEPOSITS**

Years ended December 31,	2008		2007		2006	
	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
	(in thousands)					
Interest-bearing transaction accounts	\$ 10,271	0.14%	\$ 10,658	0.25%	\$ 9,210	0.26%
Money market deposit accounts	139,109	0.70%	149,518	1.52%	150,950	1.37%
Savings accounts	37,832	0.27%	38,698	0.51%	40,612	0.50%
Time deposits, \$100,000 or more	122,666	3.89%	111,650	4.91%	106,227	3.83%
Other time deposits	203,208	4.06%	187,198	4.52%	157,133	4.41%
Total interest-bearing deposits	513,086	2.75%	497,722	3.31%	464,132	2.86%
Demand deposits	104,954		96,475		98,622	
Total deposits	\$ 618,040		\$ 594,197		\$ 562,754	

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The following table shows time deposits in amounts of \$100,000 or more as of December 31, 2008, 2007 and 2006 by time remaining until maturity.

**TABLE XI**  
**TIME DEPOSITS OF \$100,000 OR MORE**

As of December 31,	2008	2007 (in thousands)	2006
<b>Maturing in:</b>			
3 months or less	\$ 31,675	\$ 43,827	\$ 34,561
3 through 6 months	30,987	27,797	19,826
6 through 12 months	39,147	24,525	26,779
Greater than 12 months	25,953	22,467	26,523
	\$ 127,762	\$ 118,616	\$ 107,689

**Return on Equity and Assets**

The return on average stockholders' equity and assets, the dividend pay-out ratio, and the average equity to average assets ratio for the past three years are presented below.

Years Ended December 31,	2008	2007	2006
Return on average assets	0.82%	0.97%	0.88%
Return on average equity	8.26%	10.29%	9.68%
Dividend pay-out ratio	47.66%	37.78%	39.76%
Average equity to average assets	9.87%	9.39%	9.13%

**Capital Resources**

Total stockholders' equity as of December 31, 2008 was \$82.9 million, up 4.00% from \$79.7 million on December 31, 2007. The Company's capital position remains strong as evidenced by the regulatory capital measurements. Under the banking regulations, Total Capital is composed of core capital (Tier 1) and supplemental capital (Tier 2). Tier 1 capital consists of common stockholders' equity less goodwill. Tier 2 capital consists of certain qualifying debt and a qualifying portion of the allowance for loan losses. The following is a summary of the Company's capital ratios for 2008, 2007 and 2006. As shown below, these ratios were all well above the regulatory minimum levels.

	2008 Regulatory Minimums	2008	2007	2006
Tier 1	4.00%	12.48%	12.64%	12.41%
Total Capital	8.00%	13.44%	13.45%	13.18%
Tier 1 Leverage	4.00%	10.00%	9.67%	9.19%

Year-end book value was \$16.90 in 2008 and \$16.24 in 2007. Cash dividends were \$3.2 million, or \$0.66 per share in 2008 and \$3.0 million, or \$0.61 per share in 2007. The common stock of the Company has not been extensively traded. The table below shows the high and low sales prices for each quarter of 2008 and 2007. The stock is quoted on the NASDAQ Capital Market under the symbol "OPOF" and the prices below are based on trade information as reported by The NASDAQ Stock Market, LLC. There were 1,233 stockholders of record of the Company as of December 31, 2008. This stockholder count does not include stockholders who hold their stock in a nominee registration.

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The following is a summary of the quarterly dividends paid and high and low market prices on Old Point Financial Corporation common stock for 2008 and 2007. The share data is adjusted to reflect the 5 for 4 stock split in the form of a dividend declared on August 16, 2007 and paid on October 1, 2007.

	2008			2007		
	Dividend	Market Price		Dividend	Market Price	
		High	Low		High	Low
1st Quarter	\$ 0.16	\$ 20.95	\$ 16.43	\$ 0.14	\$ 23.16	\$ 21.20
2nd Quarter	\$ 0.16	\$ 19.03	\$ 16.25	\$ 0.15	\$ 22.38	\$ 20.40
3rd Quarter	\$ 0.17	\$ 22.00	\$ 16.00	\$ 0.16	\$ 21.00	\$ 16.78
4th Quarter	\$ 0.17	\$ 20.99	\$ 16.05	\$ 0.16	\$ 20.47	\$ 17.43

**Liquidity**

Liquidity is the ability of the Company to meet present and future financial obligations through either the sale or maturity of existing assets or the acquisition of additional funds through liability management. Liquid assets include cash, interest-bearing deposits with banks, federal funds sold, investments in securities and loans maturing within one year.

In addition, secondary sources are available through the use of borrowed funds if the need should arise. The Company's sources of funds include a large stable deposit base and secured advances from the FHLB. As of December 31, 2008, the Company had \$179.2 million in FHLB borrowing availability. The Company has available short-term unsecured borrowed funds in the form of federal funds with correspondent banks. As of year-end 2008, the Company had \$40.0 million available in federal funds to handle any short-term borrowing needs.

As a result of the Company's management of liquid assets, availability of borrowed funds and the ability to generate liquidity through liability funding, management believes that the Company maintains overall liquidity sufficient to satisfy its depositors' requirements and to meet its customers' future borrowing needs.

The following table sets forth information relating to the Company's sources of liquidity and the outstanding commitments for use of liquidity at December 31, 2008 and December 31, 2007. Dividing the total sources of liquidity by the outstanding commitments for use of liquidity derives the liquidity coverage ratio.

**LIQUIDITY SOURCES AND USES**

(in thousands)

	December 31, 2008			December 31, 2007		
	Total	In Use	Available	Total	In Use	Available
<b>Sources:</b>						
Federal funds lines of credit	\$ 40,000	\$	\$ 40,000	\$ 40,000	\$	\$ 40,000
Federal Home Loan Bank advances	249,234	70,000	179,234	245,352	80,000	165,352
Federal funds sold			17,814			35,197
Securities, available for sale and unpledged at fair value			12,405			29,062
Total short-term funding sources			\$ 249,453			\$ 269,611
<b>Uses:</b>						
Unfunded loan commitments and lending lines of credit			32,856			43,926
Letters of credit			1,708			1,650
Commitments to purchase assets			1,775			708
Anticipated decline in borrowed funds (demand note)			427			315
Total potential short-term funding uses			\$ 36,766			\$ 46,599
Liquidity coverage ratio			678.5%			578.6%



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Management is not aware of any market or institutional trends, events or uncertainties that are expected to have a material effect on the liquidity, capital resources or operations of the Company. Nor is management aware of any current recommendations by regulatory authorities that would have a material effect on liquidity, capital resources or operations. The Company's internal sources of such liquidity are deposits, loan and investment repayments and securities available for sale. The Company's primary external source of liquidity is advances from the FHLB of Atlanta.

**Effects of Inflation**

Management believes that the key to achieving satisfactory performance in an inflationary environment is its ability to maintain or improve its net interest margin and to generate additional fee income. The Company's policy of investing in and funding with interest-sensitive assets and liabilities is intended to reduce the risks inherent in a volatile inflationary economy.

**Off-Balance Sheet Lending Related Commitments**

The Company had \$108.5 million in consumer and commercial commitments at December 31, 2008. The Company also had \$5.5 million at December 31, 2008 in letters of credit that the Bank will fund if certain future events occur. It is expected that only a portion of these commitments will ever actually be funded.

Management believes that the Company has the liquidity and capital resources to handle these commitments in the normal course of business. See Note 13 of the Notes to Consolidated Financial Statements included in Item 8, "Financial Statements and Supplemental Data" of this report on Form 10-K.

**Contractual Obligations**

In the normal course of business there are various outstanding contractual obligations of the Company that will require future cash outflows. In addition, there are commitments and contingent liabilities, such as commitments to extend credit that may or may not require future cash outflows. The following table provides the Company's contractual obligations as of December 31, 2008:

(in thousands)

<i>Contractual Obligations</i>	<i>Total</i>	<i>Less Than 1 Year</i>	<i>1-3 Years</i>	<i>3-5 Years</i>	<i>More Than 5 Years</i>
Short-Term Debt Obligations	\$ 33,282	\$ 33,282			
Long-Term Debt Obligations	\$ 70,000	\$ 5,000	\$ 40,000		\$ 25,000
Operating Lease Obligations	\$ 922	\$ 331	\$ 558	\$ 33	
Commitment to purchase assets	\$ 1,775	\$ 1,775			
<b>Total contractual cash obligations excluding deposits</b>	<b>\$ 105,979</b>	<b>\$ 40,388</b>	<b>\$ 40,558</b>	<b>\$ 33</b>	<b>\$ 25,000</b>
Deposits	\$ 646,524	\$ 545,392	\$ 94,101	\$ 7,031	
<b>Total</b>	<b>\$ 752,503</b>	<b>\$ 585,780</b>	<b>\$ 134,659</b>	<b>\$ 7,064</b>	<b>\$ 25,000</b>

Short-term debt obligations include federal funds purchased, repurchase agreements and U.S. Treasury demand note. As of December 31, 2008, the long-term debt obligations of FHLB advances decreased to \$70.0 million as compared to \$80.0 million as of December 31, 2007.

**Table of Contents****Short-Term Borrowings**

Short-term borrowings consist of the following at December 31, 2008, 2007 and 2006:

**TABLE XII**  
**SHORT-TERM BORROWINGS**

	2008		2007		2006	
	Balance	Rate	Balance	Rate	Balance	Rate
	(in thousands)					
<b>Balance at December 31,</b>						
Repurchase agreements	\$ 32,855	0.85%	\$ 63,691	3.43%	\$ 56,696	3.99%
U.S. Treasury demand notes and other borrowed money	427	0.00%	534	4.00%	357	5.00%
Total	\$ 33,282	0.84%	\$ 64,225	3.43%	\$ 57,053	4.00%
<b>Average daily balance at December 31,</b>						
Federal funds purchased	\$ 1,066	2.31%	\$ 503	5.59%	\$ 2,863	4.96%
Repurchase agreements	49,194	1.72%	50,967	3.77%	47,682	3.66%
U.S. Treasury demand notes and other borrowed money	489	1.39%	412	4.79%	622	4.71%
Total	\$ 50,749	1.73%	\$ 51,882	3.80%	\$ 51,167	3.74%
<b>Maximum month-end outstanding balance:</b>						
Federal funds purchased	\$ 9,000		\$		\$ 11,100	
Repurchase agreements	\$ 60,385		\$ 64,783		\$ 56,696	
U.S. Treasury demand notes and other borrowed money	\$ 1,944		\$ 1,886		\$ 1,256	

**Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

This information is incorporated herein by reference from Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, on pages 14 through 30 of this report on Form 10-K.

**Item 8. Financial Statements and Supplementary Data**

The consolidated financial statements and related footnotes of the Company are presented below followed by the financial statements of the Parent.

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Shareholders

Old Point Financial Corporation and subsidiaries

Hampton, Virginia

We have audited the accompanying consolidated balance sheets of Old Point Financial Corporation and subsidiaries as of December 31, 2008 and 2007, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years ended December 31, 2008, 2007 and 2006. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Old Point Financial Corporation and subsidiaries as of December 31, 2008 and 2007, and the results of their operations and their cash flows for the years ended December 31, 2008, 2007 and 2006, in conformity with U.S. generally accepted accounting principles.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Old Point Financial Corporation and subsidiaries' internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 5, 2009 expressed an unqualified opinion on the effectiveness of Old Point Financial Corporation and subsidiaries' internal control over financial reporting.

Winchester, Virginia

March 5, 2009



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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Shareholders

Old Point Financial Corporation and subsidiaries

Hampton, Virginia

We have audited Old Point Financial Corporation and subsidiaries' internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Old Point Financial Corporation and subsidiaries' management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying *Management's Report on Internal Control over Financial Reporting*. Our responsibility is to express an opinion on the Corporation's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A corporation's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A corporation's internal control over financial reporting includes those policies and procedures that (a) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the corporation; (b) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the corporation are being made only in accordance with authorizations of management and directors of the corporation; and (c) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the corporation's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Old Point Financial Corporation and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets as of December 31, 2008 and 2007 and the related consolidated statements of income, changes in stockholders' equity and cash flows for the years ended December 31, 2008, 2007 and 2006 of Old Point Financial Corporation and subsidiaries and our report dated March 5, 2009 expressed an unqualified opinion.

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Winchester, Virginia

March 5, 2009

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**Table of Contents****Old Point Financial Corporation and Subsidiaries**

## Consolidated Balance Sheets

	December 31, 2008                  2007 (in thousands)	
<b>Assets</b>		
Cash and due from banks	\$ 29,511	\$ 16,367
Federal funds sold	17,814	35,197
Cash and cash equivalents	47,325	51,564
Securities available-for-sale, at fair value	96,988	123,653
Securities held-to-maturity (fair value approximates \$3,116 and \$2,947)	3,067	2,904
Restricted securities	4,791	5,284
Loans, net of allowance for loan losses of \$6,406 and \$5,130	631,046	592,014
Premises and equipment, net	27,143	27,002
Bank owned life insurance	14,018	12,801
Other real estate owned, net	3,751	1,119
Other assets	6,836	6,216
	<b>\$ 834,965</b>	<b>\$ 822,557</b>
<b>Liabilities &amp; Stockholders Equity</b>		
Deposits:		
Noninterest-bearing deposits	\$ 123,755	\$ 95,970
Savings deposits	187,105	185,823
Time deposits	335,664	314,372
Total deposits	646,524	596,165
Federal funds purchased, repurchase agreements and other borrowings	33,282	64,225
Federal Home Loan Bank advances	70,000	80,000
Accrued expenses and other liabilities	2,261	2,460
Total liabilities	752,067	742,850
Commitments and contingencies		
Stockholders equity:		
Common stock, \$5 par value, 10,000,000 shares authorized; 4,905,229 and 4,907,567 shares issued	24,526	24,538
Additional paid-in capital	15,506	15,357
Retained earnings	43,251	40,039
Accumulated other comprehensive loss	(385)	(227)
Total stockholders equity	82,898	79,707
	<b>\$ 834,965</b>	<b>\$ 822,557</b>

See Notes to Consolidated Financial Statements.

**Table of Contents****Old Point Financial Corporation and Subsidiaries**

## Consolidated Statements of Income

	Years Ended December 31,		
	2008	2007	2006
	(in thousands, except per share data)		
<b>Interest and Dividend Income:</b>			
Interest and fees on loans	\$ 40,870	\$ 41,887	\$ 37,440
Interest on federal funds sold	387	994	467
Interest on securities:			
Taxable	3,377	4,470	5,118
Tax-exempt	925	1,247	1,445
Dividends and interest on all other securities	942	423	415
 Total interest and dividend income	 46,501	 49,021	 44,885
<b>Interest Expense:</b>			
Interest on savings and interest-bearing demand deposits	1,095	2,502	2,290
Interest on time deposits	13,007	13,949	11,003
Interest on federal funds purchased, repurchase agreements and other borrowings	877	1,970	1,913
Interest on Federal Home Loan Bank advances	4,027	4,928	5,070
 Total interest expense	 19,006	 23,349	 20,276
Net interest income	27,495	25,672	24,609
Provision for loan losses	2,400	1,000	1,200
 Net interest income, after provision for loan losses	 25,095	 24,672	 23,409
<b>Noninterest Income:</b>			
Income from fiduciary activities	3,109	3,116	2,669
Service charges on deposit accounts	5,894	5,779	5,445
Other service charges, commissions and fees	2,587	2,480	2,197
Income from bank owned life insurance	716	622	547
Gain (loss) on disposal of premises and equipment	227	134	(8)
Gain (loss) on available-for-sale securities	(47)	3	9
Other operating income	236	352	539
 Total noninterest income	 12,722	 12,486	 11,398
<b>Noninterest Expense:</b>			
Salaries and employee benefits	17,041	15,931	15,192
Occupancy and equipment	3,903	3,640	3,514
Service fees	390	370	706
Data processing	996	878	738
Advertising	773	724	775
Customer development	752	696	684
Employee professional development	662	645	591
Loss on write down of other real estate owned	428		
Other	3,431	3,139	2,973
 Total noninterest expenses	 28,376	 26,023	 25,173
 Income before income taxes	 9,441	 11,135	 9,634

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Income tax expense	2,651	3,166	2,610
Net income	\$ 6,790	\$ 7,969	\$ 7,024
<b>Basic Earnings per Share *</b>			
Average shares outstanding (in thousands)	4,904	4,957	4,990
Net income per share of common stock	\$ 1.39	\$ 1.61	\$ 1.41
<b>Diluted Earnings per Share *</b>			
Average shares outstanding (in thousands)	4,935	4,998	5,061
Net income per share of common stock	\$ 1.38	\$ 1.59	\$ 1.39
See Notes to Consolidated Financial Statements.			

\* Per share data has been adjusted to reflect the 5 for 4 stock split in the form of a dividend declared on August 16, 2007 and paid on October 1, 2007.

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## Consolidated Statements of Changes in Stockholders' Equity

Years ended December 31, 2008, 2007, and 2006

	Shares of Common Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
	(in thousands, except share data)					
<b>Balance at December 31, 2005</b>	4,013,553	\$ 20,068	\$ 14,320	\$ 39,074	\$ (2,406)	\$ 71,056
Comprehensive income:						
Net income				7,024		7,024
Unrealized holding gains arising during the period (net of tax, \$404)				0	785	785
Reclassification adjustment, (net of tax, \$3)					(6)	(6)
Total comprehensive income				7,024	779	7,803
Adjustment to initially apply FASB Statement No. 158 (net of tax, \$326) (in regards to pension plan)					(633)	(633)
Sale of common stock	12,215	61	358	(260)		159
Repurchase and retirement of common stock	(33,613)	(168)		(800)		(968)
Nonqualified stock options			41			41
Cash dividends (\$.56 per share)				(2,793)		(2,793)
<b>Balance at December 31, 2006</b>	3,992,155	\$ 19,961	\$ 14,719	\$ 42,245	\$ (2,260)	\$ 74,665
Comprehensive income:						
Net income				7,969		7,969
Unrealized holding gains arising during the period (net of tax, \$914)					1,775	1,775
Reclassification adjustment, (net of tax, \$1)					(2)	(2)
Pension liability adjustment (net of tax, \$134)					260	260
Total comprehensive income				7,969	2,033	10,002
Sale of common stock	19,716	99	575	(500)		174
Repurchase and retirement of common stock	(90,310)	(452)		(1,731)		(2,183)
Stock split in the form of a 25% stock dividend	986,006	4,930		(4,930)		0
Cash paid in lieu of fractional shares				(4)		(4)
Nonqualified stock options			34			34
Stock compensation expense			29			29
Cash dividends (\$.61 per share)				(3,010)		(3,010)
<b>Balance at December 31, 2007</b>	4,907,567	\$ 24,538	\$ 15,357	\$ 40,039	\$ (227)	\$ 79,707
Comprehensive income:						
Net income				6,790		6,790
Unrealized holding gains arising during the period (net of tax, \$256)					496	496
Reclassification adjustment (net of tax, \$16)					31	31
Pension liability adjustment (net of tax benefit, \$353)					(685)	(685)
Total comprehensive income (loss)				6,790	(158)	6,632

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Adjustment to apply FASB Statement No.158 (net of tax, \$11) (in regards to pension plan)					22		22
Adjustment to apply EITF 06-4 (net of tax, \$144) (in regards to split-dollar life insurance)					(281)		(281)
Sale of common stock	3,062	15	37		(13)		39
Repurchase and retirement of common stock	(5,400)	(27)			(70)		(97)
Stock compensation expense				112			112
Cash dividends (\$.66 per share)					(3,236)		(3,236)
<b>Balance at December 31, 2008</b>	<b>4,905,229</b>	<b>\$ 24,526</b>	<b>\$ 15,506</b>	<b>\$ 43,251</b>	<b>\$</b>	<b>(385)</b>	<b>\$ 82,898</b>

See Notes to Consolidated Financial Statements.

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## Consolidated Statements of Cash Flows

Years Ended December 31,	2008	2007 (in thousands)	2006
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net income	\$ 6,790	\$ 7,969	\$ 7,024
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	1,768	1,688	1,589
Provision for loan losses	2,400	1,000	1,200
Net (gain) loss on sale of available-for-sale securities	47	(3)	(9)
Net accretion and amortization of securities	(73)	(64)	(54)
Net (gain) loss on disposal of premises and equipment	(227)	(134)	5
Net gain on sale of other real estate owned		(14)	
Stock compensation expense	112	29	
Valuation allowance on OREO properties	428		
Deferred tax expense benefit	(565)	(183)	(36)
Increase in other assets	(2,536)	(2,516)	(850)
Increase (decrease) in other liabilities	(198)	333	184
<b>Net cash provided by operating activities</b>	<b>7,946</b>	<b>8,105</b>	<b>9,053</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Purchases of available-for-sale securities	(90,091)	(47,415)	(6,977)
Purchases of held-to-maturity securities	(3,400)	(1,400)	(1,200)
Proceeds from maturities and calls of securities	113,291	104,217	14,387
Proceeds from sales of available-for-sale securities	8,066	3,630	2,860
Loans made to customers	(293,706)	(183,156)	(300,785)
Principal payments received on loans	249,215	167,756	211,026
Proceeds from sales of other real estate owned		254	
Purchases of premises and equipment	(1,682)	(2,146)	(6,727)
<b>Net cash provided by (used in) investing activities</b>	<b>(18,307)</b>	<b>41,740</b>	<b>(87,416)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Increase (decrease) in noninterest-bearing deposits	27,785	(683)	(2,033)
Increase (decrease) in savings deposits	1,282	(15,450)	5,440
Proceeds from the sale of time deposits	275,748	240,299	191,905
Payments for maturing time deposits	(254,456)	(216,415)	(143,641)
Increase (decrease) in federal funds purchased and repurchase agreements	(30,836)	6,995	7,785
Increase (decrease) in Federal Home Loan Bank advances	(10,000)	(45,000)	45,000
Increase (decrease) in interest-bearing demand notes and other borrowed money	(107)	178	(1,354)
Proceeds from issuance of common stock	39	174	159
Repurchase and retirement of common stock	(97)	(2,183)	(968)
Cash in lieu of shares		(4)	
Effect of nonqualified stock options		34	41
Cash dividends paid on common stock	(3,236)	(3,010)	(2,793)
<b>Net cash provided by (used in) financing activities</b>	<b>6,122</b>	<b>(35,065)</b>	<b>99,541</b>
Net increase (decrease) in cash and cash equivalents	(4,239)	14,780	21,178
Cash and cash equivalents at beginning of period	51,564	36,784	15,606
<b>Cash and cash equivalents at end of period</b>	<b>\$ 47,325</b>	<b>\$ 51,564</b>	<b>\$ 36,784</b>



**SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION**

Cash payments for:

Interest	\$ 19,667	\$ 23,245	\$ 19,463
Income tax	\$ 3,275	\$ 3,375	\$ 2,625

**SUPPLEMENTAL SCHEDULE OF NONCASH TRANSACTIONS**

Unrealized gain on investment securities	\$ 752	\$ 2,686	\$ 1,180
Loans transferred to other real estate owned	\$ 2,921	\$ 955	\$
Change in pension liability	\$ (1,005)	\$ (394)	\$ 959
Adjustment to reflect change in accounting principle - split-dollar post retirement benefits	\$ (425)	\$	\$

See Notes to Consolidated Financial Statements.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1. Significant Accounting Policies**

**PRINCIPLES OF CONSOLIDATION:**

The consolidated financial statements include the accounts of Old Point Financial Corporation (the Company) and its wholly-owned subsidiaries, The Old Point National Bank of Phoebus (the Bank) and Old Point Trust & Financial Services N.A. (Trust). All significant intercompany balances and transactions have been eliminated in consolidation.

**NATURE OF OPERATIONS:**

Old Point Financial Corporation is a holding company that conducts substantially all of its operations through two subsidiaries, The Old Point National Bank of Phoebus and Old Point Trust and Financial Services, N.A. The Bank services individual and commercial customers, the majority of which are in Hampton Roads. As of December 31, 2008, the Bank had 20 branch offices. The Bank offers a full range of deposit and loan products to its retail and commercial customers. Trust offers a full range of services for individuals and businesses. Products and services include retirement planning, estate planning, financial planning, trust accounts, tax services and investment management services.

**USE OF ESTIMATES:**

In preparing consolidated financial statements in conformity with U.S. generally accepted accounting principles, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and the valuation of deferred tax assets.

**CASH AND CASH EQUIVALENTS:**

For purposes of the consolidated statements of cash flows, cash and cash equivalents includes cash and balances due from banks and federal funds sold, all which mature within 90 days.

**INVESTMENT SECURITIES:**

SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities (SFAS 115), addresses the accounting and reporting for investments in equity securities that have readily determinable fair values and for all investments in debt securities. Those investments are to be classified in two categories and accounted for as follows:

**Held-to-maturity** - Debt securities for which the Company has the positive intent and ability to hold to maturity are classified as held-to-maturity securities and reported at cost, adjusted for premiums and discounts that are recognized in interest income using the interest method over the period to maturity.

**Available-for-sale** - Debt and equity securities not classified as held-to-maturity securities are classified as available-for-sale securities and recorded at fair value, with unrealized gains and losses reported as a component of comprehensive income. Gains and losses on the sale of available-for-sale securities are determined using the specific identification method.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer, and (iii) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

**LOANS:**

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The Company grants mortgage, commercial and consumer loans to customers. A substantial portion of the loan portfolio is represented by mortgage loans throughout Hampton Roads. The ability of the Company's debtors to honor their contracts is dependent upon the real estate and general economic conditions in this area.

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Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally are reported at their outstanding unpaid principal balances adjusted for charge-offs, the allowance for loan losses and any deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. Loan origination fees and certain direct origination costs are capitalized and recognized as an adjustment of the yield on the related loan.

Accrual of interest is discontinued on a loan when management believes, after considering collection efforts and other factors, that the borrower's financial condition is such that collection of interest is doubtful.

All interest accrued but not collected for loans that are placed on nonaccrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash basis or cost recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

**ALLOWANCE FOR LOAN LOSSES:**

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific and general components. The specific component relates to loans that are classified as doubtful or substandard. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in estimating specific and general losses in the portfolio.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer and residential loans for impairment disclosures, unless such loans are the subject of a restructuring agreement.

**OFF-BALANCE SHEET CREDIT RELATED FINANCIAL INSTRUMENTS:**

In the ordinary course of business, the Company has entered into commitments to extend credit, including commitments under commercial letters of credit and lines of credit. Such financial instruments are recorded when they are funded.

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### **OTHER REAL ESTATE OWNED:**

Other real estate owned is carried at the lower of carrying amount or estimated fair value less cost to sell and consists of foreclosed real property and other property held for sale. The estimated fair value is reviewed periodically by management and any write-downs are charged against current earnings. Revenue and expenses and changes in the valuation allowance are included in net expenses from foreclosed assets.

### **PREMISES AND EQUIPMENT:**

Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation and amortization. Premises and equipment are depreciated over their estimated useful lives ranging from three to 39 years; leasehold improvements are amortized over the lives of the respective leases or the estimated useful life of the leasehold improvement, whichever is less. Software is amortized over its estimated useful life ranging from three to five years. Depreciation and amortization are calculated on the straight-line method.

### **INCOME TAXES:**

Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the new deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax basis of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws.

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable of the taxing authorities upon examination.

Interest and penalties associated with unrecognized tax benefits are classified as additional income taxes in the statement of income.

### **PENSION PLAN:**

The Company has a non-contributory defined benefit pension plan. Effective September 30, 2006, the Company took action to freeze the plan. Benefits for participants will remain frozen in the plan until such time as further action occurs. No additional participants will be added to the plan.

Although the plan is frozen, contributions to the plan will continue using the Company's policy to fund the maximum amount of contributions allowed for tax purposes. The Company accrues an amount equal to its actuarially computed obligation under the plan.

The actuarial valuation was performed using the initial frozen liability method. Under this method, the Company's contribution equals the sum of the amount necessary to amortize the frozen initial liability (past service base) over a period of years and the normal cost of the plan.

### **STOCK COMPENSATION PLANS:**

Share-based compensation arrangements include stock options, restricted stock plans, performance-based awards, stock appreciation rights and employee stock purchase plans. SFAS 123R, "Share-Based Payments", requires all share-based payments to employees to be valued using a fair value method on the date of grant and to be expensed based on that fair value over the applicable vesting period.

For additional information on stock-based compensation, see Note 9 of the Notes to Consolidated Financial Statements of this report on Form 10-K.

### **EARNINGS PER COMMON SHARE:**

Basic earnings per share represents income available to common stockholders divided by the weighted-average



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number of common shares outstanding during the period. Diluted earnings per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by the Company relate solely to outstanding stock options and are determined using the treasury stock method.

Per share data has been adjusted to reflect the 5 for 4 stock split in the form of a dividend declared on August 16, 2007 and paid on October 1, 2007. Earnings per common share have been computed based on the following:

	Years Ended December 31,		
	2008	2007	2006
	(in thousands)		
Net Income applicable to common stock	\$ 6,790	\$ 7,969	\$ 7,024
Average number of common shares outstanding	4,904	4,957	4,990
Effect of dilutive options	31	41	71
 Average number of common shares outstanding used to calculate diluted earnings per common share	 4,935	 4,998	 5,061

There were 188,210 anti-dilutive shares in 2008, 261,290 in 2007 and 87,000 in 2006.

**TRUST ASSETS AND INCOME:**

Securities and other property held by Trust in a fiduciary or agency capacity are not assets of the Company and are not included in the accompanying consolidated financial statements.

**ADVERTISING EXPENSES:**

Advertising expenses are expensed as incurred.

**RECLASSIFICATIONS:**

Certain amounts in the consolidated financial statements have been reclassified to conform with classifications adopted in the current year.

**RECENT ACCOUNTING PRONOUNCEMENTS:**

In September 2006, the Financial Accounting Standards Board (FASB) reached a consensus on Emerging Issues Task Force (EITF) Issue 06-4, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements, (EITF Issue 06-4). In March 2007, the FASB reached a consensus on EITF Issue 06-10, Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements, (EITF Issue 06-10). Both of these standards require a company to recognize an obligation over an employee's service period based upon the substantive agreement with the employee such as the promise to maintain a life insurance policy or provide a death benefit postretirement. The Company adopted the provisions of these standards effective January 1, 2008. The Company charged \$281 thousand to retained earnings (net of tax) and \$26 thousand to expense in 2008 due to the adoption of these standards.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements, but rather, provides enhanced guidance to other pronouncements that require or permit assets or liabilities to be measured at fair value. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those years. The FASB approved a one-year deferral for the implementation of the Statement for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. The Company adopted SFAS 157 effective January 1, 2008. The adoption of SFAS 157 did not have a material impact on the Company's consolidated financial statements.

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In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159). This Statement permits entities to choose to measure many financial instruments and

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certain other items at fair value. The objective of this Statement is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. The fair value option established by this Statement permits all entities to choose to measure eligible items at fair value at specified election dates. A business entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. The fair value option may be applied instrument by instrument and is irrevocable. SFAS 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007, with early adoption available in certain circumstances. The Company adopted SFAS 159 effective January 1, 2008. The Company decided not to report any existing financial assets or liabilities at fair value that are not already reported, thus the adoption of this statement did not have a material impact on the Company's consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141(R), Business Combinations (SFAS 141(R)). The Standard will significantly change the financial accounting and reporting of business combination transactions. SFAS 141(R) establishes principles for how an acquirer recognizes and measures the identifiable assets acquired, liabilities assumed, and any noncontrolling interest in the acquiree; recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141(R) is effective for acquisition dates on or after the beginning of an entity's first year that begins after December 15, 2008. The Company does not expect the implementation of SFAS 141(R) to have a material impact on its consolidated financial statements, at this time.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements an Amendment of ARB No. 51 (SFAS 160). The Standard will significantly change the financial accounting and reporting of noncontrolling (or minority) interests in consolidated financial statements. SFAS 160 is effective as of the beginning of an entity's first fiscal year that begins after December 15, 2008, with early adoption prohibited. The Company does not expect the implementation of SFAS 160 to have a material impact on its consolidated financial statements, at this time.

In November 2007, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No.109, Written Loan Commitments Recorded at Fair Value through Earnings (SAB 109). SAB 109 expresses the current view of the staff that the expected net future cash flows related to the associated servicing of the loan should be included in the measurement of all written loan commitments that are accounted for at fair value through earnings. SEC registrants are expected to apply the views in Question 1 of SAB 109 on a prospective basis to derivative loan commitments issued or modified in fiscal quarters beginning after December 15, 2007. Implementation of SAB 109 did not have a material impact on the Company's consolidated financial statements.

In December 2007, the SEC issued Staff Accounting Bulletin No. 110, Use of a Simplified Method in Developing Expected Term of Share Options (SAB 110). SAB 110 expresses the current view of the staff that it will accept a company's election to use the simplified method discussed in SAB 107 for estimating the expected term of plain vanilla share options regardless of whether the company has sufficient information to make more refined estimates. The staff noted that it understands that detailed information about employee exercise patterns may not be widely available by December 31, 2007. Accordingly, the staff will continue to accept, under certain circumstances, the use of the simplified method beyond December 31, 2007. Implementation of SAB 110 did not have a material impact on the Company's consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities an amendment of SFAS No. 133, (SFAS No. 161). SFAS No. 161 requires that an entity provide enhanced disclosures related to derivative and hedging activities. SFAS No. 161 is effective for the Company on January 1, 2009 and is not expected to have a material impact on the Company's consolidated financial statements.

In April 2008, the FASB issued FASB Staff Position (FSP) No. 142-3, Determination of the Useful Life of Intangible Assets (FSP No. 142-3). FSP No. 142-3 amends the factors an entity should consider in developing renewal or extension assumptions used in determining the useful life of recognized intangible assets under FASB SFAS No. 142, Goodwill and Other Intangible Assets (SFAS No. 142). The intent of FSP No. 142-3 is to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the assets under SFAS No. 141(R). FSP No. 142-3 is

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effective for the Company on January 1, 2009, and applies prospectively to intangible assets that are acquired individually or with a group of other assets in business combinations and asset acquisitions. The adoption of FSP No. 142-3 is not expected to have a material impact on the Company's consolidated financial statements.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles*, (SFAS No. 162). SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles. SFAS No. 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles*. Management does not expect the adoption of the provision of SFAS No. 162 to have any impact on the Company's consolidated financial statements.

In September 2008, the FASB issued FSP FAS 133-1 and FIN 45-4, *Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161*, (FSP 133-1 and FIN 45-4). FSP 133-1 and FIN 45-4 require a seller of credit derivatives to disclose information about its credit derivatives and hybrid instruments that have embedded credit derivatives to enable users of financial statements to assess their potential effect on its financial position, financial performance and cash flows. The disclosures required by FSP 133-1 and FIN 45-4 will be effective for the Company on December 31, 2008 and are not expected to have a material impact on the Company's consolidated financial statements.

In October 2008, the FASB issued FSP 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 No. 157 in determining the fair value of a financial asset during periods of inactive markets. FSP 157-3 was effective as of September 30, 2008 and did not have material impact on the Company's consolidated financial statements.

In December 2008, the FASB issued FSP No. FAS 140-4 and FIN 46(R)-8, *Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities*. FSP No. FAS 140-4 and FIN 46(R)-8 requires enhanced disclosures about transfers of financial assets and interests in variable interest entities. The FSP is effective for interim and annual periods ending after December 15, 2008. Since the FSP requires only additional disclosures concerning transfers of financial assets and interest in variable interest entities, adoption of the FSP will not affect the Company's financial condition, results of operations or cash flows.

In January 2009, the FASB reached a consensus on EITF Issue 99-20-1. This FSP amends the impairment guidance in EITF Issue No. 99-20, *Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets*, to achieve more consistent determination of whether an other-than-temporary impairment has occurred. The FSP also retains and emphasizes the objective of an other-than-temporary impairment assessment and the related disclosure requirements in FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and other related guidance. The FSP is effective for interim and annual reporting periods ending after December 15, 2008 and shall be applied prospectively. The FSP was effective as of December 31, 2008 and did not have a material impact on the Company's consolidated financial statements.

**NOTE 2. Restrictions on Cash and Amounts Due from Banks**

The Company must maintain a reserve against its deposits in accordance with Regulation D of the Federal Reserve Act. For the final weekly reporting period in the years ended December 2008 and 2007, the aggregate amount of daily average required reserves, net of vault cash, was approximately \$350 thousand for both years.

Due to the Temporary Liquidity Guarantee Program, all of the deposits that the Company had at other financial institutions as of December 31, 2008 are fully insured by the FDIC.

**NOTE 3. Securities Portfolio**

At December 31, 2008, the securities portfolio was composed of securities classified as held-to-maturity and available-for-sale, in conjunction with SFAS 115. Securities held-to-maturity are carried at cost, adjusted for amortization of premiums and accretion of discounts, and securities available-for-sale are carried at fair value.

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The amortized cost and fair value of securities held-to-maturity at December 31, 2008 and 2007 were:

	Amortized Cost	Gross Unrealized Gains (in thousands)	Gross Unrealized Losses	Fair Value
<b>December 31, 2008</b>				
Obligations of U. S. Government agencies	\$ 2,600	\$ 28	\$	\$ 2,628
Obligations of state and political subdivisions	467	21		488
	\$ 3,067	\$ 49	\$	\$ 3,116
<b>December 31, 2007</b>				
Obligations of U. S. Government agencies	\$ 2,300	\$ 7	\$ (2)	\$ 2,305
Obligations of state and political subdivisions	604	38		642
	\$ 2,904	\$ 45	\$ (2)	\$ 2,947

The amortized cost and fair values of securities available-for-sale at December 31, 2008 and 2007 were:

	Amortized Cost	Gross Unrealized Gains (in thousands)	Gross Unrealized Losses	Fair Value
<b>December 31, 2008</b>				
U. S. Treasury securities	\$ 399	\$ 1	\$	\$ 400
Obligations of U. S. Government agencies	77,241	871		78,112
Obligations of state and political subdivisions	14,959	156		15,115
Mortgage-backed securities	2,462		(9)	2,453
Money market investments	908			908
<b>Total</b>	<b>\$ 95,969</b>	<b>\$ 1,028</b>	<b>\$ (9)</b>	<b>\$ 96,988</b>
<b>December 31, 2007</b>				
U. S. Treasury securities	\$ 986	\$ 2	\$	\$ 988
Obligations of U. S. Government agencies	95,760	233	(282)	95,711
Obligations of state and political subdivisions	25,031	310		25,341
Money market investments	1,604			1,604
Other marketable equity securities	50		(41)	9
<b>Total</b>	<b>\$ 123,431</b>	<b>\$ 545</b>	<b>\$ (323)</b>	<b>\$ 123,653</b>

Securities with an amortized cost of \$82.8 million and \$91.8 million at December 31, 2008 and 2007, respectively, were pledged to secure public deposits and securities sold under agreements to repurchase, FHLB advances and for other purposes required or permitted by law.

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The amortized cost and fair value of securities at December 31, 2008 by contractual maturity are shown below.

	December 31, 2008			
	Available-For-Sale Amortized Cost	Fair Value	Held-To-Maturity Amortized Cost	Fair Value
	(in thousands)			
Due in one year or less	\$ 30,252	\$ 30,561	\$ 300	\$ 300
Due after one year through five years	60,340	61,015	2,767	2,816
Due after five years through ten years	3,554	3,583		
Due after ten years	915	921		
Total debt securities	95,061	96,080	3,067	3,116
Other securities without stated maturities	908	908		
Total securities	\$ 95,969	\$ 96,988	\$ 3,067	\$ 3,116

Information pertaining to securities with gross unrealized losses at December 31, 2008 aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

	Year Ended December 31, 2008					
	Less Than Twelve Months		More Than Twelve Months		Total	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
	(in thousands)					
<u>Securities Available-for-Sale</u>						
Debt securities:						
Mortgage-backed securities	\$ 9	\$ 2,453	\$	\$	\$ 9	\$ 2,453
Total securities available-for-sale	\$ 9	\$ 2,453	\$	\$	\$ 9	\$ 2,453

	Year Ended December 31, 2007					
	Less Than Twelve Months		More Than Twelve Months		Total	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
	(in thousands)					
<u>Securities Available-for-Sale</u>						
Debt securities:						
Obligations of U. S. Government agencies	\$	\$	\$ 282	\$ 55,480	\$ 282	\$ 55,480
Total debt securities			282	55,480	282	55,480
Other marketable equity securities			41	9	41	9
Total securities available-for-sale	\$	\$	\$ 323	\$ 55,489	\$ 323	\$ 55,489

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<u>Securities Held-to-Maturity</u>							
Obligations of U. S. Government agencies	\$	\$	\$ 2	\$	899	\$ 2	\$ 899
<b>Total securities held-to-maturity</b>	<b>\$</b>	<b>\$</b>	<b>\$ 2</b>	<b>\$</b>	<b>899</b>	<b>\$ 2</b>	<b>\$ 899</b>
Total	\$	\$	\$ 325	\$	56,388	\$ 325	\$ 56,388

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Management evaluates securities for other-than-temporary impairment on at least a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer, and (iii) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

At December 31, 2008, 2 debt securities had unrealized losses with aggregate depreciation of 0.009% from the Company's amortized cost basis. At December 31, 2007, 36 debt securities had unrealized losses with aggregate depreciation of 0.2% from the Company's amortized cost basis. The 2008 unrealized losses relate to mortgage-backed securities. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and industry analysts' reports. The unrealized losses are a result of interest rates and not credit issues. As the Company has the ability to hold debt securities until maturity, or for the foreseeable future if classified as available for sale, no declines are deemed to be other than temporary.

**NOTE 4, Loans**

A summary of the balances of loans follows:

	2008	2007
	(in thousands)	
Commercial and other loans	\$ 73,086	\$ 70,741
Real estate loans:		
Construction	60,604	56,007
Farmland	726	44
Equity lines of credit	33,624	30,383
1-4 family residential	134,965	123,006
Multifamily residential	6,623	7,031
Nonfarm nonresidential	283,983	254,790
Installment loans to individuals	40,789	51,912
Tax-exempt loans	2,738	2,992
<b>Total loans</b>	<b>637,138</b>	<b>596,906</b>
Less: Allowance for loan losses	(6,406)	(5,130)
Net deferred loan costs	314	238
Loans, net	\$ 631,046	\$ 592,014

At December 31, 2008 and 2007, there were \$351.2 million and \$317.8 million, or 55.1% and 53.2%, respectively of total loans concentrated in commercial real estate. Commercial real estate for purposes of this note includes all construction loans, loans secured by multifamily residential properties and loans secured by nonfarm, nonresidential properties. At December 31, 2008 and 2007, construction loans represented 9.5% and 9.4% of total loans, loans secured by multifamily residential properties represented 1.0% and 1.2%, and loans secured by nonfarm, nonresidential properties represented 44.6% and 42.7%, respectively. Construction loans at December 31, 2008 and 2007 included \$39.7 million and \$32.6 million in loans to commercial builders of single family housing in the Hampton Roads market, representing 6.2% and 5.5% of total loans, respectively.

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The following is a summary of information pertaining to impaired and nonaccrual loans:

	December 31, 2008      2007 (in thousands)	
Impaired loans without a valuation allowance	\$ 12,023	\$ 7,939
Impaired loans with a valuation allowance	888	84
<b>Total impaired loans</b>	<b>\$ 12,911</b>	<b>\$ 8,023</b>
Valuation allowance related to impaired loans	\$ 269	\$ 27
<b>Total nonaccrual loans</b>	<b>\$ 1,045</b>	<b>\$ 84</b>
Total loans past-due ninety days or more and still accruing interest	\$ 3,529	\$ 623

	Years Ended December 31, 2008      2007      2006 (in thousands)		
Average investment in impaired loans	\$ 10,467	\$ 5,562	\$ 2,800
Interest income recognized on impaired loans	\$ 393	\$ 610	\$ 196
Interest that would have been recognized if loans had been accruing	\$ 459	\$ 79	\$ 38

The Bank has had, and may be expected to have in the future, banking transactions in the ordinary course of business with directors, executive officers, their immediate families and companies in which they are principal owners (commonly referred to as related parties), on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with others. The aggregate direct and indirect loans to these persons totaled \$2.9 million at December 31, 2008 and 2007. These totals do not include loans made in the ordinary course of business to other companies where a director or executive officer of the Bank was also a director or officer of such company but not a principal owner. None of the directors or executive officers had direct or indirect loans exceeding 10% of stockholders' equity at December 31, 2008. Changes to the outstanding loan balances are as follows:

	2008      2007 (in thousands)	
Balance, beginning of year	\$ 2,867	\$ 3,675
Additions	280	1,839
Reductions	(299)	(2,647)
 Balance, end of year	 \$ 2,848	 \$ 2,867

**NOTE 5. Allowance for Loan Losses**

Changes in the allowance for loan losses are as follows:

	2008      2007      2006 (in thousands)		
Balance, beginning of year	\$ 5,130	\$ 4,784	\$ 4,448
Recoveries	463	381	331
Provision for loan losses	2,400	1,000	1,200
Loans charged off	(1,587)	(1,035)	(1,195)
 Balance, end of year	 \$ 6,406	 \$ 5,130	 \$ 4,784





**Table of Contents****NOTE 6. Premises and Equipment**

At December 31, premises and equipment consisted of:

	2008	2007
	(in thousands)	
Land	\$ 7,711	\$ 7,854
Buildings	22,065	21,697
Leasehold improvements	855	837
Furniture, fixtures and equipment	14,400	13,074
	45,031	43,462
Less accumulated depreciation and amortization	17,888	16,460
	\$ 27,143	\$ 27,002

Depreciation expense for the years ended December 31, 2008, 2007 and 2006 amounted to \$1.8 million, \$1.7 million and \$1.6 million, respectively.

**NOTE 7. Deposits**

The aggregate amount of time deposits in denominations of \$100,000 or more at December 31, 2008 and 2007 was \$127.8 million and \$118.6 million, respectively.

At December 31, 2008, the scheduled maturities of time deposits (in thousands) are as follows:

2009	\$ 234,532
2010	72,986
2011	16,467
2012	4,648
2013	7,031
	\$ 335,664

**NOTE 8. Federal Home Loan Bank Advances and Other Borrowings**

The Bank's short-term borrowings include federal funds purchased, repurchase agreements and U. S. Treasury demand notes. Securities sold under agreements to repurchase, which totaled \$32,855 and \$63,691 as of December 31, 2008 and 2007, respectively, are classified as secured borrowings generally mature within one to four days from the transaction date. Securities sold under agreements to repurchase are reflected at the amount of cash received in connection with the transaction. The Company may be required to provide additional collateral based on the fair value of the underlying securities. The U.S. Treasury demand notes are subject to call by the U.S. Treasury with interest paid monthly at the rate of 25 basis points ( $\frac{1}{4}\%$ ) below the federal funds rate. U.S. Treasury demand notes totaled \$427 thousand and \$534 thousand as of December 31, 2008 and 2007, respectively.

The Bank's fixed-rate, long-term debt of \$70.0 million at December 31, 2008 matures through 2016. The Bank had \$80.0 million in fixed-rate, long-term debt at December 31, 2007. At December 31, 2008 and 2007, the interest rates ranged from 4.74% to 6.49%. At December 31, 2008 and 2007, the weighted average interest rate was 5.12% and 5.08%, respectively. FHLB advances are secured by a blanket lien on qualified 1-4 family residential real estate loans and by selected commercial real estate loans.



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The contractual maturities of long-term debt are as follows:

	2008		December 31, 2007	
	Fixed Rate	Total	Fixed Rate	Total
	(in thousands)			
Due in 2008			10,000	10,000
Due in 2009	5,000	5,000	5,000	5,000
Due in 2010	30,000	30,000	30,000	30,000
Due in 2012	10,000	10,000	10,000	10,000
Due in 2016	25,000	25,000	25,000	25,000
Total long-term debt	\$ 70,000	\$ 70,000	\$ 80,000	\$ 80,000

**NOTE 9. Employee Benefit Plans**

**Stock Option Plan**

On March 9, 2008, the Company's 1998 stock option plan expired. Currently, options to purchase 286,899 shares of common stock granted under the stock option plan are outstanding at December 31, 2008. The exercise price of each option equals the market price of the Company's common stock on the date of the grant and an option's maximum term is ten years. All share data have been adjusted to reflect the 5 for 4 stock split in the form of a dividend declared on August 16, 2007 and paid on October 1, 2007.

Stock option plan activity for the year ended December 31, 2008 is summarized below:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in thousands)
Options outstanding, January 1, 2008	363,041	\$ 18.99		
Granted				
Exercised	(3,062)	12.65		
Canceled or expired	(73,080)	22.18		
Options outstanding, December 31, 2008	286,899	18.25	5.67	\$ 727
Options exercisable, December 31, 2008	199,931	17.46	4.31	\$ 727

The aggregate intrinsic value of a stock option in the table above represents the total pre-tax intrinsic value (the amount by which the current market value of the underlying stock exceeds the exercise price of the option) that would have been received by the option holders had all option holders exercised their options on December 31, 2008. This amount changes based on changes in the market value of the Company's stock.

The fair value of each option granted in 2007 is estimated using the Black Scholes option pricing model with the following assumptions: dividend yield of 2.46%, expected volatility of 27.398%, risk-free interest rate of 4.47% and an expected option life of six and one-half years. The grant date fair value of options granted during 2007 was \$5.48. There were no options granted in 2008 and 2006.

The total proceeds of the in-the-money options exercised during the year ended December 31, 2008 and December 31, 2007 was \$39 thousand and \$365 thousand. Total intrinsic value of options exercised during years ended December 31, 2008, 2007 and 2006 was \$14 thousand, \$344 thousand and \$153 thousand, respectively.



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As of December 31, 2008, there was \$478 thousand unrecognized compensation expense. As of December 31, 2007 there was \$543 thousand unrecognized compensation expense. Compensation expense was \$112 thousand and \$29 thousand as of December 31, 2008 and December 31, 2007.

Information pertaining to options outstanding at December 31, 2008 is as follows:

Range of Exercise Prices	Options Outstanding			Options Exercisable		
	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Exercise Price	
\$9.81	36,460	8.3	\$ 9.81	36,460	\$ 9.81	
12.91	62,229	7.4	12.91	62,229	12.91	
20.05	108,710	1.2	20.05	21,742	20.05	
23.83	79,500	4.4	23.83	79,500	23.83	
	286,899	5.67	\$ 18.25	199,931	\$ 17.46	

**401(k) Plan**

The Company has a 401(k) Plan in which substantially all employees are eligible to participate. Employees may contribute up to 15% of their compensation subject to certain limits based on federal tax laws. The Company makes matching contributions equal to 100% of the first 4% of an employee's compensation contributed to the plan. Matching contributions vest to the employee immediately. The Company may make profit sharing contributions to the plan as determined by the Board of Directors. Contributions vest to the employee over a six-year period. For the years ended December 31, 2008, 2007 and 2006, expense attributable to the plan amounted to \$601 thousand, \$628 thousand and \$421 thousand, respectively.

**NOTE 10. Income Taxes**

The Company files income tax returns in the U.S. federal jurisdiction and the Commonwealth of Virginia. With few exceptions, the Company is no longer subject to U.S. federal, state and local income tax examinations by tax authorities for years prior to 2005.

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The components of the net deferred tax asset, included in other assets, are as follows:

	December 31, 2008      2007 (in thousands)	
<b>Deferred tax assets:</b>		
Allowance for loan losses	\$ 2,178	\$ 1,744
Interest on non-accrual loans	26	15
Foreclosed assets	234	64
Pension - adjustment to apply FASB 158	545	192
BOLI benefit liability*	62	145
Unexercised nonqualified options	9	2
	\$ 3,054	\$ 2,162
<b>Deferred tax liabilities:</b>		
Depreciation	\$ (345)	\$ (408)
Accretion of discounts on securities	(6)	(12)
Deferred loan fees and costs	(325)	(327)
Pension*	(461)	(416)
Net unrealized gains on securities available-for-sale	(347)	(75)
	(1,484)	(1,238)
Net deferred tax assets	\$ 1,570	\$ 924

\* 2007 figures adjusted for change in accounting principle.

The components of income tax expense are as follows:

	2008	2007	2006
	(in thousands)		
Current tax expense	\$ 3,216	\$ 3,349	\$ 2,646
Deferred tax expense	(565)	(183)	(36)
Reported tax expense	\$ 2,651	\$ 3,166	\$ 2,610

A reconciliation of the expected Federal income tax expense on income before income taxes with the reported income tax expense follows:

	2008	2007	2006
	(in thousands)		
Expected tax expense (34%)	\$ 3,210	\$ 3,786	\$ 3,276
Interest expense on tax-exempt assets	34	56	58
Tax-exempt interest	(360)	(475)	(544)
Officers' life insurance	(243)	(212)	(187)
Other, net	10	11	7
Reported tax expense	\$ 2,651	\$ 3,166	\$ 2,610

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The effective tax rates for 2008, 2007 and 2006 were 28.1%, 28.4% and 27.1%, respectively.

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**NOTE 11. Lease Commitments**

The Bank has noncancellable leases on premises and equipment expiring at various dates, not including extensions, to the year 2013. Certain leases provide for increased annual payments based on increases in real estate taxes and the Consumer Price Index.

The total approximate minimum rental commitment at December 31, 2008 under noncancellable leases is \$922 thousand which is due as follows:

Year	(in thousands)
2009	331
2010	257
2011	175
2012	126
2013	33
Total	\$ 922

The aggregate rental expense of premises and equipment was \$337 thousand, \$346 thousand and \$360 thousand for 2008, 2007 and 2006, respectively.

**NOTE 12. Pension Plan**

The Company provides pension benefits for eligible participants through a non-contributory defined benefits pension plan. The plan was frozen effective September 30, 2006; therefore no additional participants will be added to the plan.

FASB No. 158 requires that employers measure plan assets and obligations as of the balance sheet date. This requirement was effective for fiscal years ending after December 15, 2008. Prior to FASB No. 158, information pertaining to activity in the plan used a measurement date of September 30.



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Information pertaining to the activity in the plan, using a measurement date of December 31, is as follows:

	Years ended December 31	
	2008	2007
	(in thousands)	
<b>Change in benefit obligation</b>		
Benefit obligation at beginning of year	\$ 5,085	\$ 5,320
Service cost		
Interest cost	304	364
Benefits paid	(163)	(511)
Gain due to change in discount rate	(145)	(315)
Actuarial change	(424)	227
Benefit obligation at end of year	\$ 4,657	\$ 5,085
<b>Change in plan assets</b>		
Fair value of plan assets at beginning of year	\$ 5,743	\$ 5,460
Expected return on plan assets	(1,169)	794
Employer contribution		
Benefits paid	(163)	(511)
Fair value of plan assets at end of year	\$ 4,411	\$ 5,743
Funded Status at end of year	\$ (246)	\$ 658
<b>Amounts recognized in the consolidated balance sheets at December 31</b>		
Prepaid pension cost (pension liability)	\$ (246)	\$ 658
<b>Amounts recognized in accumulated other comprehensive income (loss), net of tax consist of:</b>		
Net loss	\$ 1,058	\$ 373
Accumulated benefit obligation	\$ 4,657	\$ 5,085
	<b>2008</b>	<b>2007</b>
<b>Assumptions used to determine the benefit obligations at December 31</b>		
Discount rate	6.49%	6.25%

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	Years ended December 31		
	2008	2007	2006
(in thousands)			
<b>Components of net periodic pension cost (benefit)</b>			
Service cost	\$	\$	\$ 504
Interest cost		304	288
Actual return on plan assets		(439)	(411)
Amortization of deferred asset gain (loss)			(21)
Amortization of prior service cost			4
Amortization of unrecognized loss		34	179
Net periodic pension (benefit) cost	\$ (135)	\$ (89)	\$ 638
<b>Components of other amounts recognized in accumulated other comprehensive income (loss)</b>			
Net loss	\$ (1,038)	(360)	(1,676)
Amortization of loss		(34)	(179)
Amortization of prior service cost			(4)
Total recognized in OCI	\$ (1,038)	\$ (394)	\$ (1,859)
Total recognized in net periodic benefit cost and accumulated other comprehensive income (loss)	\$ (1,173)	\$ (483)	\$ (1,221)

	Years ended December 31	
	2008	2007
<b>Assumptions used to determine net periodic pension cost</b>		
Discount rate	6.25%	5.75%
Expected long-term rate of return on plan assets	8.00%	8.00%
The overall expected long-term rate of return on plan assets was determined based on the current asset allocation and the related volatility of those investments.		

	Percentage of Plan Assets	
	2008	2007
<b>Weighted average asset allocations at December 31</b>		
Cash and cash equivalents	18%	6%
Government agencies	37%	39%
Corporate debt and equity	45%	55%
	100%	100%

The pension invests in large and mid-cap equities and government and corporate bonds, with the following target allocations: equities 50%, fixed income 40% and cash 10%. The pension does not invest in options or derivatives.

No contributions were made to the plan in 2008 or 2007.

The actuarial valuation was performed using the initial frozen liability method. Under this method, the Company's contribution equals the sum of the amount necessary to amortize the frozen initial liability (past service base) over a period of years and the normal cost of the plan.

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Estimated future benefit payments, which reflect expected future service, as appropriate, are as follows (in thousands):

2009	\$ 556
2010	259
2011	169
2012	258
2013	231
Years 2014 - 2018	1,748
<b>Total</b>	<b>\$ 3,221</b>

**NOTE 13. Commitments and Contingencies**

In the normal course of business, the Bank makes various commitments and incurs certain contingent liabilities. These commitments and contingencies represent off-balance sheet risk for the Bank. To meet the financing needs of its customers, the Bank makes lending commitments under commercial lines of credit, home equity lines and construction and development loans. The Bank also incurs contingent liabilities related to irrevocable letters of credit.

Off-balance sheet items at December 31 are as follows:

	2008	2007
	(in thousands)	
<b>Commitments to extend credit:</b>		
Home equity lines of credit	\$ 28,729	\$ 27,341
Commercial real estate, construction and development loans committed but not funded	35,624	63,031
Other lines of credit (principally commercial)	44,101	45,459
<b>Total</b>	<b>\$ 108,454</b>	<b>\$ 135,831</b>
Irrevocable letters of credit	\$ 5,515	\$ 5,502

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank, upon extensions of credit is based on management's credit evaluation of the customer. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment and income-producing commercial properties.

Unfunded commitments under commercial lines-of-credit, revolving credit lines, and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. These lines-of-credit are uncollateralized and usually do not contain a specified maturity date, and ultimately may not be drawn upon to the total extent to which the Bank is committed.

Standby letters of credit and financial guarantees written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support private borrowing agreements. The majority of guarantees extends for less than two years and expire in decreasing amounts through 2010, with the exception of one guarantee which extends for 10 years and expires in 2014. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. The Bank holds various collateral supporting those commitments for which collateral is deemed necessary.

Various legal claims arise from time to time in the normal course of business, which management does not anticipate will have a material effect on the Company's consolidated financial statements.



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### **NOTE 14. Fair Value Measurements**

The fair value of a financial instrument is the current amount that would be exchanged between willing parties, other than in a forced liquidation. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumption used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. SFAS No. 107

Disclosures about Fair Value of Financial Instruments (SFAS 107) excludes certain financial instruments and all non-financial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company.

The following methods and assumptions were used by the Company in estimating fair value disclosures for financial instruments:

#### **Cash and cash equivalents**

The carrying amounts of cash and short-term instruments approximate fair values.

#### **Investment securities**

Fair values for securities, excluding restricted stock, are based on quoted market prices. The carrying value of restricted stock approximates fair value based on the redemption provisions of the FHLB.

#### **Loans receivable**

For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for certain mortgage loans (e.g., one-to-four family residential), credit card loans, and other consumer loans are based on quoted market prices of similar loans sold in conjunction with securitization transactions, adjusted for differences in loan characteristics. Fair values for other loans (e.g., commercial real estate and investment property mortgage loans, commercial and industrial loans) are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for non-performing loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

#### **Deposit liabilities**

The fair value of demand deposits, savings and certain money market deposits is the amount payable on demand at the reporting date. The fair value of certificates of deposits is estimated by discounting the future cash flows using the rates currently offered for deposits of similar remaining maturities.

#### **Short-term borrowings**

The carrying amounts of federal funds purchased, repurchase agreements, and other short-term borrowings maturing within 90 days approximate their fair values. Fair values of other short-term borrowings are estimated using discounted cash flow analyses based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

#### **Long-term borrowings**

The fair values of the Company's long-term borrowings are estimated using discounted cash flow analyses based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

#### **Accrued interest**

The carrying amounts of accrued interest approximate fair value.

#### **Commitments to extend credit and irrevocable letters of credit**

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The fair value of commitments is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of letters of credit is based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligations with the counterparties at the reporting date. At December 31, 2008 and 2007, the fair value of fees charged for loan commitments and irrevocable letters of credit was immaterial.

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The estimated fair values, and related carrying or notional amounts, of the Company's financial instruments are as follows:

	2008		December 31, 2007	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
(in thousands)				
<b>Financial assets:</b>				
Cash and cash equivalents	\$ 47,325	\$ 47,325	\$ 51,564	\$ 51,564
Securities available-for-sale	96,988	96,988	123,653	123,653
Securities held-to-maturity	3,067	3,116	2,904	2,947
Loans, net of allowances for loan losses	631,046	633,820	592,014	593,945
Accrued interest receivable	3,210	3,210	3,211	3,211
<b>Financial liabilities:</b>				
Deposits	646,524	649,055	596,165	595,623
Federal funds purchased, repurchase agreements and other borrowings	33,282	33,282	64,225	64,223
Federal Home Loan Bank advances	70,000	77,219	80,000	83,296
Accrued interest payable	1,777	1,777	2,438	2,438

The Company adopted SFAS No. 157, Fair Value Measurements (SFAS 157), on January 1, 2008 to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. SFAS 157 clarifies that fair value of certain assets and liabilities is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants.

In February of 2008, the FASB issued Staff Position No. 157-2 (FSP 157-2) which delayed the effective date of SFAS 157 for certain nonfinancial assets and nonfinancial liabilities except for those items that are recognized or disclosed at fair value in the financial statements on a recurring basis. FSP 157-2 defers the effective date of SFAS 157 for such nonfinancial assets and nonfinancial liabilities to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. Thus, the Company has only partially applied SFAS 157. Those items affected by FSP 157-2 include other real estate owned (OREO).

In October of 2008, the FASB issued Staff Position No. 157-3 (FSP 157-3) to clarify the application of SFAS 157 in a market that is not active and to provide 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 upon issuance, including prior periods for which financials statements were not issued.

SFAS 157 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's market assumptions. The three levels of the fair value hierarchy under SFAS 157 based on these two types of inputs are as follows:

- Level 1 Valuation is based on quoted prices in active markets for identical assets and liabilities.
- Level 2 Valuation is based on observable inputs including quoted prices in active markets for similar assets and liabilities, quoted prices for identical or similar assets and liabilities in less active markets, and model-based valuation techniques for which significant assumptions can be derived primarily from or corroborated by observable data in the market.

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Level 3 Valuation is based on model-based techniques that use one or more significant inputs or assumptions that are unobservable in the market.

The following describes the valuation techniques used by the Company to measure certain financial assets and liabilities recorded at fair value on a recurring basis in the financial statements:

**Securities available for sale**

Securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, when available (Level 1). If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar securities for which significant assumptions are derived primarily from or corroborated by observable market data. Third party vendors compile prices from various sources and may determine the fair value of identical or similar securities by using pricing models that considers observable market data (Level 2).

The following table presents the balances of financial assets and liabilities measured at fair value on a recurring basis as of December 31, 2008:

**Fair Value Measurements at December 31, 2008**  
(in thousands)

Description	Balance	Quoted Prices in		
		Active Markets for Identical Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Assets:</b>				
Available-for-sale securities	\$ 96,988	\$	\$ 96,988	\$

Certain financial assets are measured at fair value on a nonrecurring basis in accordance with GAAP. Adjustments to the fair value of these assets usually result from the application of lower-of-cost-or-market accounting or write-downs of individual assets.

The following describes the valuation techniques used by the Company to measure certain financial assets recorded at fair value on a nonrecurring basis in the financial statements:

**Impaired Loans**

Loans are designated as impaired when, in the judgment of management based on current information and events, it is probable that all amounts due according to the contractual terms of the loan agreement will not be collected. The measurement of loss associated with impaired loans can be based on either the observable market price of the loan or the fair value of the collateral. Fair value is measured based on the value of the collateral securing the loans. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable. The vast majority of the collateral is real estate. The value of real estate collateral is determined utilizing an income or market valuation approach based on an appraisal conducted by an independent, licensed appraiser outside of the Company using observable market data (Level 2). However, if the collateral is a house or building in the process of construction or if an appraisal of the real estate property is over two years old, then the fair value is considered Level 3. The value of business equipment is based upon an outside appraisal if deemed significant, or the net book value on the applicable business financial statements if not considered significant using observable market data. Likewise, values for inventory and accounts receivables collateral are based on financial statement balances or aging reports (Level 3). Impaired loans allocated to the Allowance for Loan Losses are measured at fair value on a nonrecurring basis. Any fair value adjustments are recorded in the period incurred as provision for loan losses on the Consolidated Statements of Income.



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The following table summarizes the Company's financial assets that were measured at fair value on a nonrecurring basis during the period.

Description	Carrying Value at December 31, 2008 (in thousands)			
	Balance	Quoted Prices in Active Markets for Identical Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Assets:</b>				
Impaired Loans	\$ 12,642	\$	\$ 2,117	\$ 10,525

**NOTE 15. Regulatory Matters**

The Company (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can cause certain mandatory and possibly additional discretionary actions to be initiated by regulators that, if undertaken, could have a direct material effect on the Company's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined) and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2008 and 2007, that the Company and the Bank meets all capital adequacy requirements to which they are subject.

As of December 31, 2008, the most recent notification from the Comptroller categorized the Bank as well-capitalized under the regulatory framework for prompt corrective action. To be categorized as well-capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following tables. There are no conditions or events since the notification that management believes have changed the Bank's category. The Company's and the Bank's actual capital amounts and ratios as of December 31, 2008 and 2007 are also presented in the table.

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	Actual		Minimum Requirement		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(in thousands)					
<b>December 31, 2008:</b>						
Total Capital to Risk Weighted Assets:						
Consolidated	\$ 89,689	13.44%	\$ 53,367	8.00%	N/A	N/A
Old Point National Bank	84,484	12.69%	53,267	8.00%	\$ 66,584	10.00%
Tier 1 Capital to Risk Weighted Assets:						
Consolidated	83,283	12.48%	26,684	4.00%	N/A	N/A
Old Point National Bank	78,078	11.73%	26,633	4.00%	39,950	6.00%
Tier 1 Capital to Average Assets:						
Consolidated	83,283	10.00%	33,301	4.00%	N/A	N/A
Old Point National Bank	78,078	9.38%	33,308	4.00%	41,635	5.00%
<b>December 31, 2007:</b>						
Total Capital to Risk Weighted Assets:						
Consolidated	\$ 84,905	13.45%	\$ 50,486	8.00%	N/A	N/A
Old Point National Bank	80,014	12.68%	50,476	8.00%	\$ 63,095	10.00%
Tier 1 Capital to Risk Weighted Assets:						
Consolidated	79,775	12.64%	25,243	4.00%	N/A	N/A
Old Point National Bank	74,884	11.87%	25,238	4.00%	37,857	6.00%
Tier 1 Capital to Average Assets:						
Consolidated	79,775	9.67%	24,761	3.00%	N/A	N/A
Old Point National Bank	74,884	9.13%	24,612	3.00%	41,020	5.00%

The approval of the Comptroller is required if the total of all dividends declared by a national bank in any calendar year exceeds the Bank's net profits for that year combined with its retained net profits for the preceding two calendar years. Under this formula, the Bank and Trust can distribute as dividends to the Company in 2008, without approval of the Comptroller, \$12.9 million plus an additional amount equal to the Bank's and Trust's retained net profits for 2009 up to the date of any dividend declaration.

**Table of Contents****NOTE 16. Quarterly Data (Unaudited)**

	Year Ended December 31,							
	2008				2007			
	(in thousands, except per share data)							
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Interest and dividend income	\$ 11,254	\$ 11,717	\$ 11,656	\$ 11,874	\$ 12,356	\$ 12,418	\$ 12,181	\$ 12,067
Interest expense	(4,220)	(4,552)	(4,850)	(5,384)	(5,897)	(5,891)	(5,703)	(5,858)
Net interest income	7,034	7,165	6,806	6,490	6,459	6,527	6,478	6,209
Provision for loan losses	(1,000)	(800)	(300)	(300)	(300)	(200)	(200)	(300)
Net interest income, after provision for loan losses	6,034	6,365	6,506	6,190	6,159	6,327	6,278	5,909
Noninterest income	2,958	3,367	3,174	3,223	3,238	3,036	3,133	3,078
Noninterest expenses	(7,825)	(6,933)	(6,957)	(6,661)	(6,539)	(6,585)	(6,574)	(6,325)
Income before income taxes	1,167	2,799	2,723	2,752	2,858	2,778	2,837	2,662
Provision for income taxes	(260)	(821)	(788)	(782)	(813)	(798)	(810)	(745)
Net income	\$ 907	\$ 1,978	\$ 1,935	\$ 1,970	\$ 2,045	\$ 1,980	\$ 2,027	\$ 1,917
Earnings per common share:*								
Basic	\$ 0.19	\$ 0.40	\$ 0.40	\$ 0.40	\$ 0.42	\$ 0.40	\$ 0.41	\$ 0.38
Diluted	\$ 0.18	\$ 0.40	\$ 0.39	\$ 0.40	\$ 0.41	\$ 0.40	\$ 0.40	\$ 0.38

\* Per share data have been adjusted to reflect the 5 for 4 stock split in the form of a dividend declared on August 16, 2007 and paid on October 1, 2007.

**Table of Contents****NOTE 17. Condensed Financial Statements of Parent Company**

Financial information pertaining to Old Point Financial Corporation (parent company only) is as follows:

	<b>December 31,</b>	
	<b>2008</b>	<b>2007</b>
	<b>(in thousands)</b>	
<b>Balance Sheets</b>		
Assets		
Cash and cash equivalents	\$ 159	\$ 243
Securities available-for-sale	100	1,100
Securities held-to-maturity	467	604
Investment in common stock of subsidiaries	82,273	78,898
Other assets	144	231
Total assets	\$ 83,143	\$ 81,076
Liabilities and Stockholders' Equity		
Note payable - subsidiary	\$ 244	\$ 1,364
Other liabilities	1	5
Common stock	24,526	24,538
Additional paid-in capital	15,506	15,357
Retained earnings	43,251	40,039
Accumulated other comprehensive loss	(385)	(227)
Total liabilities and stockholders' equity	\$ 83,143	\$ 81,076

	<b>Years Ended December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
	<b>(in thousands)</b>		
<b>Statements of Income</b>			
Income:			
Dividends from subsidiary	\$ 3,400	\$ 3,200	\$ 3,200
Interest on investments	38	77	87
Other income	300	144	144
Total income	3,738	3,421	3,431
Expenses:			
Salary and benefits	563	398	369
Stationery, supplies and printing	65	44	40
Service fees	138	127	102
Other operating expenses	207	85	26
Total expenses	973	654	537
Income before income taxes and equity in undistributed net income of subsidiaries	2,765	2,767	2,894
Income tax benefit	228	151	122
	2,993	2,918	3,016
Equity in undistributed net income of subsidiaries	3,797	5,051	4,008

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Net income	\$ 6,790	\$ 7,969	\$ 7,024
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	Years Ended December 31,		
	2008	2007	2006
	(in thousands)		
<b>Statements of Cash Flows</b>			
<b>Cash flows from operating activities:</b>			
Net income	\$ 6,790	\$ 7,969	\$ 7,024
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity in undistributed net income of subsidiaries	(3,797)	(5,051)	(4,008)
Stock compensation expense	112	29	
Decrease (increase) in other assets	93	13	(15)
Increase (decrease) in other liabilities	(5)	5	
<b>Net cash provided by operating activities</b>	<b>3,193</b>	<b>2,965</b>	<b>3,001</b>
<b>Cash flows from investing activities:</b>			
Proceeds from sale of investment securities	1,137	128	
Maturities and calls of investment securities			91
Payments for investments in subsidiaries		330	645
<b>Net cash provided by investing activities</b>	<b>1,137</b>	<b>458</b>	<b>736</b>
<b>Cash flows from financing activities:</b>			
Proceeds from advances from subsidiaries	36	1,492	
Repayment of advances from subsidiaries	(1,156)	(128)	
Proceeds from issuance of common stock	39	174	159
Repurchase and retirement of common stock	(97)	(2,183)	(968)
Cash paid in lieu of fractional shares		(4)	
Effect of nonqualified stock options		34	41
Cash dividends paid on common stock	(3,236)	(3,010)	(2,793)
<b>Net cash used in financing activities</b>	<b>(4,414)</b>	<b>(3,625)</b>	<b>(3,561)</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>(84)</b>	<b>(202)</b>	<b>176</b>
<b>Cash and cash equivalents at beginning of year</b>	<b>243</b>	<b>445</b>	<b>269</b>
<b>Cash and cash equivalents at end of year</b>	<b>\$ 159</b>	<b>\$ 243</b>	<b>\$ 445</b>

**Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure**

None.

**Item 9A. Controls and Procedures**

*Disclosure Controls and Procedures.* Management evaluated, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, the effectiveness of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) as of the end of the period covered by this report. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective as of the end of the period covered by this report to ensure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act, is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to management, including the Company's Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

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In designing and evaluating its disclosure controls and procedures, management recognized that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. The design of any disclosure controls and procedures also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

*Management's Report on Internal Control over Financial Reporting.* Management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) of the Exchange Act.

Because of its inherent limitations, a system of internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

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Management evaluated, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, the effectiveness of our internal control over financial reporting as of December 31, 2008. In conducting this evaluation, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control-Integrated Framework*. Based on this evaluation, using those criteria, management concluded that our internal control over financial reporting was effective as of December 31, 2008.

The Company's internal control over financial reporting as of December 31, 2008 has been audited by Yount, Hyde & Barbour, P.C., the independent registered public accounting firm that also audited the Company's consolidated financial statements included in this report on Form 10-K. Yount, Hyde & Barbour, P.C.'s attestation report on effectiveness of the Company's internal control over financial reporting appears on page 30 of this report.

*Changes in Internal Control over Financial Reporting.* There was no change in the internal control over financial reporting that occurred during the fiscal quarter ended December 31, 2008 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

### **Item 9B. Other Information**

None.

## **Part III**

Except as otherwise indicated, information called for by the following items under Part III is contained in the Proxy Statement for the Company's 2009 Annual Meeting of Stockholders (the 2009 Proxy Statement) to be held on April 28, 2009.

### **Item 10. Directors, Executive Officers and Corporate Governance**

The information with respect to the directors of the Company is set forth under the caption "Election of Directors" in the 2009 Proxy Statement and is incorporated herein by reference. The information regarding the Section 16(a) reporting requirements of the directors and executive officers is set forth under the caption "Section 16(a) Beneficial Ownership Reporting Compliance" in the 2009 Proxy Statement and is incorporated herein by reference. The information concerning the executive officers of the Company required by this item is included in Part I of this report on Form 10-K under the caption "Executive Officers of the Registrant." The information regarding the Company's Audit Committee and its Audit Committee Financial Expert is set forth under the caption "Board Committees and Attendance" in the 2009 Proxy Statement and is incorporated herein by reference.

The Company has a Code of Ethics which details principles and responsibilities governing ethical conduct for all Company directors, officers, employees and principal stockholders.

A copy of the Code of Ethics will be provided free of charge, upon written request made to Company's secretary at 1 West Mellen Street, Hampton, Virginia 23663 or by calling (757) 728-1200. The Code of Ethics is also posted on the Company's website at [www.oldpoint.com](http://www.oldpoint.com) in the "About Old Point" section under "Investor Relations" and then "Governance Documents" of the website. The Company intends to satisfy the disclosure requirements of Form 8-K with respect to waivers of or amendments to the Code of Ethics with respect to certain officers of the Company by posting such disclosures on its website under "Waivers of or amendments to the Code of Ethics." The Company may, however, elect to disclose any such amendment or waiver in a report on Form 8-K filed with the SEC either in addition to or in lieu of the website disclosure.

### **Item 11. Executive Compensation**

The information set forth under the captions "Compensation Committee Interlocks and Insider Participation" and "Executive Compensation" in the 2009 Proxy Statement is incorporated herein by reference.

*Five Year Stock Performance.* The line graph below compares the Company's stockholder return with the return of the NASDAQ Bank Index and the Russell 2000 Index.





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This performance graph was created by comparing the percentage change in stock prices for the Company and the indices on a year to year basis, factoring in dividend payments, and looking only at the closing price of the stock as of December 31 of each year surveyed. This graph may be affected by unusually high or low prices at December 31, 2003 or by temporary swings in stock price at December 31 of any given year. Accordingly, this is not necessarily the best measure of the Company's performance.

The index reflects the total return on the stock that is shown, including price appreciation, all stock splits and stock dividends, and reinvestment of cash dividends at time of payment, relative to the value of the stock at the beginning of the time period. Thus a move from 100 to 150 on the index scale indicates a 50% increase in the value of the investment. The NASDAQ Bank Composite Index contains all non-holding company banking institutions traded on the NASDAQ exchange. In addition to traditional banks this includes thrifts, but does not include other non-regulated finance companies. The Russell 2000 Index is comprised of the smallest 2000 companies in the Russell 3000 Index, which tracks almost 99% of the stocks included in portfolios of institutional investors.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

The information set forth under the caption "Securities Authorized for Issuance Under Equity Compensation Plans" in the 2009 Proxy Statement is incorporated herein by reference.

The information set forth under the caption "Security Ownership of Certain Beneficial Owners and Management" in the 2009 Proxy Statement is incorporated herein by reference.

**Item 13. Certain Relationships and Related Transactions, and Director Independence**

The information set forth under the caption "Interest of Management in Certain Transactions" in the 2009 Proxy Statement is incorporated herein by reference.

The information regarding director independence set forth under the captions "Board Committees and Attendance" in the 2009 Proxy Statement is incorporated herein by reference.

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**Item 14. Principal Accounting Fees and Services**

The information set forth under the caption Principal Accountant Fees and Audit Committee Pre-Approval Policy in the 2009 Proxy Statement is incorporated herein by reference.

**Part IV**

**Item 15. Exhibits, Financial Statement Schedules**

**(a)(1) Financial Statements**

The following consolidated financial statements and reports are included in Part II, Item 8, of this report on Form 10K.

Report of Independent Registered Public Accounting Firm (Yount, Hyde & Barbour, P.C.)

Consolidated Balance Sheets December 31, 2008 and 2007

Consolidated Statements of Income Years Ended December 31, 2008, 2007 and 2006

Consolidated Statements of Changes in Stockholders Equity Years Ended December 31, 2008, 2007 and 2006

Consolidated Statements of Cash Flows Years Ended December 31, 2008, 2007 and 2006

Notes to Consolidated Financial Statements

**(a)(2) Financial Statement Schedules**

All schedules are omitted since they are not required, are not applicable, or the required information is shown in the consolidated financial statements or notes thereto.

**(a)(3) Exhibits**

The following exhibits are filed as part of this Form 10-K and this list includes the Exhibit Index.

<b>Exhibit No.</b>	<b>Description</b>
3.1	Articles of Incorporation of Old Point Financial Corporation, as amended June 22, 2000
3.2	Bylaws of Old Point Financial Corporation, as amended and restated September 11, 2007 (incorporated by reference to Exhibit 3.2 to Form 8-K/A filed on September 20, 2007)
10.1*	Old Point Financial Corporation 1998 Stock Option Plan, as amended April 24, 2001 (incorporated by reference to Exhibit 4.4 to Form S-8 filed July 24, 2001)
10.2*	Form of Incentive Stock Option Agreement (incorporated by reference to Exhibit 10.2 to Form 10-K filed March 30, 2005)
10.3*	Form of Non-Qualified Stock Option Agreement (incorporated by reference to Exhibit 10.3 to Form 10-K filed March 30, 2005)
10.4*	Form of Life Insurance Endorsement Method Split Dollar Plan Agreement with The Northwestern Mutual Life Insurance Company entered into with each of Robert F. Shuford, Louis G. Morris, Margaret P. Causby, Laurie D. Grabow and Eugene M. Jordan, II (incorporated by reference to Exhibit 10.4 to Form 10-K filed March 30, 2005)
10.5*	Directors Compensation

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10.6*	Base Salaries of Executive Officers of the Registrant
10.7*	Description of Management Incentive Plan
10.7.1*	2009 Target Bonuses and Performance Goals under the Management Incentive Plan (incorporated by reference to Form 8-K filed February 12, 2009)

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- 10.8\* Form of Life Insurance Endorsement Method Split Dollar Plan Agreement with Ohio National Life Assurance Corporation entered into with each of Louis G. Morris, Laurie D. Grabow, Eugene M. Jordan, II and Melissa L. Burroughs (incorporated by reference to Exhibit 10.8 to form 10-K filed March 14, 2008)
- 10.9 Memorandum of Understanding between The Old Point National Bank of Phoebus and Tidewater Mortgage Services, Inc., dated September 10, 2007 (incorporated by reference to Exhibit 10.8 to Form 10-Q filed November 9, 2007)
- 10.10\* Form of 162 Insurance Plan
- 21 Subsidiaries of the Registrant (incorporated by reference to Exhibit 21 to Form 10-K filed March 30, 2005)
- 23 Consent of Yount, Hyde & Barbour, P.C.
- 24 Powers of Attorney
- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
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- \* Denotes management contract.

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**OLD POINT FINANCIAL CORPORATION**

/s/ Robert F. Shuford  
Robert F. Shuford,  
Chairman, President & Chief Executive Officer

Date: March 12, 2009

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

/s/ Robert F. Shuford Robert F. Shuford	Chairman, President & Chief Executive Officer and Director Principal Executive Officer
Date: March 12, 2009	
/s/ Laurie D. Grabow Laurie D. Grabow	Chief Financial Officer & Senior Vice President/ Finance Principal Financial & Accounting Officer
Date: March 12, 2009	
/s/ David L. Bernd* David L. Bernd	Director
/s/ James Reade Chisman* James Reade Chisman	Director
/s/ Richard F. Clark* Richard F. Clark	Director
/s/ Russell S. Evans, Jr.* Russell S. Evans, Jr.	Director
/s/ Dr. Arthur D. Greene* Dr. Arthur D. Greene	Director
/s/ Stephen D. Harris* Stephen D. Harris	Director
/s/ John Cabot Ishon* John Cabot Ishon	Director
/s/ John B. Morgan, II* John B. Morgan, II	Director
/s/ Louis G. Morris* Louis G. Morris	Director

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/s/ Robert L. Riddle\*  
Robert L. Riddle

Director

/s/ Dr. H. Robert Schappert\*  
Dr. H. Robert Schappert

Director

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/s/ Robert F. Shuford, Jr.* Robert F. Shuford, Jr.	Director
/s/ Ellen Clark Thacker* Ellen Clark Thacker	Director
/s/ Joseph R. Witt* Joseph R. Witt	Director
/s/ Melvin R. Zimm* Melvin R. Zimm	Director

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\* By Robert F. Shuford, as Attorney in Fact  
Date: March 12, 2009