PROSPECT CAPITAL CORP
Form 8-K/A
August 31, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 8-K/A

AMENDMENT NO. 1
TO

CURRENT REPORT
Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Date of Report (Date of earliest event reported): **August 31, 2012 (June 15, 2012)**

Prospect Capital Corporation

(Exact name of registrant as specified in its charter)

MARYLAND	**814-00659**	**43-2048643**
(State or other jurisdiction of incorporation)	(Commission File Number)	(IRS Employer Identification No.)

10 East 40th Street, 44th Floor, New York, New York 10016

(Address of principal executive offices, including zip code)

(212) 448-0702

(Registrant s telephone number, including area code)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

o Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

o Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

o Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

o Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

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Prospect Capital Corporation hereby amends its Current Report on Form 8-K, which was initially filed on June 15, 2012, to include the financial statements of First Tower Corp. and subsidiaries in response to Item 9.01. These financial statements appear beginning on Page F-1 of this Amendment No. 1 to Current Report on Form 8-K/A

Item 2.01 Completion of Acquisition or Disposition of Assets.

On June 15, 2012, Prospect Capital Corporation (Prospect) completed the acquisition from First Tower Corp. (First Tower) of the businesses of First Tower, a private multiline specialty finance company based in Flowood, Mississippi with over 150 branch offices (the Acquisition) pursuant to a definitive agreement entered into on March 19, 2012 (the Agreement). Prospect acquired 80.1% of First Tower for $110,200,000 of cash from Prospect s credit facility and 14,518,207 unregistered shares of Prospect common stock (the Shares). The assets of First Tower acquired in the Acquisition include, among other things, the subsidiaries owned by First Tower, which hold leaseholds and tangible property associated with First Tower s businesses.

The foregoing description of the Acquisition and the Agreement does not purport to be complete and is qualified in its entirety by reference to the full text of the Agreement, which is filed as Exhibit 2.1 to the Current Report on Form 8-K filed by Prospect on March 21, 2012 and is incorporated by reference into this Item 2.01.

Forward-Looking Statements

Information set forth in this Amendment No. 1 to Current Report on Form 8-K/A contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, whose safe harbor for forward-looking statements does not apply to business development companies. Any such statements, other than statements of historical fact, are highly likely to be affected by other unknowable future events and conditions, including elements of the future that are or are not under Prospect s control, and that Prospect may or may not have considered; accordingly, such statements cannot be guarantees or assurances of any aspect of future performance. Actual developments and results are highly likely to vary materially from these estimates and projections of the future. Such statements speak only as of the time when made, and Prospect undertakes no obligation to update any such statement now or in the future.

Item 3.02 Unregistered Sales of Equity Securities.

The information set forth under Item 2.01 of this Amendment No. 1 to Current Report on Form 8-K/A is incorporated herein by reference.

Prospect issued the Shares to First Tower and the shareholders of First Tower, each of which is an accredited investor as that term is defined in Rule 501 of the Securities Act of 1933, as amended (the Securities Act) in reliance on the exemption from registration provided by Section 4(2) of the Securities Act and Regulation D promulgated thereunder, with such Shares subject to applicable resale restrictions under the Securities Act. The Shares were valued at $11.06 for purposes of the Acquisition.

Item 9.01 Financial Statements and Exhibits.

(a) Financial statements of businesses acquired.

The financial statements required by this Item 9.01(a) appear beginning on page F-1 of this Amendment No. 1 to Current Report on Form 8-K/A and are hereby incorporated by reference herein.

(d) Exhibits

23.1 Consent of Independent Auditors

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this Amendment No. 1 to Current Report on Form 8-K/A to be signed on its behalf by the undersigned hereunto duly authorized.

Prospect Capital Corporation

By:	/s/ M. Grier Eliasek
Name:	M. Grier Eliasek
Title:	Chief Operating Officer

Date: August 31, 2012

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FIRST TOWER CORP. AND SUBSIDIARIES

DECEMBER 31, 2011 AND 2010

MARCH 31, 2012 AND 2011

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INDEPENDENT AUDITORS REPORT

To the Board of Directors and Stockholders

First Tower Corp and Subsidiaries

Jackson, Mississippi

We have audited the accompanying consolidated balance sheets of First Tower Corp and subsidiaries (the Company) as of December 31, 2011 and 2010, and the related consolidated statements of income and comprehensive income, changes in stockholders equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 present fairly, in all material respects, the financial position of First Tower Corp and subsidiaries as of December 31, 2011 and 2010, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ Carr, Riggs & Ingram, LLC

Carr Riggs & Ingram, LLC

Ridgeland, Mississippi

March 26, 2012

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First Tower Corp and Subsidiaries

Consolidated Balance Sheets

December 31,		**2011**		**2010**
Assets				
Cash and cash equivalents	**$**	**7,794,924**	$	5,818,312
Investment in trading securities		**997,043**		950,175
Investment securities available for sale		**40,354,778**		36,924,221
Finance receivables, net		**370,484,877**		325,878,569
Prepaid reinsurance premiums		**2,131,740**		1,935,343
Reinsurance recoverables		**1,922,337**		1,738,204
Other receivables		**514,042**		558,586
Real estate acquired by foreclosure		**948,680**		898,501
Property and equipment, net		**4,709,142**		4,709,194
Net deferred income tax asset		**14,115,911**		14,002,008
Other assets		**721,522**		615,844
Total assets	**$**	**444,694,996**	$	394,028,957
Liabilities and Stockholders Equity				
Liabilities:				
Notes payable	**$**	**222,758,982**	$	202,799,325
Unearned premiums		**36,916,207**		32,993,976
Policy claim reserves		**2,474,858**		2,367,089
Accounts payable and accrued expenses		**7,633,029**		4,641,698
Income taxes payable		**1,691,979**		1,855,208
Other liabilities		**900,659**		428,917
Total liabilities		**272,375,714**		245,086,213
Commitments and contingencies (Notes 4, 6, 11, 16 and 17)				
Stockholders Equity:				
Common stock, $1 par value, 1,000,000 shares authorized, 165,801 shares issued and outstanding		**165,801**		165,801
Accumulated other comprehensive income, net of income tax effect of $992,000 in 2011 and $572,000 in 2010		**1,641,981**		964,260
Retained earnings		**170,511,500**		147,812,683
Total stockholders equity		**172,319,282**		148,942,744
Total liabilities and stockholders equity	**$**	**444,694,996**	$	394,028,957

See notes to consolidated financial statements.

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First Tower Corp and Subsidiaries

Consolidated Statements of Income and Comprehensive Income

Years ending December 31,	**2011**	**2010**
Revenues:		
Interest and fee income from finance receivables	**$ 124,532,238**	$ 106,557,114
Insurance premiums	**25,915,785**	22,921,507
Net investment income	**1,311,740**	1,394,833
Net realized investment gains	**221,279**	258,179
Other income	**8,935,245**	7,832,171
Total revenues	**160,916,287**	138,963,804
Expenses:		
Interest expense	**8,170,528**	7,754,661
Policyholders benefits	**4,577,419**	4,101,951
Salaries and fringe benefits	**29,820,256**	26,331,933
Provision for credit losses	**27,773,811**	25,708,036
Other operating expenses	**24,559,864**	21,104,041
Total expenses	**94,901,878**	85,000,622
Income before income taxes	**66,014,409**	53,963,182
Provision for income taxes	**24,256,810**	19,790,740
Net income	**41,757,599**	34,172,442
Other comprehensive income (loss), net of income tax effects of approximately $(420,000) in 2011 and ($54,000) in 2010:		
Unrealized gain on interest rate swap agreements		58,091
Unrealized holding gains on securities	**790,837**	198,629
Reclassification adjustments for amounts included in net income	**(113,116)**	(8,373)
Other comprehensive income	**677,721**	248,347
Comprehensive income	**$ 42,435,320**	$ 34,420,789

See notes to consolidated financial statements.

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First Tower Corp and Subsidiaries

Consolidated Statements of Changes in Stockholders Equity

Years ending December 31, 2011 and 2010	**Common Stock**	**Accumulated Other Comprehensive Loss**	**Retained Earnings**	**Total**
Balance, January 1, 2010	$ 165,801	$ 715,913	$ 127,867,593	$ 128,749,307
Net income			34,172,442	34,172,442
Dividends paid			(14,227,352)	(14,227,352)
Change in unrealized gain on interest rate swap agreements		151,867		151,867
Change in net unrealized gain on investment securities available for sale		96,480		96,480
Balance, December 31, 2010	165,801	964,260	147,812,683	148,942,744
Net income			**41,757,599**	**41,757,599**
Dividends paid			**(19,058,782)**	**(19,058,782)**
Change in net unrealized gain on investment securities available for sale		**677,721**		**677,721**
Balance, December 31, 2011	**$ 165,801**	**$ 1,641,981**	**$ 170,511,500**	**$ 172,319,282**

See notes to consolidated financial statements.

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First Tower Corp and Subsidiaries

Consolidated Statements of Cash Flows

Years ending December 31,	2011	2010
Cash flows from operating activities:		
Net income	$ 41,757,599	$ 34,172,442
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization, net	1,459,798	1,425,709
Amortization of premiums on securities, net	359,200	282,109
Gain on sale of investments, net	(221,279)	(258,179)
Loss from sale and impairments of real estate	346,362	170,668
Gain on sale of other assets	(91,733)	(29,887)
Deferred income tax provision (benefit)	(534,903)	401,552
Provision for credit losses	27,773,811	25,708,036
Net loan origination costs deferred	(501,843)	(406,693)
Purchase of trading securities	(8,773)	(6,647)
Changes in operating assets and liabilities:		
Prepaid reinsurance	(196,397)	(178,550)
Reinsurance recoverables	(184,133)	(84,026)
Other receivables	44,544	(19,324)
Other assets	(105,679)	(61,660)
Policy claim reserves	107,769	145,316
Accounts payable and accrued expenses	2,991,331	(912,209)
Income taxes payable	(163,229)	(902,262)
Unearned premiums	3,922,231	3,320,566
Other liabilities	471,741	244,634
Net cash provided by operating activities	77,226,417	63,011,595
Cash flows from investing activities:		
Finance receivables purchased	(958,436)	(4,443,673)
Finance receivables originated	(418,864,398)	(386,367,797)
Finance receivables repaid	346,854,471	325,842,406
Proceeds from sales of real estate	693,546	785,404
Proceeds from calls or maturities of investment securities	3,365,000	2,535,000
Proceeds from sales of investment securities	5,552,832	5,886,122
Purchases of investment securities	(11,425,681)	(9,505,345)
Proceeds from sales of property and equipment	77,338	42,872
Purchase of property and equipment	(1,445,352)	(1,566,229)
Net cash used in investing activities	(76,150,680)	(66,791,240)
Cash flows from financing activities:		
Net changes in short-term borrowings	19,959,657	20,775,517
Dividends paid	(19,058,782)	(14,227,352)
Net cash provided by financing activities	900,875	6,548,165
Increase in cash and cash equivalents	1,976,612	2,768,520

Cash and cash equivalents at beginning of year		**5,818,312**		3,049,792
Cash and cash equivalents at end of year	**$**	**7,794,924**	$	5,818,312
Supplemental cash flow disclosures:				
Non-cash activities - Real estate acquired in satisfaction of finance receivables	**$**	**1,090,000**	$	1,107,000
Interest paid	**$**	**8,102,000**	$	7,537,000
Income taxes paid	**$**	**24,957,000**	$	20,303,000

See notes to consolidated financial statements.

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First Tower Corp and Subsidiaries

Notes to Consolidated Financial Statements

NOTE 1 SUMMARY OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES

Business and Basis of Consolidation

First Tower Corp is engaged in consumer lending and related insurance activities through its wholly-owned subsidiaries, Tower Loan of Mississippi, Inc., First Tower Loan, Inc., Gulfco of Mississippi, Inc., Gulfco of Louisiana, Inc., Tower Loan of Missouri, Inc., Tower Auto Loan, Inc., American Federated Insurance Company, and American Federated Life Insurance Company, all of which are collectively referred to as the Company . The Company acquires and services finance receivables (direct loans, real estate loans and sales finance contracts) through branch offices principally located in Mississippi, Louisiana and Missouri. In addition, the Company writes credit insurance when requested by its loan customers.

The Company is subject to various state laws and regulations in each of the states in which it operates and which are enforced by the respective state regulatory authorities. These state laws and regulations impact the economic terms of the Company s products. As a result, the terms of products offered by the Company vary among the states in which it operates in order to comply with each state s specific laws and regulations.

The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

In connection with the preparation of the consolidated financial statements, management of the Company evaluated subsequent events through March 26, 2012, which is the date the consolidated financial statements were available to be issued.

Accounting Standards Codification

The Financial Accounting Standards Board s (FASB) Accounting Standards Codification (ASC) became effective on July 1, 2009. At that date, the ASC became FASB s officially recognized source of authoritative U.S. generally accepted accounting principles (GAAP) applicable to all public and non-public non-governmental entities, superseding existing FASB, American Institute of Certified Public Accountants (AICPA), Emerging Issues Task Force (EITF) and related literature. All other accounting literature is considered non-authoritative for a non-public or non-governmental entity. The switch to the ASC affects the way entities refer to U.S. GAAP in financial statements and accounting policies. Citing particular content in the ASC involves specifying the unique numeric path to the content.

Use of Estimates

The Company s consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America. In preparing its financial statements, the Company is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the dates of the balance sheets and the reported amounts of revenues and expenses for the years then ended. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to change include the determination of the allowance for credit losses, policy claim reserves and the valuation of investments.

First Tower Corp and Subsidiaries

Notes to Consolidated Financial Statements

NOTE 1 SUMMARY OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investment in Trading Securities

The Company has an investment in a large capitalization equity mutual fund which it accounts for using the fair value option allowed by ASC 825-10 and which is classified as a trading security. Changes in the unrealized gains and losses of this investment are recognized through earnings. Dividends on trading securities are recognized in net investment income.

Fair Value Measurements

The Company carries its trading securities, and its investment securities available-for-sale at fair value on a recurring basis and measures certain other assets and liabilities at fair value on a nonrecurring basis using a hierarchy of measurements which requires it to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

Three levels of inputs are used to measure fair value:

Level 1 Valuations based on unadjusted quoted prices for identical assets in active markets accessible at the measurement date.

Level 2 Valuations derived for similar assets in active markets, or other inputs that are observable or can be corroborated by market data.

Level 3 Valuations derived from unobservable (supported by little or no market activity) inputs that reflect an entity s best estimate of what hypothetical market participants would use to determine a transaction price at the reporting date.

When quoted market prices in active markets are unavailable, the Company determines fair value using various valuation techniques and models based on a range of observable market inputs including pricing models, quoted market price of publicly traded securities with similar duration and yield, time value, yield curve, prepayment speeds, default rates and discounted cash flow. In most cases, these estimates are determined based on independent third party valuation information, and the amounts are disclosed in the Level 2 of the fair value hierarchy. Generally, the

Company obtains a single price or quote per instrument from independent third parties to assist in establishing the fair value of these investments.

If quoted market prices and independent third party valuation information are unavailable, the Company produces an estimate of fair value based on internally developed valuation techniques, which, depending on the level of observable market inputs, will render the fair value estimate as Level 2 or 3. On occasions when pricing service data is unavailable, the Company may rely on bid/ask spreads from dealers in determining fair value.

To the extent the Company determines that a price or quote is inconsistent with actual trading activity observed in that investment or similar investments, or if the Company does not think the quote is reflective of the market value for the investment, the Company internally develops a fair value using this other market information and discloses the input as a Level 3.

Investment Securities Available for Sale

Investments in debt securities are classified as available for sale. Available for sale securities are carried at fair value, with changes in the fair value of such securities being reported as other

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First Tower Corp and Subsidiaries

Notes to Consolidated Financial Statements

NOTE 1 SUMMARY OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

comprehensive income (loss), net of related deferred income taxes (benefit). When the fair value of a security falls below carrying value, an evaluation must be made to determine if the unrealized loss is a temporary or other than temporary impairment. Impaired debt securities that are not deemed to be temporarily impaired are written down to net realizable value by a charge to earnings to the extent the impairment is related to credit losses or if the Company intends, or more-likely-than not will be required, to sell the security before recovery of the security s amortized cost basis. In estimating other than temporary impairments, the Company considers the duration of time and extent to which the amortized cost exceeds fair value, the financial condition of the issuer, and the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for anticipated recovery in fair value.

Premiums and discounts on debt securities are recognized as adjustments to net investment income by the interest method over the period to maturity and adjusted for prepayments as applicable. Realized gains and losses on sales of investment securities are determined using the specific identification method.

Finance Receivables

Finance receivables are stated at the amount of unpaid principal and finance charges, including deferred loan costs, and reduced by unearned finance charges, unearned discounts and an allowance for credit losses. For finance receivables originated by the Company, non-refundable loan origination fees and certain direct origination costs are deferred and recognized as an adjustment of the finance receivable yield over the contractual life of the related loan. Unamortized amounts are recognized in income when finance receivables are renewed or paid in full.

For a significant group of finance receivables purchased from other lenders, the Company recognizes finance charge income pursuant to the provisions ASC 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality*, for its investment in finance receivables. ASC 310-30 limits the yield that may be accreted (accretable yield) to the excess of the Company s estimate of undiscounted expected principal, interest and other cash flows (cash flows expected at the acquisition to be collected) over the Company s initial investment in the finance receivables. Prepayment expectations are not considered in this evaluation. Subsequent increases in cash flows expected to be collected are recognized prospectively through adjustment of the finance receivables yield over its remaining life. Decreases in cash flows expected to be collected are recognized as impairment to the finance receivable portfolios.

Real Estate Acquired by Foreclosure

The Company records real estate acquired by foreclosure at the lesser of the outstanding finance receivable amount (including accrued interest, if any) or fair value, less estimated costs to sell, at the time of foreclosure. Any resulting loss on foreclosure is charged to the allowance for credit losses and a new basis is established in the property. A valuation allowance and a corresponding charge to operations is established to reflect declines in value subsequent to acquisition, if any, below the new basis. Operating expenses of such properties, net of related income, and gains and losses on their disposition are included in other operating expenses.

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First Tower Corp and Subsidiaries

Notes to Consolidated Financial Statements

NOTE 1 SUMMARY OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

Property and Equipment

Property and equipment are stated at cost. Depreciation is computed using the straight-line method. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to income when incurred; significant renewals and betterments are capitalized. The Company evaluates the recoverability of property, plant and equipment and other long-term assets when events or changes in circumstances indicate that the carrying value of such assets may not be recoverable, based upon expectations of non-discounted cash flows and operating income.

Income Recognition

Precomputed finance charges are included in the gross amount of the Company s finance receivables. These precomputed charges are deferred and recognized as income on an accrual basis using the effective interest method over the terms of receivables. However, with certain exceptions, state regulations allow interest refunds to be made according to the Rule of 78 s method for payoffs and renewals. Since a significant percentage of the Company s precomputed accounts are paid off or renewed prior to maturity, the result is that a majority of the precomputed accounts effectively yield on a Rule of 78 s basis. The difference between income previously recognized under the interest yield method and the Rule of 78 s method is recognized as an adjustment to interest income at the time of the renewal or payoff.

Renewals and refinancings require that the borrower meet the underwriting guidelines similar to a new customer and, as a result, the interest rate and effective yield, as well as the other terms of the refinanced receivables are comparable to finance receivables with customers with similar risks who are not refinancing; therefore, all renewals and refinancings are treated as new finance receivables. Unearned finance charges and discounts from the original receivable being renewed or refinanced are recognized in interest income when the new finance receivable is granted. Finance charge refunds, net of any applicable prepayment penalties, are charged to interest income at the time of the new finance receivable.

Insurance premiums on credit life and accident and health policies written by the Company are earned over the term of the policy using the pro-rata method, for level-term life policies, and the effective yield method, for decreasing-term life policies. Premiums on accident and health policies are earned based on an average of the pro-rata method and the effective yield method. Property and casualty credit insurance premiums written by the Company are earned over the period of insurance coverage using the pro-rata method or the effective yield method, depending on whether the amount of insurance coverage generally remains level or declines.

Commissions earned from the sale of accidental death and dismemberment insurance coverage and motor club memberships to finance customers are recognized at the time of origination. The Company has no future obligations related to the sale of these products. Other income includes commissions earned of $8,025,000 in 2011 and $7,044,000 in 2010.

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First Tower Corp and Subsidiaries

Notes to Consolidated Financial Statements

NOTE 1 SUMMARY OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

Credit Losses

The allowance for credit losses is determined by several factors based upon each portfolio segment. Segments in the finance receivable portfolio include personal property, real estate and other. Historical loss experience is the primary factor in the determination of the allowance for credit losses. An evaluation is performed to compare the amount of accounts charged off, net of recoveries of such accounts, in relation to the average net outstanding finance receivables for the period being reviewed. Historically, management has found that this methodology has provided an adequate allowance due to the Company s loan portfolio segments consisting of a large number of smaller balance homogeneous finance receivables. Further, management routinely evaluates the inherent risks and change in the volume and composition of the Company s finance receivable portfolio based on its extensive experience in the consumer finance industry in consideration of estimating the adequacy of the allowance. Also considered are delinquency trends, economic conditions, and industry factors. Provisions for credit losses are charged to income in amounts sufficient to maintain an allowance for credit losses at a level considered adequate to cover the probable loss inherent in the finance receivable portfolio. Since the estimates used in determining the allowance for credit losses are influenced by outside factors, such as consumer payment patterns and general economic conditions, there is uncertainty inherent in these estimates, making it reasonably possible that they could change. Interest on past due finance receivables is recognized until charge-off. Finance receivables are generally charged off when they are five months contractually past due.

Policy Claim Reserves

Policy claim reserves represent (i) the liability for losses and loss-adjustment expenses related to credit property contracts and (ii) the liabilities for future policy benefits related to credit life and accident and health insurance. The liability for loss and loss adjustment expenses includes an amount determined from loss reports and individual cases and an amount, based on past experience, for losses incurred but not reported. The liabilities for future policy benefits have been computed utilizing accepted actuarial techniques. Such liabilities are necessarily based on estimates and, while management believes that the amount is adequate, the ultimate liability may be in excess of or less than the amounts provided. The methods for making such estimates and for establishing the resulting liabilities are continually reviewed, and any adjustments are reflected in earnings currently.

Reinsurance

The Company reduces its exposure relating to credit accident and health insurance through a quota share reinsurance agreement (see Note 4). Amounts recoverable from the reinsurer are estimated in a manner consistent with the claim liability associated with the reinsured policy.

Income Taxes

Deferred tax assets and liabilities are determined based on the differences between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect in the years in which the differences are expected to reverse.

Cash and Cash Equivalents

For purposes of the consolidated statements of cash flows, the Company considers certificates of deposit and all short-term securities with original maturities of three months or less to be cash equivalents.

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First Tower Corp and Subsidiaries

Notes to Consolidated Financial Statements

NOTE 1 SUMMARY OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

Fair Value Disclosures of Financial Instruments

The following methods and assumptions were used by the Company to estimate the fair value of each class of financial instruments:

Cash and Cash Equivalents

The carrying amounts reported in the consolidated balance sheets for these financial instruments approximate their fair values.

Investment Securities

The fair value of investments in trading securities and securities available for sale are generally obtained from independent pricing services based upon valuations for similar assets in active markets or other inputs derived from objectively verifiable information.

Finance Receivables

The fair value of finance receivables approximates the carrying value since the estimated life, assuming prepayments, is short-term in nature.

Other Receivables and Payables

The carrying value amounts reported in the consolidated financial statements approximated their fair value.

Notes Payable

The carrying amounts of borrowings under the line-of-credit agreements approximated their fair values as the interest charged for these borrowings fluctuate with market changes.

Comprehensive Income

Comprehensive income for the Company consists of net earnings, changes in unrealized gains (losses) on investment securities classified as available-for-sale and changes in the fair value of interest rate swap agreements, net of taxes, and is presented in the consolidated statements of income and comprehensive income.

Advertising

Advertising costs are expensed as incurred. Advertising expenses approximated $4,071,000 in 2011 and $3,476,000 in 2010.

Effects of Recent Accounting Guidance

In May 2011, the FASB issued a new accounting standard update under Accounting Standards Update (ASU) No. 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Faire Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs.* The amendments in ASU 2011-4 generally represent clarification of Topic 820, but also include instances where a particular principle or requirement for measuring fair value or disclosing information about fair value has changed. The most significant change in disclosures is an expansion of the information required for Level 3 measurements based on unobservable inputs. The standard will be effective for the Company on January 1, 2012.

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First Tower Corp and Subsidiaries

Notes to Consolidated Financial Statements

NOTE 1 SUMMARY OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

In June 2011, the FASB issued new authoritative accounting guidance under ASU No. 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income.* ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in shareholders equity. As a result companies must report comprehensive income in either a single continuous statement of comprehensive income which contains two sections, net income and other comprehensive income, or in two separate but consecutive statements. This new guidance is to be applied retrospectively and will be effective for the Company on January 1, 2012.

In December 2011, the FASB issued new authoritative accounting guidance under ASU No. 2011-12, *Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update 2011-05.* ASU 2011-12 defers certain aspects of ASU 2011-05 that relate to the presentation of reclassification adjustments. This new guidance will be effective for the Company on January 1, 2012.

In October 2010, the FASB issued new authoritative accounting guidance under ASU No. 2010-26, *Financial Services Insurance (Topic 944), Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts.* ASU 2010-26 amends prior accounting guidance to specify which costs incurred in the acquisition of new or renewal insurance contracts qualify for deferral. This standard will be effective for the Company on January 1, 2012.

The Company is currently evaluating the impact the adoption of these accounting standards updates could have on its consolidated financial statements.

Reclassifications

Certain reclassifications have been made to the 2010 consolidated financial statements in order to conform to the method of presentation used in 2011.

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NOTE 2 INVESTMENT SECURITIES

The cost or amortized cost of securities available for sale and their approximate fair values at December 31, 2011 and 2010 were as follows:

December 31, 2011	Cost or Amortized Cost	Approximate Fair Value	Gross Unrealized Gains	Gross Unrealized Losses
Debt securities:				
U.S. Government agencies and corporations	$ 2,598,669	$ 2,692,597	$ 93,928	$
Obligations of states and political subdivisions	18,199,841	19,603,799	1,430,401	26,444
Corporate securities	14,504,237	15,503,864	1,023,929	24,302
Mortgage-backed securities	2,457,786	2,554,518	107,807	11,075
Total investment securities	$ 37,760,533	$ 40,354,778	$ 2,656,065	$ 61,821
December 31, 2010				
Debt securities:				
U.S. Government agencies and corporations	$ 2,881,111	$ 2,951,081	$ 90,456	$ 20,486
Obligations of states and political subdivisions	17,304,321	17,869,374	667,265	102,213
Corporate securities	13,127,158	13,900,694	839,300	65,764
Mortgage-backed securities	2,116,111	2,203,072	90,133	3,172
Total investment securities	$ 35,428,701	$ 36,924,221	$ 1,687,154	$ 191,635

Accumulated other comprehensive income (loss) includes unrealized gains on available for sale securities, net of income tax effects, of approximately $1,642,000 and $964,000 at December 31, 2011 and 2010, respectively.

The length of time temporarily impaired securities have been held in a loss position as of December 31, 2010 and 2009 is summarized below:

	Less than 12 months		12 months or more		Total	
December 31, 2011	**Estimated Fair Value**	**Unrealized Losses**	**Estimated Fair Value**	**Unrealized Losses**	**Estimated Fair Value**	**Unrealized Losses**
	$ 297,920	$ 1,393	$ 771,596	$ 25,051	$ 1,069,516	$ 26,444

Obligations of states and political subdivisions						
Corporate securities	2,225,305	24,302			2,225,305	24,302
Mortgage-backed securities	730,461	11,075			730,461	11,075
Total	$ 3,253,686	$ 36,770	$ 771,596	$ 25,051	$ 4,025,282	$ 61,821

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NOTE 2 INVESTMENT SECURITIES (Continued)

	Less than 12 months		12 months or more		Total	
December 31, 2010	**Estimated Fair Value**	**Unrealized Losses**	**Estimated Fair Value**	**Unrealized Losses**	**Estimated Fair Value**	**Unrealized Losses**
U.S. Government and agencies securities	$ 934,029	$ 20,486			$ 934,029	$ 20,486
Obligations of states and political subdidivisions	2,290,500	67,105	$ 1,349,483	$ 35,108	3,639,983	102,213
Corporate securities	1,813,081	65,764			1,813,081	65,764
Mortgage-backed securities	414,284	3,172			414,284	3,172
Total	$ 5,451,894	$ 156,527	$ 1,349,483	$ 35,108	$ 6,801,377	$ 191,635

Substantially all gross unrealized losses at December 31, 2011 and 2010 were attributable to interest rate changes and general disruptions in the credit market subsequent to purchase rather than an adverse change in cash flows or a fundamental weakness in the credit quality of the issuer or the underlying assets and are thus considered temporarily impaired. Due to the issuers continued satisfaction of the securities obligations in accordance with contractual terms, the expectation that they will continue to do so and the Company s intent and ability relative to these investments, management believes the securities in unrealized loss positions are temporarily depressed.

As of December 31, 2011 the Company had 26 debt securities with temporary impairments, including 5 securities classified as obligations of state and political subdivisions, 17 securities classified as corporate securities, and 4 investments classified as mortgage-backed securities.

As of December 31, 2010, the Company had 31 debt securities with temporary impairments, including 1 security classified as U.S. Government agencies and corporations, 21 securities classified as obligations of state and political subdivisions, 7 securities classified as corporate securities, and 2 investments classified as mortgage-backed securities.

Management of the Company evaluates securities for other-than-temporary impairment (OTTI) no less than annually or when economic or market concerns warrant such evaluation. The evaluation is based upon factors such as the creditworthiness of the issuer, the underlying collateral, if applicable, and the continuing performance of the securities. Management also evaluates other facts and circumstances that may be indicative of an OTTI condition. This includes, but is not limited to, an evaluation of the type of security, length of time and extent to which the fair value has been less than cost, and near-term prospects of the issuer.

The Company segregates the OTTI impact on impaired securities where impairment in value was deemed to be other than temporary between the component representing credit loss and the component representing loss related to other factors.

The Company assesses whether a credit loss exists by considering whether (i) the Company has the intent to sell the security, (ii) it is more likely than not that it will be required to sell the security before recovery, or (iii) it does not expect to recover the entire amortized cost basis of a debt security. The portion of the fair value decline attributable to credit loss is recognized as a charge to earnings. The credit loss evaluation is determined by comparing the present value of the cash

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NOTE 2 INVESTMENT SECURITIES (Continued)

flows expected to be collected, discounted at the rate in effect before recognizing any OTTI with the amortized cost basis of the debt security. The Company uses the cash flow expected to be realized from the security, which includes assumptions about interest rates, timing and severity of defaults, estimates of potential recoveries, the cash flow distribution from the bond indenture and other factors, then applies a discount rate equal to the effective yield of the security. The difference between the present value of the expected cash flows and the amortized book value is considered a credit loss. The difference between the fair market value and the security s remaining amortized cost is recognized in other comprehensive income or loss.

A rollforward of credit losses recognized in earnings on available-for-sale securities, for which a portion of OTTI loss remains in AOCI, is as follows:

In thousands, for the years ending December 31,	**2011**	**2010**
Amounts related to credit losses on securities held, beginning of year	**$ 1,161,142**	$ 1,161,142
Less accumulated losses on investments disposed of during the year	**(646,750)**	