

MIDSOUTH BANCORP INC  
Form 10-Q  
August 08, 2014

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

FORM 10-Q

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

For the quarterly period ended June 30, 2014

OR

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

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

COMMISSION FILE NUMBER 1-11826

MIDSOUTH BANCORP, INC.

(Exact name of registrant as specified in its charter)

Louisiana

(State or other jurisdiction of incorporation or organization)

72-1020809

(I.R.S. Employer Identification No.)

102 Versailles Boulevard, Lafayette, Louisiana 70501

(Address of principal executive offices, including zip code)

(337) 237-8343

(Registrant's telephone number, including area code)

Indicate by checkmark 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 small reporting company.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Small 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

As of August 8, 2014, there were 11,334,499 shares of the registrant's Common Stock, par value \$0.10 per share, outstanding.



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## Part I – Financial Information

## Item 1. Financial Statements.

## MidSouth Bancorp, Inc. and Subsidiaries

## Consolidated Balance Sheets

(dollars in thousands, except share data)

	June 30, 2014 (unaudited)	December 31, 2013* (audited)
<b>Assets</b>		
Cash and due from banks, including required reserves of \$9,726 and \$9,542, respectively	\$48,979	\$43,488
Interest-bearing deposits in banks	12,881	13,993
Federal funds sold	2,075	2,250
Securities available-for-sale, at fair value (cost of \$296,798 at June 30, 2014 and \$341,828 at December 31, 2013)	301,028	341,665
Securities held-to-maturity (fair value of \$148,559 at June 30, 2014 and \$151,168 at December 31, 2013)	148,927	155,523
Other investments	12,090	11,526
Loans	1,224,182	1,137,554
Allowance for loan losses	(9,075 )	(8,779 )
Loans, net	1,215,107	1,128,775
Bank premises and equipment, net	71,787	72,343
Accrued interest receivable	6,368	6,692
Goodwill	42,171	42,171
Intangibles	7,388	7,941
Cash surrender value of life insurance	13,544	13,450
Other real estate	6,314	6,687
Other assets	7,619	4,656
<b>Total assets</b>	<b>\$1,896,278</b>	<b>\$1,851,160</b>
<b>Liabilities and Shareholders' Equity</b>		
<b>Liabilities:</b>		
<b>Deposits:</b>		
Non-interest-bearing	\$389,734	\$383,257
Interest-bearing	1,135,688	1,135,546
<b>Total deposits</b>	<b>1,525,422</b>	<b>1,518,803</b>
Securities sold under agreements to repurchase	67,574	53,916
Short-term Federal Home Loan Bank advances	35,000	25,000
Notes payable	26,990	27,703
Junior subordinated debentures	29,384	29,384
Other liabilities	9,492	5,605
<b>Total liabilities</b>	<b>1,693,862</b>	<b>1,660,411</b>
<b>Commitments and contingencies</b>		
<b>Shareholders' equity:</b>		
Series B Preferred stock, no par value; 5,000,000 shares authorized, 32,000 shares issued and outstanding at June 30, 2014 and December 31, 2013	32,000	32,000
Series C Preferred stock, no par value; 100,000 shares authorized, 94,561 and 99,971 issued and 94,474 and 99,971 outstanding at June 30, 2014 and December 31, 2013, respectively; 87 shares in treasury at June 30, 2014 and none at December 31, 2014	9,456	9,997
Common stock, \$0.10 par value; 30,000,000 shares authorized, 11,446,631 and 11,407,196 issued and 11,296,147 and 11,256,712 outstanding at June 30, 2014 and December 31,	1,145	1,141

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2013, respectively; 150,484 shares in treasury at June 30, 2014 and December 31, 2013

Additional paid-in capital	111,952	111,017
Unearned ESOP shares	(283 )	-
Accumulated other comprehensive income (loss)	2,749	(106 )
Treasury stock, at cost	(3,295 )	(3,286 )
Retained earnings	48,692	39,986
Total shareholders' equity	202,416	190,749
Total liabilities and shareholders' equity	\$1,896,278	\$1,851,160

See notes to unaudited consolidated financial statements.

\* Derived from audited financial statements.

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MidSouth Bancorp, Inc. and Subsidiaries  
 Consolidated Statements of Earnings (unaudited)  
 (in thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Interest income:				
Loans, including fees	\$17,769	\$18,197	\$35,252	\$35,314
Securities and other investments:				
Taxable	2,064	2,251	4,200	4,310
Nontaxable	661	812	1,354	1,651
Federal funds sold	1	1	2	5
Time and interest bearing deposits in other banks	11	17	27	55
Other investments	89	78	159	150
Total interest income	20,595	21,356	40,994	41,485
Interest expense:				
Deposits	858	990	1,729	2,068
Securities sold under agreements to repurchase	199	182	379	361
Other borrowings and payable	105	106	211	230
Junior subordinated debentures	320	336	667	672
Total interest expense	1,482	1,614	2,986	3,331
Net interest income	19,113	19,742	38,008	38,154
Provision for loan losses	1,200	1,250	1,750	1,800
Net interest income after provision for loan losses	17,913	18,492	36,258	36,354
Non-interest income:				
Service charges on deposits	2,448	2,271	4,828	4,442
Gain on securities, net	128	-	128	204
ATM and debit card income	1,853	1,638	3,567	2,994
Executive officer life insurance proceeds	-	-	3,000	-
Other charges and fees	832	1,095	1,655	1,795
Total non-interest income	5,261	5,004	13,178	9,435
Non-interest expenses:				
Salaries and employee benefits	8,488	8,369	17,301	16,761
Occupancy expense	3,689	3,725	7,480	7,322
FDIC insurance	251	244	513	589
Other	4,695	5,929	9,531	11,026
Total non-interest expenses	17,123	18,267	34,825	35,698
Income before income taxes	6,051	5,229	14,611	10,091
Income tax expense	1,935	1,566	3,637	3,000
Net earnings	4,116	3,663	10,974	7,091
Dividends on preferred stock	170	392	350	684
Net earnings available to common shareholders	\$3,946	\$3,271	\$10,624	\$6,407

Earnings per share:

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Basic	\$0.35	\$0.29	\$0.94	\$0.57
Diluted	\$0.34	\$0.29	\$0.91	\$0.56
Weighted average number of shares outstanding:				
Basic	11,288	11,239	11,273	11,238
Diluted	11,923	11,839	11,897	11,846
Dividends declared per common share	\$0.09	\$0.08	\$0.17	\$0.15

See notes to unaudited consolidated financial statements.

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MidSouth Bancorp, Inc. and Subsidiaries

Consolidated Statements of Comprehensive Income (Loss) (unaudited)

(in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Net earnings	\$4,116	\$3,663	\$10,974	\$7,091
Other comprehensive income (loss), net of tax:				
Unrealized gains (losses) on securities available-for-sale:				
Unrealized holding gains (losses) arising during the year	1,574	(8,993)	4,520	(10,108)
Less: reclassification adjustment for gains on sales of securities available-for-sale	(128 )	-	(128 )	(204 )
Total other comprehensive income (loss), before tax	1,446	(8,993)	4,392	(10,312)
Income tax effect related to items of other comprehensive income (loss)	(506 )	3,148	(1,537 )	3,609
Total other comprehensive income (loss), net of tax	940	(5,845)	2,855	(6,703 )
Total comprehensive income (loss)	\$5,056	\$(2,182)	\$13,829	\$388

See notes to unaudited consolidated financial statements.



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MidSouth Bancorp, Inc. and Subsidiaries

Consolidated Statement of Shareholders' Equity (unaudited)

For the Six Months Ended June 30, 2014

(in thousands, except share and per share data)

	Preferred Stock		Common Stock		Additional Paid-in Capital	Unearned ESOP Shares	Accumulated Other Comprehensive Income			Retained Earnings	Total
	Shares	Amount	Shares	Amount			Treasury Stock	Income (Loss)			
Balance - December 31, 2013	131,971	\$41,997	11,407,196	\$1,141	\$111,017	\$-	\$(106 )	\$(3,286)	\$39,986	\$190,749	
Net earnings	-	-	-	-	-	-	-	-	10,974	10,974	
Dividends on Series B and Series C preferred stock	-	-	-	-	-	-	-	-	(350 )	(350 )	
Dividends on common stock, \$0.17 per share	-	-	-	-	-	-	-	-	(1,918 )	(1,918 )	
Conversion of Series C preferred stock to common stock	(5,410 )	(541 )	30,057	3	538	-	-	-	-	-	
Repurchase of preferred stock, 87 shares	-	-	-	-	-	-	-	(9 )	-	(9 )	
Increase in ESOP obligation	-	-	-	-	-	(283)	-	-	-	(283 )	
Exercise of stock options	-	-	9,378	1	120	-	-	-	-	121	
Tax benefit resulting from issuance of stock options, net adjustment	-	-	-	-	1	-	-	-	-	1	
Stock option expense	-	-	-	-	276	-	-	-	-	276	
Change in accumulated other comprehensive income (loss)	-	-	-	-	-	-	2,855	-	-	2,855	
Balance - June 30, 2014	126,561	\$41,456	11,446,631	\$1,145	\$111,952	\$(283)	\$2,749	\$(3,295)	\$48,692	\$202,416	

See notes to unaudited consolidated financial statements.



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MidSouth Bancorp, Inc. and Subsidiaries  
 Consolidated Statements of Cash Flows (unaudited)  
 (in thousands)

	For the Six Months Ended June 30,	
	2014	2013
Cash flows from operating activities:		
Net earnings	\$10,974	\$7,091
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation	2,987	2,696
Accretion of purchase accounting adjustments	(1,450 )	(3,732 )
Provision for loan losses	1,750	1,800
Provision for deferred tax expense	1,246	996
Amortization of premiums on securities, net	1,763	2,384
Amortization of other investments	2	9
Stock option expense	276	123
Restricted stock expense	-	21
Net gain on sale of investment securities	(128 )	(204 )
Net loss on sale of other real estate owned	5	112
Net write down of other real estate owned	31	347
Net (gain) loss on sale/disposal of premises and equipment	(12 )	148
Change in accrued interest receivable	324	(73 )
Change in accrued interest payable	(43 )	(145 )
Change in other assets & other liabilities, net	(2,023 )	537
Net cash provided by operating activities	15,702	12,110
Cash flows from investing activities:		
Net decrease in time deposits in other banks	-	881
Proceeds from maturities and calls of securities available-for-sale	21,634	44,861
Proceeds from maturities and calls of securities held-to-maturity	7,156	13,784
Proceeds from sale of securities available-for-sale	22,153	41,839
Purchases of securities available-for-sale	-	(47,304)
Purchases of securities held-to-maturity	(1,104 )	(24,700)
Proceeds from redemptions of other investments	150	1,000
Purchases of other investments	(564 )	(2,651 )
Net change in loans	(86,692)	(64,053)
Purchases of premises and equipment	(2,909 )	(7,274 )
Proceeds from sale of premises and equipment	490	10
Proceeds from sale of other real estate owned	338	619
Net cash used in investing activities	(39,348)	(42,988)
Cash flows from financing activities:		
Change in deposits	6,765	(15,702)
Change in securities sold under agreements to repurchase	13,658	10,263
Borrowings on Federal Home Loan Bank advances	10,000	25,000
Repayments of Federal Home Loan Bank advances	(30 )	(28 )
Repayments of notes payable	(500 )	(500 )
Purchase of treasury stock	(9 )	-
Proceeds and tax benefit from exercise of stock options	122	30
Payment of dividends on preferred stock	(355 )	(660 )

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Payment of dividends on common stock	(1,801 )	(1,520 )
Net cash provided by financing activities	27,850	16,883
Net increase (decrease) in cash and cash equivalents	4,204	(13,995)
Cash and cash equivalents, beginning of period	59,731	73,573
Cash and cash equivalents, end of period	\$63,935	\$59,578
Supplemental cash flow information:		
Interest paid	\$3,030	\$3,269
Income taxes paid	3,560	3,050
Noncash investing and financing activities:		
Transfer of loans to other real estate	77	482
Change in accrued common stock dividends	117	166
Change in accrued preferred stock dividends	(5 )	24
Financed sales of other real estate	84	-
Net change in loan to ESOP	(283 )	-

See notes to unaudited consolidated financial statements.

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MidSouth Bancorp, Inc. and Subsidiaries  
 Notes to Interim Consolidated Financial Statements  
 June 30, 2014  
 (Unaudited)

## 1. Basis of Presentation

The accompanying unaudited consolidated financial statements and notes thereto contain all adjustments, consisting only of normal recurring adjustments, necessary to present fairly, in accordance with accounting principles generally accepted in the United States of America (“GAAP”), the financial position of MidSouth Bancorp, Inc. (the “Company”) and its subsidiaries as of June 30, 2014 and the results of their operations and their cash flows for the periods presented. The interim financial information should be read in conjunction with the annual consolidated financial statements and the notes thereto included in the Company’s 2013 Annual Report on Form 10-K.

The results of operations for the six-month period ended June 30, 2014 are not necessarily indicative of the results to be expected for the entire year.

Use of Estimates — The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

Summary of Significant Accounting Policies — The accounting and reporting policies of the Company conform with GAAP and general practices within the banking industry. There have been no material changes or developments in the application of accounting principles or in our evaluation of the accounting estimates and the underlying assumptions or methodologies that we believe to be Critical Accounting Policies and Estimates as disclosed in our 2013 Annual Report on Form 10-K.

Recently Adopted Accounting Pronouncements — ASU 2014-04, Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure (a consensus of the FASB Emerging Issues Task Force) provides guidance on when an in-substance repossession or foreclosure occurs, which requires the mortgage loan to be derecognized and the related real estate be recognized. Creditors must disclose the amount of foreclosed residential real estate held as well as the amount of collateralized loans for which foreclosure is in process. The effective date of this Update is for fiscal years beginning on or after December 15, 2014 and interim periods within those annual periods. Adoption of this Update is not expected to have a material effect on the Company’s consolidated financial statements or the interim notes to the consolidated financial statements.

## 2. Investment Securities

The portfolio of investment securities consisted of the following (in thousands):

	June 30, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
U.S. Government sponsored enterprises	\$ 11,201	\$ 1	\$ 111	\$ 11,091
Obligations of state and political subdivisions	50,581	2,046	54	52,573
GSE mortgage-backed securities	114,947	3,146	621	117,472

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Collateralized mortgage obligations: residential	68,193	354	2,083	66,464
Collateralized mortgage obligations: commercial	26,731	388	101	27,018
Other asset-backed securities	24,681	404	-	25,085
Collateralized debt obligation	464	861	-	1,325
	\$296,798	\$ 7,200	\$ 2,970	\$301,028

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	December 31, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
U.S. Government sponsored enterprises	\$ 11,455	\$ 1	\$ 191	\$ 11,265
Obligations of state and political subdivisions	57,925	2,296	243	59,978
GSE mortgage-backed securities	146,129	2,029	2,193	145,965
Collateralized mortgage obligations: residential	73,569	212	2,894	70,887
Collateralized mortgage obligations: commercial	27,082	416	152	27,346
Other asset-backed securities	25,204	351	66	25,489
Collateralized debt obligation	464	271	-	735
	\$ 341,828	\$ 5,576	\$ 5,739	\$ 341,665

	June 30, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held-to-maturity:				
Obligations of state and political subdivisions	\$ 46,804	\$ 97	\$ 679	\$ 46,222
GSE mortgage-backed securities	73,054	977	321	73,710
Collateralized mortgage obligations: residential	13,515	-	520	12,995
Collateralized mortgage obligations: commercial	15,554	78	-	15,632
	\$ 148,927	\$ 1,152	\$ 1,520	\$ 148,559

	December 31, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held-to-maturity:				
Obligations of state and political subdivisions	\$ 47,377	\$ 38	\$ 2,586	\$ 44,829
GSE mortgage-backed securities	78,272	148	1,079	77,341
Collateralized mortgage obligations: residential	14,189	-	979	13,210
Collateralized mortgage obligations: commercial	15,685	103	-	15,788
	\$ 155,523	\$ 289	\$ 4,644	\$ 151,168

With the exception of three private-label collateralized mortgage obligations (“CMOs”) with a combined balance remaining of \$53,000 at June 30, 2014, all of the Company’s CMOs are government-sponsored enterprise (“GSE”) securities.

The amortized cost and fair value of debt securities at June 30, 2014 by contractual maturity are shown in the following table (in thousands) with the exception of other asset-backed securities, mortgage-backed securities, CMOs, and the collateralized debt obligation. Expected maturities may differ from contractual maturities for mortgage-backed securities and CMOs because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

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	Amortized Cost	Fair Value
Available-for-sale:		
Due in one year or less	\$ 10,544	\$ 10,705
Due after one year through five years	33,691	34,681
Due after five years through ten years	12,376	13,116
Due after ten years	5,171	5,162
Other asset-backed securities	24,681	25,085
Mortgage-backed securities and collateralized mortgage obligations:		
Residential	183,140	183,936
Commercial	26,731	27,018
Collateralized debt obligation	464	1,325
	\$ 296,798	\$ 301,028

	Amortized Cost	Fair Value
Held-to-maturity:		
Due in one year or less	\$ 107	\$ 105
Due after one year through five years	2,639	2,659
Due after five years through ten years	6,910	6,831
Due after ten years	37,148	36,627
Mortgage-backed securities and collateralized mortgage obligations:		
Residential	86,569	86,705
Commercial	15,554	15,632
	\$ 148,927	\$ 148,559

Details concerning investment securities with unrealized losses are as follows (in thousands):

	June 30, 2014 Securities with losses under 12 months		Securities with losses over 12 months		Total	Gross Unrealized Loss
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss		
Available-for-sale:						
U.S. Government sponsored enterprises	\$-	\$ -	\$ 10,386	\$ 111	\$ 10,386	\$ 111
Obligations of state and political subdivisions	656	5	3,726	49	4,382	54
GSE mortgage-backed securities	3,662	13	40,979	608	44,641	621
Collateralized mortgage obligations: residential	4,730	17	45,254	2,066	49,984	2,083
Collateralized mortgage obligations: commercial	-	-	4,097	101	4,097	101
	\$ 9,048	\$ 35	\$ 104,442	\$ 2,935	\$ 113,490	\$ 2,970



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	December 31, 2013					
	Securities with losses under 12 months		Securities with losses over 12 months		Total	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
Available-for-sale:						
U.S. Government sponsored enterprises	\$10,463	\$ 191	\$-	\$ -	\$10,463	\$ 191
Obligations of state and political subdivisions	4,256	243	-	-	4,256	243
GSE mortgage-backed securities	68,028	2,193	-	-	68,028	2,193
Collateralized mortgage obligations: residential	56,975	2,563	4,371	331	61,346	2,894
Collateralized mortgage obligations: commercial	4,282	152	-	-	4,282	152
Other asset-backed securities	13,099	66	-	-	13,099	66
	\$157,103	\$ 5,408	\$4,371	\$ 331	\$161,474	\$ 5,739

	June 30, 2014					
	Securities with losses under 12 months		Securities with losses over 12 months		Total	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
Held-to-maturity:						
Obligations of state and political subdivisions	\$7,816	\$ 59	\$29,812	\$ 620	\$37,628	\$ 679
GSE mortgage-backed securities	-	-	29,908	321	29,908	321
Collateralized mortgage obligations: residential	-	-	12,995	520	12,995	520
	\$7,816	\$ 59	\$72,715	\$ 1,461	\$80,531	\$ 1,520

	December 31, 2013					
	Securities with losses under 12 months		Securities with losses over 12 months		Total	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
Held-to-maturity:						
Obligations of state and political subdivisions	\$42,246	\$ 2,569	\$685	\$ 17	\$42,931	\$ 2,586
GSE mortgage-backed securities	31,042	1,079	-	-	31,042	1,079
Collateralized mortgage obligations: residential	13,210	979	-	-	13,210	979
	\$86,498	\$ 4,627	\$685	\$ 17	\$87,183	\$ 4,644

Management evaluates each quarter whether unrealized losses on securities represent impairment that is other than temporary. For debt securities, the Company considers its intent to sell the securities or if it is more likely than not the Company will be required to sell the securities. If such impairment is identified, based upon the intent to sell or the more likely than not threshold, the carrying amount of the security is reduced to fair value with a charge to earnings. Upon the result of the aforementioned review, management then reviews for potential other than temporary impairment based upon other qualitative factors. In making this evaluation, management considers changes in market rates relative to those available when the security was acquired, changes in market expectations about the timing of

cash flows from securities that can be prepaid, performance of the debt security, and changes in the market's perception of the issuer's financial health and the security's credit quality. If determined that a debt security has incurred other than temporary impairment, then the amount of the credit related impairment is determined. If a credit loss is evident, the amount of the credit loss is charged to earnings and the non-credit related impairment is recognized through other comprehensive income.

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As of June 30, 2014, 90 securities had unrealized losses totaling 2.26% of the individual securities' amortized cost basis and 1.01% of the Company's total amortized cost basis. 70 of the 90 securities had been in an unrealized loss position for over twelve months at June 30, 2014. These 70 securities had an amortized cost basis and unrealized loss of \$181.6 million and \$4.5 million, respectively. The unrealized losses on debt securities at June 30, 2014 resulted from changing market interest rates over the yields available at the time the underlying securities were purchased. Management identified no impairment related to credit quality. At June 30, 2014, management had the intent and ability to hold impaired securities and no impairment was evaluated as other than temporary. As a result, no other than temporary impairment losses were recognized during the six months ended June 30, 2014.

During the six months ended June 30, 2014, the Company sold four securities classified as available-for-sale at a net gain of \$128,000. All of the securities were sold at a gain. During the six months ended June 30, 2013, the Company sold 21 securities classified as available-for-sale at a net gain of \$204,000. Of the 21 securities sold, 18 securities were sold with gains totaling \$217,000 and three securities were sold at a loss of \$13,000.

Securities with an aggregate carrying value of approximately \$283.3 million and \$259.9 million at June 30, 2014 and December 31, 2013, respectively, were pledged to secure public funds on deposit and for other purposes required or permitted by law.

### 3. Credit Quality of Loans and Allowance for Loan Losses

The loan portfolio consisted of the following (in thousands):

	June 30, 2014	December 31, 2013
Commercial, financial and agricultural	\$454,310	\$403,976
Real estate - construction	86,238	82,691
Real estate – commercial	413,565	397,135
Real estate – residential	153,082	146,841
Installment loans to individuals	108,581	97,459
Lease financing receivable	4,750	5,542
Other	3,656	3,910
	1,224,182	1,137,554
Less allowance for loan losses	(9,075 )	(8,779 )
	\$1,215,107	\$1,128,775

The Company monitors loan concentrations and evaluates individual customer and aggregate industry leverage, profitability, risk rating distributions, and liquidity for each major standard industry classification segment. At June 30, 2014, one industry segment concentration, the oil and gas industry, constituted more than 10% of the loan portfolio. The Company's exposure in the oil and gas industry, including related service and manufacturing industries, totaled approximately \$261.8 million, or 21.4% of total loans. Additionally, the Company's exposure to loans secured by commercial real estate is monitored. At June 30, 2014, loans secured by commercial real estate (including commercial construction, farmland and multifamily loans) totaled approximately \$476.3 million. Of the \$476.3 million, \$379.2 million represent CRE loans, 64% of which are secured by owner-occupied commercial properties. Of the \$476.3 million in loans secured by commercial real estate, \$3.4 million, or 0.7%, were on nonaccrual status at June 30, 2014.

#### Allowance for Loan Losses

The allowance for loan losses is a valuation account available to absorb probable losses on loans. All losses are charged to the allowance for loan losses when the loss actually occurs or when a determination is made that a loss is

likely to occur. Recoveries are credited to the allowance for loan losses at the time of recovery. Quarterly, the probable level of losses in the existing portfolio is estimated through consideration of various factors. Based on these estimates, the allowance for loan losses is increased by charges to earnings and decreased by charge offs (net of recoveries).

The allowance is composed of general reserves and specific reserves. General reserves are determined by applying loss percentages to segments of the portfolio. The loss percentages are based on each segment's historical loss experience, generally over the past twelve to eighteen months, and adjustment factors derived from conditions in the Company's internal and external environment. All loans considered to be impaired are evaluated on an individual basis to determine specific reserve allocations in accordance with GAAP. Loans for which specific reserves are provided are excluded from the calculation of general reserves.

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Loans acquired in business combinations are initially recorded at fair value, which includes an estimate of credit losses expected to be realized over the remaining lives of the loans, and therefore no corresponding allowance for loan losses is recorded for these loans at acquisition. Methods utilized to estimate any subsequently required allowance for loan losses for acquired loans not deemed credit-impaired at acquisition are similar to originated loans; however, the estimate of loss is based on the unpaid principal balance and then compared to any remaining unaccreted purchase discount. To the extent that the calculated loss is greater than the remaining unaccreted purchase discount, an allowance is recorded for such difference.

The Company has an internal loan review department that is independent of the lending function to challenge and corroborate the loan grade assigned by the lender and to provide additional analysis in determining the adequacy of the allowance for loan losses.

A rollforward of the activity within the allowance for loan losses by loan type and recorded investment in loans for the six months ended June 30, 2014 and 2013 is as follows (in thousands):

	June 30, 2014							Total
	Coml, Fin, and Agric	Real Estate			Consumer	Finance Leases		
		Constructi	Commercial	Residential		Coml	Other	
Allowance for loan losses:								
Beginning balance	\$3,906	\$1,046	\$1,389	\$1,141	\$1,273	\$21	\$3	\$8,779
Charge-offs	(1,135 )	-	(17 )	(176 )	(350 )	-	-	(1,678 )
Recoveries	42	-	42	39	101	-	-	224
Provision	1,970	(53 )	(23 )	(325 )	184	(4 )	1	1,750
Ending balance	\$4,783	\$993	\$1,391	\$679	\$1,208	\$17	\$4	\$9,075
Ending balance: individually evaluated for impairment	\$208	\$3	\$55	\$152	\$145	\$-	\$-	\$563
Ending balance: collectively evaluated for impairment	\$4,575	\$990	\$1,336	\$527	\$1,063	\$17	\$4	\$8,512
Loans:								
Ending balance	\$454,310	\$86,238	\$413,565	\$153,082	\$108,581	\$4,750	\$3,656	\$1,224,182
Ending balance: individually evaluated for impairment	\$1,793	\$152	\$3,234	\$1,214	\$340	\$-	\$-	\$6,733
Ending balance: collectively evaluated for impairment	\$452,517	\$86,086	\$409,631	\$151,763	\$108,241	\$4,750	\$3,656	\$1,216,644
Ending balance: loans acquired with deteriorated credit quality	\$-	\$-	\$700	\$105	\$-	\$-	\$-	\$805

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	June 30, 2013							Total
	Coml, Fin, and Agric	Real Estate Construction	Commercial	Residential	Consumer	Finance Leases Coml	Other	
Allowance for loan losses:								
Beginning balance	\$ 1,535	\$ 2,147	\$ 2,166	\$ 936	\$ 543	\$ 41	\$ 2	\$ 7,370
Charge-offs	(245 )	-	(18 )	(115 )	(413 )	-	-	(791 )
Recoveries	39	5	15	26	67	-	-	152
Provision	2,364	(1,061 )	80	(328 )	760	(17 )	2	1,800
Ending balance	\$ 3,693	\$ 1,091	\$ 2,243	\$ 519	\$ 957	\$ 24	\$ 4	\$ 8,531
Ending balance: individually evaluated for impairment	\$ 328	\$ 54	\$ 21	\$ 68	\$ 128	\$ -	\$ -	\$ 599
Ending balance: collectively evaluated for impairment	\$ 3,365	\$ 1,037	\$ 2,222	\$ 451	\$ 829	\$ 24	\$ 4	\$ 7,932
Loans:								
Ending balance	\$ 391,241	\$ 82,851	\$ 404,543	\$ 141,689	\$ 90,571	\$ 5,656	\$ 2,021	\$ 1,118,572
Ending balance: individually evaluated for impairment	\$ 1,648	\$ 262	\$ 2,556	\$ 1,024	\$ 315	\$ -	\$ -	\$ 5,805
Ending balance: collectively evaluated for impairment	\$ 389,593	\$ 82,589	\$ 401,277	\$ 140,375	\$ 90,256	\$ 5,656	\$ 2,021	\$ 1,111,767
Ending balance: loans acquired with deteriorated credit quality	\$ -	\$ -	\$ 710	\$ 290	\$ -	\$ -	\$ -	\$ 1,000

## Non-Accrual and Past Due Loans

Loans are considered past due if the required principal and interest payment have not been received as of the date such payments were due. Loans are placed on non-accrual status when, in management's opinion, the probability of collection of interest is deemed insufficient to warrant further accrual. For loans placed on non-accrual status, the accrual of interest is discontinued and subsequent payments received are applied to the principal balance. Interest income is recorded after principal has been satisfied and as payments are received. Non-accrual loans may be returned to accrual status if all principal and interest amounts contractually owed are reasonably assured of repayment within a reasonable period and there is a period of at least six months to one year of repayment performance by the borrower depending on the contractual payment terms.

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An age analysis of past due loans (including both accruing and non-accruing loans) is as follows (in thousands):

June 30, 2014							
	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Current	Total Loans	Recorded Investment > 90 days and Accruing
Commercial, financial, and agricultural	\$1,846	\$790	\$1,591	\$4,227	\$450,083	\$454,310	\$ 27
Commercial real estate - construction	58	-	73	131	62,626	62,757	-
Commercial real estate - other	1,658	378	2,902	4,938	408,627	413,565	159
Residential - construction	-	-	44	44	23,437	23,481	-
Residential - prime	763	33	905	1,701	151,381	153,082	-
Consumer - credit card	22	8	17	47	5,957	6,004	17
Consumer - other	514	321	333	1,168	101,409	102,577	-
Lease financing receivable	-	-	-	-	4,750	4,750	-
Other loans	118	5	-	123	3,533	3,656	-
	\$4,979	\$1,535	\$5,865	\$12,379	\$1,211,803	\$1,224,182	\$ 203

December 31, 2013							
	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Current	Total Loans	Recorded Investment > 90 days and Accruing
Commercial, financial, and agricultural	\$4,350	\$208	\$1,256	\$5,814	\$398,162	\$403,976	\$ 26
Commercial real estate - construction	36	-	63	99	64,794	64,893	-
Commercial real estate - other	1,230	1,447	2,395	5,072	392,063	397,135	141
Residential - construction	149	-	-	149	17,649	17,798	-
Residential - prime	2,984	870	307	4,161	142,680	146,841	-
Consumer - credit card	36	-	7	43	6,163	6,206	7
Consumer - other	767	102	269	1,138	90,115	91,253	4
Lease financing receivable	-	-	-	-	5,542	5,542	-
Other loans	125	-	-	125	3,785	3,910	-
	\$9,677	\$2,627	\$4,297	\$16,601	\$1,120,953	\$1,137,554	\$ 178

Non-accrual loans are as follows (in thousands):

	June 30, 2014	December 31, 2013
Commercial, financial, and agricultural	\$1,779	\$ 1,272
Commercial real estate - construction	108	100
Commercial real estate - other	3,296	2,290
Residential - construction	44	-
Residential - prime	1,340	1,153
Consumer - credit card	-	-
Consumer - other	346	284
Lease financing receivable	-	-

Other	-	-
	\$6,913	\$ 5,099



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The amount of interest that would have been recorded on non-accrual loans, had the loans not been classified as non-accrual, totaled approximately \$275,000 and \$281,000 for the six months ended June 30, 2014 and 2013, respectively. Interest actually received on non-accrual loans at June 30, 2014 and 2013 was \$91,000 and \$243,000, respectively.

## Impaired Loans

Loans are considered impaired when, based upon current information, it is probable the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. All loans classified as special mention, substandard, or doubtful, based on credit risk rating factors, and are reviewed for impairment. An allowance for each impaired loan is calculated based on the present value of expected future cash flows discounted at the loan's effective interest rate or at the loan's observable market price or the fair value of the collateral if the loan is collaterally dependent. All impaired loans are reviewed, at a minimum, on a quarterly basis. Existing valuations are reviewed to determine if additional discounts or new appraisals are required. After this review, when comparing the resulting collateral valuation to the outstanding loan balance, if the discounted collateral value exceeds the loan balance no specific allocation is reserved. Acquired impaired loans are generally not subject to individual evaluation for impairment and are not reported with impaired loans or troubled debt restructurings, even if they would otherwise qualify for such treatment.

Loans that are individually evaluated for impairment are as follows (in thousands):

	June 30, 2014				
	Recorded	Unpaid	Related	Average	Interest
	Investment	Principal	Allowance	Recorded	Income
	Balance	Balance		Investment	Recognized
With no related allowance recorded:					
Commercial, financial, and agricultural	\$508	\$901	\$ -	\$ 1,175	\$ -
Commercial real estate – construction	69	69	-	71	-
Commercial real estate – other	2,869	3,343	-	2,783	2
Residential – prime	469	469	-	499	1
Residential – construction	44	44	-	44	-
Consumer – other	64	64	-	62	-
Subtotal:	4,023	4,890	-	4,634	3
With an allowance recorded:					
Commercial, financial, and agricultural	1,285	1,285	208	858	1
Commercial real estate – construction	39	39	3	39	1
Commercial real estate – other	365	365	55	431	-
Residential – prime	745	764	152	583	10
Consumer – other	276	291	145	254	1
Subtotal:	2,710	2,744	563	2,165	13
Totals:					
Commercial	5,027	5,894	263	5,247	3
Residential	1,214	1,233	152	1,082	11
Construction	152	152	3	154	1
Consumer	340	355	145	316	1
Grand total:	\$6,733	\$7,634	\$ 563	\$ 6,799	\$ 16

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	December 31, 2013			Average	Interest
	Recorded	Unpaid Principal	Related	Recorded	Income
	Investment	Balance	Allowance	Investment	Recognized
With no related allowance recorded:					
Commercial, financial, and agricultural	\$671	\$ 1,107	\$ -	\$ 617	\$ 3
Commercial real estate – construction	61	61	-	416	-
Commercial real estate – other	1,850	2,324	-	2,190	8
Residential – prime	525	525	-	1,050	14
Consumer – other	66	66	-	90	1
Subtotal:	3,173	4,083	-	4,363	26
With an allowance recorded:					
Commercial, financial, and agricultural	570	570	168	821	3
Commercial real estate – construction	39	39	3	102	1
Commercial real estate – other	363	363	54	372	11
Residential – prime	375	395	60	214	4
Consumer – other	205	205	120	211	2
Subtotal:	1,552	1,572	405	1,720	21
Totals:					
Commercial	3,454	4,364	222	4,000	25
Residential	900	920	60	1,264	18
Construction	100	100	3	518	1
Consumer	271	271	120	301	3
Grand total:	\$4,725	\$ 5,655	\$ 405	\$ 6,083	\$ 47

## Credit Quality

The Company manages credit risk by observing written underwriting standards and lending policy established by the Board of Directors and management to govern all lending activities. The risk management program requires that each individual loan officer review his or her portfolio on a quarterly basis and assign recommended credit ratings on each loan. These efforts are supplemented by independent reviews performed by a loan review officer and other validations performed by the internal audit department. The results of the reviews are reported directly to the Audit Committee of the Board of Directors.

Loans can be classified into the following three risk rating grades: pass, special mention, and substandard/doubtful. Factors considered in determining a risk rating grade include debt service capacity, capital structure/liquidity, management, collateral quality, industry risk, company trends/operating performance, repayment source, revenue diversification/customer concentration, quality of financial information, and financing alternatives. Pass grade signifies the highest quality of loans to loans with reasonable credit risk, which may include borrowers with marginally adequate financial performance, but have the ability to repay the debt. Special mention loans have potential weaknesses that warrant extra attention from the loan officer and other management personnel, but still have the ability to repay the debt. Substandard classification includes loans with well-defined weaknesses with risk of potential loss. Loans classified as doubtful are considered to have little recovery value and are charged off.

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The following tables present the classes of loans by risk rating (in thousands):

June 30, 2014

Commercial Credit Exposure  
Credit Risk Profile by  
Creditworthiness Category

	Commercial, financial, and agricultural	Commercial real estate - construction	Commercial real estate - other	Total	% of Total
Pass	\$443,503	\$ 62,615	\$ 387,732	\$893,850	96.05 %
Special mention	6,303	34	8,269	14,606	1.57 %
Substandard	4,250	108	17,564	21,922	2.35 %
Doubtful	254	-	-	254	0.03 %
	\$454,310	\$ 62,757	\$ 413,565	\$930,632	100.00 %

Residential Credit Exposure  
Credit Risk Profile by  
Creditworthiness Category

	Residential - construction	Residential prime	Total	% of Total
Pass	\$ 23,437	\$ 148,562	\$171,999	97.42 %
Special mention	-	444	444	0.25 %
Substandard	44	4,076	4,120	2.33 %
	\$ 23,481	\$ 153,082	\$176,563	100.00 %

Consumer and Commercial Credit  
Exposure  
Credit Risk Profile Based on  
Payment Activity

	Consumer - credit card	Consumer other	Lease financing receivable	Other	Total	% of Total
Performing	\$ 5,995	\$102,178	\$ 4,750	\$3,656	\$116,579	99.65 %
Nonperforming	9	399	-	-	408	0.35 %
	\$ 6,004	\$102,577	\$ 4,750	\$3,656	\$116,987	100.00 %

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December 31, 2013

Commercial Credit Exposure  
Credit Risk Profile by  
Creditworthiness Category

	Commercial, financial, and agricultural	Commercial real estate - construction	Commercial real estate - other	Total	% of Total
Pass	\$ 397,513	\$ 63,577	\$ 371,618	\$ 832,708	96.15 %
Special mention	2,962	49	8,781	11,792	1.36 %
Substandard	3,272	1,267	16,736	21,275	2.46 %
Doubtful	229	-	-	229	0.03 %
	\$ 403,976	\$ 64,893	\$ 397,135	\$ 866,004	100.00 %

Residential Credit Exposure  
Credit Risk Profile by  
Creditworthiness Category

	Residential - construction	Residential prime	Total	% of Total
Pass	\$ 17,798	\$ 143,790	\$ 161,588	98.15 %
Special mention	-	548	548	0.33 %
Substandard	-	2,503	2,503	1.52 %
	\$ 17,798	\$ 146,841	\$ 164,639	100.00 %

Consumer and Commercial Credit  
Exposure  
Credit Risk Profile Based on  
Payment Activity

	Consumer - credit card	Consumer other	Lease financing receivable	Other	Total	% of Total
Performing	\$ 6,196	\$ 90,978	\$ 5,542	\$ 3,910	\$ 106,626	99.73 %
Nonperforming	10	275	-	-	285	0.27 %
	\$ 6,206	\$ 91,253	\$ 5,542	\$ 3,910	\$ 106,911	100.00 %

## Troubled Debt Restructurings

A troubled debt restructuring (“TDR”) is a restructuring of a debt made by the Company to a debtor for economic or legal reasons related to the debtor’s financial difficulties that it would not otherwise consider. The Company grants the concession in an attempt to protect as much of its investment as possible.

Information about the Company’s TDRs is as follows (in thousands):

June 30, 2014			
Current Due Greater	Past	Nonaccrual TDRs	Total TDRs

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		Than		
		30		
		Days		
Commercial, financial and agricultural	\$23	\$ -	\$ 234	\$ 257
Real estate - commercial	160	-	-	160
	\$183	\$ -	\$ 234	\$ 417

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	December 31, 2013			
	Past Due Greater Than 30 Days			
	Current	Nonaccrual	Total	
		TDRs	TDRs	
Commercial, financial and agricultural	\$-	\$ 23	\$ 233	\$ 256
Real estate - commercial	156	-	-	156
	\$156	\$ 23	\$ 233	\$ 412

During the three months ended June 30, 2014, there were no loans identified as a TDR, and there were no defaults on any loans that were modified as TDRs during the preceding twelve months. During the three months ended June 30, 2013, there were no loans identified as a TDR, and there were no defaults on any loans that were modified as TDRs during the preceding twelve months. During the six months ended June 30, 2014, there was one loan relationship with a pre-modification balance of \$1.2 million identified as a TDR through a modification of the original loan terms. The loan was paid off during the second quarter of 2014 and, therefore, is not reflected in the balance of TDRs at June 30, 2014. During the six months ended June 30, 2014, there were no defaults on any loans that were modified as TDRs during the preceding twelve months. During the six months ended June 30, 2013, one loan with a pre-modification balance of \$27,000 was identified as a TDR, and there were no defaults on any loans that were modified as TDRs during the preceding twelve months. For purposes of the determination of an allowance for loan losses on these TDRs, as an identified TDR, the Company considers a loss probable on the loan and, as a result is reviewed for specific impairment in accordance with the Company's allowance for loan loss methodology. If it is determined losses are probable on such TDRs, either because of delinquency or other credit quality indicator, the Company establishes specific reserves for these loans. As of June 30, 2014, there were no commitments to lend additional funds to debtors owing sums to the Company whose terms have been modified in TDRs.

## 4. Other Comprehensive Income (Loss)

The following is a summary of the tax effects allocated to each component of other comprehensive income (loss) (in thousands):

	Three Months Ended June 30,					
	2014			2013		
	Before Tax Amount	Tax Effect	Net of Tax Amount	Before Tax Amount	Tax Effect	Net of Tax Amount
Other comprehensive income (loss):						
Securities available-for-sale:						
Change in unrealized gain during period	\$1,574	\$(551)	\$1,023	\$(8,993)	\$3,148	\$(5,845)
Reclassification adjustment for gains included in net income	(128)	45	(83)	-	-	-
Total other comprehensive income (loss)	\$1,446	\$(506)	\$940	\$(8,993)	\$3,148	\$(5,845)

	Six Months Ended June 30,					
	2014			2013		
	Before Tax Amount	Tax Effect	Net of Tax Amount	Before Tax Amount	Tax Effect	Net of Tax Amount
Other comprehensive income (loss):						
Securities available-for-sale:						

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Change in unrealized gain during period	\$4,520	\$(1,582)	\$2,938	\$(10,108)	\$3,538	\$(6,570)
Reclassification adjustment for gains included in net income	(128 )	45	(83 )	(204 )	71	(133 )
Total other comprehensive income (loss)	\$4,392	\$(1,537)	\$2,855	\$(10,312)	\$3,609	\$(6,703)

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The reclassifications out of accumulated other comprehensive income into net income are presented below (in thousands):

	Three Months Ended June 30,	
	2014	2013
	Reclassifications	Reclassifications
	Out	Out
	of	of
Details about	Accumulated	Accumulated
Accumulated Other	Other	Other
Comprehensive Income	Comprehensive Statement	Comprehensive Statement
Components	Income Line Item	Income Line Item
Unrealized gains and losses on securities available-for-sale:		
	\$(128) Gain on securities, net	\$- Gain on securities, net
	45 Tax expense	- Tax expense
	\$(83 )Net of tax	\$- Net of tax
	Six Months Ended June 30,	
	2014	2013
	Reclassifications	Reclassifications
	Out	Out
	of	of
Details about	Accumulated	Accumulated
Accumulated Other	Other	Other
Comprehensive Income	Comprehensive Statement	Comprehensive Statement
Components	Income Line Item	Income Line Item
Unrealized gains and losses on securities available-for-sale:		
	Gain on securities,	Gain on securities,
	\$(128)net	\$(204)net
	45 Tax expense	71 Tax expense
	\$(83 )Net of tax	\$(133)Net of tax

## 5. Earnings Per Common Share

Following is a summary of the information used in the computation of earnings per common share (in thousands):

	Three Months		Six Months Ended	
	Ended June 30,	2013	June 30,	2013
	2014	2013	2014	2013
Net earnings available to common shareholders	\$3,946	\$3,271	\$10,624	\$6,407
Dividends on Series C preferred stock	90	100	190	200
Adjusted net earnings available to common shareholders	\$4,036	\$3,371	\$10,814	\$6,607
Weighted average number of common shares outstanding used in computation of basic earnings per common share	11,288	11,239	11,273	11,238
Effect of dilutive securities:				
Stock options	89	40	81	45
Convertible preferred stock	546	560	543	563
Weighted average number of common shares outstanding plus effect of dilutive securities – used in computation of diluted earnings per share	11,923	11,839	11,897	11,846



Options to acquire 7,355 and 18,331 shares of common stock were not included in computing diluted earnings per share for the quarters and six months ended June 30, 2014 and 2013, respectively, because the effects of these shares were anti-dilutive as a result of the exercise price of such options.

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## 6. Declaration of Dividends

A first quarter dividend of \$0.08 per share for holders of common stock of record on March 14, 2014 was declared on January 15, 2014, and was paid on April 1, 2014. On January 15, 2014, the Company also declared a 1.00% dividend for holders of its Series C preferred stock of record on April 1, 2014, which was paid on April 15, 2014. On May 21, 2014, the Company declared a second quarter dividend of \$0.09 per share for holders of common stock of record on June 13, 2014, and was paid on July 1, 2014. On May 21, 2014, the Company also declared a 1.00% dividend for holders of its Series C preferred stock of record on July 1, 2014, which was paid on July 15, 2014. On July 16, 2014, the Company declared a third quarter dividend of \$0.09 per share for holders of common stock of record on September 15, 2014 to be paid on October 1, 2014. On July 16, 2014, the Company also declared a 1.00% dividend for holders of its Series C preferred stock of record on October 1, 2014 to be paid on October 15, 2014.

## 7. Intangibles

A summary of core deposit intangible assets as of June 30, 2014 and December 31, 2013 is as follows (in thousands):

	June 30, 2014	December 31, 2013
Gross carrying amount	\$11,674	\$11,674
Less accumulated amortization	(4,286 )	(3,733 )
Net carrying amount	\$7,388	\$7,941

## 8. Fair Value Measurement

The Company groups assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1 – Valuation is based upon quoted prices for identical instruments traded in active markets.

Level 2 – Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3 – Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

Following is a description of valuation methodologies used for assets and liabilities which are either recorded or disclosed at fair value.

Cash and Cash Equivalents—The carrying value of cash and cash equivalents is a reasonable estimate of fair value.

Securities Available-for-Sale—Securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange and U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter market funds. Securities are classified as Level 2 within the valuation hierarchy when the Company obtains fair value measurements from an

independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information, and the bond's terms and conditions, among other things. Level 2 inputs are used to value U.S. Agency securities, mortgage-backed securities, asset-backed securities, municipal securities, single issue trust preferred securities, certain pooled trust preferred securities, collateralized debt obligations and certain equity securities that are not actively traded.

**Securities Held-to-Maturity**—The fair value of securities held-to-maturity is estimated using the same measurement techniques as securities available-for-sale.

**Other Investments**—The carrying value of other investments is a reasonable estimate of fair value.

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Loans—For disclosure purposes, the fair value of fixed rate loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings. For variable rate loans, the carrying amount is a reasonable estimate of fair value. The Company does not record loans at fair value on a recurring basis. No adjustment to fair value is taken related to illiquidity discounts. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management uses one of three methods to measure impairment, which, include collateral value, market value of similar debt, and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. Impaired loans where an allowance is established based on the fair value of collateral or where the loan balance has been charged down to fair value require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the impaired loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and adjusts the appraisal value by taking an additional discount for market conditions and there is no observable market price, the Company records the impaired loan as nonrecurring Level 3.

For non-performing loans, collateral valuations currently in file are reviewed for acceptability in terms of timeliness and applicability. Although each determination is made based on the facts and circumstances of each credit, generally valuations are no longer considered acceptable when there has been physical deterioration of the property from when it was last appraised, or there has been a significant change in the underlying assumptions of the appraisal. If the valuation is deemed to be unacceptable, a new appraisal is ordered. New appraisals are typically received within 4-6 weeks. While awaiting new appraisals, the valuation in the file is utilized, net of discounts. Discounts are derived from available relevant market data, selling costs, taxes, and insurance. Any perceived collateral deficiency utilizing the discounted value is specifically reserved (as required by ASC Topic 310) until the new appraisal is received or charged off. Thus, provisions or charge-offs are recognized in the period the credit is identified as non-performing.

The following sources are utilized to set appropriate discounts: in-market real estate agents, current local sales data, bank history for devaluation of similar property, Sheriff's valuations and buy/sell contracts. If a real estate agent is used to market and sell the property, values are discounted 10% for selling costs. Additional discounts may be applied if research from the above sources indicates a discount is appropriate given devaluation of similar property from the time of the initial valuation.

Other Real Estate—Other real estate ("ORE") properties are adjusted to fair value upon transfer of the loans to other real estate, and annually thereafter to insure other real estate assets are carried at the lower of carrying value or fair value. Exceptions to obtaining initial appraisals are properties where a buy/sell agreement exists for the loan value or greater, or where a Sheriff's valuation has been received for properties liquidated through a Sheriff sale. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the ORE as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and adjusts the appraisal value by taking an additional discount for market conditions and there is no observable market prices, the Company records the ORE asset as nonrecurring Level 3.

Cash Surrender Value of Life Insurance Policies—Fair value for life insurance cash surrender value is based on cash surrender values indicated by the insurance companies.

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

estimated fair value does not include customer related intangibles.

Securities Sold Under Agreements to Repurchase—The fair value approximates the carrying value of securities sold under agreements to repurchase due to their short-term nature.

Short-term Federal Home Loan Bank Advances—The fair value approximates the carrying value of short-term FHLB advances due to their short-term nature.

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Notes Payable—The fair value approximates the carrying value of short-term notes payable due to their short-term nature. The fair value of long-term notes payable is estimated using a discounted cash flow analysis that applies interest rates currently being offered on similar types of borrowings with similar terms.

Junior Subordinated Debentures—For junior subordinated debentures that bear interest on a floating basis, the carrying amount approximates fair value. For junior subordinated debentures that bear interest on a fixed rate basis, the fair value is estimated using a discounted cash flow analysis that applies interest rates currently being offered on similar types of borrowings.

Commitments to Extend Credit, Standby Letters of Credit and Credit Card Guarantees—Because commitments to extend credit and standby letters of credit are generally short-term and made using variable rates, the carrying value and estimated fair value associated with these instruments are immaterial.

## Assets Recorded at Fair Value

The table below presents information about certain assets and liabilities measured at fair value on a recurring basis (in thousands):

Description	Assets / Liabilities Measured at Fair Value at June 30, 2014	Fair Value Measurements at June 30, 2014		
		Level 1	Level 2	Level 3
Available-for-sale securities:				
U.S. Government sponsored enterprises	\$ 11,091	\$-	\$ 11,091	\$ -
Obligations of state and political subdivisions	52,573	-	52,573	-
GSE mortgage-backed securities	117,472	-	117,472	-
Collateralized mortgage obligations: residential	66,464	-	66,464	-
Collateralized mortgage obligations: commercial	27,018	-	27,018	-
Other asset-backed securities	25,085	-	25,085	-
Collateralized debt obligation	1,325	-	1,325	-
Description	Assets / Liabilities Measured at Fair Value at December 31, 2013	Fair Value Measurements at December 31, 2013		
		Level 1	Level 2	Level 3
Available-for-sale securities:				
U.S. Government sponsored enterprises	\$ 11,265	\$-	\$ 11,265	\$ -
Obligations of state and political subdivisions	59,978	-	59,978	-
GSE mortgage-backed securities	145,965	-	145,965	-
Collateralized mortgage obligations: residential	70,887	-	70,887	-
Collateralized mortgage obligations: commercial	27,346	-	27,346	-
Other asset-backed securities	25,489	-	25,489	-
Collateralized debt obligation	735	-	735	-

Certain assets and liabilities are measured at fair value on a nonrecurring basis and are included in the table below (in thousands). Impaired loans are Level 2 assets measured using appraisals from external parties of the collateral less any prior liens. Other real estate properties are also Level 2 assets measured using appraisals from external parties.

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Description	Assets /	Fair Value		
	Liabilities	Measurements		
	Measured at	at June 30, 2014		
	Fair Value			
	at June 30,	Level	Level	Level
	2014	1	2	3
Impaired loans	\$ 2,760	\$-	\$2,760	\$ -
Other real estate	6,314	-	6,314	-

Description	Assets /	Fair Value		
	Liabilities	Measurements		
	Measured	at December 31,		
	at Fair	2013		
	Value			
	at			
	December	Level	Level	Level
	31, 2013	1	2	3
Impaired loans	\$ 1,973	\$-	\$1,973	\$ -
Other real estate	6,687	-	6,687	-

## Limitations

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's holdings of a particular financial instrument. Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on many judgments. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on existing on and off-balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Significant assets and liabilities that are not considered financial instruments include deferred income taxes and premises and equipment. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in the estimates.

The carrying amounts and estimated fair values of the Company's financial instruments are as follows at June 30, 2014 and December 31, 2013 (in thousands):

	Carrying Value	Fair Value Measurements at June 30, 2014 Using:		
		Level 1	Level 2	Level 3
Financial assets:				
Cash and cash equivalents	\$63,935	\$63,935	\$-	\$-
Securities available-for-sale	301,028	-	301,028	-
Securities held-to-maturity	148,927	-	148,559	-
Other investments	12,090	12,090	-	-
Loans, net	1,215,107	-	-	1,232,806
Cash surrender value of life insurance policies	13,544	-	13,544	-
Financial liabilities:				



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Non-interest-bearing deposits	389,734	-	389,734	-
Interest-bearing deposits	1,135,688	-	915,178	221,008
Securities sold under agreements to repurchase	67,574	67,574	-	-
Short-term Federal Home Loan Bank advances	35,000	-	35,000	-
Notes payable	26,990	-	-	28,082
Junior subordinated debentures	29,384	-	22,167	7,224

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	Carrying Value	Fair Value Measurements at December 31, 2013 Using:		
		Level 1	Level 2	Level 3
Financial assets:				
Cash and cash equivalents	\$59,731	\$59,731	\$-	\$-
Securities available-for-sale	341,665	-	341,665	-
Securities held-to-maturity	155,523	-	151,168	-
Other investments	11,526	11,526	-	-
Loans, net	1,128,775	-	-	1,139,740
Cash surrender value of life insurance policies	13,450	-	13,450	-
Financial liabilities:				
Non-interest-bearing deposits	383,257	-	383,257	-
Interest-bearing deposits	1,135,546	-	895,346	241,359
Securities sold under agreements to repurchase	53,916	53,916	-	-
Short-term Federal Home Loan Bank advances	25,000	-	25,000	-
Notes payable	27,703	-	-	28,813
Junior subordinated debentures	29,384	-	22,167	7,776

## 9. Subsequent Events

In July 2014, the Company closed on the sale of commercial property held as ORE which resulted in a \$1.1 million gain on sale of ORE and reduced ORE owned from the \$6.3 million held at June 30, 2014 to \$4.9 million, or 22.2%. The \$1.1 million gain recorded will have an estimated after tax effect on diluted earnings per share of \$0.06 for the third quarter of 2014.

On August 22, 2014, MidSouth will redeem in full its \$7.2 million Statutory Trust 1 and Capital Securities (TRUPS) at a redemption price of 103.57% to par. The redemption has been approved by federal banking regulators and will result in an after tax charge to third quarter earnings of approximately \$167,000, or \$0.01 on diluted earnings per share. The resulting improvement in earnings from the reduction in interest expense on the TRUPS, net of the impact of the cost of funds used to pay off the TRUPS and the reduction in dividend income earned on the Capital Securities is estimated to be approximately \$113,000 per quarter after tax or \$0.01 per diluted share.

Third quarter 2014 earnings will also be impacted by approximately \$200,000 in FIS consulting costs associated with a process improvement initiative and \$330,000 in costs associated with the demolition and rebuilding of the current banking center in Sulphur, Louisiana. The after tax effect of the \$550,000 in nonoperating costs expected in the third quarter is estimated to be \$0.03 on diluted earnings per share.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operation.

MidSouth Bancorp, Inc. (the "Company") is a financial holding company headquartered in Lafayette, Louisiana that conducts substantially all of its business through its wholly owned subsidiary bank, MidSouth Bank, N.A. (the "Bank"). We offer complete banking services to commercial and retail customers in Louisiana and south and central Texas with 60 locations and are connected to a worldwide ATM network that provides customers with access to more than 55,000 surcharge-free ATMs. We are community oriented and focus primarily on offering commercial and consumer loan and deposit services to individuals, small businesses, and middle market businesses.

The following discussion and analysis identifies significant factors that have affected our financial position and operating results during the periods included in the financial statements accompanying this report. We encourage you to read this discussion in conjunction with our consolidated financial statements and the notes thereto presented herein and with the financial statements, the notes thereto, and related Management's Discussion and Analysis of Financial Condition and Results of Operation in the Company's Annual Report on Form 10-K for the year ended December 31, 2013.

Forward-Looking Statements

Certain statements included in this Report, other than statements of historical fact, are forward-looking statements (as such term is defined in Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and the regulations thereunder), which are intended to be covered by the safe harbors created thereby. Forward-looking statements include, but are not limited to certain statements under the captions "Business," "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations."

The words "anticipate," "believe," "estimate," "expect," "intend," "may," "plan," "will," "would," "could," "should," "guidance," "continue," "project," "forecast," "confident," and similar expressions are typically used to identify forward-looking statements. These statements are based on assumptions and assessments made by management in light of their experience and their perception of historical trends, current conditions, expected future developments and other factors they believe to be appropriate. Any forward-looking statements are not guarantees of our future performance and are subject to risks and uncertainties and may be affected by various factors that may cause actual results, developments and business decisions to differ materially from those in the forward-looking statements. Some of the factors that may cause actual results, developments and business decisions to differ materially from those contemplated by such forward-looking statements include the factors discussed under the caption "Risk Factors" in our 2013 Annual Report on form 10-K and under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this Report and the following:

- changes in interest rates and market prices that could affect the net interest margin, asset valuation, and expense levels;
- changes in local economic and business conditions, including, without limitation, changes related to the oil and gas industries, that could adversely affect customers and their ability to repay borrowings under agreed upon terms, adversely affect the value of the underlying collateral related to their borrowings, and reduce demand for loans;
- increased competition for deposits and loans which could affect compositions, rates and terms;
- changes in the levels of prepayments received on loans and investment securities that adversely affect the yield and value of the earning assets;
- a deviation in actual experience from the underlying assumptions used to determine and establish our allowance for loan losses ("ALL"), which could result in greater than expected loan losses;
- changes in the availability of funds resulting from reduced liquidity or increased costs;
- the timing, ability to complete and the impact of proposed and/or future acquisitions, the success or failure of integrating acquired operations, and the ability to capitalize on growth opportunities upon entering new markets;

- the timing, ability to complete and the impact of proposed and/or future efficiency initiatives;
- the ability to acquire, operate, and maintain effective and efficient operating systems;
- increased asset levels and changes in the composition of assets that would impact capital levels and regulatory capital ratios;
- loss of critical personnel and the challenge of hiring qualified personnel at reasonable compensation levels;

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- legislative and regulatory changes, including the changes in the regulatory capital framework under the Federal Reserve Board's Basel III regulatory capital reforms, the impact of regulations under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"), including the implementation of the Consumer Financial Protection Bureau, and other changes in banking, securities and tax laws and regulations and their application by our regulators, changes in the scope and cost of Federal Deposit Insurance Corporation ("FDIC") insurance and other coverage;
- regulations and restrictions resulting from our participation in government sponsored programs such as the U.S. Treasury's Small Business Lending Fund, including potential retroactive changes in such programs;
- changes in accounting principles, policies, and guidelines applicable to financial holding companies and banking;
- acts of war, terrorism, cyber intrusion, weather, or other catastrophic events beyond our control; and
- the ability to manage the risks involved in the foregoing.

We can give no assurance that any of the events anticipated by the forward-looking statements will occur or, if any of them does, what impact they will have on our results of operations and financial condition. We disclaim any intent or obligation to publicly update or revise any forward-looking statements, regardless of whether new information becomes available, future developments occur or otherwise.

## Critical Accounting Policies

Certain critical accounting policies affect the more significant judgments and estimates used in the preparation of the consolidated financial statements. Our significant accounting policies are described in the notes to the consolidated financial statements included in this report. The accounting principles we follow and the methods of applying these principles conform to accounting principles generally accepted in the United States of America ("GAAP") and general banking practices. Our most critical accounting policy relates to the determination of the allowance for loan losses, which reflects the estimated losses resulting from the inability of its borrowers to make loan payments. The determination of the adequacy of the allowance involves significant judgment and complexity and is based on many factors. If the financial condition of our borrowers were to deteriorate, resulting in an impairment of their ability to make payments, the estimates would be updated and additional provisions for loan losses may be required. See Asset Quality – Nonperforming Assets and Allowance for Loan Losses and Note 1 and Note 4 of the footnotes to the consolidated financial statements.

Another of our critical accounting policies relates to the valuation of goodwill, intangible assets and other purchase accounting adjustments. We account for acquisitions in accordance with ASC Topic No. 805, which requires the use of the purchase method of accounting. Under this method, we are required to record assets acquired and liabilities assumed at their fair value, including intangible assets. Determination of fair value involves estimates based on internal valuations of discounted cash flow analyses performed, third party valuations, or other valuation techniques that involve subjective assumptions. Additionally, the term of the useful lives and appropriate amortization periods of intangible assets is subjective. Resulting goodwill from an acquisition under the purchase method of accounting represents the excess of the purchase price over the fair value of net assets acquired. Goodwill is not amortized, but is evaluated for impairment annually or more frequently if deemed necessary. If the fair value of an asset exceeds the carrying amount of the asset, no charge to goodwill is made. If the carrying amount exceeds the fair value of the asset, goodwill will be adjusted through a charge to earnings. Given the instability of the economic environment, it is reasonably possible that the methodology of the assessment of potential loan losses and goodwill impairment could change in the near-term or could result in impairment going forward.

A third critical accounting policy relates to deferred tax assets and liabilities. We record deferred tax assets and deferred tax liabilities for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Future tax benefits, such as net operating loss carry forwards, are recognized to the extent that realization of such benefits is more likely than not. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which

the assets and liabilities are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income tax expense in the period that includes the enactment date. In the event the future tax consequences of differences between the financial reporting bases and the tax bases of our assets and liabilities results in deferred tax assets, an evaluation of the probability of being able to realize the future benefits indicated by such assets is required. A valuation allowance is provided when it is more likely than not that a portion or the full amount of the deferred tax asset will not be realized. In assessing the ability to realize the deferred tax assets, management considers the scheduled reversals of deferred tax liabilities, projected future taxable income, and tax planning strategies. A deferred tax liability is not recognized for portions of the allowance for loan losses for income tax purposes in excess of the financial statement balance. Such a deferred tax liability will only be recognized when it becomes apparent that those temporary differences will reverse in the foreseeable future. A tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% more likely of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded.

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Results of Operations

Earnings Analysis

We reported net earnings available to common shareholders of \$3.9 million for the second quarter of 2014, compared to net earnings available to common shareholders of \$3.3 million reported for the second quarter of 2013. Diluted earnings for the second quarter of 2014 were \$0.34 per common share, compared to \$0.29 per common share reported for the second quarter of 2013.

Revenues from consolidated operations decreased \$372,000 in quarterly comparison. Interest income decreased \$761,000 in quarterly comparison, as a \$1.2 million decrease in loan valuation income was partially offset by an \$813,000 increase in interest income earned on a higher volume of loans. Interest income on investment securities decreased \$338,000 in quarterly comparison, as cash flows from the portfolio were used to fund loan growth. Noninterest income increased \$257,000 in quarterly comparison, from \$5.0 million for the three months ended June 30, 2013 to \$5.3 million for the three months ended June 30, 2014. Noninterest expenses decreased \$1.1 million for the second quarter 2014 compared to second quarter 2013 and included approximately \$107,000 in non-operating efficiency consultant expenses. The provision for loan losses decreased \$50,000, and income tax expense increased \$369,000 in quarterly comparison.

Dividends paid on the Series B Preferred Stock issued to the Treasury as a result of our participation in the Small Business Lending Fund (“SBLF”) totaled \$80,000 for the second quarter of 2014 based on a dividend rate of 1.00%, compared to \$292,000 for the second quarter of 2013 at a rate of 3.65%. The Series C Preferred Stock issued in conjunction with the acquisition of PSB Financial Corporation (“PSB”) paid dividends totaling \$90,000 for the three months ended June 30, 2014 and \$100,000 for the three months ended June 30, 2013.

In year-over-year comparison, net earnings available to common shareholders increased \$4.2 million, from \$6.4 million at June 30, 2013 to \$10.6 million at June 30, 2014. The first quarter of 2014 included \$3.0 million of executive life insurance proceeds recorded in noninterest income and after-tax related noninterest expenses of \$160,000, following the unexpected passing of former Vice Chairman and Chief Operating Officer Jerry Reaux. The first six months of 2014 included efficiency consultant expenses of \$160,000. The first quarter of 2013 included \$214,000 of net merger and conversion related expenses associated with the PSB acquisition. Excluding these non-operating income and expenses, operating earnings increased \$1.4 million in year-to-date comparison and included a \$743,000 increase in noninterest income and a \$1.0 million decrease in non-interest expense. A reduction in the dividend rate paid on the Series B preferred stock issued in connection with SBLF resulted in a \$334,000 decrease in dividends on preferred stock in year-over-year comparison, and income tax expense increased \$637,000 in year-over-year comparison.

The earnings improvement noted in our quarterly and year-to-date comparisons resulted from a profitability initiative announced in the fourth quarter of 2013 designed primarily to improve core revenue through loan growth and reduce overhead expenses through cost reduction and containment measures and through process re-engineering. In executing the initiative, our team grew loans \$86.6 million or 7.6% over the six months ended June 30, 2014. The interest earned on the increased volume of loans offset the impact of a \$2.0 million decrease in accretion income on purchased loans. Focused efforts to reduce overhead expenses resulted in an \$873,000 decrease in noninterest expenses over the same period. In comparing fourth quarter of 2013 noninterest expenses to second quarter of 2014 noninterest expenses, the decrease is \$1.3 million. To further bolster our efficiency efforts, we signed an engagement letter in the first quarter of 2014 with FIS, a consulting firm specializing in helping banks improve their processes. FIS has begun a thorough review of many of the major functions and processes of the bank to identify recommendations for improvement and will assist us in implementing those process improvements we choose to make. This process review began in the first quarter of 2014 and will be substantially complete by the end of 2014. Implementation of recommendations resulting from the process will be on-going throughout 2014 and 2015.





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Our primary source of earnings is net interest income, which is the difference between interest earned on loans and investments and interest paid on deposits and other interest-bearing liabilities. Changes in the volume and mix of earning assets and interest-bearing liabilities combined with changes in market rates of interest greatly affect net interest income. Our net interest margin on a taxable equivalent basis, which is net interest income as a percentage of average earning assets, was 4.58% and 4.87% for the three months ended June 30, 2014 and 2013, respectively. Tables 1 and 3 and tables 2 and 4 below analyze the changes in net interest income in the three months ended June 30, 2014 and 2013 and the six months ended June 30, 2014 and 2013, respectively.

Fully taxable-equivalent (“FTE”) net interest income totaled \$19.5 million and \$20.1 million for the quarters ended June 30, 2014 and 2013, respectively. The FTE net interest income decreased \$620,000 in prior year quarterly comparison primarily due to a reduction in purchase accounting adjustments on acquired loans. The average volume of loans increased \$125.6 million in quarterly comparison, and the average yield on loans decreased 85 basis points, from 6.76% to 5.91%. The purchase accounting adjustments added 23 basis points to the average yield on loans for the second quarter of 2014 and 75 basis points to the average yield on loans for the second quarter of 2013. Net of the impact of the purchase accounting adjustments, average loan yields declined 33 basis points in prior year quarterly comparison, from 6.01% to 5.68%. Loan yields have declined primarily as the result of a sustained low interest rate environment.

Investment securities totaled \$450.0 million, or 23.7% of total assets at June 30, 2014, versus \$530.9 million, or 28.5% of total assets at June 30, 2013. The investment portfolio had an effective duration of 3.9 years and an unrealized gain of \$4.2 million at June 30, 2014. The average volume of investment securities decreased \$72.4 million in prior year quarterly comparison. The average tax equivalent yield on investment securities increased 11 basis points, from 2.52% to 2.63%. The \$72.4 million decrease in investment securities combined with a \$23.7 million increase in short-term FHLB advances over the past twelve months primarily funded the increase in loans during the same period.

The average yield on all earning assets decreased 33 basis points in prior year quarterly comparison, from 5.26% for the second quarter of 2013 to 4.93% for the second quarter of 2014. Net of the impact of purchase accounting adjustments, the average yield on total earning assets decreased 1 basis point, from 4.78% to 4.77% for the three month periods ended June 30, 2013 and 2014, respectively.

The impact to interest expense of a \$43.3 million increase in the average volume of interest bearing liabilities was offset by a 5 basis point decrease in the average rate paid on interest bearing liabilities, from 0.51% at June 30, 2013 to 0.46% at June 30, 2014. Net of purchase accounting adjustments on acquired certificates of deposit and FHLB borrowings, the average rate paid on interest bearing liabilities was 0.60% for the second quarter of 2013 and declined to 0.51% for the second quarter of 2014.

Included in notes payable is an average of \$27.2 million of borrowed funds, which consists of FHLB advances and a note payable with First National Bankers Bank. The FHLB advances are fixed rate advances with rates ranging from 1.99% to 5.06% and have a range of maturities from July 2014 to January 2019. The FHLB advances are collateralized by a blanket lien on first mortgages and other qualifying loans. The note payable with First National Bankers Bank requires annual payments of \$250,000 and bears an interest rate equal to New York Prime. Short-term FHLB advances totaled \$35.0 million at June 30, 2014. The rate on these short-term advances range from 0.17% to 0.18%, and they mature in August 2014 and September 2014. The short-term advances partially funded the loan growth we experienced in the first and second quarter of 2014.

The average rate paid on our junior subordinated debentures decreased 21 basis points in prior year quarterly comparison, from 4.52% for the second quarter of 2013 to 4.31% for the second quarter of 2014. The variable rate

debentures carry a floating rate tied to the 3-month LIBOR with added rate variances ranging from plus 170 basis points to plus 330 basis points, adjustable and payable quarterly. We also have \$7.2 million of junior subordinated debentures outstanding that carry a fixed interest rate of 10.20%. We have received regulatory approval for full redemption of the \$7.2 million fixed rate junior subordinated debentures effective August 22, 2014.

As a result of these changes in volume and yield on earning assets and interest bearing liabilities, the FTE net interest margin decreased 29 basis points, from 4.87% for the second quarter of 2013 to 4.58% for the second quarter of 2014. Net of purchase accounting adjustments on loans, deposits and FHLB borrowings, the FTE margin increased 6 basis points, from 4.33% for the second quarter of 2013 to 4.39% for the second quarter of 2014.

In year-to-date comparison, FTE net interest income decreased \$132,000 primarily due to a decrease in purchase accounting adjustments that resulted in a decrease in the average yield on loans, from 6.70% at June 30, 2013 to 6.04% at June 30, 2014. The average yield on earning assets decreased in year-to-date comparison, from 5.14% at June 30, 2013 to 4.98% at June 30, 2014. The purchase accounting adjustments added 77 basis points to the average yield on loans for the first six months of 2013 and 32 basis points for the first six months of 2014. Net of purchase accounting adjustments, the average yield on earning assets increased 9 basis points, from 4.66% at June 30, 2013 to 4.75% at June 30, 2014.

Interest expense decreased in year-over-year comparison primarily due to a decrease in the average rate paid on interest bearing liabilities. The average rate paid on interest-bearing liabilities decreased 7 basis points, from 0.54% at June 30, 2013 to 0.47% at June 30, 2014. Net of purchase accounting adjustments, the average rate paid on interest-bearing liabilities decreased 11 basis points, from 0.63% at June 30, 2013 to 0.52% at June 30, 2014. The FTE net interest margin decreased 12 basis points, from 4.74% for the six months ended June 30, 2013 to 4.62% for the six months ended June 30, 2014. Net of purchase accounting adjustments, the FTE net interest margin increased 18 basis points, from 4.18% to 4.36% for the six months ended June 30, 2013 and 2014, respectively.

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Table 1

## Consolidated Average Balances, Interest and Rates

(in thousands)

	Three Months Ended June 30,			2013				
	2014 Average Volume	Interest	Average Yield/Rate	Average Volume	Interest	Average Yield/Rate		
<b>Assets</b>								
Investment securities <sup>1</sup>								
Taxable	\$379,124	\$2,064	2.18	% \$434,730	\$2,251	2.07	%	
Tax exempt <sup>2</sup>	87,964	1,007	4.58	% 104,747	1,149	4.39	%	
Total investment securities	467,088	3,071	2.63	% 539,477	3,400	2.52	%	
Federal funds sold	2,260	1	0.18	% 1,593	1	0.25	%	
Time and interest bearing deposits in other banks								
Other investments	16,789	11	0.26	% 23,346	17	0.29	%	
Total loans <sup>3</sup>	11,679	89	3.05	% 10,056	78	3.10	%	
Total earning assets	1,205,930	17,769	5.91	% 1,080,295	18,197	6.76	%	
Allowance for loan losses	1,703,746	20,941	4.93	% 1,654,767	21,693	5.26	%	
Nonearning assets	(8,533 )			(7,425 )				
Total assets	192,513			203,141				
	\$1,887,726			\$1,850,483				
<b>Liabilities and shareholders' equity</b>								
Total interest bearing deposits	\$1,156,638	\$858	0.30	% \$1,149,285	\$990	0.35	%	
Securities sold under repurchase agreements	62,322	199	1.28	% 47,667	182	1.53	%	
Federal funds purchased	679	1	0.58	% 1,466	3	0.81	%	
Short-term FHLB advances	25,110	9	0.14	% -	-	-	%	
Notes payable	27,218	95	1.38	% 30,259	103	1.35	%	
Junior subordinated debentures	29,384	320	4.31	% 29,384	336	4.52	%	
Total interest bearing liabilities	1,301,351	1,482	0.46	% 1,258,061	1,614	0.51	%	
Demand deposits	376,272			389,035				
Other liabilities	8,846			11,103				
Shareholders' equity	201,257			192,284				
Total liabilities and shareholders' equity	\$1,887,726			\$1,850,483				
Net interest income and net interest spread		\$19,459	4.47	%	\$20,079	4.75	%	
Net yield on interest earning assets			4.58	%		4.87	%	

<sup>1</sup> Securities classified as available-for-sale are included in average balances. Interest income figures reflect interest earned on such securities.

<sup>2</sup> Interest income of \$346,000 for 2014 and \$337,000 for 2013 is added to interest earned on tax-exempt obligations to reflect tax equivalent yields using a tax rate of 35%.

<sup>3</sup> Interest income includes loan fees of \$1,397,000 for 2014 and \$1,517,000 for 2013. Nonaccrual loans are included in average balances and income on such loans is recognized on a cash basis.

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## Table 2

## Consolidated Average Balances, Interest and Rates

(in thousands)

	Six Months Ended June 30,							
	2014			2013				
	Average Volume	Interest	Average Yield/Rate		Average Volume	Interest	Average Yield/Rate	
<b>Assets</b>								
Investment securities <sup>1</sup>								
Taxable	\$388,332	\$4,200	2.16	%	\$430,397	\$4,310	2.00	%
Tax exempt <sup>2</sup>	89,867	2,066	4.60	%	105,859	2,349	4.44	%
Total investment securities	478,199	6,266	2.62	%	536,256	6,659	2.48	%
Federal funds sold	2,589	2	0.15	%	4,789	5	0.21	%
Time and interest bearing deposits in other banks								
	21,315	27	0.25	%	40,492	55	0.27	%
Other investments	11,604	159	2.74	%	9,688	150	3.10	%
Total loans <sup>3</sup>	1,176,632	35,252	6.04	%	1,062,141	35,314	6.70	%
Total earning assets	1,690,339	41,706	4.98	%	1,653,366	42,183	5.14	%
Allowance for loan losses	(8,610 )				(7,291 )			
Nonearning assets	191,820				205,642			
Total assets	\$1,873,549				\$1,851,717			
<b>Liabilities and shareholders' equity</b>								
Total interest bearing deposits	\$1,155,829	\$1,729	0.30	%	\$1,141,230	\$2,068	0.37	%
Securities sold under repurchase agreements	55,406	379	1.38	%	46,661	361	1.56	%
Federal funds purchased	425	1	0.47	%	737	3	0.81	%
Short-term FHLB advances	25,055	18	0.14	%	564	1	0.35	%
Notes payable	27,396	192	1.39	%	28,915	208	1.41	%
Other borrowings/payables	-	-	-		1,116	18	3.21	%
Junior subordinated debentures	29,384	667	4.51	%	29,384	672	4.55	%
Total interest bearing liabilities	1,293,495	2,986	0.47	%	1,248,607	3,331	0.54	%
Demand deposits	374,319				399,276			
Other liabilities	7,599				12,405			
Shareholders' equity	198,136				191,429			
Total liabilities and shareholders' equity	\$1,873,549				\$1,851,717			
Net interest income and net interest spread		\$38,720	4.51	%		\$38,852	4.60	%
Net yield on interest earning assets			4.62	%			4.74	%

<sup>1</sup> Securities classified as available-for-sale are included in average balances. Interest income figures reflect interest earned on such securities.

<sup>2</sup> Interest income of \$712,000 for 2014 and \$698,000 for 2013 is added to interest earned on tax-exempt obligations to reflect tax equivalent yields using a tax rate of 35%.

<sup>3</sup> Interest income includes loan fees of \$2,742,000 for 2014 and \$2,598,000 for 2013. Nonaccrual loans are included in average balances and income on such loans is recognized on a cash basis.

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## Table 3

## Changes in Taxable-Equivalent Net Interest Income

(in thousands)

	Three Months Ended June 30, 2014 compared to June 30, 2013		
	Total	Change	
	Increase	Attributable To	(Decrease)
	Volume	Rates	
Taxable-equivalent earned on:			
Investment securities			
Taxable	\$(187)	\$(299 )	\$112
Tax exempt	(142)	(190 )	48
Time and interest bearing deposits in other banks	(6 )	(4 )	(2 )
Other investments	11	12	(1 )
Loans, including fees	(428)	1,989	(2,417)
Total	(752)	1,508	(2,260)
Interest paid on:			
Interest bearing deposits	(132)	6	(138 )
Securities sold under repurchase agreements	17	50	(33 )
Federal funds purchased	(1 )	(2 )	1
Short-term FHLB advances	8	10	(2 )
Notes payable	(8 )	(8 )	-
Junior subordinated debentures	(16 )	-	(16 )
Total	(132)	56	(188 )
Taxable-equivalent net interest income	\$(620)	\$1,452	\$(2,072)

Note: In Table 3, changes due to volume and rate have generally been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts to the changes in each.

## Table 4

## Changes in Taxable-Equivalent Net Interest Income

(in thousands)

	Six Months Ended June 30, 2014 compared to June 30, 2013		
	Total	Change	
	Increase	Attributable To	(Decrease)
	Volume	Rates	
Taxable-equivalent earned on:			
Investment securities			
Taxable	\$(110)	\$(440 )	\$330
Tax exempt	(283)	(366 )	83
Federal funds sold	(3 )	(2 )	(1 )
Time and interest bearing deposits in other banks	(28 )	(24 )	(4 )
Other investments	9	27	(18 )
Loans, including fees	(62 )	3,611	(3,673)
Total	(477)	2,806	(3,283)

Interest paid on:			
Interest bearing deposits	(339)	26	(365 )
Securities sold under repurchase agreements	18	63	(45 )
Federal funds purchased	(2 )	(1 )	(1 )
Short-term FHLB advances	17	18	(1 )
Notes payable	(16 )	(8 )	(8 )
Other borrowings/payable	(18 )	(18 )	-
Junior subordinated debentures	(5 )	-	(5 )
Total	(345)	80	(425 )
Taxable-equivalent net interest income	\$(132)	\$2,726	\$(2,858)

Note: In Table 4, changes due to volume and rate have generally been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts to the changes in each.

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Non-interest income increased \$257,000 in quarterly comparison, from \$5.0 million for the three months ended June 30, 2013 to \$5.3 million for the three months ended June 30, 2014. Increases in non-interest income consisted primarily of \$177,000 in service charges on deposit accounts, \$128,000 in gain on sales of securities and \$215,000 in ATM/debit card income, which were partially offset by decreases of \$145,000 in fees earned from credit-related products and \$89,000 in mortgage banking fees. For the six-month period ended June 30, 2014, non-interest income totaled \$13.2 million compared to \$9.4 million, a net increase of \$3.8 million year-over-year. The first six months of 2014 included \$3.0 million of executive life insurance proceeds recorded in non-interest income. Excluding the \$3.0 million of life insurance income, increases in non-interest income consisted primarily of \$386,000 in service charges on deposit accounts and \$573,000 in ATM and debit card income due to higher transaction volume.

Non-interest Expense

Non-interest expenses decreased \$1.1 million for the second quarter 2014 compared to second quarter 2013 and included approximately \$107,000 of non-operating efficiency consultant expenses. Excluding these non-operating expenses in 2014, non-interest expenses decreased \$1.3 million for the second quarter 2014 compared to second quarter 2013 and consisted primarily of decreases of \$351,000 in expenses on ORE and other repossessed assets, \$155,000 in marketing expenses, \$209,000 in legal and professional fees, \$122,000 in corporate development expense, \$124,000 in courier expense and \$155,000 in the cost of printing and supplies. The decreased costs were partially offset by a \$119,000 increase in salaries and benefits costs and a \$110,000 increase in ATM/debit card expense. The increase in salaries and benefits costs was driven by an increase in group health insurance expense of \$248,000 due to a higher volume of claims. Net of the increase in group health insurance, salary and benefits costs declined \$129,000.

Non-interest expenses decreased \$873,000 in year-to-date comparison, from \$35.7 million for the six months ended June 30, 2013 to \$34.8 million for the six months ended June 30, 2014. The first six months of 2014 included approximately \$189,000 in non-operating expenses related primarily to expenses associated with incentive compensation plans for Mr. Reaux and \$160,000 of non-operating efficiency consultant expenses. The first six months of 2013 included \$214,000 of net merger and conversion related expenses associated with the PSB acquisition. Excluding the non-operating expenses in 2014 and 2013, decreases in noninterest expense included \$321,000 in marketing expenses, \$303,000 in legal and professional fees, \$250,000 in the cost of printing and supplies, \$159,000 in courier expense, \$112,000 in fraud losses and \$312,000 in expenses on ORE and repossessed assets. The decrease was partially offset by a \$401,000 increase in salaries and benefits costs (primarily increased group health insurance costs) and a \$366,000 increase in ATM/debit card expense.

Analysis of Balance Sheet

Total consolidated assets at June 30, 2014 and December 31, 2013 were \$1.9 billion. Deposits totaled \$1.5 billion at June 30, 2014 and December 31, 2013. Our stable core deposit base, which excludes time deposits, grew \$25.5 million and accounted for 85.5% of deposits at June 30, 2014 compared to 84.2% of deposits at year end 2013.

Securities available-for-sale totaled \$301.0 million at June 30, 2014, a decrease of \$40.7 million from \$341.7 million at December 31, 2013. The securities available-for-sale portfolio declined primarily due to \$22.2 million in sales of securities and \$21.6 million in calls, maturities and pay-downs that offset a \$4.4 million increase in the unrealized gain on the available-for-sale portfolio. Securities held-to-maturity decreased \$6.6 million, from \$155.5 million at December 31, 2013 to \$148.9 million at June 30, 2014, primarily due to \$7.2 million in calls, maturities and pay-downs for the held-to-maturity portfolio that offset \$1.1 million in purchases. The investment securities portfolio had an effective duration of 3.9 years and an unrealized gain of \$4.2 million at June 30, 2014.

Net loans totaled \$1.2 billion at June 30, 2014, compared to \$1.1 billion at December 31, 2013. Total loans grew \$86.6 million, or 7.6%, from year end 2013. An increase of \$50.3 million in the commercial loan portfolio accounted for the majority of the increase in total loans. The composition of the Company's loan portfolio is reflected in Table 5 below.

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## Table 5

## Composition of Loans

(in thousands)

	June 30, 2014	December 31, 2013
Commercial, financial, and agricultural	\$454,310	\$403,976
Real estate – construction	86,238	82,691
Real estate – commercial	413,565	397,135
Real estate – residential	153,082	146,841
Installment loans to individuals	108,581	97,459
Lease financing receivable	4,750	5,542
Other	3,656	3,910
	\$1,224,182	\$1,137,554
Less allowance for loan losses	(9,075 )	(8,779 )
Net loans	\$1,215,107	\$1,128,775

Within the \$413.6 million commercial real estate portfolio, \$379.2 million is secured by commercial property, \$15.1 million is secured by multi-family property, and \$19.2 million is secured by farmland. Of the \$379.2 million secured by commercial property, \$241.1 million, or 63.6%, is owner-occupied. Of the \$153.1 million residential real estate portfolio, 86.8% represented loans secured by first liens. We believe our risk within the real estate and construction portfolios is diversified throughout our markets and that current exposure within the two portfolios is sufficiently provided for within the ALL at June 30, 2014.

## Off-Balance Sheet Arrangements

In the normal course of operations, the Company engages in a variety of financial transactions that, in accordance with GAAP, are not recorded in the financial statements. These transactions involve, to varying degrees, elements of credit, interest rate, and liquidity risk. Such transactions are used primarily to manage customers' requests for funding and take the form of loan commitments, letters of credit and lines of credit. For the period ended June 30, 2014, we did not engage in any off-balance sheet transactions reasonably likely to have a material impact on our financial condition, results of operations, or cash flows.

## Liquidity and Capital

Bank Liquidity

Liquidity is the availability of funds to meet maturing contractual obligations and to fund operations. The Bank's primary liquidity needs involve its ability to accommodate customers' demands for deposit withdrawals as well as customers' requests for credit. Liquidity is deemed adequate when sufficient cash to meet these needs can be promptly raised at a reasonable cost to the Bank.

Liquidity is provided primarily by three sources: a stable base of funding sources, an adequate level of assets that can be readily converted into cash, and borrowing lines with correspondent banks. Although the Bank historically has not utilized brokered deposits, this is a fourth potential source of liquidity, albeit one that is more costly and volatile. Our core deposits are our most stable and important source of funding. Cash deposits at other banks, federal funds sold, and principal payments received on loans and mortgage-backed securities provide additional primary sources of liquidity. Approximately \$38.3 million in projected cash flows from securities repayments for the remainder of 2014 provides an additional source of liquidity.

The Bank also has significant borrowing capacity with the FRB-Atlanta and with the FHLB-Dallas. As of June 30, 2014, we had no borrowings with the FRB-Atlanta. Long-term FHLB-Dallas advances totaled \$26.5 million at June 30, 2014 and are fixed rate advances with rates ranging from 1.99% to 5.06% and have a range of maturities from July 2014 to January 2019. Short-term FHLB-Dallas advances totaled \$35.0 million at June 30, 2014. The rate on these advances at June 30, 2014 range from 0.17% to 0.18%, and they mature in August 2014 and September 2014. The Bank has the ability to post additional collateral of approximately \$165.4 million if necessary to meet liquidity needs. Additionally, \$241.7 million in loan collateral is pledged under a Borrower-in-Custody line with the FRB-Atlanta. Under existing agreements with the FHLB-Dallas, our borrowing capacity totaled \$286.7 million at June 30, 2014. Additional unsecured borrowing lines totaling \$33.5 million are available through correspondent banks. We utilize these contingency funding alternatives to meet deposit volatility, which is more likely in the current environment, given unusual competitive offerings within our markets.

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Company Liquidity

At the Company level, cash is needed primarily to meet interest payments on the junior subordinated debentures, dividends on our common stock and dividend payments on the Series B and Series C Preferred Stocks. The dividend rate on the Series B Preferred Stock issued to the U.S. Treasury for participation in the Small Business Lending Fund (“SBLF”) was 1.00% for the three months ended June 30, 2014 and December 31, 2013. The dividend rate was set at 1.00% for the fourth quarter of 2013 due to attaining the target 10% growth rate in qualified small business loans during the second quarter of 2013. Beginning February 2016, the dividend rate will increase to 9% per annum.

On December 28, 2012, the Company issued 756,511 shares of common stock and 99,971 shares of Series C Preferred Stock in connection with the PSB acquisition. During the first six months of 2014, 5,410 shares of Series C Preferred Stock were converted into 30,057 shares of the Company’s common stock. The Series C Preferred Stock is entitled to the payment of noncumulative dividends, if and when declared by the Company’s Board of Directors, at the rate of 4.00% per annum, payable quarterly in arrears on January 15, April 15, July 15 and October 15 of each year. The Series C Preferred Stock paid dividends totaling \$90,000 for the three months ended June 30, 2014.

Dividends from the Bank totaling \$9.0 million provided additional liquidity for the Company during the six months ended June 30, 2014. As of June 30, 2014, the Bank had the ability to pay dividends to the Company of approximately \$18.7 million without prior approval from its primary regulator. As a publicly traded company, the Company also has the ability, subject to market conditions, to issue additional shares of common stock and other securities to provide funds as needed for operations and future growth of the Company.

Capital

The Company and the Bank are required to maintain certain minimum capital levels. Risk-based capital requirements are intended to make regulatory capital more sensitive to the risk profile of an institution's assets. At June 30, 2014, the Company and the Bank were in compliance with statutory minimum capital requirements and were classified as “well capitalized.” Minimum capital requirements include a total risk-based capital ratio of 8.0%, with Tier 1 capital not less than 4.0%, and a Tier 1 leverage ratio (Tier 1 to total average adjusted assets) of 4.0% based upon the regulators latest composite rating of the institution. As of June 30, 2014, the Company’s Tier 1 leverage ratio was 9.81%, Tier 1 capital to risk-weighted assets was 13.34% and total capital to risk-weighted assets was 14.03%. The Bank had a Tier 1 leverage capital ratio of 8.99% at June 30, 2014. As of June 30, 2014, proforma ratios reflecting the payoff of the Statutory Trust 1 resulted in a 40 basis point decrease in the Tier 1 leverage ratio, from 9.81% to 9.41%. Proforma Tier 1 risk-based capital ratio and total risk based capital ratios decrease 52 basis points, to 12.82% and 13.51%, respectively.

In July 2013, the federal bank regulatory agencies adopted rules to implement the Basel III capital framework and for calculating risk-weighted assets, as modified by the U.S. federal bank regulators. These rules, known as “Basel III”, create a new regulatory capital standard based on Tier 1 common equity and increase the minimum leverage and risk-based capital ratios applicable to all banking organization.

The Basel III rules include new minimum risk-based and leverage ratios, and modify capital and asset definitions for purposes of calculating these ratios. Among other things, the Basel III rules will impact regulatory capital ratios of banking organizations in the following manner, when fully phased in: create a new requirement to maintain a ratio of common equity Tier 1 capital to total risk-weighted assets of not less than 4.5%; increase the minimum leverage capital ratio to 4.0% for all banking organizations (currently 3.0% for certain banking organizations); increase the minimum Tier 1 risk-based capital ratio from 4.0% to 6.0%; and maintain the minimum total risk-based capital ratio at 8.0%. In addition, the Basel III rules subject banking organizations to certain limitations on capital distributions and discretionary bonus payments to executive officers if the organization does not maintain a capital conservation buffer of 2.5% above the new regulatory minimum capital ratios. The effect of the capital conservation buffer will be to

increase the minimum common equity Tier 1 capital ratio to 7.0%, the minimum Tier 1 risk-based capital ratio to 8.5% and the minimum total risk-based capital ratio to 10.5%, for banking organizations seeking to avoid the limitations on capital distributions and discretionary bonus payments to executive officers.

The new minimum capital requirements are effective on January 1, 2015 for community banking organizations, such as MidSouth, whereas other requirements of the Basel III rules phase in over time. While we believe our current capital levels would be adequate under the new rules, the ultimate impact of these rules on the Company and the Bank is unknown at this time.

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Asset Quality

Credit Risk Management

We manage credit risk primarily by observing written, board approved policies that govern all credit underwriting and approval activities. Our Chief Credit Officer (“CCO”) is responsible for credit underwriting and loan operations for the Bank. The role of the CCO includes on-going review and development of lending policies, commercial credit analysis, centralized consumer underwriting, loan operations documentation and funding, and overall credit risk management procedures. The current risk management process requires that each individual loan officer review his or her portfolio on a quarterly basis and assign recommended credit ratings on each loan. These efforts are supplemented by independent reviews performed by the loan review officer and other validations performed by the internal audit department. The results of the reviews are reported directly to the Audit Committee of the Board of Directors. We believe the conservative nature of our underwriting practices has resulted in strong credit quality in our loan portfolio. Completed loan applications, credit bureau reports, financial statements, and a committee approval process remain a part of credit decisions. Documentation of the loan decision process is required on each credit application, whether approved or denied, to ensure thorough and consistent procedures. Additionally, we have historically recognized and disclosed significant problem loans quickly and taken prompt action to address material weaknesses in those credits.

Credit concentrations are monitored and reported quarterly whereby individual customer and aggregate industry leverage, profitability, risk rating distributions, and liquidity are evaluated for each major standard industry classification segment. At June 30, 2014, one industry segment concentration, the oil and gas industry, aggregated more than 10% of our loan portfolio. Our exposure in the oil and gas industry, including related service and manufacturing industries, totaled approximately \$261.8 million, or 21.4% of total loans. Additionally, we monitor our exposure to loans secured by commercial real estate. At June 30, 2014, loans secured by commercial real estate (including commercial construction, farmland and multifamily loans) totaled approximately \$476.3 million, with \$3.4 million, or 0.7% on nonaccrual status. Of the \$476.3 million, \$379.2 million represent CRE loans, 64% of which are secured by owner-occupied commercial properties. Additional information regarding credit quality by loan classification is provided in Note 3 – Credit Quality of Loans and Allowance for Loan Losses and Note 8 – Fair Value Measurement in the notes to the interim consolidated financial statements.

Nonperforming Assets and Allowance for Loan Loss

Table 6 summarizes the Company's nonperforming assets for the quarters ending June 30, 2014 and 2013, and December 31, 2013.

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## Table 6

## Nonperforming Assets and Loans Past Due 90 Days or More and Still Accruing

(in thousands)

	December			
	June 30,	31,	June 30,	
	2014	2013	2013	
Nonaccrual loans	\$6,913	\$ 5,099	\$6,772	
Loans past due 90 days and over and still accruing	203	178	117	
Total nonperforming loans	7,116	5,277	6,889	
Other real estate	6,314	6,687	6,900	
Other foreclosed assets	81	20	-	
Total nonperforming assets	\$13,511	\$ 11,984	\$13,789	
Troubled debt restructurings	\$417	\$ 412	\$535	
Nonperforming assets to total assets	0.71 %	0.65 %	0.74 %	
Nonperforming assets to total loans + ORE + other assets repossessed	1.10 %	1.05 %	1.23 %	
ALL to nonperforming loans	127.53 %	166.36 %	123.84 %	
ALL to total loans	0.74 %	0.77 %	0.76 %	
QTD charge-offs	\$990	\$ 740	\$267	
QTD recoveries	100	53	91	
QTD net charge-offs	\$890	\$ 687	\$176	
Annualized net charge-offs to total loans	0.29 %	0.24 %	0.06 %	

Nonperforming assets totaled \$13.5 million at June 30, 2014, an increase of \$1.5 million from the \$12.0 million reported at year-end 2013 and a decrease of \$278,000 from the \$13.8 million reported at June 30, 2013. The increase in the first six months of 2014 resulted from a \$1.8 million increase in nonaccrual loans. Allowance coverage for nonperforming loans was 127.53% at June 30, 2014 compared to 166.36% at December 31, 2013 and 123.84% at June 30, 2013. The ALL/total loans ratio remained relatively constant at 0.74% compared to 0.77% at year-end 2013 and 0.76% at June 30, 2013. Including valuation accounting adjustments on acquired loans, the total adjustments and ALL was 1.29% of loans at June 30, 2014. The ratio of annualized net charge-offs to total loans was 0.29% for the three months ended June 30, 2014, compared to 0.24% for the three months ended December 31, 2013, and 0.06% for the three months ended June 30, 2013.

Total nonperforming assets to total loans plus ORE and other assets repossessed remained relatively constant at 1.10% at June 30, 2014 from 1.05% at December 31, 2013, down from the 1.23% at June 30, 2013. Loans classified as troubled debt restructurings ("TDRs") totaled \$417,000 at June 30, 2014 compared to \$412,000 at December 31, 2013 and \$535,000 at June 30, 2013. Classified assets, including ORE, increased \$2.2 million, or 7.1%, to \$33.1 million compared to \$30.9 million at December 31, 2013. Additional information regarding impaired loans is included in Note 4 – Credit Quality of Loans and Allowance for Loan Losses and Note 9 – Fair Value Measurement in the notes to the interim consolidated financial statements.

Quarterly evaluations of the allowance for loan losses are performed in accordance with GAAP and regulatory guidelines. The ALL is comprised of specific reserves assigned to each impaired loan for which a probable loss has been identified as well as general reserves to maintain the allowance at an acceptable level for other loans in the portfolio where historical loss experience is available that indicates certain probable losses may exist. Factors considered in determining provisions include estimated losses in significant credits; known deterioration in concentrations of credit; historical loss experience; trends in nonperforming assets; volume, maturity and composition of the loan portfolio; off-balance sheet credit risk; lending policies and control systems; national and local economic

conditions; the experience, ability and depth of lending management; and the results of examinations of the loan portfolio by regulatory agencies and others. The processes by which we determine the appropriate level of the ALL, and the corresponding provision for probable credit losses, involves considerable judgment; therefore, no assurance can be given that future losses will not vary from current estimates. We believe the \$9.1 million in the ALL as of June 30, 2014 is sufficient to cover probable losses in the loan portfolio.

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Impact of Inflation and Changing Prices

The consolidated financial statements and notes thereto, presented herein, have been prepared in accordance with GAAP, which require the measurement of financial position and operating results in terms of historical dollars without considering the change in the relative purchasing power of money over time due to inflation. The impact of inflation is reflected in the increased cost of the Company's operations. Unlike most industrial companies, nearly all the assets and liabilities of the Company are financial. As a result, interest rates have a greater impact on the Company's performance than do the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

There have been no significant changes from the information regarding market risk disclosed under the heading "Funding Sources - Interest Rate Sensitivity" in the Company's Annual Report on Form 10-K for the year ended December 31, 2013.

Item 4. Controls and Procedures.

The Company's Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). As of the end of the period covered by this Quarterly Report on Form 10-Q, the Chief Executive Officer and Chief Financial Officer have concluded that such disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it submits under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission rules and forms.

During the second quarter of 2014, there was no change in the Company's internal controls over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.



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Part II – Other Information

Item 1. Legal Proceedings.

The Bank has been named as a defendant in various legal actions arising from normal business activities in which damages of various amounts are claimed. While the amount, if any, of ultimate liability with respect to such matters cannot be currently determined, management believes, after consulting with legal counsel, that any such liability will not have a material adverse effect on the Company’s consolidated financial position, results of operations, or cash flows. However, in the event of unexpected future developments in these matters, if the ultimate resolution of any such matter is unfavorable, the result may be material to the Company’s consolidated financial position, consolidated results of operations or consolidated cash flows.

Item 1A. Risk Factors.

There have been no material changes from the risk factors previously disclosed in our Form 10-K for the year ended December 31, 2013.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

The Company did not sell any unregistered equity securities or repurchase any equity securities during the quarter ended June 30, 2014.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

None.

Item 5. Other Information.

None.

Item 6. Exhibits.

<u>Exhibit Number</u>	<u>Document Description</u>
3.1	Amended and Restated Articles of Incorporation of MidSouth Bancorp, Inc. (restated solely for purposes of Item 601(b)(3) of Regulation S-K) (filed as Exhibit 3.1 to MidSouth's Annual Report on Form 10-K filed on March 18, 2013 and incorporated herein by reference).
3.2	Amended and Restated By-laws of MidSouth Bancorp, Inc. effective as of September 12, 2012 (restated solely for purposes of Item 601(b)(3) of Regulation S-K (filed as Exhibit 3.3 to MidSouth’s Quarterly Report on Form 10-Q for the quarter ended September 30, 2012 and incorporated herein by reference).
<u>31.1</u>	Certification pursuant to Exchange Act Rules 13(a) – 14(a)

31.2 Certification pursuant to Exchange Act Rules 13(a) – 14(a)

32.1 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.2 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

101 The following financial information from the Registrant’s Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2014, formatted in Extensible Business Reporting Language (“XBRL”):  
(i) Consolidated Statements of Operations, (ii) Consolidated Balance Sheets, (iii) Consolidated Statements of Cash Flows and (iv) Notes to Consolidated Financial Statements.\*

\* Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not to be “filed” or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, or Section 18 of the Securities Act of 1934, as amended, and otherwise are not subject to liability under these sections.  
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Signatures

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

MidSouth Bancorp, Inc.  
(Registrant)

Date: August 8, 2014

/s/ C. R. Cloutier

C. R. Cloutier, President and CEO  
(Principal Executive Officer)

/s/ James R. McLemore

James R. McLemore, CFO  
(Principal Financial Officer)

/s/ Teri S. Stelly

Teri S. Stelly, Controller  
(Principal Accounting Officer)