

MIDSOUTH BANCORP INC
Form 10-Q
November 10, 2008

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 September 30, 2008
OR

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

For the transition period

from _____ to _____

COMMISSION FILE NUMBER 1-11826
MIDSOUTH BANCORP, INC.
(Exact name of registrant as specified in its charter)

Louisiana 72-1020809
(State of other jurisdiction of incorporation or (I.R.S. Employer Identification No.)
organization)

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 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 is a large accelerated filer, an accelerated filer, a
non-accelerated filer, or a smaller reporting company.

Large accelerated filer Accelerated filer
 Non-accelerated filer Smaller reporting company

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

YES NO

As of October 31, 2008, there were 6,788,884 shares of the registrant's Common Stock, par value \$0.10 per share, outstanding.

Table of Contents

Part I – Financial Information

Item 1. Financial Statements.

Consolidated Statements of Condition
Consolidated Statements of Earnings (unaudited)
Consolidated Statement of Stockholders' Equity (unaudited)
Consolidated Statement of Stockholders' Equity (unaudited)
Consolidated Statements of Cash Flows (unaudited)
Notes to Interim Consolidated Financial Statements

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

Forward Looking Statements
Critical Accounting Policies
Results of Operations
Liquidity
Asset Quality
Impact of Inflation and Changing Prices

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Item 4. Controls and Procedures.

Part II – Other Information

Item 1. Legal Proceedings.

Item 1A. Risk Factors.

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

Item 3. Defaults Upon Senior Securities.

Item 4. Submission of Matters to a Vote of Security Holders.

Item 5. Other Information.

Item 6. Exhibits.

Signatures

Table of Contents

Part I – Financial Information

Item 1. Financial Statements.

MidSouth Bancorp, Inc. and Subsidiaries
Consolidated Statements of Condition

	September 30, 2008 (unaudited)	December 31, 2007 (audited)
Assets		
Cash and due from banks	\$ 28,838,897	\$ 25,419,029
Interest-bearing deposits in other banks	13,877	53,499
Federal funds sold	159	5,400,000
Time deposits in other banks	15,000,000	-
Securities available-for-sale, at fair value (cost of \$223,192,965 at September 30, 2008 and \$180,220,461 at December 31, 2007)	222,478,129	181,452,189
Securities held-to-maturity (estimated fair value of \$7,670,347 at September 30, 2008 and \$10,974,266 at December 31, 2007)	7,533,922	10,745,947
Other investments	4,305,135	4,020,537
Loans	579,454,333	569,505,238
Allowance for loan losses	(6,269,988)	(5,611,582)
Loans, net of allowance	573,184,345	563,893,656
Bank premises and equipment, net	40,348,665	39,229,018
Accrued interest receivable	5,672,808	5,748,784
Goodwill and intangibles	9,636,812	9,759,295
Cash surrender value of life insurance	4,339,616	4,219,117
Other assets	5,149,740	4,114,983
Total assets	\$ 916,502,105	\$ 854,056,054
Liabilities and Stockholders' Equity		
Liabilities:		
Deposits:		
Non-interest bearing	\$ 190,769,539	\$ 182,588,179
Interest bearing	580,341,492	550,928,818
Total deposits	771,111,031	733,516,997
Borrowings	54,041,628	30,716,572
Accrued interest payable	1,009,595	1,314,110
Junior subordinated debentures	15,465,000	15,465,000
Other liabilities	4,371,280	4,574,495
Total liabilities	845,998,534	785,587,174
Stockholders' Equity:		
Preferred stock, no par value; 5,000,000 shares authorized, none issued or outstanding	-	-
	678,888	672,299

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Common stock, \$0.10 par value- 10,000,000 shares authorized; 6,788,884 and 6,722,993 issued and 6,618,558 and 6,576,165 outstanding at September 30, 2008 and December 31, 2007, respectively

Capital surplus	52,075,839	51,326,349
Unearned ESOP shares	(45,401)	(132,708)
Accumulated other comprehensive income	(471,792)	812,941
Treasury stock- 170,326 shares at September 30, 2008 and 146,828 shares at December 31, 2007, at cost	(3,538,267)	(3,040,489)
Retained earnings	21,804,304	18,830,488
Total stockholders' equity	70,503,571	68,468,880
Total liabilities and stockholders' equity	\$ 916,502,105	\$ 854,056,054

See notes to unaudited consolidated financial statements.

Table of ContentsMidSouth Bancorp, Inc. and Subsidiaries
Consolidated Statements of Earnings (unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Interest income:				
Loans, including fees	\$ 11,101,597	\$ 12,460,906	\$ 34,309,815	\$ 35,439,056
Securities and other investments				
Taxable	1,346,749	1,046,379	3,536,537	3,082,751
Nontaxable	1,095,755	1,036,780	3,165,496	3,097,464
Federal funds sold	90,690	106,440	761,839	775,835
Total interest income	13,634,791	14,650,505	41,773,687	42,395,106
Interest expense:				
Deposits	3,016,349	4,430,762	11,024,387	13,713,330
Borrowings	265,700	452,492	661,363	645,195
Junior subordinated debentures	296,628	350,281	918,746	1,044,174
Total interest expense	3,578,677	5,233,535	12,604,496	15,402,699
Net interest income	10,056,114	9,416,970	29,169,191	26,992,407
Provision for loan losses	500,000	300,000	2,555,000	650,000
Net interest income after provision for loan losses	9,556,114	9,116,970	26,614,191	26,342,407
Non-interest income:				
Service charges on deposits	2,760,878	2,449,769	7,693,315	7,245,344
ATM and debit card income	727,057	773,914	1,962,262	1,510,802
Other charges and fees	493,381	350,213	1,717,568	1,770,882
Total non-interest income	3,981,316	3,573,896	11,373,145	10,527,028
Non-interest expenses:				
Salaries and employee benefits	5,394,706	5,215,368	15,771,956	14,716,502
Occupancy expense	2,282,969	1,760,542	6,280,926	4,947,729
Other	3,557,888	2,765,900	10,569,552	8,402,045
Total non-interest expenses	11,235,563	9,741,810	32,622,434	28,066,276
Income before income taxes	2,301,867	2,949,056	5,364,902	8,803,159
Provision for income taxes	445,356	508,445	891,434	1,921,406
Net earnings	\$ 1,856,511	\$ 2,440,611	\$ 4,473,468	\$ 6,881,753
Earnings per share:				
Basic	\$ 0.28	\$ 0.37	\$ 0.68	\$ 1.05
Diluted	\$ 0.28	\$ 0.37	\$ 0.67	\$ 1.04

See notes to unaudited consolidated financial statements.

Table of Contents

MidSouth Bancorp, Inc. and Subsidiaries
Consolidated Statement of Stockholders' Equity (unaudited)
For the Nine Months Ended September 30, 2008

	Common Stock Shares	Common Stock Amount	Capital Surplus	Unearned ESOP Shares	Accumulated Other Comprehensive Income	Treasury Stock	Retained Earnings	Total
Balance- January 1, 2008	6,722,993	\$ 672,299	\$ 51,326,349	\$ (132,708)	\$ 812,941	\$ (3,040,489)	\$ 18,830,488	\$ 68,468,880
Cumulative-effect adjustment for the adoption of EITF 06-4	-	-	-	-	-	-	(114,954)	(114,954)
Net earnings	-	-	-	-	-	-	4,473,468	4,473,468
Comprehensive income:								
Net change in unrealized losses on securities available-for-sale, net of taxes	-	-	-	-	(1,284,733)	-	-	(1,284,733)
Comprehensive income								3,188,735
Cash dividends on common stock, \$0.21 per share	-	-	-	-	-	-	(1,384,698)	(1,384,698)
Exercise of stock options	65,891	6,589	469,383	-	-	-	-	475,973
Tax benefit resulting from exercise of stock options	-	-	204,032	-	-	-	-	204,032
Purchase of treasury stock	-	-	-	-	-	(497,778)	-	(497,778)
ESOP compensation expense	-	-	24,500	87,307	-	-	-	111,807
Stock option expense	-	-	51,575	-	-	-	-	51,575
Balance- September 30, 2008	6,788,884	\$ 678,888	\$ 52,075,839	\$ (45,401)	\$ (471,792)	\$ (3,538,267)	\$ 21,804,304	\$ 70,503,570

See notes to unaudited consolidated financial statements.

Table of Contents

MidSouth Bancorp, Inc. and Subsidiaries
 Consolidated Statement of Stockholders' Equity (unaudited)
 For the Nine Months Ended September 30, 2007

	Common Stock Shares	Common Stock Amount	Capital Surplus	Unearned Shares	Accumulated Other Comprehensive Income	Treasury Stock	Retained Earnings	Total
Balance- January 1, 2007	6,355,946	\$ 635,595	\$ 42,907,597	\$ (251,259)	\$ (858,133)	\$ (2,518,411)	\$ 19,828,087	\$ 59,743,476
Net earnings	-	-	-	-	-	-	6,881,753	6,881,753
Comprehensive income:								
Net change in unrealized losses on securities available-for-sale, net of taxes	-	-	-	-	576,289	-	-	576,289
Comprehensive income								7,458,042
Cash dividends on common stock, \$0.18 per share	-	-	-	-	-	-	(1,189,986)	(1,189,986)
Stock dividend of 5% per common share	320,168	32,017	7,821,698	-	-	-	(7,853,715)	-
Exercise of stock options	47,409	4,741	266,001	-	-	-	-	270,742
Tax benefit resulting from exercise of stock options	-	-	137,716	-	-	-	-	137,716
Purchase of treasury stock	-	-	-	-	-	(381,251)	-	(381,251)
ESOP compensation expense	-	-	86,250	88,202	-	-	-	174,452
Stock option expense	-	-	73,647	-	-	-	-	73,647
Balance- September 30, 2007	6,723,523	\$ 672,353	\$ 51,292,909	\$ (163,057)	\$ (281,844)	\$ (2,899,662)	\$ 17,666,139	\$ 66,286,838

See notes to unaudited consolidated financial statements.

Table of ContentsMidSouth Bancorp, Inc. and Subsidiaries
Consolidated Statements of Cash Flows (unaudited)For the Nine Months Ended September 30,
2008 2007

	2008	2007
Cash flows from operating activities:		
Net earnings	\$ 4,473,468	\$ 6,881,753
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	2,461,255	2,070,223
Provision for loan losses	2,555,000	650,000
Deferred income tax benefit	472,707	497,784
Amortization of premiums on securities, net	270,955	449,973
Net loss on sale of premises and equipment	189,571	27,510
Net loss on sale of other real estate owned	-	27,533
Impairment on premises and equipment	-	(20,706)
Stock option compensation expense	51,575	73,647
Change in accrued interest receivable	75,976	(323,389)
Change in accrued interest payable	(304,515)	(106,271)
Other, net	(495,976)	932,460
Net cash provided by operating activities	9,750,016	11,160,517
Cash flows from investing activities:		
Net increase in interest earning deposits in other banks	(15,000,000)	-
Proceeds from maturities and calls of securities available-for-sale	43,961,177	21,966,866
Proceeds from maturities and calls of securities held-to-maturity	3,218,725	4,395,500
Proceeds from other investments	1,468,900	-
Purchases of securities available-for-sale	(87,208,994)	(22,600,250)
Purchases of other investments	(1,755,840)	(2,655,225)
Loan originations, net of repayments	(12,257,899)	(54,494,614)
Purchase of premises and equipment	(3,657,631)	(7,818,016)
Proceeds from sale of premises and equipment	9,641	57,085
Proceeds from sales of other real estate owned	-	448,522
Net cash used in investing activities	(71,221,921)	(60,700,132)
Cash flows from financing activities:		
Change in deposits	37,594,034	(1,825,575)
Change in repurchase agreements	10,343,056	14,541,074
Change in federal funds purchased	500,000	5,000,000
Proceeds from FHLB advances	19,100,000	260,508,500
Repayments of FHLB advances	(23,500,000)	(253,828,500)
Proceeds from Federal Reserve Bank discount window	50,672,000	-
Repayments of Federal Reserve Bank discount window	(33,790,000)	-
Purchase of treasury stock	(497,778)	(381,251)

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Payment of dividends on common stock	(1,649,006)	(1,313,787)
Proceeds from exercise of stock options	475,972	270,742
Excess tax benefit from stock option exercises	204,032	137,716
Net cash provided by financing activities	59,452,310	23,108,919
Net decrease in cash and cash equivalents	(2,019,595)	(26,430,696)
Cash and cash equivalents, beginning of period	30,872,528	57,404,341
Cash and cash equivalents, end of period	\$ 28,852,933	\$ 30,973,645

See notes to unaudited consolidated financial statements.

-7-

Table of Contents

MidSouth Bancorp, Inc. and Subsidiaries
Notes to Interim Consolidated Financial Statements
September 30, 2008
(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, the financial position of the Company and its subsidiaries as of September 30, 2008 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 2007 Annual Report and Form 10-K.

The results of operations for the nine month period ended September 30, 2008 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 accounting principles generally accepted in the United States of America 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 accounting principles generally accepted in the United States of America 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 Form 10-K for the year ended December 31, 2007.

Recent Accounting Pronouncements—In December 2007, FASB issued Statement No. 141R, Business Combinations (“SFAS No. 141R”). Under SFAS No. 141, organizations utilized the announcement date as the measurement date for the purchase price of the acquired entity. SFAS No. 141R requires measurement at the date the acquirer obtains control of the acquiree, generally referred to as the acquisition date. SFAS No. 141R will have a significant impact on the accounting for transaction and restructuring costs, as well as the initial recognition of contingent assets and liabilities assumed during a business combination. Under SFAS No. 141R, adjustments to the acquired entity's deferred tax assets and uncertain tax position balances occurring outside the measurement period are recorded as a component of the income tax expense, rather than goodwill. SFAS No. 141R is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. As the provisions of SFAS No. 141R are applied prospectively, the impact to the Company cannot be determined until a transaction occurs.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements (“SFAS No. 160”), which will require noncontrolling interests (previously referred to as minority interests) to be treated as a separate component of equity, not as a liability or other item outside of permanent equity. SFAS No. 160 applies to the accounting for noncontrolling interests and transactions with noncontrolling interest holders in consolidated financial statements. SFAS No. 160 is effective for periods beginning on or after December 15, 2008. Earlier

application is prohibited. SFAS No. 160 will be applied prospectively to all noncontrolling interests, including any that arose before the effective date except that comparative period information must be recast to classify noncontrolling interests in equity, attribute net earnings and other comprehensive income to noncontrolling interests, and provide other disclosures required by SFAS No. 160. The Company does not expect the adoption of SFAS No. 160 to have any impact on its financial position, results of operation, and cash flows.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133 (“SFAS No. 161”). SFAS No. 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of derivative instruments and related gains and losses, and disclosures about credit-risk-related contingent features in derivative agreements. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The statement provides only for enhanced disclosures. The Company does not participate in derivative instruments or hedging activities. Therefore, adoption will have no impact on our financial position, results of operations, and cash flows.

Reclassifications—Certain reclassifications have been made to the prior years’ financial statements in order to conform to the classifications adopted for reporting in 2008. The reclassifications had no impact on stockholders’ equity or net earnings.

Table of Contents

2. Allowance for Loan Losses

A summary of the activity in the allowance for loan losses is as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Balance, beginning of period	\$ 6,286	\$ 5,182	\$ 5,612	\$ 4,977
Provision for loan losses	500	300	2,555	650
Recoveries	39	36	125	78
Loans charged-off	(555)	(221)	(1,873)	(408)
Reclassifications	-	-	(149)	-
Balance, end of period	\$ 6,270	\$ 5,297	\$ 6,270	\$ 5,297

In the second quarter of 2008, approximately \$149,000 of the allowance for loan loss was identified as a reserve for unfunded loan commitments. The reserve was classified as a liability in accordance with SFAS No. 5, Accounting for Contingencies, in the same period.

3. Earnings Per Common Share

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Net earnings	\$ 1,857	\$ 2,441	\$ 4,473	\$ 6,881
Weighted average number of common shares outstanding used in computation of basic earnings per common share	6,614	6,573	6,604	6,568
Effect of dilutive securities:				
Stock options	22	65	23	71
Weighted average number of common shares outstanding plus effect of dilutive securities – used in computation of diluted earnings per share	6,636	6,638	6,627	6,639

Options on 46,365 shares of common stock were not included in computing diluted EPS for the three month and nine months ended September 30, 2008 because the effect of these shares was anti-dilutive.

4. Declaration of Dividends

On January 28, 2008, the Company declared a \$0.07 per share quarterly dividend for holders of record on March 12, 2008. The second quarter \$0.07 per share dividend was declared on April 17, 2008 for shareholders of record on June 16, 2008. The third quarter \$0.07 per share dividend was declared on July 16, 2008 for shareholders of record on September 17, 2008.

5. Deferred Compensation and Postretirement Benefits

In September 2006, the FASB's Emerging Issues Task Force ("EITF") reached a consensus on the issue No. 06-4 Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements ("EITF 06-4"). The issue was ratified by FASB on March 28, 2007. Entities affected by this

issue purchase life insurance on “key” employees, which extend into the individual’s retirement period. The issue requires affected entities to recognize a liability for future benefits based on the substantive agreement with the employee. EITF 06-4 is effective for all financial statements issued for fiscal years beginning after December 15, 2007. This issue was applied through a cumulative-effect adjustment to retained earnings as of January 1, 2008 in the amount of \$114,954.

Table of Contents

6. Fair Value Measurement

Effective January 1, 2008, the Company adopted Statements of Financial Accounting Standards (“SFAS”) No. 157, Fair Value Measurements (“SFAS No. 157”) and SFAS No. 159 The Fair Value Option for Financial Assets and Liabilities (“SFAS No. 159”). SFAS No. 157, which was issued in September 2006, establishes a framework for using fair value. It defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS No. 159, which was issued in February 2007, generally permits the measurement of selected eligible financial instruments at fair value at specified election dates. Upon adoption of SFAS No. 159, the Company did not elect to apply the fair value measurement option for any of its financial instruments.

In accordance with SFAS No. 157, we group our financial assets and financial liabilities measured 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 — Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange. Level 1 also includes securities that are traded by dealers or brokers in active markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 — Valuations for assets and liabilities traded in less active dealer or broker markets. For example, municipal securities valuations are based on markets that are currently offering similar financial products. Valuations are obtained from third party pricing services for identical or comparable assets or liabilities.

Level 3 — Valuations for assets and liabilities that are derived from other valuation methodologies, including option pricing models, discounted cash flow models and similar techniques, and not based on market exchange, dealer, or broker traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets or liabilities.

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

Description	Total Carrying Amount in Statement of Condition at September 30, 2008	Assets / Liabilities Measured at Fair Value at September 30, 2008	Fair Value Measurements at September 30, 2008 using:		
			Level 1	Level 2	Level 3
Available-for-sale securities	\$ 222,478	\$ 222,478	\$ 135	\$ 222,343	\$ -

7. Borrowings

Borrowings consisted of the following (in thousands):

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	September 30, 2008	December 31, 2007
Securities sold under agreements to repurchase	\$ 36,660	\$ 26,317
Federal funds purchased	500	-
Federal Reserve Bank Discount Window	16,882	-
FHLB Advances	-	4,400
	\$ 54,042	\$ 30,717

-10-

Table of Contents

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

MidSouth Bancorp, Inc. ("the Company") is a bank 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"). MidSouth Bank, N.A. offers complete banking services to commercial and retail customers in south Louisiana and southeast Texas with 35 locations and more than 170 ATMs. The Company is community oriented and focuses primarily on offering commercial and consumer loan and deposit services to individuals, small businesses, and middle market businesses.

Forward Looking Statements

The Private Securities Litigation Act of 1995 provides a safe harbor for disclosure of information about a company's anticipated future financial performance. This act protects a company from unwarranted litigation if actual results differ from management expectations. This management's discussion and analysis reflects management's current views and estimates of future economic circumstances, industry conditions, the Company's performance, and financial results based on reasonable assumptions. A number of factors and uncertainties could cause actual results to differ materially from the anticipated results and expectations expressed in the discussion. These factors and uncertainties include, but are not limited to:

- 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 that could adversely affect customers and their ability to repay borrowings under agreed upon terms and/or adversely affect the value of the underlying collateral related to the borrowings;
 - increased competition for deposits and loans that could affect 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 the Allowance for Loan Losses ("ALL");
 - changes in the availability of funds resulting from reduced liquidity or increased costs;
- the timing and impact of future acquisitions, the success or failure of integrating operations, and the ability to capitalize on growth opportunities upon entering new markets;
 - 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;
- changes in government regulations and accounting principles, policies, and guidelines applicable to financial holding companies and banking; and
 - acts of terrorism, weather, or other events beyond the Company's control.

Critical Accounting Policies

Certain critical accounting policies affect the more significant judgments and estimates used in the preparation of the consolidated financial statements. The Company's significant accounting policies are described in the notes to the consolidated financial statements included in Form 10-K for the year ended December 31, 2007. The accounting principles followed by the Company and the methods of applying these principles conform with accounting principles

generally accepted in the United States of America (“GAAP”) and general banking practices. The Company’s most critical accounting policy relates to its allowance for loan losses, which reflects the estimated losses resulting from the inability of its borrowers to make loan payments. If the financial condition of its borrowers were to deteriorate, resulting in an impairment of their ability to make payments, the Company’s estimates would be updated and additional provisions for loan losses may be required (see Asset Quality).

Another of the Company’s critical accounting policies relates to its goodwill and intangible assets. Goodwill represents the excess of the purchase price over the fair value of net assets acquired. In accordance with SFAS No. 142, Goodwill and Other Intangible Assets, goodwill is not amortized but evaluated for impairment annually. 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.

A third critical accounting policy relates to stock-based compensation. SFAS No. 123R requires that stock based compensation transactions be recognized as compensation expense in the statement of earnings based on the fair market value on the date of the grant. SFAS No. 123R further requires that management make assumptions including stock price volatility and employee turnover that are utilized to measure compensation expense. The fair value of the stock options granted is estimated at the date of grant using the Black-Scholes option-pricing model. This model requires the input of highly subjective assumptions. The Company recognized stock option expense of \$51,575, for the grant-date fair value of stock options vested in the nine months ended September 30, 2008. The Company has not granted any new stock options during 2008.

Results of Operations

The Company reported earnings of \$1,857,000 for the third quarter ended September 30, 2008, a decrease of 23.9% over earnings of \$2,441,000 reported for the third quarter of 2007. Diluted earnings per share for the third quarter of 2008 were \$0.28 per share, a decrease of 24.3% over the \$0.37 per share for the third quarter of 2007.

For the nine months ended September 30, 2008, earnings totaled \$4,473,000, a 35.0% decrease from earnings of \$6,882,000 for the first nine months of 2007. Diluted earnings per share were \$0.67 for the first nine months of 2008, compared to \$1.04 for the first nine months of 2007.

The decrease in earnings for the third quarter of 2008 compared to the third quarter of 2007 is primarily attributable to a \$1,493,000 increase in non-interest expenses related to franchise growth and a \$200,000 increase in provisions for loan losses, partially offset by an increase in revenues. The decrease in earnings in year-to-date comparison is primarily attributable to a \$4,557,000 increase in non-interest expenses related to franchise growth and a \$1,905,000 increase in provisions for loan losses. A \$1.0 million decrease in provisions for income taxes and improvement in revenues reduced the impact of the increased expenses in year-to-date comparisons.

During the third quarter of 2008, a different type of challenge was presented in the form of Hurricanes Gustav and Ike. In response, the Company successfully implemented business continuity plans in preparation for and response to these storms. Minimal damages were incurred at impacted facilities and total costs to be incurred from the hurricanes are estimated to total \$200,000. Approximately half of the costs were incurred in the third quarter. The damages were below the Company’s insurance deductible applicable for a named storm.

Third quarter 2008 earnings were impacted by a \$500,000 provision for loan losses, compared to \$300,000 in the third quarter of 2007. The increase in the provision for loan loss was due primarily to a \$26.4 million increase in total loans and \$516,000 in net-charge offs reported for the third quarter of 2008. Nonperforming loans for the third quarter of 2008 increased \$7.7 million compared to the third quarter of 2007 and \$6.4 million compared to the second quarter of 2008. The increase was primarily due to one large loan relationship in the Baton Rouge market placed on nonaccrual status during the third quarter that had been recognized as a potential problem loan relationship in the second quarter of 2008. The lost revenue on this loan also had a negative impact on the quarterly net interest margin. Total

nonperforming assets to total assets were 1.13% for the third quarter of 2008, compared to 0.22% for the third quarter of 2007.

Quarterly revenues for the Company, defined as net interest income and non-interest income, increased \$1.0 million, or 8.1%, for the third quarter of 2008 compared to the third quarter of 2007. The improvement in revenues resulted in part from an increase of \$639,000 in net interest income, driven by a lower cost of interest-bearing liabilities. Interest expense decreased \$1,655,000 for the three months ended September 30, 2008, as compared to the same period ended September 30, 2007, as the Company adjusted deposit rates in response to the 225 basis point drop in interest rates by the Federal Open Market Committee ("FOMC") over the first nine months of 2008. Non-interest income increased \$407,000 due to an increase in service charges on deposit accounts, including non-sufficient funds fees. The improvement in revenues was offset by a \$1,493,000 increase in non-interest expense attributed primarily to increased occupancy, marketing, salaries and benefits, regulatory and consulting costs.

Earnings Analysis

Net Interest Income

The primary source of earnings for the Company is the difference between interest earned on loans and investments (earning assets) and interest paid on deposits and other liabilities (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.

Net interest income totaled \$10,056,000 for the third quarter of 2008, an increase of 6.8%, or \$639,000, from the \$9,417,000 reported for the third quarter of 2007. The improvement in net interest income was due primarily to a lower cost of average interest-bearing liabilities. The cost of average interest-bearing liabilities decreased 135 basis points, from 3.54% for the third quarter of 2007, to 2.19% for the third quarter of 2008. The rate decrease was primarily attributable to a 125 basis point decrease in the cost of interest-bearing deposits, from 3.29% to 2.04%, as rates were lowered in response to FOMC rate cuts.

Interest income on earning assets decreased \$1.0 million in quarterly comparison as the average earning asset yield dropped 118 basis points, from 7.90% at September 30, 2007 to 6.72% at September 30, 2008. Interest income on loans decreased \$1.4 million in quarterly comparison, as loan yields dropped 126 basis points to 7.71% at September 30, 2008, offsetting the impact of a \$21.3 million increase in the average loan volume. Due to the single loan relationship in the Baton Rouge market placed on nonaccrual status during the third quarter 2008, interest income on loans was negatively impacted by approximately \$100,000, which resulted in a 7 basis point decrease in average loan yield for the third quarter of 2008 and a 2 basis point decrease for the first nine months of 2008. The lost revenue related to the loan relationship drove down the net interest margin 5 basis points for the third quarter 2008 and 2 basis points for the first nine months of 2008. Interest income on investments and other interest-earning assets increased \$345,000 as a result of a \$26.5 million increase in the average volume of investments and a \$22.8 million increase in average other interest-earning assets with yields of 4.85% and 2.93%, respectively.

Interest expense for the third quarter of 2008 decreased \$1,655,000 in comparison to the third quarter of 2007. Lower average rates paid on interest-bearing liabilities lessened the impact of a \$63.0 million increase in the average volume of interest-bearing liabilities in quarterly comparison. The increase in interest-bearing liabilities was primarily in commercial Platinum money market deposits, certificates of deposit, securities sold under agreements to repurchase, and federal funds purchased. The combination of the higher volume of overnight and short-term earning assets, combined with the decreased loan yields and increased volume of interest-bearing liabilities, resulted in a 15 basis point decline in the taxable equivalent net interest margin. The margin fell to 5.01% for the third quarter of 2008, from 5.16% for the third quarter of 2007.

The average rate paid on the Company's junior subordinated debentures decreased 135 basis points from third quarter of 2007 to third quarter of 2008, primarily due to the adjustable rate on the \$8.2 million of such debentures issued in the fourth quarter of 2004. The debentures carry a floating rate equal to the 3-month LIBOR plus 2.50%, adjustable and payable quarterly. The rate was 5.70% and 8.09% at September 30, 2008 and 2007, respectively. The debentures mature on September 20, 2034 and, under certain circumstances, are subject to repayment on September 20, 2009 or thereafter. In February 2001, the Company issued \$7.2 million of junior subordinated debentures. The debentures carry a fixed interest rate of 10.20% and mature on February 22, 2031.

Net interest income increased \$2,177,000, or 8.1%, for the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007. Despite the increase in net interest income, the Company's taxable equivalent net interest margin declined 19 basis points, from 5.08% at September 30, 2007 to 4.89% at September 30, 2008 in nine month comparison. The average rate paid on interest-bearing liabilities decreased 103 basis points, from 3.59% at September 30, 2007 to 2.56% at September 30, 2008, and lowered interest expense by \$2,798,000 in nine month comparison. A 94 basis point reduction in the average yield on loans offset a \$42.2 million increase in the average volume of loans to reduce interest income by \$1,129,000. The decrease in interest income from loans was partially offset by a \$508,000 increase in interest income from investment securities and other earning assets.

Table of Contents

Table 1
Consolidated Average Balances, Interest and Rates
(in thousands)

	Three Months Ended September 30,					
	2008			2007		
	Average Volume	Interest	Average Yield/Rate	Average Volume	Interest	Average Yield/Rate
Assets						
Investment securities¹						
Taxable	\$ 108,346	\$ 1,182	4.36%	\$ 86,972	\$ 1,044	4.80%
Tax exempt ²	115,660	1,551	5.36%	110,262	1,467	5.32%
Other investments	4,403	39	3.54%	4,667	59	5.06%
Total investments	228,409	2,772	4.85%	201,901	2,570	5.09%
Federal funds sold	9,882	49	1.94%	3,705	47	4.96%
Loans						
Commercial and real estate						
Installment	457,841	8,557	7.44%	439,089	10,079	9.11%
Total loans ³	114,834	2,544	8.81%	112,251	2,382	8.42%
Other earning assets	572,675	11,101	7.71%	551,340	12,461	8.97%
Total earning assets	22,844	168	2.93%	91	2	8.72%
Total earning assets	833,810	14,090	6.72%	757,037	15,080	7.90%
Allowance for loan losses	(6,220)			(5,138)		
Nonearning assets	89,038			79,479		
Total assets	\$ 916,628			\$ 831,378		
Liabilities and stockholders' equity						
NOW, money market, and savings						
Certificates of deposits	\$ 445,431	\$ 1,580	1.41%	\$ 417,022	\$ 3,169	3.01%
Total interest-bearing deposits	141,622	1,436	4.03%	117,588	1,262	4.26%
Securities sold under repurchase agreements	587,053	3,016	2.04%	534,610	4,431	3.29%
Federal funds purchased	38,712	210	2.12%	13,403	149	4.35%
Federal Home Loan Bank advances ⁴	5,738	40	2.73%	501	7	5.47%
Federal Reserve Discount window	5	-	2.52%	22,720	297	5.12%
Total borrowings	2,753	16	2.27%	-	-	-
Junior subordinated debentures	47,208	266	2.20%	36,624	453	4.84%
	15,465	297	7.51%	15,465	350	8.86%
	649,726	3,579	2.19%	586,699	5,234	3.54%

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Total interest-bearing liabilities			
Demand deposits	189,904		176,893
Other liabilities	5,231		4,023
Stockholders' equity	71,767		63,763
Total liabilities and stockholders' equity	\$ 916,628		\$ 831,378