MIDSOUTH BANCORP INC
Form 10-Q
August 09, 2011

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

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2011
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 organization)	(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 x 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 x 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 x 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 x

As of August 9, 2011, there were 9,730,266 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.
MidSouth Bancorp, Inc. and Subsidiaries
Consolidated Statements of Condition
(dollars in thousands, except share data)

	June 30, 2011 (unaudited)	December 31, 2010* (audited)
Assets		
Cash and due from banks, including required reserves of $3,914 and $3,487, respectively	$21,006	$20,758
Interest-bearing deposits in banks	51,281	69,452
Federal funds sold	1,952	1,697
Time deposits held in banks	-	5,164
Securities available-for-sale, at fair value (cost of $312,732 at June 30, 2011 and $257,472 at December 31, 2010)	322,272	263,809
Securities held-to-maturity (fair value of $344 at June 30, 2011 and $1,608 at December 31, 2010)	340	1,588
Other investments	5,060	5,062
Loans	587,412	580,812
Allowance for loan losses	(7,313)	(8,813)
Loans, net	580,099	571,999
Bank premises and equipment, net	37,178	36,592
Accrued interest receivable	4,541	4,628
Goodwill	9,271	9,271
Intangibles	74	115
Cash surrender value of life insurance	4,772	4,698
Other real estate	5,677	1,206
Other assets	5,582	6,300
Total assets	$1,049,105	$1,002,339
Liabilities and Shareholders' Equity		
Liabilities:		
Deposits:		
Non-interest-bearing	$217,706	$199,460
Interest bearing	608,190	601,312
Total deposits	825,896	800,772
Securities sold under agreements to repurchase	45,963	43,826
Junior subordinated debentures	15,465	15,465
Unsettled securities purchased	15,159	-
Other liabilities	7,492	5,623
Total liabilities	909,975	865,686
Commitments and contingencies	-	-
Shareholders' equity:		
Preferred stock, no par value; 5,000,000 shares authorized, 20,000 shares issued and outstanding at June 30, 2011 and at December 31, 2010	19,507	19,408
	988	988

Common stock, $0.10 par value; 30,000,000 shares authorized, 9,880,743 issued and 9,730,266 outstanding at June 30, 2011 and December 31, 2010		
Additional paid-in capital	89,966	89,893
Unearned ESOP shares	(47)	(104)
Accumulated other comprehensive income	6,297	4,182
Treasury stock – 150,477 shares at June 30, 2011 and December 31, 2010, at cost	(3,286)	(3,286)
Retained earnings	25,705	25,572
Total shareholders' equity	139,130	136,653
Total liabilities and shareholders' equity	$1,049,105	$1,002,339

See notes to unaudited consolidated financial statements.
* Derived from audited financial statements.

Table of Contents

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,	
	2011	2010	2011	2010
Interest income:				
Loans, including fees	$9,736	$9,929	$19,212	$19,728
Securities and other investments:				
Taxable	1,264	891	2,131	1,891
Nontaxable	852	998	1,782	2,023
Federal funds sold	2	1	5	1
Time and interest bearing deposits in other banks	46	76	121	156
Other investments	35	34	72	69
Total interest income	11,935	11,929	23,323	23,868
Interest expense:				
Deposits	964	1,424	1,972	2,991
Securities sold under agreements to repurchase	198	238	395	464
Federal funds purchased	-	-	-	2
Other borrowed money	-	-	-	3
Junior subordinated debentures	242	243	484	484
Total interest expense	1,404	1,905	2,851	3,944
Net interest income	10,531	10,024	20,472	19,924
Provision for loan losses	900	1,500	2,500	2,650
Net interest income after provision for loan losses	9,631	8,524	17,972	17,274
Non-interest income:				
Service charges on deposits	1,548	2,610	3,285	5,058
Gain on securities, net	58	-	99	-
ATM and debit card income	955	844	1,833	1,630
Other charges and fees	652	570	1,027	977
Total non-interest income	3,213	4,024	6,244	7,665
Non-interest expenses:				
Salaries and employee benefits	5,039	4,938	10,202	10,188
Occupancy expense	2,191	2,284	4,244	4,532
FDIC insurance	212	337	523	652
Other	3,791	3,610	6,991	6,531
Total non-interest expenses	11,233	11,169	21,960	21,903
Income before income taxes	1,611	1,379	2,256	3,036
Income tax expense	(258)	(129)	(161)	(351)
Net earnings	1,353	1,250	2,095	2,685
Dividends on preferred stock and accretion of warrants	299	299	599	598
Net earnings available to common shareholders	$1,054	$951	$1,496	$2,087

Earnings per share:				
Basic	$0.10	$0.10	$0.15	$0.22
Diluted	$0.10	$0.10	$0.15	$0.22

See notes to unaudited consolidated financial statements.

MidSouth Bancorp, Inc. and Subsidiaries
Consolidated Statement of Shareholders' Equity (unaudited)
For the Six Months Ended June 30, 2011
(in thousands, except share and per share data)

	Preferred Stock		Common Stock		Additional Paid-in	Unearned ESOP	Accumulated Other Comprehensive	Treasury	Retained	
	Shares	Amount	Shares	Amount	Capital	Shares	Income	Stock	Earnings	Total
Balance- December 31, 2010	20,000	$19,408	9,880,743	$988	$89,893	$(104)	$4,182	$(3,286)	$25,572	$136,653
Net earnings	-	-	-	-	-	-	-	-	2,095	2,095
Unrealized holding gains on securities available-for-sale arising during the period, net of income tax expense of $1,123	-	-	-	-	-	-	2,180	-	-	2,180
Reclassification adjustment for gain on securities available-for-sale, net of income tax expense of $34	-	-	-	-	-	-	(65)	-	-	(65)
Comprehensive income	-	-	-	-	-	-	-	-	-	4,210
Dividends on preferred stock and accretion of common stock warrants	-	99	-	-	-	-	-	-	(599)	(500)
Dividends on common stock, $0.14 per share	-	-	-	-	-	-	-	-	(1,363)	(1,363)
ESOP compensation expense	-	-	-	-	25	57	-	-	-	82
Stock option and restricted stock compensation expense	-	-	-	-	48	-	-	-	-	48
Balance- June 30, 2011	20,000	$19,507	9,880,743	$988	$89,966	$(47)	$6,297	$(3,286)	$25,705	$139,130

See notes to unaudited consolidated financial statements.

4

Table of Contents

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

	For the Six Months Ended June 30, 2011	2010
Cash flows from operating activities:		
Net earnings	$2,095	$2,685
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	1,543	1,785
Provision for loan losses	2,500	2,650
Provision for deferred tax expense	(77)	(466)
Amortization of premiums on securities, net	511	584
Amortization of other investments	7	7
Stock compensation expense	48	3
Net gain on sale of investment securities	(99)	-
Net loss on sale of other real estate	66	141
Net loss on sale of premises and equipment	-	64
Change in accrued interest receivable	87	298
Change in accrued interest payable	(56)	(124)
Other, net	1,773	1,439
Net cash provided by operating activities	8,398	9,066
Cash flows from investing activities:		
Net decrease in time deposits in other banks	5,164	16,062
Proceeds from maturities and calls of securities available-for-sale	40,654	20,752
Proceeds from maturities and calls of securities held-to-maturity	900	1,456
Proceeds from sale of securities available-for-sale	3,895	-
Purchases of securities available-for-sale	(84,713)	(26,107)
Purchases of other investments	(5)	(172)
Net change in loans	(15,885)	(3,474)
Purchases of premises and equipment	(2,094)	(274)
Proceeds from sale of premises and equipment	6	-
Proceeds from sale of other real estate	614	409
Purchase of other real estate	-	(450)
Net cash provided by (used in) investing activities	(51,464)	8,202
Cash flows from financing activities:		
Change in deposits	25,124	(3,378)
Change in securities sold under agreements to repurchase	2,137	(2,391)
Change in federal funds purchased	-	(1,700)
Issuance of common stock and treasury stock, net of offering expenses	-	4,769
Payment of dividends on preferred stock	(500)	(499)
Payment of dividends on common stock	(1,363)	(1,146)
Proceeds from exercise of stock options	-	17
Net cash provided by (used in) financing activities	25,398	(4,328)
Net (decrease) increase in cash and cash equivalents	(17,668)	12,940

Cash and cash equivalents, beginning of period	91,907	23,351
Cash and cash equivalents, end of period	$74,239	$36,291
Supplemental information- Noncash items		
Accretion of warrants	$99	$99
Transfer of loans to other real estate	5,342	(336)
Net change in loan to ESOP	57	55

See notes to unaudited consolidated financial statements.

5

Table of Contents

MidSouth Bancorp, Inc. and Subsidiaries
Notes to Interim Consolidated Financial Statements
June 30, 2011
(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 MidSouth Bancorp, Inc. (the “Company”) and its subsidiaries as of June 30, 2011 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 2010 Annual Report on Form 10-K.

The results of operations for the six month period ended June 30, 2011 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 2010 Annual Report on Form 10-K.

Recently Adopted Accounting Pronouncements — In December 2010, the FASB issued Accounting Standards Update No. 2010-28, When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts (“ASU No. 2010-28”). ASU No. 2010-28 requires entities with reporting units with zero or negative carrying amounts to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In doing so, entities should consider whether there are any adverse qualitative factors indicating that an impairment may exist. For public companies this guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. ASU No. 2010-28 was not applicable to the Company for the second quarter of 2011 as negative goodwill did not exist at June 30, 2011.

In December 2010, the FASB issued Accounting Standards Update No. 2010-29, Disclosure of Supplementary Pro Forma Information for Business Combinations (“ASU No. 2010-29”). ASU No. 2010-29 specifies that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. ASU No. 2010-29 is effective prospectively 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, 2010, and was not applicable to the Company for the quarter ended June 30, 2011, as no business combinations have occurred.

Recently Issued Accounting Pronouncements — In April 2011, the FASB issued ASU No. 2011-02, A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring, which amends guidance for evaluating whether the restructuring of a receivable by a creditor is a troubled debt restructuring ("TDR"). The ASU responds to concerns that creditors are inconsistently applying existing guidance for identifying TDRs. The main provision of this Update will require a creditor to separately conclude whether the restructuring constitutes a concession and whether the debtor is experiencing financial difficulties, in order to determine if a restructuring constitutes a TDR. Guidance is also provided to assist the creditor in evaluating these two criteria. Furthermore, the amendments clarify that a creditor is precluded from using the effective interest rate test, as described in the debtors guidance on restructuring payables, when evaluating whether a restructuring constitutes a TDR. ASU 2011-02 is effective for a public entity for interim and annual periods beginning on or after June 15, 2011. Retrospective application is required for restructurings occurring on or after the beginning of the fiscal year of adoption for purposes of identifying and disclosing TDRs. However, an entity should apply prospectively changes in the method used to calculate impairment on receivables. At the same time it adopts ASU 2011-02, a public entity will be required to disclose the activity-based information about TDRs that was previously deferred by ASU No. 2011-01, Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20. The Company will adopt ASU No. 2011-02 for the interim period beginning July 1, 2011. Adoption of ASU No. 2011-02 is not expected to have a material impact on the Company's results of operations, financial position or disclosures.

Table of Contents

In April 2011, the FASB issued ASU No. 2011-03, Transfers and Servicing (Topic 860): Reconsideration of Effective Control for Repurchase Agreements. The amendments in this Update remove from the assessment of effective control (1) the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee, and (2) the collateral maintenance implementation guidance related to that criterion. Other criteria applicable to the assessment of effective control are not changed by the amendments in this Update. The guidance in this Update is effective for the first interim or annual period beginning on or after December 15, 2011. The guidance should be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. Early adoption is not permitted. ASU No. 2011-03 is not expected to have a material impact on the Company’s results of operations, financial position or disclosures.

In May 2011, the FASB issued ASU 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. The amendments in this Update result in common fair value measurement and disclosure requirements in U.S. GAAP and IFRSs. Consequently, the amendments change the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. For many of the requirements, the Board does not intend for the amendments in this Update to result in a change in the application of the requirements in Topic 820. The Update also reflects the FASB’s consideration of the different characteristics of public and non-public entities and the needs of users of their financial statements. Non-public entities will be exempt from a number of the new disclosure requirements. The amendments in this Update are to be applied prospectively. For public entities, the amendments are effective during interim and annual periods beginning after December 15, 2011. Early application by public entities is not permitted.

In June 2011, the FASB issued ASU 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income. The amendments in this Update allows an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. This Update eliminates the option to present the components of other comprehensive income as part of the statement of changes in shareholders’ equity. The amendments in this Update do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. The amendments in this Update should be applied retrospectively. For public entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Early adoption is permitted, because compliance with the amendments is already permitted. The amendments do not require any transition disclosures.

Reclassifications—Certain reclassifications have been made to the prior years’ financial statements in order to conform to the classifications adopted for reporting in 2011. The reclassifications had no impact on shareholders’ equity or net income.

Table of Contents

2. Investment Securities

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

	June 30, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
U.S. Government sponsored enterprises	$ 91,238	$ 1,091	$ -	$ 92,329
Obligations of state and political subdivisions	94,691	4,963	8	99,646
GSE mortgage-backed securities	77,030	2,674	-	79,704
Collateralized mortgage obligations	49,773	842	22	50,593
	$ 312,732	$ 9,570	$ 30	$ 322,272

	December 31, 2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
U.S. Government sponsored enterprises	$ 116,560	$ 1,138	$ -	$ 117,698
Obligations of state and political subdivisions	105,376	3,593	117	108,852
GSE mortgage-backed securities	10,642	830	-	11,472
Collateralized mortgage obligations	24,894	936	43	25,787
	$ 257,472	$ 6,497	$ 160	$ 263,809

	June 30, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held-to-maturity:				
Obligations of state and political subdivisions	$ 340	$ 4	$ -	$ 344

	December 31, 2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held-to-maturity:				
Obligations of state and political subdivisions	$ 1,588	$ 20	$ -	$ 1,608

With the exception of three private-label collateralized mortgage obligations (“CMOs”) with a combined balance remaining of $166,000 at June 30, 2011, all of the Company’s CMOs are government-sponsored enterprise securities.

8

Table of Contents

The amortized cost and fair value of debt securities at June 30, 2011 by contractual maturity are shown in the following table (in thousands) with the exception of mortgage-backed securities and collateralized mortgage obligations. Expected maturities may differ from contractual maturities for mortgage-backed securities and collateralized mortgage obligations because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
Available-for-sale:		
Due in one year or less	$ 34,134	$ 34,333
Due after one year through five years	108,481	111,892
Due after five years through ten years	36,681	38,899
Due after ten years	6,633	6,851
Mortgage-backed securities and collateralized mortgage obligations	126,803	130,297
	$ 312,732	$ 322,272

	Amortized Cost	Fair Value
Held-to-maturity:		
Due in one year or less	$ 140	$ 143
Due after one year through five years	200	201
	$ 340	$ 344

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

	June 30, 2011					
	Securities with losses under 12 months		Securities with losses over 12 months		Total	
Available-for-sale:	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
Obligations of state and political subdivisions	$ 697	$ 8	$ -	$ -	$ 697	$ 8
Collateralized mortgage obligations	5,010	17	166	5	5,176	22
	$ 5,707	$ 25	$ 166	$ 5	$ 5,873	$ 30

	December 31, 2010					
	Securities with losses under 12 months		Securities with losses over 12 months		Total	
Available-for-sale:	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
Obligations of state and political subdivisions	$ 6,919	$ 117	$ -	$ -	$ 6,919	$ 117
	4,689	36	227	7	4,916	43

Collateralized mortgage obligations						
	$ 11,608	$ 153	$ 227	$ 7	$ 11,835	$ 160

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.

Table of Contents

The unrealized losses on debt securities at June 30, 2011 resulted from changing market interest rates over the yields available at the time the underlying securities were purchased. Of the 159 securities issued by state and political subdivisions, one contained unrealized losses at June 30, 2011. Three of the 22 collateralized mortgage obligations also contained unrealized losses. Management identified no impairment related to credit quality. At June 30, 2011, 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 three months ended June 30, 2011.

During the six months ended June 30, 2011, the Company sold five securities classified as available for sale and one security classified as held to maturity. Of the available for sale securities, four securities were sold with gains totaling $94,000 and one security was sold at a loss of $4,000 for a net gain of $90,000. The securities were sold as a result of an external review performed on the municipal securities portfolio. The decision to sell the one held to maturity security, which was sold at a gain of $9,000, was based on the inability to obtain current financial information on the municipality. The sale was consistent with action taken on other securities with a similar deficiency, as identified in the external review. The Company did not sell any investment securities during the six month period ending June 30, 2010.

Securities with an aggregate carrying value of approximately $139.1 million and $150.6 million at June 30, 2011 and December 31, 2010, respectively, were pledged to secure public funds on deposit and for other purposes required or permitted by law.

3. Other Investments

The Company is required to own stock in the Federal Reserve Bank of Atlanta ("FRB-Atlanta") and as a member of the Federal Home Loan Bank system, owns stock in the Federal Home Loan Bank of Dallas ("FHLB-Dallas"). The Company accounts for FRB-Atlanta and FHLB-Dallas stock as other investments along with stock ownership in two correspondent banks and a Community Reinvestment Act ("CRA") investment in a Senior Housing Crime Prevention program in Louisiana. The CRA investment consisted of three government-sponsored agency mortgage-backed securities purchased by the Company and held by the Senior Housing Crime Prevention program. The majority of the interest earned on the securities provides income to the program.

For impairment analysis, the Company reviews financial statements and regulatory capital ratios for each of the banks in which the Company owns stock to verify financial stability and regulatory compliance with capital requirements. As of June 30, 2011 and December 31, 2010, based upon quarterly reviews, management determined that there was no impairment in the bank stocks held as other investments.

The aggregate carrying amount of other investments consisted of the following (in thousands):

	June 30, 2011	December 31, 2010
FRB-Atlanta	$ 1,628	$ 1,624
FHLB-Dallas	585	584
Other bank stocks	713	713
CRA investment	2,134	2,141
	$ 5,060	$ 5,062

Table of Contents

4. Credit Quality of Loans and Allowance for Loan Losses

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

	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Balance, beginning of period	$ 6,752	$ 7,917	$ 8,813	$ 7,995
Provision for loan losses	900	1,500	2,500	2,650
Recoveries	122	99	208	151
Loans charged-off	(461)	(1,045)	(4,208)	(2,325)
Balance, end of period	$ 7,313	$ 8,471	$ 7,313	$ 8,471

The Company's loans individually evaluated for impairment were approximately $14.7 million at June 30, 2011 and $25.2 million at December 31, 2010. Specific reserves totaling $825,000 were established for $4.9 million of impaired loans reported at June 30, 2011. At December 31, 2010, specific reserves totaling $3.1 million were established for $11.9 million of impaired loans. Interest recognized on impaired loans totaled $172,000 at June 30, 2011. Loans classified as TDRs totaled $463,000 and $653,000 at June 30, 2011 and December 31, 2010, respectively. Four commercial loans were classified as TDRs due to a reduction in monthly payments granted to the borrowers and one small consumer loan was classified as a TDR due to a credit exception granted to the borrower. As of June 30, 2011, there have been no commitments to lend additional funds to debtors owing receivables whose terms have been modified in TDRs.

To provide greater transparency on non-performing assets, additional disclosures required by ASU 2010-20 have been included below. Allowance for loan losses is reported by portfolio segment and further detail of credit quality indicators are provided by class of loans.

Modifications by Class of Loans
(in thousands)

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled debt restructuring as of June 30, 2011:			
Commercial, financial, and agricultural	4	$ 451	$ 451
Consumer - other	1	12	12
		$ 463	$ 463

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled debt restructuring as of December 31, 2010:			
Commercial, financial, and agricultural	1	$ 194	$ 194
Commercial real estate - other	1	446	446
Consumer - other	1	13	13

	$ 653	$ 653

11

Table of Contents

Allowance for Loan Losses and Recorded Investment in Loans
For the Six Months Ended June 30, 2011 (in thousands)

	Coml, Fin, and Agric	Real Estate Construction	Real Estate Commercial	Real Estate Residential	Consumer	Finance Leases Coml	Other	Total
Allowance for loan losses:								
Beginning balance	$1,664	$2,963	$ 2,565	$ 862	$ 730	$29	$-	$8,813
Charge-offs	(437)	(2,072)	(1,215)	(185)	(298)	(1)	-	(4,208)
Recoveries	106	13	-	4	85	-	-	208
Provision	634	825	522	178	337	4	-	2,500
Ending balance	$1,967	$1,729	$ 1,872	$ 859	$ 854	$32	$-	$7,313
Ending balance: individually evaluated for impairment	$414	$285	$ 8	$ 16	$ 102	$-	$-	$825
Loans:								
Ending balance	$194,136	$46,608	$ 213,007	$ 71,589	$ 56,768	$4,660	$644	$587,412
Ending balance: individually evaluated for impairment	$3,042	$7,522	$ 2,224	$ 1,616	$ 248	$18	$15	$14,685

Allowance for Loan Losses and Recorded Investment in Loans
For the Year Ended December 31, 2010 (in thousands)

	Coml, Fin, and Agric	Real Estate Construction	Real Estate Commercial	Real Estate Residential	Consumer	Finance Leases Coml	Other	Total
Allowance for loan losses:								
Beginning balance	$2,105	$2,240	$ 1,683	$ 631	$ 1,315	$21	$-	$7,995
Charge-offs	(1,333)	(1,478)	(130)	(146)	(1,368)	(1)	-	(4,456)
Recoveries	50	1	1	60	141	1	-	254
Provision	842	2,200	1,011	317	642	8	-	5,020
Ending balance	$1,664	$2,963	$ 2,565	$ 862	$ 730	$29	$-	$8,813
Ending balance: individually evaluated for impairment	$27	$2,024	$ 827	$ 84	$ 91	$-	$-	$3,053
Loans:								
Ending balance	$177,598	$54,164	$ 208,764	$ 72,460	$ 62,272	$4,748	$806	$580,812
Ending balance: individually	$3,549	$10,813	$ 8,780	$ 1,761	$ 275	$-	$-	$25,178

evaluated for
impairment

12

Table of Contents

Credit Quality Indicators by Class of Loans
As of June 30, 2011 (in thousands)

Commercial Credit Exposure
Credit Risk Profile by Creditworthiness Category

	Commercial, Financial, and Agricultural	Commercial Real Estate Construction	Commercial Real Estate -Other	Commercial Total	% of Total Commercial
Pass	$ 183,907	$ 29,246	$ 198,232	$ 411,385	91.5 %
Special Mention	3,169	3,680	4,935	11,784	2.6 %
Substandard	7,060	9,338	9,840	26,238	5.9 %
	$ 194,136	$ 42,264	$ 213,007	$ 449,407	100.0 %

Residential Credit Exposure
Credit Risk Profile by Creditworthiness Category

	Residential - Construction	Residential - Prime	Residential - Subprime	Residential Total	% of Total Residential
Pass	$ 4,130	$ 66,852	$ -	$ 70,982	93.5 %
Special mention	-	2,087	-	2,087	2.7 %
Substandard	214	2,650	-	2,864	3.8 %
	$ 4,344	$ 71,589	$ -	$ 75,933	100.0 %

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

	Consumer - Credit Card	Consumer -Other	Finance Leases Commercial	Other Loans	Consumer Total	% of Total Consumer
Performing	$ 4,993	$ 51,490	$ 4,642	$ 644	$ 61,769	99.5 %
Nonperforming	10	275	18	-	303	0.5 %
	$ 5,003	$ 51,765	$ 4,660	$ 644	$ 62,072	100.0 %

Credit Quality Indicators by Class of Loans
As of December 31, 2010 (in thousands)

Commercial Credit Exposure
Credit Risk Profile by Creditworthiness Category

	Commercial, Financial, and Agricultural	Commercial Real Estate Construction	Commercial Real Estate -Other	Commercial Total	% of Total Commercial
Pass	$ 165,581	$ 32,061	$ 191,089	$ 388,731	89.50 %
Special Mention	3,661	3,851	3,726	11,238	2.59 %
Substandard	8,356	12,077	13,949	34,382	7.91 %
	$ 177,598	$ 47,989	$ 208,764	$ 434,351	100.0 %

Residential Credit Exposure
Credit Risk Profile by Creditworthiness Category

	Residential - Construction	Residential - Prime	Residential - Subprime	Residential Total	% of Total Residential
Pass	$ 5,959	$ 66,867	$ -	$ 72,826	92.61 %
Special mention	-	2,501	-	2,501	3.18 %
Substandard	216	3,092	-	3,308	4.21 %
	$ 6,175	$ 72,460	$ -	$ 78,635	100.0 %

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

	Consumer - Credit Card	Consumer -Other	Finance Leases Commercial	Other Loans	Consumer Total	% of Total Consumer
Performing	$ 5,318	$ 56,905	$ 4,748	$ 806	$ 67,777	99.93 %
Nonperforming	-	49	-	-	49	0.07 %
	$ 5,318	$ 56,954	$ 4,748	$ 806	$ 67,826	100.0 %

14

Table of Contents

Age Analysis of Past Due Loans by Class of Loans
(in thousands)

As of June 30, 2011	30-59 Days Past Due (1)	60-89 Days Past Due (1)	Greater than 90 Days Past Due (1)	Total Past Due	Current	Total Loans	Recorded Investment > 90 days and Accruing
Commercial, financial, and agricultural	$1,137	$41	$2,479	$3,657	$190,479	$194,136	$37
Commercial real estate - construction	52	50	4,398	4,500	37,764	42,264	-
Commercial real estate - other	1,570	185	1,134	2,889	210,118	213,007	-
Consumer - credit card	17	-	5	22	4,981	5,003	5
Consumer - other	183	80	235	498	51,267	51,765	27
Residential - construction	-	-	-	-	4,344	4,344	-
Residential - prime	917	135	649	1,701	69,888	71,589	-
Residential - subprime	-	-	-	-	-	-	-
Other loans	69	-	15	84	560	644	-
Finance leases commercial	4	-	18	22	4,638	4,660	-
	$3,949	$491	$8,933	$13,373	$574,039	$587,412	$69

As of December 31, 2010	30-59 Days Past Due (1)	60-89 Days Past Due (1)	Greater than 90 Days Past Due (1)	Total Past Due	Current	Total Loans	Recorded Investment > 90 days and Accruing
Commercial, financial, and agricultural	$1,298	$114	$2,405	$3,817	$173,781	$177,598	$17
Commercial real estate - construction	3,334	-	3,324	6,658	41,331	47,989	-
Commercial real estate - other	642	6,579	1,234	8,455	200,309	208,764	-
Consumer - credit card	50	23	-	73	5,245	5,318	-

Consumer - other	407	79	280	766	56,188	56,954	49
Residential - construction	-	-	-	-	6,175	6,175	-
Residential - prime	1,023	22	1,155	2,200	70,260	72,460	-
Residential - subprime	-	-	-	-	-	-	-
Other loans	102	3	-	105	701	806	-
Finance leases commercial	-	-	-	-	4,748	4,748	-
	$6,856	$6,820	$8,398	$22,074	$558,738	$580,812	$66

(1) Past due amounts may include loans on nonaccrual status.

Table of Contents

Impaired Loans
(in thousands)

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
As of June 30, 2011					
With no related allowance recorded:					
Commercial, financial, and agricultural	$1,450	$1,568	$-	$1,822	$9
Commercial real estate – construction	4,844	6,554	-	6,160	99
Commercial real estate – other	2,044	2,124	-	4,884	18
Consumer – other	50	58	-	77	-
Residential – prime	1,375	1,375	-	1,578	22
Finance leases	18	19	-	9	-
Other	15	15	-	8	2
Subtotal:	$9,796	$11,713	$-	$14,538	$150
With an allowance recorded:					
Commercial	1,592	1,592	414	1,358	16
Commercial real estate – construction	2,678	5,698	285	1,339	-
Commercial real estate – other	180	180	8	180	-
Consumer – other	198	203	102	183	2
Residential – prime	241	241	16	232	4
Subtotal:	$4,889	$7,914	$825	$3,292	$22
Totals:					
Commercial	12,821	17,750	707	15,760	144
Consumer	248	261	102	260	2
Residential	1,616	1,616	16	1,810	26
Grand total:	$14,685	$19,627	$825	$17,830	$172

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
As of December 31, 2010					
With no related allowance recorded:					
Commercial, financial, and agricultural	$3,291	$3,538	$-	$4,036	$85
Commercial real estate – construction	5,918	9,175	-	5,584	179
Commercial real estate – other	2,407	2,487	-	1,941	114
Consumer – other	90	90	-	80	8
Residential – prime	1,549	1,549	-	1,166	77
Subtotal:	$13,255	$16,839	$-	$12,807	$463
With an allowance recorded:					
Commercial	258	258	27	1,671	6
Commercial real estate – construction	4,895	4,895	2,024	4,098	140
Commercial real estate – other	6,373	6,373	827	6,632	2
Consumer – other	185	185	91	262	3
Residential – prime	212	212	84	320	12
Subtotal:	$11,923	$11,923	$3,053	$12,983	$163
Totals:					
Commercial	23,142	26,726	2,878	23,962	526

Consumer	275	275	91	342	11
Residential	1,761	1,761	84	1,486	89
Grand total:	$25,178	$28,762	$3,053	$25,790	$626

Table of Contents

Loans on Nonaccrual Status
(in thousands)

	June 30, 2011	December 31, 2010
Commercial, financial, and agricultural	$ 2,591	$ 2,589
Commercial real estate - construction	4,993	8,220
Commercial real estate - other	1,571	7,378
Consumer - credit card	-	-
Consumer - other	235	261
Residential - construction	-	-
Residential - prime	1,033	1,155
Residential - subprime	-	-
Other loans	15	-
Finance leases commercial	18	-
	$ 10,456	$ 19,603

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 Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Net earnings available to common shareholders	$1,054	$951	$1,496	$2,087
Weighted average number of common shares outstanding used in computation of basic earnings per common share	9,723	9,707	9,722	9,692
Effect of dilutive securities:				
Stock options	13	18	13	18
Restricted stock	3	-	4	-
Warrants	-	4	-	5
Weighted average number of common shares outstanding plus effect of dilutive securities – used in computation of diluted earnings per share	9,739	9,729	9,739	9,715

Options to acquire 18,331 and 23,786 shares of common stock were not included in computing diluted earnings per share for the quarter and six months ended June 30, 2011 and 2010, respectively, because the effect of these shares was anti-dilutive. For the quarter and six months ended June 30, 2010, 22,047 shares of restricted stock were not included in computed diluted earnings because the effect of these shares was anti-dilutive. As a result of the completion of a qualified equity offering in December 2009, warrants issued to the U. S. Department of the Treasury (the “Treasury”) to purchase 208,768 shares of our common stock were reduced to 104,384 shares. The remaining 104,384 shares subject to the warrants were anti-dilutive and not included in the computation of diluted earnings per share for the quarter and six months ended June 30, 2011.

6. Declaration of Dividends

A first quarter dividend of $0.07 per share for holders of common stock of record on March 17, 2011 was declared on January 25, 2011 and was paid on April 1, 2011. On April 26, 2011, the Company declared a second quarter dividend of $0.07 per share for holders of common stock of record on June 16, 2011, and was paid on July 1, 2011. A third quarter dividend was declared on July 27, 2011 in the amount of $0.07 per share for holders of common stock of record on September 16, 2011 to be paid on October 1, 2011.

Table of Contents

The Company's ability to declare and pay dividends on its common stock is subject to first having paid all accrued cumulative preferred dividends that are due. For three years following the issuance of the Fixed Rate Cumulative Perpetual Preferred Stock, Series A ("Series A Preferred Stock") to the Treasury on January 9, 2009, the Company may not increase its per share common stock dividend rate above $0.28 without the Treasury's consent, unless the Treasury has transferred all the Series A Preferred Stock to third parties.

7. 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.

Time Deposits Held in Banks—Fair values for fixed-rate time deposits are estimated using a discounted cash flow analysis that applies interest rates currently being offered on time deposits of similar terms of maturity.

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, municipal securities, single issue trust preferred securities, certain pooled trust preferred securities, and certain equity securities that are not actively traded.

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

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.

Table of Contents

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: 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 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 we have received a Sheriff's valuation 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 other real estate 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 other real estate 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.

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.

Table of Contents

Assets Recorded at Fair Value

Below is a table that 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, 2011	Fair Value Measurements at June 30, 2011 using: Level 1	Level 2	Level 3
Available-for-sale securities:				
U.S. Government sponsored enterprises	$92,329	$-	$92,329	$-
Obligations of state and political subdivisions	99,646	-	99,646	-
GSE mortgage-backed securities	79,704			