

MIDSOUTH BANCORP INC  
Form 10-Q  
May 09, 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 March 31, 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 May 9, 2014, there were 11,286,769 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)

|  | March 31,<br>2014<br>(unaudited) | December<br>31, 2013*<br>(audited) |
|--|----------------------------------|------------------------------------|
| <b>Assets</b>  |                                  |                                    |
| Cash and due from banks, including required reserves of \$9,902 and \$9,542, respectively  | \$39,087                         | \$43,488                           |
| Interest-bearing deposits in banks   | 24,041                           | 13,993                             |
| Federal funds sold   | 1,375                            | 2,250                              |
| Securities available-for-sale, at fair value (cost of \$328,705 at March 31, 2014 and \$341,828 at December 31, 2013)  | 331,488                          | 341,665                            |
| Securities held-to-maturity (fair value of \$149,974 at March 31, 2014 and \$151,168 at December 31, 2013)   | 152,162                          | 155,523                            |
| Other investments  | 11,530                           | 11,526                             |
| Loans  | 1,184,189                        | 1,137,554                          |
| Allowance for loan losses  | (8,765 )                         | (8,779 )                           |
| Loans, net   | 1,175,424                        | 1,128,775                          |
| Bank premises and equipment, net   | 72,500                           | 72,343                             |
| Accrued interest receivable  | 6,495                            | 6,692                              |
| Goodwill   | 42,171                           | 42,171                             |
| Intangibles  | 7,664                            | 7,941                              |
| Cash surrender value of life insurance   | 13,505                           | 13,450                             |
| Other real estate  | 6,525                            | 6,687                              |
| Other assets   | 4,958                            | 4,656                              |
| <b>Total assets</b>  | <b>\$1,888,925</b>               | <b>\$1,851,160</b>                 |
| <b>Liabilities and Shareholders' Equity</b>  |                                  |                                    |
| <b>Liabilities:</b>  |                                  |                                    |
| <b>Deposits:</b>   |                                  |                                    |
| Non-interest-bearing   | \$379,576                        | \$383,257                          |
| Interest-bearing   | 1,168,354                        | 1,135,546                          |
| <b>Total deposits</b>  | <b>1,547,930</b>                 | <b>1,518,803</b>                   |
| Securities sold under agreements to repurchase   | 51,995                           | 53,916                             |
| Short-term Federal Home Loan Bank advances   | 25,000                           | 25,000                             |
| Notes payable  | 27,347                           | 27,703                             |
| Junior subordinated debentures   | 29,384                           | 29,384                             |
| Other liabilities  | 8,632                            | 5,605                              |
| <b>Total liabilities</b>   | <b>1,690,288</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 March 31, 2014 and December 31, 2013  | 32,000                           | 32,000                             |
| Series C Preferred stock, no par value; 100,000 shares authorized, 95,483 shares issued and outstanding at March 31, 2014 and 99,971 shares issued and outstanding and December 31, 2013 | 9,548                            | 9,997                              |
| Common stock, \$0.10 par value; 30,000,000 shares authorized, 11,432,131 and 11,407,196 issued and 11,281,647 and 11,256,712 outstanding at March 31, 2014 and December 31,              | 1,143                            | 1,141                              |

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|  |             |             |
|--|-------------|-------------|
| 2013, respectively   |             |             |
| Additional paid-in capital   | 111,659     | 111,017     |
| Accumulated other comprehensive income (loss)                                    | 1,809       | (106 )      |
| Treasury stock – 150,484 shares at March 31, 2014 and December 31, 2013, at cost | (3,286 )    | (3,286 )    |
| Retained earnings  | 45,764      | 39,986      |
| Total shareholders' equity   | 198,637     | 190,749     |
| Total liabilities and shareholders' equity                                       | \$1,888,925 | \$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<br>Ended March 31, |          |
|---|---------------------------------|----------|
|   | 2014                            | 2013     |
| Interest income:                                    |                                 |          |
| Loans, including fees                               | \$17,483                        | \$17,117 |
| Securities and other investments:                   |                                 |          |
| Taxable   | 2,136                           | 2,059    |
| Nontaxable  | 693                             | 839      |
| Federal funds sold                                  | 1                               | 4        |
| Time and interest bearing deposits in other banks   | 16                              | 38       |
| Other investments                                   | 70                              | 72       |
| Total interest income                               | 20,399                          | 20,129   |
| Interest expense:                                   |                                 |          |
| Deposits  | 871                             | 1,078    |
| Securities sold under agreements to repurchase      | 180                             | 179      |
| Other borrowings and payable                        | 106                             | 124      |
| Junior subordinated debentures                      | 347                             | 336      |
| Total interest expense                              | 1,504                           | 1,717    |
| Net interest income                                 | 18,895                          | 18,412   |
| Provision for loan losses                           | 550                             | 550      |
| Net interest income after provision for loan losses | 18,345                          | 17,862   |
| Non-interest income:                                |                                 |          |
| Service charges on deposits                         | 2,380                           | 2,171    |
| Gain on securities, net                             | -                               | 204      |
| ATM and debit card income                           | 1,714                           | 1,356    |
| Executive officer life insurance proceeds           | 3,000                           | -        |
| Other charges and fees                              | 823                             | 700      |
| Total non-interest income                           | 7,917                           | 4,431    |
| Non-interest expenses:                              |                                 |          |
| Salaries and employee benefits                      | 8,813                           | 8,392    |
| Occupancy expense                                   | 3,791                           | 3,597    |
| FDIC insurance                                      | 262                             | 345      |
| Other   | 4,836                           | 5,097    |
| Total non-interest expenses                         | 17,702                          | 17,431   |
| Income before income taxes                          | 8,560                           | 4,862    |
| Income tax expense                                  | 1,702                           | 1,434    |
| Net earnings  | 6,858                           | 3,428    |
| Dividends on preferred stock                        | 180                             | 292      |
| Net earnings available to common shareholders       | \$6,678                         | \$3,136  |
| Earnings per common share:                          |                                 |          |

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|  |        |        |
|--|--------|--------|
| Basic  | \$0.59 | \$0.28 |
| Diluted  | \$0.57 | \$0.27 |
| Weighted average number of shares outstanding: |        |        |
| Basic  | 11,258 | 11,238 |
| Diluted  | 11,879 | 11,866 |
| Dividends declared per common share            | \$0.08 | \$0.07 |

See notes to unaudited consolidated financial statements.

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MidSouth Bancorp, Inc. and Subsidiaries

Consolidated Statements of Comprehensive Income (unaudited)

(in thousands)

|   | Three Months<br>Ended March 31, |         |
|---|---------------------------------|---------|
|   | 2014                            | 2013    |
| Net earnings  | \$6,858                         | \$3,428 |
| Other comprehensive income (loss), net of tax:  |                                 |         |
| Unrealized gains on securities available-for-sale:                                    |                                 |         |
| Unrealized holding gains arising during the year                                      | 2,946                           | (1,115) |
| Less: reclassification adjustment for gains on sales of securities available-for-sale | -                               | (204 )  |
| Total other comprehensive income (loss), before tax                                   | 2,946                           | (1,319) |
| Income tax effect related to items of other comprehensive income (loss)               | (1,031)                         | 461     |
| Total other comprehensive income (loss), net of tax                                   | 1,915                           | (858 )  |
| Total comprehensive income  | \$8,773                         | \$2,570 |

See notes to unaudited consolidated financial statements.

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MidSouth Bancorp, Inc. and Subsidiaries

Consolidated Statement of Shareholders' Equity (unaudited)

For the Three Months Ended March 31, 2014

(in thousands, except share and per share data)

|   | Preferred<br>Stock |          | Common<br>Stock |         | Additional<br>Paid-in<br>Capital | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Treasury<br>Stock | Retained<br>Earnings | Total     |
|---|--------------------|----------|-----------------|---------|----------------------------------|---|-------------------|----------------------|-----------|
|   | Shares             | Amount   | Shares          | Amount  |                                  |   |                   |                      |           |
| Balance -<br>December 31,<br>2013                               | 131,971            | \$41,997 | 11,407,196      | \$1,141 | \$111,017                        | \$ (106 )   | \$(3,286)         | \$39,986             | \$190,749 |
| Net earnings  | -                  | -        | -               | -       | -                                | -   | -                 | 6,858                | 6,858     |
| Dividends on<br>Series B and<br>Series C<br>preferred stock     | -                  | -        | -               | -       | -                                | -   | -                 | (180 )               | (180 )    |
| Dividends on<br>common stock,<br>\$0.08 per share               | -                  | -        | -               | -       | -                                | -   | -                 | (900 )               | (900 )    |
| Conversion of<br>Series C<br>preferred stock<br>to common stock | (4,488 )           | (449 )   | 24,935          | 2       | 447                              | -   | -                 | -                    | -         |
| Stock option<br>expense   | -                  | -        | -               | -       | 195                              | -   | -                 | -                    | 195       |
| Change in<br>accumulated<br>other<br>comprehensive<br>income    | -                  | -        | -               | -       | -                                | 1,915   | -                 | -                    | 1,915     |
| Balance – March<br>31, 2014                                     | 127,483            | \$41,548 | 11,432,131      | \$1,143 | \$111,659                        | \$ 1,809  | \$(3,286)         | \$45,764             | \$198,637 |

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 Three<br>Months Ended<br>March 31, |           |
|---|--|-----------|
|   | 2014                                       | 2013      |
| Cash flows from operating activities:   |  |           |
| Net earnings  | \$6,858                                    | \$3,428   |
| Adjustments to reconcile net earnings to net cash provided by operating activities: |  |           |
| Depreciation  | 1,473                                      | 1,321     |
| Accretion of purchase accounting adjustments  | (981 )                                     | (1,914 )  |
| Provision for loan losses   | 550  | 550       |
| Provision for deferred tax expense  | 277  | 599       |
| Amortization of premiums on securities, net   | 930  | 1,299     |
| Amortization of other investments   | 1  | 5         |
| Stock option expense  | 195  | 62        |
| Restricted stock expense  | -  | 8         |
| Net gain on sale of investment securities   | -  | (204 )    |
| Net loss on sale of other real estate owned   | 26   | 8         |
| Net write down of other real estate owned   | 31   | 47        |
| Net (gain) loss on sale/disposal of premises and equipment                          | (28 )                                      | 6         |
| Change in accrued interest receivable   | 197  | (156 )    |
| Change in accrued interest payable  | (204 )                                     | (286 )    |
| Change in other assets & other liabilities, net                                     | 1,565                                      | 1,284     |
| Net cash provided by operating activities   | 10,890                                     | 6,057     |
| Cash flows from investing activities:   |  |           |
| Net decrease in time deposits in other banks  | -  | 881       |
| Proceeds from maturities and calls of securities available-for-sale                 | 12,316                                     | 23,664    |
| Proceeds from maturities and calls of securities held-to-maturity                   | 4,191                                      | 7,620     |
| Proceeds from sale of securities available-for-sale                                 | -  | 41,839    |
| Purchases of securities available-for-sale  | -  | (35,866 ) |
| Purchases of securities held-to-maturity  | (1,104 )                                   | (22,194 ) |
| Proceeds from redemptions of other investments                                      | 150  | -         |
| Purchases of other investments  | (3 )                                       | (1,712 )  |
| Net change in loans   | (46,021)                                   | 15,075    |
| Purchases of premises and equipment   | (1,634 )                                   | (4,664 )  |
| Proceeds from sale of premises and equipment  | 32   | 1         |
| Proceeds from sale of other real estate owned                                       | 15   | 306       |
| Net cash (used in) provided by investing activities                                 | (32,058)                                   | 24,950    |
| Cash flows from financing activities:   |  |           |
| Change in deposits  | 29,206                                     | 8,453     |
| Change in securities sold under agreements to repurchase                            | (1,921 )                                   | 7,110     |
| Repayments of Federal Home Loan Bank advances                                       | (15 )                                      | (14 )     |
| Repayments of notes payable   | (250 )                                     | (250 )    |
| Proceeds and tax benefit from exercise of stock options                             | -  | 30        |
| Payment of dividends on preferred stock   | (180 )                                     | (368 )    |
| Payment of dividends on common stock  | (900 )                                     | (1,532 )  |

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|  |          |           |
|--|----------|-----------|
| Net cash provided by financing activities      | 25,940   | 13,429    |
| Net increase in cash and cash equivalents      | 4,772    | 44,436    |
| Cash and cash equivalents, beginning of period | 59,731   | 73,573    |
| Cash and cash equivalents, end of period       | \$64,503 | \$118,009 |

Supplemental cash flow information:

|  |         |         |
|--|---------|---------|
| Interest paid                              | \$1,708 | \$2,003 |
| Income taxes paid                          | -       | 200     |
| Noncash investing and financing activities |         |         |
| Transfer of loans to other real estate     | -       | 417     |
| Accrued preferred stock dividends          | 180     | 292     |
| Financed sales of other real estate        | 84      | -       |

See notes to unaudited consolidated financial statements.

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MidSouth Bancorp, Inc. and Subsidiaries  
 Notes to Interim Consolidated Financial Statements  
 March 31, 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 March 31, 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 three-month period ended March 31, 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):

|   | March 31, 2014 |                        |                         |            |
|---|----------------|------------------------|-------------------------|------------|
|   | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| Available-for-sale:                             |                |                        |                         |            |
| U.S. Government sponsored enterprises           | \$ 11,328      | \$ 1                   | \$ 163                  | \$ 11,166  |
| Obligations of state and political subdivisions | 52,097         | 2,079                  | 116                     | 54,060     |
| GSE mortgage-backed securities                  | 141,719        | 2,597                  | 1,371                   | 142,945    |

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|  |           |          |          |           |
|--|-----------|----------|----------|-----------|
| Collateralized mortgage obligations: residential | 71,137    | 360      | 2,147    | 69,350    |
| Collateralized mortgage obligations: commercial  | 27,005    | 374      | 148      | 27,231    |
| Other asset-backed securities                    | 24,955    | 432      | 24       | 25,363    |
| Collateralized debt obligation                   | 464       | 909      | -        | 1,373     |
|  | \$328,705 | \$ 6,752 | \$ 3,969 | \$331,488 |

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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 |

|  | March 31, 2014 |                        |                         |            |
|--|----------------|------------------------|-------------------------|------------|
|  | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| Held-to-maturity:                                |                |                        |                         |            |
| Obligations of state and political subdivisions  | \$ 46,999      | \$ 18                  | \$ 1,492                | \$ 45,525  |
| GSE mortgage-backed securities                   | 75,634         | 590                    | 706                     | 75,518     |
| Collateralized mortgage obligations: residential | 13,897         | -                      | 671                     | 13,226     |
| Collateralized mortgage obligations: commercial  | 15,632         | 73                     | -                       | 15,705     |
|  | \$ 152,162     | \$ 681                 | \$ 2,869                | \$ 149,974 |

|  | 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 \$57,000 at March 31, 2014, all of the Company’s CMOs are government-sponsored enterprise (“GSE”) securities.

The amortized cost and fair value of debt securities at March 31, 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<br>Cost | Fair<br>Value |
|---|-------------------|---------------|
| Available-for-sale:   |                   |               |
| Due in one year or less   | \$ 8,965          | \$9,094       |
| Due after one year through five years                               | 34,408            | 35,389        |
| Due after five years through ten years                              | 14,871            | 15,649        |
| Due after ten years   | 5,181             | 5,094         |
| Other asset-backed securities                                       | 24,955            | 25,363        |
| Mortgage-backed securities and collateralized mortgage obligations: |                   |               |
| Residential   | 212,856           | 212,295       |
| Commercial  | 27,005            | 27,231        |
| Collateralized debt obligation                                      | 464               | 1,373         |
|   | \$ 328,705        | \$ 331,488    |

|   | Amortized<br>Cost | Fair<br>Value |
|---|-------------------|---------------|
| Held-to-maturity:   |                   |               |
| Due in one year or less   | \$ 107            | \$ 107        |
| Due after one year through five years                               | 2,411             | 2,408         |
| Due after five years through ten years                              | 6,928             | 6,768         |
| Due after ten years   | 37,553            | 36,242        |
| Mortgage-backed securities and collateralized mortgage obligations: |                   |               |
| Residential   | 89,531            | 88,744        |
| Commercial  | 15,632            | 15,705        |
|   | \$ 152,162        | \$ 149,974    |

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

|   | March 31, 2014                            |                             | Securities with          |                             | Total     | Gross<br>Unrealized<br>Loss |
|---|---|-----------------------------|--------------------------|-----------------------------|-----------|-----------------------------|
|   | Securities with losses<br>under 12 months |                             | losses<br>over 12 months |                             |           |                             |
|   | Fair<br>Value                             | Gross<br>Unrealized<br>Loss | Fair<br>Value            | Gross<br>Unrealized<br>Loss |           |                             |
| Available-for-sale:                             |   |                             |                          |                             |           |                             |
| U.S. Government sponsored enterprises           | \$10,413                                  | \$ 163                      | \$-                      | \$ -                        | \$10,413  | \$ 163                      |
| Obligations of state and political subdivisions | 3,850                                     | 109                         | 481                      | 7                           | 4,331     | 116                         |
| GSE mortgage-backed securities                  | 56,625                                    | 1,360                       | 10,702                   | 11                          | 67,327    | 1,371                       |
| Collateralized mortgage obligations:            |   |                             |                          |                             |           |                             |
| residential                                     | 39,722                                    | 1,471                       | 13,169                   | 676                         | 52,891    | 2,147                       |
| Collateralized mortgage obligations:            |   |                             |                          |                             |           |                             |
| commercial                                      | 4,266                                     | 148                         | -                        | -                           | 4,266     | 148                         |
| Other asset-backed securities                   | 5,864                                     | 24                          | -                        | -                           | 5,864     | 24                          |
|   | \$120,740                                 | \$ 3,275                    | \$24,352                 | \$ 694                      | \$145,092 | \$ 3,969                    |

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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              |
|  |  |                       |                                       |                       |            |                       |
|  | March 31, 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  | \$19,478                               | \$ 622                | \$21,648                              | \$ 870                | \$41,126   | \$ 1,492              |
| GSE mortgage-backed securities                   | 30,385                                 | 706                   | -                                     | -                     | 30,385     | 706                   |
| Collateralized mortgage obligations: residential | 8,924                                  | 400                   | 4,302                                 | 271                   | 13,226     | 671                   |
|  | \$58,787                               | \$ 1,728              | \$25,950                              | \$ 1,141              | \$84,737   | \$ 2,869              |
|  |  |                       |                                       |                       |            |                       |
|  | 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 March 31, 2014, 101 securities had unrealized losses totaling 2.89% of the individual securities' amortized cost basis and 1.42% of the Company's total amortized cost basis. 31 of the 101 securities had been in an unrealized loss position for over twelve months at March 31, 2014. These 31 securities had an amortized cost basis and unrealized loss of \$52.1 million and \$1.8 million, respectively. The unrealized losses on debt securities at March 31, 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 March 31, 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 three months ended March 31, 2014.

During the three months ended March 31, 2014, the Company did not sell any securities. During the three months ended March 31, 2013, the Company sold 21 securities classified as available-for-sale at a net gain of approximately \$204,000. Of the 21 securities sold, 18 securities were sold with gains totaling approximately \$217,000 and three securities were sold at a loss of approximately \$13,000.

Securities with an aggregate carrying value of approximately \$270.5 million and \$259.9 million at March 31, 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):

|  | March 31,<br>2014 | December<br>31, 2013 |
|--|-------------------|----------------------|
| Commercial, financial and agricultural | \$435,523         | \$403,976            |
| Real estate - construction             | 78,988            | 82,691               |
| Real estate – commercial               | 408,546           | 397,135              |
| Real estate – residential              | 150,551           | 146,841              |
| Installment loans to individuals       | 101,869           | 97,459               |
| Lease financing receivable             | 5,102             | 5,542                |
| Other                                  | 3,610             | 3,910                |
|  | 1,184,189         | 1,137,554            |
| Less allowance for loan losses         | (8,765 )          | (8,779 )             |
|  | \$1,175,424       | \$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 March 31, 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 \$239.3 million, or 20.2% of total loans. Additionally, the Company's exposure to loans secured by commercial real estate is monitored. At March 31, 2014, loans secured by commercial real estate (including commercial construction, farmland and multifamily loans) totaled approximately \$469.3 million. Of the \$469.3 million, \$373.9 million represent CRE loans, 63% of which are secured by owner-occupied commercial properties. Of the \$469.3 million in loans secured by commercial real estate, \$3.4 million, or 0.7%, were on nonaccrual status at March 31, 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 three months ended March 31, 2014 and 2013 is as follows (in thousands):

|  | March 31, 2014                |                             |            |             |           |                           |         | Total       |
|--|-------------------------------|-----------------------------|------------|-------------|-----------|---------------------------|---------|-------------|
|  | Coml,<br>Fin,<br>and<br>Agric | Real Estate<br>Construction | Commercial | Residential | Consumer  | Finance<br>Leases<br>Coml | Other   |             |
| Allowance for loan losses:   |                               |                             |            |             |           |                           |         |             |
| Beginning balance  | \$3,906                       | \$1,046                     | \$1,389    | \$1,141     | \$1,273   | \$21                      | \$3     | \$8,779     |
| Charge-offs  | (431)                         | (1)                         | (13)       | (84)        | (159)     | -                         | -       | (688)       |
| Recoveries   | 14                            | -                           | 37         | 8           | 65        | -                         | -       | 124         |
| Provision  | 749                           | 36                          | 8          | (172)       | (69)      | (2)                       | -       | 550         |
| Ending balance   | \$4,238                       | \$1,081                     | \$1,421    | \$893       | \$1,110   | \$19                      | \$3     | \$8,765     |
| Ending balance:<br>individually evaluated<br>for impairment              | \$86                          | \$3                         | \$57       | \$71        | \$131     | \$-                       | \$-     | \$348       |
| Ending balance:<br>collectively evaluated<br>for impairment              | \$4,152                       | \$1,078                     | \$1,364    | \$822       | \$979     | \$19                      | \$3     | \$8,417     |
| Loans:   |                               |                             |            |             |           |                           |         |             |
| Ending balance   | \$435,523                     | \$78,988                    | \$408,546  | \$150,551   | \$101,869 | \$5,102                   | \$3,610 | \$1,184,189 |
| Ending balance:<br>individually evaluated<br>for impairment              | \$2,273                       | \$154                       | \$3,195    | \$951       | \$292     | \$-                       | \$-     | \$6,865     |
| Ending balance:<br>collectively evaluated<br>for impairment              | \$433,250                     | \$78,834                    | \$404,652  | \$149,442   | \$101,577 | \$5,102                   | \$3,610 | \$1,176,467 |
| Ending balance: loans<br>acquired with<br>deteriorated credit<br>quality | \$-                           | \$-                         | \$699      | \$158       | \$-       | \$-                       | \$-     | \$857       |

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March 31, 2013

Real Estate

|   | Coml,<br>Fin,<br>and<br>Agric | Real Estate  |            |             | Consumer | Finance<br>Leases |         | Total       |
|---|-------------------------------|--------------|------------|-------------|----------|-------------------|---------|-------------|
|   |                               | Construction | Commercial | Residential |          | Coml              | Other   |             |
| Allowance for loan losses:                                      |                               |              |            |             |          |                   |         |             |
| Beginning balance   | \$1,535                       | \$2,147      | \$2,166    | \$936       | \$543    | \$41              | \$2     | \$7,370     |
| Charge-offs   | (181)                         | -            | (18)       | (109)       | (216)    | -                 | -       | (524)       |
| Recoveries  | 16                            | 5            | 10         | 1           | 29       | -                 | -       | 61          |
| Provision   | 212                           | 111          | 115        | 41          | 69       | 1                 | 1       | 550         |
| Ending balance  | \$1,582                       | \$2,263      | \$2,273    | \$869       | \$425    | \$42              | \$3     | \$7,457     |
| Ending balance:   |                               |              |            |             |          |                   |         |             |
| individually evaluated for impairment                           | \$467                         | \$51         | \$21       | \$42        | \$106    | \$-               | \$-     | \$687       |
| Ending balance:   |                               |              |            |             |          |                   |         |             |
| collectively evaluated for impairment                           | \$1,115                       | \$2,212      | \$2,252    | \$827       | \$319    | \$42              | \$3     | \$6,770     |
| Loans:  |                               |              |            |             |          |                   |         |             |
| Ending balance  | \$315,397                     | \$82,508     | \$405,705  | \$138,284   | \$88,898 | \$4,962           | \$2,105 | \$1,037,859 |
| Ending balance:   |                               |              |            |             |          |                   |         |             |
| individually evaluated for impairment                           | \$1,648                       | \$835        | \$2,688    | \$1,205     | \$255    | \$-               | \$-     | \$6,631     |
| Ending balance:   |                               |              |            |             |          |                   |         |             |
| collectively evaluated for impairment                           | \$313,749                     | \$81,673     | \$399,051  | \$136,791   | \$88,643 | \$4,962           | \$2,105 | \$1,026,974 |
| Ending balance: loans acquired with deteriorated credit quality | \$-                           | \$-          | \$3,966    | \$288       | \$-      | \$-               | \$-     | \$4,254     |

## 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):

March 31, 2014

|   | 30-59<br>Days<br>Past<br>Due | 60-89<br>Days<br>Past<br>Due | Greater<br>than 90<br>Days<br>Past<br>Due | Total<br>Past<br>Due | Current     | Total<br>Loans | Recorded<br>Investment<br>> 90 days<br>and<br>Accruing |
|---|------------------------------|------------------------------|---|----------------------|-------------|----------------|--|
| Commercial, financial, and agricultural | \$2,358                      | \$851                        | \$1,213                                   | \$4,422              | \$431,101   | \$435,523      | \$ 123   |
| Commercial real estate - construction   | 122                          | 12                           | 62  | 196                  | 60,542      | 60,738         | -  |
| Commercial real estate - other          | 1,474                        | 720                          | 2,937                                     | 5,131                | 403,415     | 408,546        | -  |
| Residential - construction              | 149                          | -                            | 44  | 193                  | 18,057      | 18,250         | -  |
| Residential - prime                     | 2,206                        | -                            | 928                                       | 3,134                | 147,417     | 150,551        | 100  |
| Consumer - credit card                  | 36                           | 34                           | 6   | 76                   | 5,782       | 5,858          | 6  |
| Consumer - other                        | 433                          | 145                          | 305                                       | 883                  | 95,128      | 96,011         | 22   |
| Lease financing receivable              | -                            | -                            | -   | -                    | 5,102       | 5,102          | -  |
| Other loans                             | 100                          | 2                            | -   | 102                  | 3,508       | 3,610          | -  |
|   | \$6,878                      | \$1,764                      | \$5,495                                   | \$14,137             | \$1,170,052 | \$1,184,189    | \$ 251   |

December 31, 2013

|   | 30-59<br>Days<br>Past<br>Due | 60-89<br>Days<br>Past<br>Due | Greater<br>than 90<br>Days<br>Past<br>Due | Total<br>Past<br>Due | Current     | Total<br>Loans | Recorded<br>Investment<br>> 90 days<br>and<br>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):

|   | March<br>31,<br>2014 | December<br>31, 2013 |
|---|----------------------|----------------------|
| Commercial, financial, and agricultural | \$1,118              | \$ 1,272             |
| Commercial real estate - construction   | 44                   | 100                  |
| Commercial real estate - other          | 3,377                | 2,290                |
| Residential - construction              | -                    | -                    |
| Residential - prime                     | 1,187                | 1,153                |
| Consumer - credit card                  | -                    | -                    |
| Consumer - other                        | 299                  | 284                  |
| Lease financing receivable              | -                    | -                    |

|       |         |          |
|-------|---------|----------|
| Other | -       | -        |
|       | \$6,025 | \$ 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 \$118,000 and \$148,000 for the three months ended March 31, 2014 and 2013, respectively. Interest actually received on non-accrual loans at March 31, 2014 and 2013 was \$88,000 and \$36,000, 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):

|   | March 31, 2014 |           |           | Average    | Interest   |
|---|----------------|-----------|-----------|------------|------------|
|   | Recorded       | Unpaid    | Related   | Recorded   | Income     |
|   | Investment     | Principal | Allowance | Investment | Recognized |
| With no related allowance recorded:     |                |           |           |            |            |
| Commercial, financial, and agricultural | \$ 1,842       | \$ 2,235  | \$ -      | \$ 1,256   | \$ 21      |
| Commercial real estate – construction   | 71             | 71        | -         | 66         | -          |
| Commercial real estate – other          | 2,697          | 3,171     | -         | 2,273      | -          |
| Residential – prime                     | 529            | 529       | -         | 527        | 1          |
| Residential – construction              | 44             | 44        | -         | 22         | -          |
| Consumer – other                        | 61             | 61        | -         | 63         | -          |
| Subtotal:                               | 5,244          | 6,111     | -         | 4,207      | 22         |
| With an allowance recorded:             |                |           |           |            |            |
| Commercial, financial, and agricultural | 431            | 431       | 86        | 501        | -          |
| Commercial real estate – construction   | 39             | 39        | 3         | 39         | 1          |
| Commercial real estate – other          | 498            | 498       | 57        | 431        | 2          |
| Residential – prime                     | 422            | 442       | 71        | 399        | 1          |
| Consumer – other                        | 231            | 245       | 131       | 218        | -          |
| Subtotal:                               | 1,621          | 1,655     | 348       | 1,588      | 4          |
| Totals:                                 |                |           |           |            |            |
| Commercial                              | 5,468          | 6,335     | 143       | 4,461      | 22         |
| Residential                             | 951            | 971       | 71        | 926        | 2          |
| Construction                            | 154            | 154       | 3         | 127        | 2          |
| Consumer                                | 292            | 306       | 131       | 281        | -          |
| Grand total:                            | \$ 6,865       | \$ 7,766  | \$ 348    | \$ 5,795   | \$ 26      |



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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):

March 31, 2014

Commercial Credit Exposure  
Credit Risk Profile by  
Creditworthiness Category

|                 | Commercial,<br>financial,<br>and<br>agricultural | Commercial<br>real estate -<br>construction | Commercial<br>real estate -<br>other | Total     | % of<br>Total |
|-----------------|--|---|--------------------------------------|-----------|---------------|
| Pass            | \$424,566  | \$ 60,579                                   | \$ 383,915                           | \$869,060 | 96.05 %       |
| Special mention | 6,864  | 49  | 7,165                                | 14,078    | 1.55 %        |
| Substandard     | 3,680  | 110   | 17,466                               | 21,256    | 2.35 %        |
| Doubtful        | 413  | -   | -                                    | 413       | 0.05 %        |
|                 | \$435,523  | \$ 60,738                                   | \$ 408,546                           | \$904,807 | 100.00 %      |

Residential Credit Exposure  
Credit Risk Profile by  
Creditworthiness Category

|                 | Residential<br>construction | Residential<br>prime | Residential<br>subprime | Total     | % of<br>Total |
|-----------------|-----------------------------|----------------------|-------------------------|-----------|---------------|
| Pass            | \$18,206                    | \$ 147,088           | \$ -                    | \$165,294 | 97.92 %       |
| Special mention | -                           | 571                  | -                       | 571       | 0.34 %        |
| Substandard     | 44                          | 2,892                | -                       | 2,936     | 1.74 %        |
|                 | \$18,250                    | \$ 150,551           | \$ -                    | \$168,801 | 100.00 %      |

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

|               | Consumer<br>credit<br>card | Consumer<br>other | Lease<br>financing<br>receivable | Other    | Total     | % of<br>Total |
|---------------|----------------------------|-------------------|----------------------------------|----------|-----------|---------------|
| Performing    | \$ 5,852                   | \$95,698          | \$ 5,102                         | \$ 3,610 | \$110,262 | 99.71 %       |
| Nonperforming | 6                          | 313               | -                                | -        | 319       | 0.29 %        |
|               | \$ 5,858                   | \$96,011          | \$ 5,102                         | \$ 3,610 | \$110,581 | 100.00 %      |

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December 31, 2013

Commercial Credit Exposure  
Credit Risk Profile by  
Creditworthiness Category

|                 | Commercial,<br>financial,<br>and<br>agricultural | Commercial<br>real estate -<br>construction | Commercial<br>real estate -<br>other | Total      | % of<br>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<br>construction | Residential<br>prime | Residential<br>- subprime | Total      | % of<br>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<br>credit<br>card | Consumer<br>other | Lease<br>financing<br>receivable | Other    | Total      | % of<br>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):

| March 31, 2014 |                        |                    |               |
|----------------|------------------------|--------------------|---------------|
| Current        | Past<br>Due<br>Greater | Nonaccrual<br>TDRs | Total<br>TDRs |

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|  |          | Than |        |          |
|--|----------|------|--------|----------|
|  |          | 30   |        |          |
|  |          | Days |        |          |
| Commercial, financial and agricultural | \$ 1,187 | \$ - | \$ 234 | \$ 1,421 |
| Real estate - commercial               | 158      | -    | -      | 158      |
|  | \$ 1,345 | \$ - | \$ 234 | \$ 1,579 |

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

During the three months ended March 31, 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, and there were no defaults on any loans that were modified as TDRs during the preceding twelve months. During the three months ended March 31, 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 March 31, 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 March 31, |           |          |           |        |           |
|--|------------------------------|-----------|----------|-----------|--------|-----------|
|  | 2014                         |           |          | 2013      |        |           |
|  | Before                       | Net of    | Before   | Net of    | Net of |           |
|  | Tax                          | Tax       | Tax      | Tax       | Tax    | Tax       |
|  | Amount                       | Effect    | Amount   | Amount    | Effect | Amount    |
| Other comprehensive income (loss):                           |                              |           |          |           |        |           |
| Securities available-for-sale:                               |                              |           |          |           |        |           |
| Change in unrealized gain during period                      | \$2,946                      | \$(1,031) | \$ 1,915 | \$(1,115) | \$ 390 | \$( 725 ) |
| Reclassification adjustment for gains included in net income | -                            | -         | -        | (204 )    | 71     | (133 )    |
| Total other comprehensive income (loss)                      | \$2,946                      | \$(1,031) | \$ 1,915 | \$(1,319) | \$ 461 | \$( 858 ) |

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

|   | Three Months Ended March 31, |                     |                     |                     |
|---|------------------------------|---------------------|---------------------|---------------------|
|   | 2014                         |                     | 2013                |                     |
|   | Reclassification of          | Reclassification of | Reclassification of | Reclassification of |
|   | Other                        | Other               | Other               | Other               |
|   | Accumulated                  | Accumulated         | Accumulated         | Accumulated         |
|   | Other                        | Other               | Other               | Other               |
| Details about Accumulated Other Comprehensive Income Components | of                           | of                  | of                  | of                  |
|   | Other                        | Other               | Other               | Other               |

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|   | Comprehensive<br>Income     | Comprehensive<br>Income        |
|---|-----------------------------|--------------------------------|
| Unrealized gains and losses on securities available-for-sale: |                             |                                |
|   | \$- Gain on securities, net | \$(204)Gain on securities, net |
|   | - Income tax expense        | 71 Income tax expense          |
|   | \$- Net of tax              | \$(133)Net of tax              |

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## 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<br>Ended March 31, |         |
|---|---------------------------------|---------|
|   | 2014                            | 2013    |
| Net earnings available to common shareholders   | \$6,678                         | \$3,136 |
| Dividends on Series C preferred stock   | 100                             | 100     |
| Adjusted net earnings available to common shareholders  | \$6,778                         | \$3,236 |
| Weighted average number of common shares outstanding used in computation of basic earnings per common share                                 | 11,258                          | 11,238  |
| Effect of dilutive securities:  |                                 |         |
| Stock options   | 74                              | 50      |
| Restricted stock  | -                               | 13      |
| Convertible preferred stock and warrants  | 547                             | 565     |
| Weighted average number of common shares outstanding plus effect of dilutive securities – used in computation of diluted earnings per share | 11,879                          | 11,866  |

Options to acquire 18,003 and 18,331 shares of common stock were not included in computing diluted earnings per share for the quarters ended March 31, 2014 and 2013, respectively, because the effects of these shares were anti-dilutive as a result of the exercise price of such options.

## 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.

## 7. Intangibles

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

|                               | March<br>31,<br>2014 | December<br>31, 2013 |
|-------------------------------|----------------------|----------------------|
| Gross carrying amount         | \$11,674             | \$11,674             |
| Less accumulated amortization | (4,010)              | (3,733)              |
| Net carrying amount           | \$7,664              | \$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.

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**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.

**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.

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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.

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 /<br>Liabilities<br>Measured<br>at Fair<br>Value<br>at March<br>31, 2014 | Fair Value<br>Measurements<br>at March 31, 2014 |           |            |
|--|---|---|-----------|------------|
|  |   | Level<br>1                                      | Level 2   | Level<br>3 |
| Available-for-sale securities:                   |   |   |           |            |
| U.S. Government sponsored enterprises            | \$ 11,166   | \$-   | \$ 11,166 | \$ -       |
| Obligations of state and political subdivisions  | 54,060  | -   | 54,060    | -          |
| GSE mortgage-backed securities                   | 142,945   | -   | 142,945   | -          |
| Collateralized mortgage obligations: residential | 69,350  | -   | 69,350    | -          |
| Collateralized mortgage obligations: commercial  | 27,231  | -   | 27,231    | -          |
| Other asset-backed securities                    | 25,363  | -   | 25,363    | -          |
| Collateralized debt obligation                   | 1,373   | -   | 1,373     | -          |

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| Description                                      | Assets /<br>Liabilities<br>Measured<br>at Fair<br>Value<br>at<br>December<br>31, 2013 | Fair Value<br>Measurements<br>at December 31,<br>2013 |           |            |
|--|---|---|-----------|------------|
|  |   | Level<br>1  | Level 2   | Level<br>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.

| Description       | Assets /<br>Liabilities<br>Measured<br>at Fair<br>Value<br>at March<br>31, 2014 | Fair Value<br>Measurements<br>at March 31, 2014 |          |            |
|-------------------|---|---|----------|------------|
|                   |   | Level<br>1                                      | Level 2  | Level<br>3 |
| Impaired loans    | \$ 2,127  | \$-   | \$ 2,127 | \$ -       |
| Other real estate | 6,525   | -   | 6,525    | -          |

| Description       | Assets /<br>Liabilities<br>Measured<br>at Fair<br>Value<br>at<br>December<br>31, 2013 | Fair Value<br>Measurements<br>at December 31,<br>2013 |          |            |
|-------------------|---|---|----------|------------|
|                   |   | Level<br>1  | Level 2  | Level<br>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.

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

|   | Carrying<br>Value | Fair Value Measurements at<br>March 31, 2014 Using:    |         |           |
|---|-------------------|--|---------|-----------|
|   |                   | Level 1  | Level 2 | Level 3   |
| Financial assets:                               |                   |  |         |           |
| Cash and cash equivalents                       | \$64,503          | \$64,503   | \$-     | \$-       |
| Securities available-for-sale                   | 331,488           | -  | 331,488 | -         |
| Securities held-to-maturity                     | 152,162           | -  | 149,974 | -         |
| Other investments                               | 11,530            | 11,530   | -       | -         |
| Loans, net                                      | 1,175,424         | -  | -       | 1,187,543 |
| Cash surrender value of life insurance policies | 13,505            | -  | 13,505  | -         |
| Financial liabilities:                          |                   |  |         |           |
| Non-interest-bearing deposits                   | 379,576           | -  | 379,576 | -         |
| Interest-bearing deposits                       | 1,168,354         | -  | 939,025 | 230,289   |
| Securities sold under agreements to repurchase  | 51,995            | 51,995   | -       | -         |
| Short-term Federal Home Loan Bank advances      | 25,000            | -  | 25,000  | -         |
| Notes payable                                   | 27,347            | -  | -       | 28,493    |
| Junior subordinated debentures                  | 29,384            | -  | 22,167  | 7,549     |
|   |                   |  |         |           |
|   | Carrying<br>Value | Fair Value Measurements at<br>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     |

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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 61 locations, including a Loan Production Office in Austin, Texas, and are connected to a worldwide ATM network that provides customers with access to more than 50,000 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 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 efforts;
- 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 \$6.7 million for the first quarter of 2014, compared to net earnings available to common shareholders of \$3.1 million reported for the first quarter of 2013. Diluted earnings for the first quarter of 2014 were \$0.57 per common share, compared to \$0.27 per common share reported for the first quarter of 2013. The first quarter of 2014 included \$3.0 million of executive officer life insurance proceeds recorded in noninterest income and after-tax related noninterest expenses of \$160,000. The life insurance proceeds were received in connection with a key man life insurance policy held on Gerald “Jerry” Reaux Jr., Vice Chairman of the Board and Chief Operating Officer of the Company and the Bank, who passed away on Sunday, February 9, 2014. Excluding these non-operating income and expenses, operating earnings per share for the first quarter of 2014 was \$0.33.

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 first quarter of 2014 based on a dividend rate of 1.00%. The Series C Preferred Stock issued in conjunction with the acquisition of PSB Financial Corporation (“PSB”) paid dividends totaling \$100,000 for the three months ended March 31, 2014.

Revenues from consolidated operations increased \$4.0 million in quarterly comparison and included \$3.0 million of executive officer life insurance proceeds recorded in noninterest income. Interest income increased \$270,000 in quarterly comparison, as a \$779,000 decrease in loan valuation income was offset by an increase in interest income earned on a higher volume of loans. Excluding the \$3.0 million of life insurance income, noninterest income increased \$486,000 in quarterly comparison, from \$4.4 million for the three months ended March 31, 2013 to \$4.9 million for the three months ended March 31, 2014. Noninterest expenses increased \$271,000 for the first quarter 2014 compared to first quarter 2013 and included approximately \$189,000 in non-operating expenses related primarily to expenses associated with incentive compensation plans for Mr. Reaux.

Net Interest Income

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 4.66% and 4.61% for the three months ended March 31, 2014 and 2013, respectively. Tables 1 and 2 below analyze the changes in net interest income in the three months ended March 31, 2014 and 2013.

Fully taxable-equivalent (“FTE”) net interest income totaled \$19.3 million and \$18.8 million for the quarters ended March 31, 2014 and 2013, respectively. The FTE net interest income increased \$500,000 in prior year quarterly comparison primarily due to a \$103.2 million increase in the average volume of loans in quarterly comparison. The average yield on loans decreased 47 basis points, from 6.65% to 6.18%, primarily due to a reduction in purchase accounting adjustments on acquired loans. The purchase accounting adjustments added 42 basis points to the average yield on loans for the first quarter of 2014 and 80 basis points to the average yield on loans for the first quarter of 2013. Net of the impact of the purchase accounting adjustments, average loan yields declined 9 basis points in prior year quarterly comparison, from 5.85% to 5.76%. Loan yields have declined primarily as the result of a sustained low interest rate environment.

Investment securities totaled \$483.7 million, or 25.6% of total assets at March 31, 2014, versus \$555.4 million, or 29.7% of total assets at March 31, 2013. The investment portfolio had an effective duration of 4.0 years and an unrealized gain of \$2.8 million at March 31, 2014. The average volume of investment securities decreased \$43.6

million in prior year quarterly comparison. The average tax equivalent yield on investment securities increased 17 basis points, from 2.44% to 2.61%. The \$43.6 million decrease in investment securities combined with a \$37.0 million reduction in time and interest bearing deposits in other banks and federal funds sold over the past twelve months partially funded the increase in loans during the same period.

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The average yield on all earning assets decreased 1 basis point in prior year quarterly comparison, from 5.03% for the first quarter of 2013 to 5.02% for the first quarter of 2014. Net of the impact of purchase accounting adjustments, the average yield on total earning assets increased 21 basis points, from 4.53% to 4.74% for the three month periods ended March 31, 2013 and 2014, respectively.

The impact to interest expense of a \$46.5 million increase in the average volume of interest bearing liabilities was offset by a 9 basis point decrease in the average rate paid on interest bearing liabilities, from 0.56% at March 31, 2013 to 0.47% at March 31, 2014. Net of purchase accounting adjustments on acquired certificates of deposit and FHLB borrowings, the average rate paid on interest bearing liabilities was 0.67% for the first quarter of 2013 and declined to 0.53% for the first quarter of 2014.

Included in notes payable is an average of \$27.6 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 April 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 \$25.0 million at March 31, 2014. The advances mature in June 2014 and bear an interest rate of 0.14%. The short-term advances partially funded the loan growth we experienced in the first quarter of 2014.

The average rate paid on our junior subordinated debentures increased 13 basis points in prior year quarterly comparison, from 4.59% for the first quarter of 2013 to 4.72% for the first 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%.

As a result of these changes in volume and yield on earning assets and interest bearing liabilities, the FTE net interest margin increased 5 basis points, from 4.61% for the first quarter of 2013 to 4.66% for the first quarter of 2014. Net of purchase accounting adjustments on loans, deposits and FHLB borrowings, the FTE margin increased 30 basis points, from 4.03% for the first quarter of 2013 to 4.33% for the first quarter of 2014.

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## Table 1

## Consolidated Average Balances, Interest and Rates

(in thousands)

|  | Three Months Ended March 31,<br>2014 |          |                       | 2013              |          |                       |   |  |
|--|--------------------------------------|----------|-----------------------|-------------------|----------|-----------------------|---|--|
|  | Average<br>Volume                    | Interest | Average<br>Yield/Rate | Average<br>Volume | Interest | Average<br>Yield/Rate |   |  |
| <b>Assets</b>  |                                      |          |                       |                   |          |                       |   |  |
| Investment securities <sup>1</sup>                   |                                      |          |                       |                   |          |                       |   |  |
| Taxable  | \$397,642                            | \$2,136  | 2.15                  | % \$426,017       | \$2,059  | 1.93                  | % |  |
| Tax exempt <sup>2</sup>                              | 91,792                               | 1,059    | 4.61                  | % 106,982         | 1,188    | 4.44                  | % |  |
| Total investment securities                          | 489,434                              | 3,195    | 2.61                  | % 532,999         | 3,247    | 2.44                  | % |  |
| Federal funds sold                                   | 2,921                                | 1        | 0.14                  | % 8,021           | 4        | 0.20                  | % |  |
| Time and interest bearing deposits in other<br>banks |                                      |          |                       |                   |          |                       |   |  |
|  | 25,891                               | 16       | 0.25                  | % 57,829          | 38       | 0.26                  | % |  |
| Other investments                                    | 11,527                               | 70       | 2.43                  | % 9,317           | 72       | 3.09                  | % |  |
| Total loans <sup>3</sup>                             | 1,147,010                            | 17,483   | 6.18                  | % 1,043,780       | 17,117   | 6.65                  | % |  |
| Total earning assets                                 | 1,676,783                            | 20,765   | 5.02                  | % 1,651,946       | 20,478   | 5.03                  | % |  |
| Allowance for loan losses                            | (8,688 )                             |          |                       | (7,151 )          |          |                       |   |  |
| Nonearning assets                                    | 191,117                              |          |                       | 205,964           |          |                       |   |  |
| Total assets   | \$1,859,212                          |          |                       | \$1,850,759       |          |                       |   |  |
| <b>Liabilities and shareholders' equity</b>          |                                      |          |                       |                   |          |                       |   |  |
| Total interest bearing deposits                      | \$1,155,011                          | \$871    | 0.31                  | % \$1,133,087     | \$1,078  | 0.39                  | % |  |
| Securities sold under repurchase agreements          | 48,413                               | 180      | 1.51                  | % 45,644          | 179      | 1.59                  | % |  |
| Federal funds purchased                              | 168                                  | -        | -                     | -                 | -        | -                     |   |  |
| Short-term FHLB advances                             | 25,000                               | 10       | 0.16                  | % -               | -        | -                     |   |  |
| Notes payable  | 27,577                               | 96       | 1.39                  | % 28,912          | 104      | 1.44                  | % |  |
| Other borrowings/payables                            | -                                    | -        | -                     | 2,000             | 20       | 4.00                  | % |  |
| Junior subordinated debentures                       | 29,384                               | 347      | 4.72                  | % 29,384          | 336      | 4.59                  | % |  |
| Total interest bearing liabilities                   | 1,285,553                            | 1,504    | 0.47                  | % 1,239,027       | 1,717    | 0.56                  | % |  |
| Demand deposits                                      | 372,342                              |          |                       | 409,639           |          |                       |   |  |
| Other liabilities                                    | 6,337                                |          |                       | 11,529            |          |                       |   |  |
| Shareholders' equity                                 | 194,980                              |          |                       | 190,564           |          |                       |   |  |
| Total liabilities and shareholders' equity           | \$1,859,212                          |          |                       | \$1,850,759       |          |                       |   |  |
| Net interest income and net interest spread          |                                      | \$19,261 | 4.55                  | %                 | \$18,761 | 4.47                  | % |  |
| Net yield on interest earning assets                 |                                      |          | 4.66                  | %                 |          | 4.61                  | % |  |

<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 \$366,000 for 2014 and \$349,000 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 \$1,345,000 for 2014 and \$1,081,000 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

## Changes in Taxable-Equivalent Net Interest Income

(in thousands)

|   | Three Months Ended<br>March 31, 2014<br>compared to March 31,<br>2013 |                                     |          |
|---|---|-------------------------------------|----------|
|   | Total<br>Increase<br>(Decrease)                                       | Change<br>Attributable To<br>Volume | Rates    |
| Taxable-equivalent earned on:                     |   |                                     |          |
| Investment securities                             |   |                                     |          |
| Taxable   | \$77  | \$(143 )                            | \$220    |
| Tax exempt  | (129)   | (174 )                              | 45       |
| Federal funds sold                                | (3 )  | (2 )                                | (1 )     |
| Time and interest bearing deposits in other banks | (22 )   | (19 )                               | (3 )     |
| Other investments                                 | (2 )  | 15                                  | (17 )    |
| Loans, including fees                             | 366   | 1,623                               | (1,257)  |
| Total   | 287   | 1,300                               | (1,013)  |
| Interest paid on:                                 |   |                                     |          |
| Interest bearing deposits                         |   |                                     |          |
| Securities sold under repurchase agreements       | (207)   | 21                                  | (228 )   |
| Short-term FHLB advances                          | 10  | 10                                  | -        |
| Notes payable                                     | (8 )  | (7 )                                | (1 )     |
| Other borrowings/payables                         | (20 )   | (20 )                               | -        |
| Junior subordinated debentures                    | 11  | -                                   | 11       |
| Total   | (213)   | 14                                  | (227 )   |
| Taxable-equivalent net interest income            | \$500   | \$1,286                             | \$(786 ) |

Note: In Table 2, 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.

Non-interest Income

Non-interest income increased \$3.5 million in quarterly comparison, from \$4.4 million for the three months ended March 31, 2013 to \$7.9 million for the three months ended March 31, 2014. Excluding the \$3.0 million of life insurance income, noninterest income increased \$486,000 in quarterly comparison. Increases in noninterest income consisted primarily of \$209,000 in service charges on deposit accounts and \$358,000 in ATM/debit card income partially offset by a decrease of \$204,000 in gain on sales of securities that occurred in the first quarter of 2013.

Non-interest Expense

Noninterest expenses increased \$271,000 for the first quarter 2014 compared to first quarter 2013 and included approximately \$189,000 in non-operating expenses related primarily to expenses associated with incentive compensation plans for Mr. Reaux. The first quarter of 2013 included \$214,000 of net merger and conversion related expenses associated with the PSB acquisition. Excluding these non-operating expenses in 2014 and 2013, increases in non-interest expenses consisted primarily of \$282,000 in salaries and benefits costs, \$276,000 in ATM/debit card expense and \$204,000 in occupancy expenses. The increased costs were partially offset by decreases of \$166,000 in



marketing expense, \$95,000 in the cost of printing and supplies, and \$94,000 in legal and professional fees. The provision for loan losses remained unchanged at \$550,000, and income tax expense increased \$268,000 in quarterly comparison.

#### Analysis of Balance Sheet

Consolidated assets remained constant at \$1.9 billion for the quarters ended March 31, 2014 and 2013 and December 31, 2013. Deposits totaled \$1.5 billion at March 31, 2014 and December 31, 2013, compared to \$1.6 billion at March 31, 2013. Our stable core deposit base, which excludes time deposits, grew \$39.6 million and accounted for 85.1% of deposits at March 31, 2014 compared to 84.2% of deposits at year end 2013.

Securities available-for-sale totaled \$331.5 million at March 31, 2014, a decrease of \$10.2 million from \$341.7 million at December 31, 2013. The securities available-for-sale portfolio declined primarily due to \$12.4 million in calls, maturities and pay-downs that offset a \$2.9 million increase in the unrealized gain on the available for sale portfolio. Securities held-to-maturity decreased \$3.3 million, from \$155.5 million at December 31, 2013 to \$152.2 million at March 31, 2014, primarily due to \$4.2 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 4.0 years and an unrealized gain of \$2.8 million at March 31, 2014.

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Net loans totaled \$1.2 billion at March 31, 2014, compared to \$1.1 billion at December 31, 2013 and \$1.0 billion at March 31, 2013. Total loans grew \$46.6 million, or 4.1% for the quarter ended March 31, 2014. An increase of \$31.5 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 3 below.

Table 3  
Composition of Loans  
(in thousands)

|   | March 31,<br>2014 | December<br>31, 2013 |
|---|-------------------|----------------------|
| Commercial, financial, and agricultural | \$435,523         | \$403,976            |
| Real estate – construction              | 78,988            | 82,691               |
| Real estate – commercial                | 408,546           | 397,135              |
| Real estate – residential               | 150,551           | 146,841              |
| Installment loans to individuals        | 101,869           | 97,459               |
| Lease financing receivable              | 5,102             | 5,542                |
| Other                                   | 3,610             | 3,910                |
|   | \$1,184,189       | \$1,137,554          |
| Less allowance for loan losses          | (8,765 )          | (8,779 )             |
| Net loans                               | \$1,175,424       | \$1,128,775          |

Within the \$408.5 million commercial real estate portfolio, \$373.9 million is secured by commercial property, \$15.8 million is secured by multi-family property, and \$18.9 million is secured by farmland. Of the \$373.9 million secured by commercial property, \$235.0 million, or 62.9%, is owner-occupied. Of the \$150.6 million residential real estate portfolio, 86.4% 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 March 31, 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 March 31, 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 \$58.5 million in projected cash flows from securities repayments for the remainder of 2014 provides an additional source of liquidity.

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The Bank also has significant borrowing capacity with the FRB-Atlanta and with the FHLB-Dallas. As of March 31, 2014, we had no borrowings with the FRB-Atlanta. Long-term FHLB-Dallas advances totaled \$26.6 million at March 31, 2014 and are fixed rate advances with rates ranging from 1.99% to 5.06% and have a range of maturities from April 2014 to January 2019. Short-term FHLB-Dallas advances totaled \$25.0 million at March 31, 2014. The rate on these advances at March 31, 2014 was 0.14%, and they mature in June 2014. The Bank has the ability to post additional collateral of approximately \$211.8 million if necessary to meet liquidity needs. Additionally, \$218.1 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 \$134.0 million at March 31, 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.

### 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 March 31, 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 quarter of 2014, 4,488 shares of Series C Preferred Stock were converted into 24,935 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 \$100,000 for the three months ended March 31, 2014.

Dividends from the Bank totaling \$3.0 million provided additional liquidity for the Company during the three months ended March 31, 2014. As of March 31, 2014, the Bank had the ability to pay dividends to the Company of approximately \$20.3 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 March 31, 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 March 31, 2014, the Company’s Tier 1 leverage ratio was 9.74%, Tier 1 capital to risk-weighted assets was 13.53% and total capital to risk-weighted assets was 14.26%. The Bank had a Tier 1 leverage capital ratio of 9.19% at March 31, 2014.

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.

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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.

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 March 31, 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 \$239.3 million, or 20.2% of total loans. Additionally, we monitor our exposure to loans secured by commercial real estate. At March 31, 2014, loans secured by commercial real estate (including commercial construction, farmland and multifamily loans) totaled approximately \$469.3 million, with \$3.4 million, or 0.7% on nonaccrual status. Of the \$469.3 million, \$373.9 million represent CRE loans, 63% 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.

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Table 4 summarizes the Company's nonperforming assets for the quarters ending March 31, 2014 and 2013, and December 31, 2013.

Table 6

Nonperforming Assets and Loans Past Due 90 Days or More and Still Accruing  
(in thousands)

|   | March<br>31,<br>2014 | December<br>31,<br>2013 | March<br>31,<br>2013 |  |  |  |
|---|----------------------|-------------------------|----------------------|--|--|--|
| Nonaccrual loans  | \$6,025              | \$ 5,099                | \$7,019              |  |  |  |
| Loans past due 90 days and over and still accruing                  | 251                  | 178                     | 163                  |  |  |  |
| Total nonperforming loans   | 6,276                | 5,277                   | 7,182                |  |  |  |
| Other real estate   | 6,525                | 6,687                   | 7,552                |  |  |  |
| Other foreclosed assets   | 56                   | 20                      | 16                   |  |  |  |
| Total nonperforming assets  | \$12,857             | \$ 11,984               | \$14,750             |  |  |  |
| Troubled debt restructurings  | \$1,579              | \$ 412                  | \$4,211              |  |  |  |
| Nonperforming assets to total assets                                | 0.68 %               | 0.65 %                  | 0.79 %               |  |  |  |
| Nonperforming assets to total loans + ORE + other foreclosed assets | 1.08 %               | 1.05 %                  | 1.41 %               |  |  |  |
| ALL to nonperforming loans  | 139.66 %             | 166.36 %                | 103.83 %             |  |  |  |
| ALL to total loans  | 0.74 %               | 0.77 %                  | 0.72 %               |  |  |  |
| QTD charge-offs   | \$688                | \$ 740                  | \$523                |  |  |  |
| QTD recoveries  | 124                  | 53                      | 60                   |  |  |  |
| QTD net charge-offs   | \$564                | \$ 687                  | \$463                |  |  |  |
| Annualized net charge-offs to total loans                           | 0.19 %               | 0.24 %                  | 0.18 %               |  |  |  |

Nonperforming assets totaled \$12.9 million at March 31, 2014, an increase of \$873,000 from the \$12.0 million reported at year-end 2013 and a decrease of \$1.9 million from the \$14.8 million reported at March 31, 2013. The increase in the first quarter of 2014 resulted from a \$926,000 increase in nonaccrual loans. Allowance coverage for nonperforming loans was 139.66% at March 31, 2014 compared to 166.36% at December 31, 2013 and 103.83% at March 31, 2013. The ALL/total loans ratio remained relatively constant at 0.74% compared to 0.77% at year-end 2013 and 0.72% at March 31, 2013. Including valuation accounting adjustments on acquired loans, the total adjustments and ALL was 1.36% of loans at March 31, 2014. The ratio of annualized net charge-offs to total loans was 0.19% for the three months ended March 31, 2014, compared to 0.24% for the three months ended December 31, 2013, and 0.18% for the three months ended March 31, 2013.

Total nonperforming assets to total loans plus ORE and other assets repossessed remained relatively constant at 1.08% at March 31, 2014 from 1.05% at December 31, 2013, down from the 1.41% at March 31, 2013. Loans classified as troubled debt restructurings ("TDRs") totaled \$1.6 million at March 31, 2014 compared to \$412,000 at December 31, 2013 and \$4.2 million at March 31, 2013. The \$1.2 million increase from year-end 2013 resulted from a loan relationship totaling \$1.2 million being placed on TDR status after an extension of payment was granted during the first quarter of 2014. Classified assets, including ORE, increased \$0.6 million, or 1.9%, to \$31.5 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 \$8.8 million in the ALL as of March 31, 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 first 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 March 31, 2014.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

None.

Item 5. Other Information.

None.

Item 6. Exhibits.

| <u>Exhibit<br/>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 14, 2014 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)  |
| <u>31.2</u>               | 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 March 31, 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: May 9, 2014

/s/ C. R. Cloutier

C. R. Cloutier, President /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)