

FIRST BANCSHARES INC /MS/
Form 10-K
March 16, 2018

U.S. SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2017

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 no. 333-94288

THE FIRST BANCSHARES, INC.

(Exact name of registrant as specified in its charter)

Mississippi

64-0862173

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(State or Other Jurisdiction of
Incorporation or Organization) (I.R.S. Employer Identification Number)

6480 U.S. Hwy. 98 West, Suite A
Hattiesburg, Mississippi 39402
(Address of principal executive offices) (Zip Code)

Issuer's telephone number: (601) 268-8998

Securities registered under Section 12(b) of the Exchange Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, \$1.00 par value	The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act.

Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the 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

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Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 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 if disclosure of delinquent filers in response to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K

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

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act (Check one):

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

Emerging Growth Company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

Based on the price at which the registrant's Common Stock was last sold on June 30, 2017, the last business day of the registrant's most recently completed second fiscal quarter, the aggregate market value of the registrant's Common Stock held by non-affiliates of the registrant was \$232,771,583.

On March 13, 2018, the registrant had outstanding 12,339,492 shares of common stock.

DOCUMENTS INCORPORATED BY REFERENCE

Certain portions of the Registrant's proxy statement to be filed for the Annual Meeting of Shareholders to be held May 24, 2018 are incorporated by reference into Part III of this Annual Report on Form 10-K. Other than those portions of the proxy statement specifically incorporated by reference pursuant to Items 10-14 of Part III hereof, no other portions of the proxy statement shall be deemed so incorporated.

THE FIRST BANCSHARES, INC.

FORM 10-K

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THE FIRST BANCSHARES, INC.

FORM 10-K

PART I

This Annual Report on Form 10-K, including information incorporated by reference herein, contains statements which constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 (the “Securities Act”) and Section 21E of the Securities Exchange Act of 1934 (the “Exchange Act”), which statements are inherently subject to risks and uncertainties. These statements are based on many assumptions and estimates and are not guarantees of future performance. Forward looking statements are statements that include projections, predictions, expectations, or beliefs about future events or results or otherwise are not statements of historical fact. Such statements are often characterized by the use of qualifying words (and their derivatives) such as “may,” “would,” “could,” “should,” “will,” “expect,” “anticipate,” “predict,” “project,” “potential,” “continue,” “assume,” “believe,” “intend,” “plan,” “forecast,” “estimate,” or other statements concerning opinions or judgments of the Company, the Bank, and management about possible future events or outcomes. Factors that could influence the accuracy of such forward looking statements include, but are not limited to, competitive pressures among financial institutions increasing significantly; economic conditions, either nationally or locally, in areas in which the Company conducts operations being less favorable than expected; legislation or regulatory changes which adversely affect the ability of the consolidated Company to conduct business combinations or new operations; financial success or changing strategies of the Bank’s customers or vendors; actions of government regulators; the level of market interest rates; and risks related to the proposed acquisitions of Sunshine Financial, Inc., including the risk that the proposed acquisition does not close when expected or at all because of required shareholder or other approvals and other conditions to closing are not received or satisfied on a timely basis or at all, the terms of the proposed transaction may need to be modified to satisfy such approvals or conditions, and the risk that anticipated benefits from the acquisition of Southwest Banc Shares, Inc. or Sunshine Financial, Inc. are not realized in the time frame anticipated or at all as a result of changes in general economic and market conditions.

Potential risks and uncertainties that could cause our actual results to differ materially from those anticipated in any forward-looking statements include, but are not limited to, the following:

- reduced earnings due to higher credit losses generally and specifically because losses in the sectors of our loan portfolio secured by real estate are greater than expected due to economic factors, including declining real estate values, increasing interest rates, increasing unemployment, or changes in payment behavior or other factors;

- general economic conditions, either nationally or regionally and especially in our primary service area, becoming less favorable than expected resulting in, among other things, a deterioration in credit quality;

- adverse changes in asset quality and resulting credit risk-related losses and expenses;

ability of borrowers to repay loans, which can be adversely affected by a number of factors, including changes in economic conditions, adverse trends or events affecting business industry groups, reductions in real estate values or markets, business closings or lay-offs, natural disasters, and international instability;

- changes in monetary and tax policies, including potential impacts from the Tax Cuts and Jobs Act;

- changes in political conditions or the legislative or regulatory environment;

the adequacy of the level of our allowance for loan losses and the amount of loan loss provisions required to replenish the allowance in future periods;

reduced earnings due to higher credit losses because our loans are concentrated by loan type, industry segment, borrower type, or location of the borrower or collateral;

- changes in the interest rate environment which could reduce anticipated or actual margins;

increased funding costs due to market illiquidity, increased competition for funding, higher interest rates, and increased regulatory requirements with regard to funding;

results of examinations by our regulatory authorities, including the possibility that the regulatory authorities may, among other things, require us to increase our allowance for loan losses through additional loan loss provisions or write-down of our assets;

the rate of delinquencies and amount of loans charged-off;

the impact of our efforts to raise capital on our financial position, liquidity, capital, and profitability;

risks and uncertainties relating to not successfully closing and integrating the currently contemplated acquisitions within our currently expected timeframe and other terms;

significant increases in competition in the banking and financial services industries;

changes in the securities markets; and

loss of consumer confidence and economic disruptions resulting from national disasters or terrorist activities;

our ability to retain our existing customers, including our deposit relationships;

changes occurring in business conditions and inflation;

changes in technology;

changes in deposit flows;

changes in accounting principles, policies, or guidelines;

our ability to maintain adequate internal controls over financial reporting;

other risks and uncertainties detailed from time to time in our filings with the Securities and Exchange Commission (“SEC”).

We have based our forward-looking statements on our current expectations about future events. Although we believe that the expectations reflected in and the assumptions underlying our forward-looking statements are reasonable, we cannot guarantee that these expectations will be achieved or the assumptions will be accurate. The Company disclaims any obligation to update such factors or to publicly announce the results of any revisions to any of the forward-looking statements included herein to reflect future events or developments. Additional information concerning these risks and uncertainties is contained in this Annual Report on Form 10-K for the year ended December 31, 2017, included in Item 1A. Risk Factors. Further information on The First Bancshares, Inc. is available in its filings with the Securities and Exchange Commission, available at the SEC’s website, <http://www.sec.gov>.

ITEM 1. BUSINESS

BUSINESS OF THE COMPANY

Overview and History

The Company was incorporated on June 23, 1995 to serve as a bank holding company for The First, A National Banking Association (“The First”), headquartered in Hattiesburg, Mississippi. The Company is a Mississippi corporation and is a registered financial holding company. The First began operations on August 5, 1996 from our main office in the Oak Grove community, which is now incorporated within the city of Hattiesburg. As of December 31, 2017, The First operated its main office and 43 full-service branches, one motor branch, and four loan production offices in Mississippi, Alabama, Louisiana and Florida. Our principal executive offices are located at 6480 U.S. Highway 98 West, Hattiesburg, Mississippi 39402, and our telephone number is (601) 268-8998.

The Company is a community-focused financial institution that offers a full range of financial services to individuals, businesses, municipal entities, and nonprofit organizations in the communities that it serves. These services include consumer and commercial loans, deposit accounts, trust services, safe deposit services and brokerage services.

We exited the recent recession with strong asset quality metrics compared to most of our peers, which we believe illustrates our historically disciplined underwriting and credit culture. As such, we benefited from our strength by taking advantage of growth opportunities when many of our peers were unable to do so. Since that time, we focused on growing earnings per share and increasing our tangible common equity and tangible book value per share. In addition, we returned to strong levels of loan growth by continuing to strengthen our relationships with existing clients and creating new relationships.

In April 2013, we completed our first post-recession acquisition with the purchase of First National Bank of Baldwin County, which resulted in our strategic entry into the south Alabama market. In July 2014 we completed our acquisition of Bay Bank, previously headquartered in Mobile, Alabama. The conversion and integration of these acquisitions have been successful to date, and we are optimistic that this market will continue to contribute to our future growth and success. Also in 2014 we established a *de novo* branch in Baton Rouge, Louisiana and a loan production office in Slidell, Louisiana.

On January 1, 2017, we completed the acquisitions of Iberville Bank and Gulf Coast Community Bank, which allowed us to expand our footprint in Florida and Louisiana. We paid a total of \$31.1 million in cash for all of the outstanding equity securities of Iberville Bank. \$2.5 million of the purchase price was held in escrow as contingency

for flood-related losses in the loan portfolio incurred due to flooding in Iberville's market area in the fall of 2016. The Company expects to receive \$498,207 from the escrow for settlement of flood-related loans.

We paid an aggregate purchase price for Gulf Coast of \$2.3 million, consisting of 89,591 shares of our common stock, in exchange for all of the outstanding equity securities of Gulf Coast. System integration for both acquisitions was completed during the second quarter of 2017.

As of December 31, 2017, we had 415 full-time employees and 8 part-time employees, and as of March 13, 2018, we had 481 full-time employees and 6 part-time employees.

Unless otherwise indicated or unless the context requires otherwise, all references in this report to "the Company", "we", "us", "our", or similar references, mean The First Bancshares, Inc. and our subsidiaries, including our banking subsidiary, The First, A National Banking Association on a consolidated basis. References to "The First" or the "Bank" mean our wholly owned banking subsidiary, The First, A National Banking Association.

Market Areas

The First currently operates in four states: Mississippi, Louisiana, Alabama and Florida, as discussed below.

Mississippi — In Mississippi, we have our main office and 16 full-service branches and one motorbank branch serving the cities of Hattiesburg, Laurel, Purvis, Picayune, Pascagoula, Bay St. Louis, Wiggins, Gulfport, Biloxi, Long Beach, Diamondhead, and the surrounding areas of Lamar, Forrest, Jones, Pearl River, Jackson, Hancock, Stone, and Harrison Counties. We also operate two loan production offices in Ocean Springs and Brandon.

Louisiana — In Louisiana, we operate 12 branches serving the cities of Addis, Baton Rouge, Bogalusa, Denham Springs, Pierre Part, Plaquemine, Plattenville, Port Allen, Prairieville, Saint Gabriel, Siegen and White Castle. We also operate one loan production office in Slidell.

Alabama — In Alabama, we operate ten branches serving the cities of Foley, Daphne, Fairhope, Gulf Shores, Orange Beach, Mobile, Bay Minette, Dauphin Island, and Theodore. We also operate one loan production office in Mobile.

Florida — In Florida, we operate five branches serving the cities of Gulf Breeze, Pace, and Pensacola.

Recent Developments

On December 6, 2017, the Company entered into an agreement and plan of merger to acquire Sunshine Financial, Inc. (“Sunshine”), the holding company of Sunshine Community Bank. Pursuant to the merger agreement, Sunshine will merge with and into First Bancshares, with First Bancshares as the surviving company, (the “Sunshine Merger.”) Immediately after the Sunshine Merger, Sunshine Community Bank, a Florida-state chartered bank and wholly owned subsidiary of Sunshine, will merge with and into The First, with The First as the surviving bank. The transaction was unanimously approved by the boards of directors of each of First Bancshares and Sunshine and is expected to close in the second quarter of 2018. Completion of the transaction is subject to customary closing conditions, and approval of Sunshine’s shareholders.

Under the terms of the agreement, holders of Sunshine common stock will receive, at the election of each Sunshine shareholder, either (i) \$27.00 in cash, or (ii) 0.93 of a share of First Bancshares’ common stock, provided that the total mix of merger consideration is fixed at 75% stock and 25% cash. The aggregate transaction consideration is valued at approximately \$32.1 million.

At December 31, 2017, Sunshine had approximately \$201 million in total consolidated assets, \$168 million in total consolidated loans, \$143 million in total consolidated deposits and \$22 million in stockholder’s equity.

On March 1, 2018, we completed our merger (the “Southwest Merger”) with Southwest Banc Shares, Inc. (“Southwest”), the holding company of First Community Bank. Southwest was merged with and into the Company, with the

Company as the surviving corporation, and, immediately thereafter, First Community Bank was merged with and into The First (collectively with the Southwest Merger referred to as the “Mergers”). The Company issued 1,134,010 shares of Company common stock valued at approximately \$36,004,818 as of March 1, 2018, plus \$24 million in cash, to the Southwest shareholders as consideration for the Southwest Merger. Each outstanding share of the Company’s common stock remained outstanding and was unaffected by the Mergers.

At December 31, 2017, Southwest had consolidated assets of \$401 million, loans of \$281 million, deposits of \$354 million, and shareholders’ equity of \$37 million.

Banking Services

We strive to provide our customers with the breadth of products and services offered by large regional banks, while maintaining the timely response and personal service of a locally owned and managed bank. In addition to offering a full range of deposit services and commercial and personal loans, we have a mortgage division. The following is a description of the products and services we offer.

Deposit Services. We offer a full range of deposit services that are typically available in most banks and savings institutions, including checking accounts, NOW accounts, savings accounts, and other time deposits of various types, ranging from daily money market accounts to longer-term certificates of deposit. The transaction accounts and time certificates are tailored to our principal market areas at rates competitive to those offered by other banks in these areas. All deposit accounts are insured by the FDIC up to the maximum amount allowed by law. We solicit these accounts from individuals, businesses, associations and organizations, and governmental authorities. In addition, we offer certain retirement account services, such as Individual Retirement Accounts (IRAs).

Loan Products. We offer a full range of commercial and personal loans. Commercial loans include both secured and unsecured loans for working capital (including loans secured by inventory and accounts receivable), business expansion (including acquisition of real estate and improvements), and purchase of equipment and machinery. Consumer loans include equity lines of credit and secured and unsecured loans for financing automobiles, home improvements, education, and personal investments. We also make real estate construction and acquisition loans. Our lending activities are subject to a variety of lending limits imposed by federal law. While differing limits apply in certain circumstances based on the type of loan or the nature of the borrower (including the borrower's relationship to the bank), in general we are subject to an aggregate loans-to-one-borrower limit of 15% of our unimpaired capital and surplus.

Mortgage Loan Division. We have a residential mortgage loan division which originates loans to purchase existing residential homes or construct new homes and to refinance existing mortgages.

Private Banking Division. We have a private banking division, which offers financial services and wealth management services to individuals who meet certain criteria.

Other Services. Other bank services we offer include on-line internet banking services, voice response telephone inquiry services, commercial sweep accounts, cash management services, safe deposit boxes, travelers checks, mobile deposit, direct deposit of payroll and social security checks, and automatic drafts for various accounts. We are associated with the automated teller machines that may be used by our customers throughout our market area and other regions. The First also offers credit card services through a correspondent bank.

Competition

The First generally competes with other financial institutions through the selection of banking products and services offered, the pricing of services, the level of service provided, the convenience and availability of services, and the degree of expertise and the personal manner in which services are offered. State law permits statewide branching by

banks and savings institutions, and many financial institutions in our market area have branch networks. Consequently, commercial banking in Mississippi, Alabama, Louisiana and Florida is highly competitive. Many large banking organizations currently operate in our market area, several of which are controlled by out-of-state ownership. In addition, competition between commercial banks and thrift institutions (savings institutions and credit unions) has been intensified significantly by the elimination of many previous distinctions between the various types of financial institutions and the expanded powers and increased activity of thrift institutions in areas of banking which previously had been the sole domain of commercial banks. Federal legislation, together with other regulatory changes by the primary regulators of the various financial institutions, has resulted in the almost total elimination of practical distinctions between a commercial bank and a thrift institution. Consequently, competition among financial institutions of all types is largely unlimited with respect to legal ability and authority to provide most financial services. Currently there are numerous other commercial banks, savings institutions, and credit unions operating in The First's primary service area.

We face increased competition from both federally-chartered and state-chartered financial and thrift institutions, as well as credit unions, consumer finance companies, insurance companies, and other institutions in the Company's market area. Some of these competitors are not subject to the same degree of regulation and restriction imposed upon the Company. Many of these competitors also have broader geographic markets and substantially greater resources and lending limits than the Company and offer certain services such as trust banking that the Company does not currently provide. In addition, many of these competitors have numerous branch offices located throughout the extended market areas of the Company that may provide these competitors with an advantage in geographic convenience that the Company does not have at present.

We also compete with numerous financial and quasi-financial institutions for deposits and loans, including providers of financial services over the internet. Recent technology advances and other changes have allowed parties to effect financial transactions that previously required the involvement of banks. For example, consumers can maintain funds in brokerage accounts or mutual funds that would have historically been held as bank deposits. Consumers can also complete transactions such as paying bills and transferring funds directly without the assistance of banks.

Available Information

We file reports with the SEC. We make available free of charge, on or through our website www.thefirstbank.com, our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and other filings pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and amendments to such filings, as soon as reasonably practicable after each is electronically filed with, or furnished to, the SEC. You may read and copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, DC 20549. Information on the operation of the Public Reference Room may be obtained by calling the Commission at 1-800-SEC-0330. The SEC maintains a website that contains the Company's reports, proxy statements, and the Company's other SEC filings. The address of the SEC's website is www.sec.gov. Information appearing on the Company's website is not part of any report that it files with the SEC.

SUPERVISION AND REGULATION

The Company and The First are subject to state and federal banking laws and regulations which impose specific requirements or restrictions on and provide for general regulatory oversight with respect to virtually all aspects of our operations. These laws and regulations are generally intended to protect depositors, the deposit insurance fund ("DIF") of the Federal Deposit Insurance Corporation ("FDIC") and the stability of the U.S. banking system as a whole, rather than for the protection of our shareholders and creditors. To the extent that the following summary describes statutory or regulatory provisions, it is qualified in its entirety by reference to the particular statutory and regulatory provisions. Any change in applicable laws or regulations may have a material effect on the business and prospects of the Company.

Beginning with the enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 and following with the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"), and now most recently the sweeping Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"), numerous regulatory requirements have been placed on the banking industry in the recent years. A significant volume of financial services regulations required by the Dodd-Frank Act have not yet been finalized by banking regulators, Congress continues to consider legislation that would make significant changes to the law and courts are addressing significant litigation arising under the Dodd-Frank Act, making it difficult to predict the ultimate effect of the Dodd-Frank Act on our business. The operations of the Company and The First may be affected by legislative changes

and the policies of various regulatory authorities. We are unable to predict the nature or the extent of the effect on our business and earnings that fiscal or monetary policies, economic control, or new federal or state legislation may have in the future.

Bank Holding Company Regulation

The Company is subject to extensive regulation by the Board of Governors of the Federal Reserve System (the “Federal Reserve”) pursuant to the Bank Holding Company Act of 1956, as amended (the “Bank Holding Company Act”). We file quarterly reports and other information with the Federal Reserve. We file reports with the SEC and are subject to its regulation with respect to our securities, financial reporting and certain governance matters. Our securities are listed on the Nasdaq Global Market, and we are subject to Nasdaq rules for listed companies.

The Company is registered with the Federal Reserve as a bank holding company and has elected to be treated as a financial holding company under the Bank Holding Company Act. As such, the Company and its subsidiaries are subject to the supervision, examination and reporting requirements of the Bank Holding Company Act and the regulations of the Federal Reserve.

The Bank Holding Company Act generally prohibits a corporation that owns a federally insured financial institution (“bank”) from engaging in activities other than banking and managing or controlling banks or other subsidiaries engaging in permissible activities. Also prohibited is acquiring or obtaining control 5% or more of the voting interests of any company that engages in activities other than those activities determined by the Federal Reserve to be so closely related to banking, managing or controlling banks as to be a proper incident thereto. In determining whether a particular activity is permissible, the Federal Reserve considers whether the performance of the activity can reasonably be expected to produce benefits to the public that outweigh possible adverse effects. Examples of activities that the Federal Reserve has determined to be permissible are making, acquiring or servicing loans; leasing personal property; providing certain investment or financial advice; performing certain data processing services; acting as agent or broker in selling credit life insurance; and performing certain insurance underwriting activities. The Bank Holding Company Act does not place territorial limits on permissible bank-related activities of bank holding companies. Even with respect to permissible activities, however, the Federal Reserve has the power to order a holding company or its subsidiaries to terminate any activity or its control of any subsidiary when the Federal Reserve has reasonable cause to believe that continuation of such activity or control of such subsidiary would pose a serious risk to the financial safety, soundness or stability of any bank subsidiary of that holding company.

The Bank Holding Company Act requires every bank holding company to obtain the prior approval of the Federal Reserve before it: (1) acquires ownership or control of any voting shares of any bank if, after such acquisition, such bank holding company will own or control more than 5% of the voting shares of such bank, (2) causes any of its non-bank subsidiaries to acquire all of the assets of a bank, (3) merges with any other bank holding company, or (4) engages in permissible non-banking activities. In reviewing a proposed covered acquisition, the Federal Reserve considers a bank holding company’s financial, managerial and competitive posture. The future prospects of the companies and banks concerned and the convenience and needs of the community to be served are also considered. The Federal Reserve also reviews any indebtedness to be incurred by a bank holding company in connection with the proposed acquisition to ensure that the bank holding company can service such indebtedness without adversely affecting its ability, and the ability of its subsidiaries, to meet their respective regulatory capital requirements. The Bank Holding Company Act further requires that consummation of approved bank holding company or bank acquisitions or mergers must be delayed for a period of not less than 15 or more than 30 days following the date of Federal Reserve approval. During such 15 to 30-day period, the Department of Justice has the right to review the competitive aspects of the proposed transaction. The Department of Justice may file a lawsuit with the relevant United States District Court seeking an injunction against the proposed acquisition.

The Federal Reserve has adopted capital adequacy guidelines for use in its examination and regulation of bank holding companies and financial holding companies. The regulatory capital of a bank holding company or financial holding company under applicable federal capital adequacy guidelines is particularly important in the Federal Reserve’s evaluation of the overall safety and soundness of the bank holding company or financial holding company and are important factors considered by the Federal Reserve in evaluating any applications made by such holding company to the Federal Reserve. If regulatory capital falls below minimum guideline levels, a financial holding company may lose its status as a financial holding company and a bank holding company or bank may be denied approval to acquire or establish additional banks or non-bank businesses or to open additional facilities. Additionally, each bank subsidiary of a financial holding company as well as the holding company itself must be well capitalized and well managed as determined by the subsidiary bank’s primary federal regulator, which in the case of The First, is the Office of the Comptroller of the Currency (the “OCC”). To be considered well managed, the bank and holding

company must have received at least a satisfactory composite rating and a satisfactory management rating at its most recent examination. The Federal Reserve rates bank holding companies through a confidential component and composite 1-5 rating system, with a composite rating of 1 being the highest rating and 5 being the lowest. This system is designed to help identify institutions requiring special attention. Financial institutions are assigned ratings based on evaluation and rating of their financial condition and operations. Components reviewed include capital adequacy, asset quality, management capability, the quality and level of earnings, the adequacy of liquidity and sensitivity to interest rate fluctuations. As of December 31, 2017, the Company and The First were both well capitalized and well managed.

A financial holding company that becomes aware that it or a subsidiary bank has ceased to be well capitalized or well managed must notify the Federal Reserve and enter into an agreement to cure the identified deficiency. If the deficiency is not cured timely, the Federal Reserve may order the financial holding company to divest its banking operations. Alternatively, to avoid divestiture, a financial holding company may cease to engage in the financial holding company activities that are unrelated to banking or otherwise impermissible for a bank holding company. See “*Capital Requirements*” below for more information.

The Gramm-Leach-Bliley Act of 1999 established a comprehensive framework that permits affiliations among qualified bank holding companies, commercial banks, insurance companies, securities firms, and other financial service providers by revising and expanding the Bank Holding Company Act framework to permit a holding company to engage in a full range of financial activities through a financial holding company.

Federal Reserve Oversight

The Company is required to give the Federal Reserve prior written notice of any purchase or redemption of its outstanding equity securities if the gross consideration for the purchase or redemption, when combined with the net consideration paid for all such purchases or redemptions during the preceding 12 months, is equal to 10% or more of the Company's consolidated net worth. The Federal Reserve may disapprove such a transaction if it determines that the proposed redemption or stock purchase would constitute an unsafe or unsound practice, would violate any law, regulation, Federal Reserve order or directive or any condition imposed by, or written agreement with, the Federal Reserve.

The Federal Reserve has issued its "Policy Statement on Cash Dividends Not Fully Covered by Earnings" (the "Policy Statement") which sets forth various guidelines that the Federal Reserve believes a bank holding company should follow in establishing its dividend policy. In general, the Federal Reserve stated that bank holding companies should pay dividends only out of current earnings. The Federal Reserve also stated that dividends should not be paid unless the prospective rate of earnings retention by the holding company appears consistent with its capital needs, asset quality and overall financial condition.

The Company is required to file annual and quarterly reports with the Federal Reserve, and such additional information as the Federal Reserve may require pursuant to the Bank Holding Company Act. The Federal Reserve may examine a bank holding company or any of its subsidiaries.

Source of Strength Doctrine

Under the Dodd-Frank Act, bank holding companies must be well-capitalized and well-managed to engage in interstate transactions. In the past, only the subsidiary banks were required to meet those standards. The Federal Reserve Board's "source of strength doctrine" has now been codified, mandating that bank holding companies such as the Company serve as a source of strength for their subsidiary banks, such that the bank holding company must be able to provide financial assistance in the event the subsidiary bank experiences financial distress.

Capital Requirements

Federal banking regulators have adopted a system using risk-based capital guidelines to evaluate the capital adequacy of banks and bank holding companies that is based upon the 1988 capital accord of the Bank for International Settlements' Basel Committee on Banking Supervision (the "Basel Committee"), a committee of central banks and bank regulators from the major industrialized countries that coordinates international standards for bank regulation. Under the guidelines, specific categories of assets and off-balance-sheet activities such as letters of credit are assigned risk weights, based generally on the perceived credit or other risks associated with the asset. Off-balance-sheet activities are assigned a credit conversion factor based on the perceived likelihood that they will become on-balance-sheet assets. These risk weights are multiplied by corresponding asset balances to determine a "risk weighted" asset base which is then measured against various measures of capital to produce capital ratios.

An organization's capital is classified in one of two tiers, Core Capital, or Tier 1, and Supplementary Capital, or Tier 2. Tier 1 capital includes common stock, retained earnings, qualifying non-cumulative perpetual preferred stock, minority interests in the equity of consolidated subsidiaries, a limited amount of qualifying trust preferred securities and qualifying cumulative perpetual preferred stock at the holding company level, less goodwill and most intangible assets. Tier 2 capital includes perpetual preferred stock and trust preferred securities not meeting the Tier 1 definition, mandatory convertible debt securities, subordinated debt, and allowances for loan and lease losses. Each category is subject to a number of regulatory definitional and qualifying requirements.

The Basel Committee in 2010 released a set of international recommendations for strengthening the regulation, supervision and risk management of banking organizations, known as Basel III. In July 2013, the Federal Reserve published final rules for the adoption of the Basel III regulatory capital framework (the “Basel III Capital Rules”). The Basel III Capital Rules became effective for us on January 1, 2015, with certain transition provisions phasing in over a period ending on January 1, 2019. The Basel III Capital Rules established a new category of capital measure, Common Equity Tier 1 capital, which includes a limited number of capital instruments from the existing definition of Tier 1 Capital, as well as raised minimum thresholds for Tier 1 Leverage capital (100 basis points), and Tier 1 Risk-based capital (200 basis points).

The Basel III Capital Rules established the following minimum capital ratios: 4.5 percent CET1 to risk-weighted assets; 6.0 percent Tier 1 capital to risk-weighted assets; 8.0 percent total capital to risk-weighted assets; and 4.0 percent Tier 1 leverage ratio to average consolidated assets. In addition, the Basel III Capital Rules also introduced a minimum “capital conservation buffer” equal to 2.5% of an organization’s total risk-weighted assets, which exists in addition to these new required minimum CET1, Tier 1, and total capital ratios. The “capital conservation buffer,” which must consist entirely of CET1, is designed to absorb losses during periods of economic stress. The Basel III Capital Rules provide for a number of deductions from and adjustments to CET1, which include the requirement that mortgage servicing rights, deferred tax assets arising from temporary differences that could not be realized through net operating loss carrybacks and significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1.

The Company and The First elected in 2015 to exclude the effects of accumulated other comprehensive income items included in stockholders’ equity from the determination of regulatory capital under the Basel III Capital Rules. Based on estimated capital ratios using Basel III definitions, the Company and The First currently exceed all capital requirements of the new rule, including the fully phased-in conservation buffer.

Certain regulatory capital ratios of the Company and The First, as of December 31, 2017, are shown in the following table:

	Capital Adequacy Ratios							
	Regulatory Minimums							
	Regulatory Minimums		The First Bancshares, Inc.		The First			
	Capitalized	Capitalized	Capitalized	Capitalized	Capitalized	Capitalized	Capitalized	Capitalized
Common Equity Tier 1 risk-based capital ratio	4.50 %	6.50 %	%	14.2	%	14.5	%	
Tier 1 risk-based capital ratio	6.00 %	8.00 %	%	14.9	%	14.5	%	
Total risk-based capital ratio	8.00 %	10.00 %	%	15.5	%	15.1	%	
Leverage ratio	4.00 %	5.00 %	%	11.7	%	11.4	%	

The essential difference between the leverage capital ratio and the risk-based capital ratios is that the latter identify and weight both balance sheet and off-balance sheet risks. Tier 1 capital generally includes common equity, retained earnings, qualifying minority interests (issued by consolidated depository institutions or foreign bank subsidiaries), accounts of consolidated subsidiaries and an amount of qualifying perpetual preferred stock, limited to 50% of Tier 1 capital. In calculating Tier 1 capital, goodwill and other disallowed intangibles and disallowed deferred tax assets and certain other assets are excluded. Tier 2 capital is a secondary component of risk-based capital, consisting primarily of perpetual preferred stock that may not be included as Tier 1 capital, mandatory convertible securities, certain types of subordinated debt and an amount of the allowance for loan losses (limited to 1.25% of risk weighted assets).

The risk-based capital guidelines are designed to make regulatory capital requirements more sensitive to differences in risk profiles among banks and bank holding companies, to take into account off-balance sheet exposure and to minimize disincentives for holding liquid assets. Under the risk-based capital guidelines, assets are assigned to one of four risk categories: 0%, 20%, 50% and 100%. For example, U.S. Treasury securities are assigned to the 0% risk category while most categories of loans are assigned to the 100% risk category. Off-balance sheet exposures such as standby letters of credit are risk-weighted and all or a portion thereof are included in risk-weighted assets based on an assessment of the relative risks that they present. The risk-weighted asset base is equal to the sum of the aggregate dollar values of assets and off-balance sheet items in each risk category, multiplied by the weight assigned to that category.

Prompt Corrective Action and Undercapitalization

The FDICIA established a system of prompt corrective action regulations and policies to resolve the problems of undercapitalized insured depository institutions. Under this system, insured depository institutions are ranked in one of five capital categories as described below. Regulators are required to take mandatory supervisory actions and are authorized to take other discretionary actions of increasing severity with respect to insured depository institutions in the three undercapitalized categories. The five capital categories for insured depository institutions under the prompt corrective action regulations consist of:

Well capitalized - equals or exceeds a 10% total risk-based capital ratio, 8% Tier 1 risk-based capital ratio, and 5% leverage ratio and is not subject to any written agreement, order or directive requiring it to maintain a specific level for any capital measure;

Adequately capitalized - equals or exceeds an 8% total risk-based capital ratio, 6% Tier 1 risk-based capital ratio, and 4% leverage ratio;

Undercapitalized - total risk-based capital ratio of less than 8%, or a Tier 1 risk-based ratio of less than 6%, or a leverage ratio of less than 4%;

Significantly undercapitalized - total risk-based capital ratio of less than 6%, or a Tier 1 risk-based capital ratio of less than 4%, or a leverage ratio of less than 3%; and

Critically undercapitalized - a ratio of tangible equity to total assets equal to or less than 2%.

The prompt corrective action regulations provide that an institution may be downgraded to the next lower category if its regulator determines, after notice and opportunity for hearing or response, that the institution is in an unsafe or unsound condition or has received and not corrected a less-than-satisfactory rating for any of the categories of asset quality, management, earnings or liquidity in its most recent examination.

Federal bank regulatory agencies are required to implement arrangements for prompt corrective action for institutions failing to meet minimum requirements to be at least adequately capitalized. FDICIA imposes an increasingly stringent array of restrictions, requirements and prohibitions as an organization's capital levels deteriorate. A bank rated "adequately capitalized" may not accept, renew or roll over brokered deposits. A "significantly undercapitalized" institution is subject to mandated capital raising activities, restrictions on interest rates paid and transactions with affiliates, removal of management and other restrictions. The OCC has only very limited discretion in dealing with a "critically undercapitalized" institution and generally must appoint a receiver or conservator (the FDIC) if the capital

deficiency is not corrected promptly.

Under the Federal Deposit Insurance Act (“FDIA”), “critically undercapitalized” banks may not, beginning 60 days after becoming critically undercapitalized, make any payment of principal or interest on their subordinated debt (subject to certain limited exceptions). In addition, under Section 18(i) of the FDIA, banks are required to obtain the advance consent of the FDIC to retire any part of their subordinated notes. Under the FDIA, a bank may not pay interest on its subordinated notes if such interest is required to be paid only out of net profits, or distribute any of its capital assets, while it remains in default on any assessment due to the FDIC.

Federal bank regulators may set capital requirements for a particular banking organization that are higher than the minimum ratios when circumstances warrant. Federal Reserve and OCC guidelines provide that banking organizations experiencing significant growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels, without significant reliance on intangible assets. Concentration of credit risks, interest rate risk (imbalances in rates, maturities or sensitivities) and risks arising from non-traditional activities, as well as an institution’s ability to manage these risks, are important factors taken into account by regulatory agencies in assessing an organization’s overall capital adequacy.

The OCC and the Federal Reserve also use a leverage ratio as an additional tool to evaluate the capital adequacy of banking organizations. The leverage ratio is a company's Tier 1 capital divided by its average total consolidated assets. A minimum leverage ratio of 3.0% is required for banks and bank holding companies that either have the highest supervisory rating or have implemented the appropriate federal regulatory authority's risk-adjusted measure for market risk. All other banks and bank holding companies are required to maintain a minimum leverage ratio of 4.0%, unless a different minimum is specified by an appropriate regulatory authority. In order to be considered well capitalized the leverage ratio must be at least 5.0%.

Our Bank's leverage ratio was 11.4% at December 31, 2017 and, as a result, it is currently classified as "well capitalized" for purposes of the OCC's prompt corrective action regulations.

The risk-based and leverage capital ratios established by federal banking regulators are minimum supervisory ratios generally applicable to banking organizations that meet specified criteria, assuming that they otherwise have received the highest regulatory ratings in their most recent examinations. Banking organizations not meeting these criteria are expected to operate with capital positions in excess of the minimum ratios. Regulators can, from time to time, change their policies or interpretations of banking practices to require changes in risk weights assigned to our Bank's assets or changes in the factors considered in order to evaluate capital adequacy, which may require our Bank to obtain additional capital to support existing asset levels or future growth or reduce asset balances in order to meet minimum acceptable capital ratios.

Additional Regulatory Issues

In June 2010, the Federal Reserve, the OCC and the FDIC issued joint guidance on executive compensation designed to help ensure that a banking organization's incentive compensation policies do not encourage imprudent risk taking and are consistent with the safety and soundness of the organization. In addition, the Dodd-Frank Act required those agencies, along with the SEC, to adopt rules to require reporting of incentive compensation and to prohibit certain compensation arrangements. The objective of the guidance is to assure that incentive compensation arrangements (i) provide incentives that do not encourage excessive risk-taking, (ii) are compatible with effective internal controls and risk management and (iii) are supported by strong corporate governance, including oversight by the board of directors. In 2016, the Federal Reserve and the FDIC proposed rules that would, depending upon the assets of the institution, directly regulate incentive compensation arrangements and would require enhanced oversight and recordkeeping. As of December 31, 2017, these rules have not been implemented.

The Company is a legal entity separate and distinct from The First. There are various restrictions that limit the ability of The First to finance, pay dividends or otherwise supply funds to the Company or other affiliates. In addition, subsidiary banks of holding companies are subject to certain restrictions under Sections 23A and 23B of the Federal Reserve Act on any extension of credit to the bank holding company or any of its subsidiaries, on investments in the

stock or other securities thereof and on the taking of such stock or securities as collateral for loans to any borrower. Further, a bank holding company and its subsidiaries are prohibited from engaging in certain tie-in arrangements in connection with extensions of credit, leases or sales of property, or furnishing of services.

Stress Testing

The Dodd-Frank Act requires stress testing of certain bank holding companies and banks that have more than \$10 billion but less than \$50 billion of consolidated assets (“medium-sized companies”). Additional stress testing is required for banking organizations having \$50 billion or more of assets. Because the consolidated assets of the Company and The First are less than these threshold levels, the stress test requirements are not currently applicable to the Company or to The First.

Company Participation in Legislative and Regulatory Initiatives

The Congress, Treasury Department and the federal banking regulators, including the FDIC, have taken broad action since early September 2008 to address volatility in the U.S. banking system. In October 2008, the Emergency Economic Stabilization Act of 2008 (“EESA”) was enacted. The EESA authorized the Treasury Department to purchase from financial institutions and their holding companies up to \$700 billion in mortgage loans, mortgage-related securities and certain other financial instruments, including debt and equity securities issued by financial institutions and their holding companies in a troubled asset relief program (“TARP”). The purpose of TARP was to restore confidence and stability to the U.S. banking system and to encourage financial institutions to increase their lending to customers and to each other. The Treasury Department allocated \$250 billion towards the TARP Capital Purchase Program (“CPP”), pursuant to which the Treasury Department purchased debt or equity securities from participating institutions. The TARP also included the Community Development Capital Initiative (“CDCI”), which was made available only to certified Community Development Financial Institutions (“CDFIs”) and imposed a lower dividend or interest rate, as applicable, than the CPP funding. Participants in the TARP are subject to executive compensation limits and are encouraged to expand their lending and mortgage loan modifications.

On February 6, 2009, as part of the CPP, the Company entered into a Letter Agreement and Securities Purchase Agreement (collectively, the “Purchase Agreement”) with the Treasury Department, pursuant to which the Company sold (i) 5,000 shares of the Company’s Fixed Rate Cumulative Perpetual Preferred Stock, Series UST (the “CPP Preferred Stock”) and (ii) a warrant (the “Warrant”) to purchase 54,705 shares of the Company’s Common Stock for an exercise price of \$13.71 per share. On September 29, 2010, after successfully obtaining CDFI certification, the Company exited the CPP by refinancing its CPP funding into lower-cost CDCI funding and also accepted additional CDCI funding. In connection with this transaction, the Company retired its CPP Preferred Stock and issued to the Treasury Department 17,123 shares of the Company’s Fixed Rate Cumulative Perpetual Preferred Stock, Series CD (the “CDCI Preferred Stock”). Including refinanced funding and newly obtained funding, the Company’s total CDCI funding was \$17,123,000.

The America Reinvestment and Recovery Act of 2009 (“ARRA”) contained expansive new restrictions on executive compensation for financial institutions and other companies participating in the TARP. As long as the Treasury continued to hold equity interests in the Company issued under the TARP, the Company monitored its compensation arrangements, modified such compensation arrangements, agreed to limit and limit its compensation deductions, and took such other actions as were necessary to comply with the standards discussed below. On December 6, 2016, the Company repurchased all 17,123 shares of its CDCI Preferred Shares from Treasury at fair market value. Therefore, as of December 6, 2016, the Company no longer had any obligations under TARP or the ARRA. However, as part of its repurchase obligations with the Treasury, the Company agreed to maintain its CDFI certification status for a period of two years. The eligibility requirements provide that the Company must:

- Have a primary mission of promoting community development;

- Provide both financial and educational services;
- Serve and maintain accountability to one or more defined target markets;
- Maintain accountability to a defined market; and
- Be a legal, non-governmental entity at the time of application (with the exception of Tribal governmental entities)

The First, A National Banking Association

OCC Regulation. The First operates as a national banking association incorporated under the laws of the United States and subject to supervision, inspection and examination by the OCC. The OCC regulates or monitors virtually all areas of The First's operations, including security devices and procedures, adequacy of capitalization and loan loss reserves, loans, investments, borrowings, deposits, mergers, issuances of securities, payment of dividends, interest rates payable on deposits, interest rates or fees chargeable on loans, establishment of branches, corporate reorganizations, maintenance of books and records, and adequacy of staff training to carry on safe lending and deposit gathering practices. The OCC imposes limitations on The First's aggregate investment in real estate, bank premises, and furniture and fixtures. The First is required by the OCC to prepare quarterly reports on its financial condition and to conduct an annual audit of its financial affairs in compliance with minimum standards and procedures prescribed by the OCC.

Safe and Sound Banking Practices; Enforcement. Banks and bank holding companies are prohibited from engaging in unsafe and unsound banking practices. Bank regulators have broad authority to prohibit and penalize activities of bank holding companies and their subsidiaries which represent unsafe and unsound banking practices or which constitute violations of laws, regulations or written directives of or agreements with regulators. Regulators have considerable discretion in identifying what they deem to be unsafe and unsound practices and in pursuing enforcement actions in response to them.

Under FDICIA, all insured institutions must undergo regular on-site examinations by their appropriate banking agency. The cost of examinations of insured depository institutions and any affiliates may be assessed by the appropriate agency against each institution or affiliate as it deems necessary or appropriate. Insured institutions are required to submit annual reports to the FDIC and the appropriate agency. FDICIA also directs the FDIC to develop with other appropriate agencies a method for insured depository institutions to provide supplemental disclosure of the estimated fair market value of assets and liabilities, to the extent feasible and practicable, in any balance sheet, financial statement, report of condition, or any other report of any insured depository institution. FDICIA also requires the federal banking regulatory agencies to prescribe, by regulation, standards for all insured depository institutions and depository institution holding companies relating, among other things, to: (i) internal controls, information systems, and audit systems; (ii) loan documentation; (iii) credit underwriting; (iv) interest rate risk exposure; and (v) asset quality.

National banks and their holding companies which have been chartered or registered or undergone a change in control within the past two years or which have been deemed by the OCC or the Federal Reserve Board, respectively, to be troubled institutions must give the OCC or the Federal Reserve Board, respectively, thirty days prior notice of the appointment of any senior executive officer or director. Within the thirty-day period, the OCC or the Federal Reserve Board, as the case may be, may approve or disapprove any such appointment.

Deposit Insurance. The FDIC establishes rates for the payment of premiums by federally insured banks and thrifts for deposit insurance. Deposits in The First are insured by the FDIC up to a maximum amount (generally \$250,000 per depositor, subject to aggregation rules). The DIF is maintained by the FDIC for commercial banks and thrifts and funded with insurance premiums from the industry that are used to offset losses from insurance payouts when banks and thrifts fail. Since 1993, insured depository institutions like The First have paid for deposit insurance under a risk-based premium system. Assessments are calculated based on the depository institution's average consolidated total assets, less its average amount of tangible equity.

Transactions With Affiliates and Insiders. The First is subject to Section 23A of the Federal Reserve Act, which places limits on the amount of loans to, and certain other transactions with, affiliates, as well as on the amount of advances to third parties collateralized by the securities or obligations of affiliates. The aggregate of all covered transactions is limited in amount, as to any one affiliate, to 10% of The First's capital and surplus and, as to all affiliates combined, to 20% of The First's capital and surplus. Furthermore, within the foregoing limitations as to amount, each covered transaction must meet specified collateral requirements.

The First is also subject to Section 23B of the Federal Reserve Act, which prohibits an institution from engaging in certain transactions with affiliates unless the transactions are on terms substantially the same, or at least as favorable to such institution, as those prevailing at the time for comparable transactions with nonaffiliated companies. The First is subject to certain restrictions on extensions of credit to executive officers, directors, certain principal shareholders, and their related interests. Such extensions of credit (i) must be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with third parties and (ii) must not involve more than the normal risk of repayment or present other unfavorable features.

Change in Control With certain limited exceptions, the BHCA and the Change in Bank Control Act, together with regulations promulgated thereunder, prohibit a person or company or a group of persons deemed to be “acting in concert” from, directly or indirectly, acquiring more than 10% (5% if the acquirer is a bank holding company) of any class of our voting stock or obtaining the ability to control in any manner the election of a majority of our directors or otherwise direct the management or policies of our company without prior notice or application to and the approval of the Federal Reserve.

Dividends. The principal source of funds from which we pay cash dividends are the dividends received from our bank subsidiary, The First. Federal banking laws and regulations restrict the amount of dividends and loans a bank may make to its parent company. A national bank may not pay dividends from its capital. All dividends must be paid out of undivided profits then on hand, after deducting expenses, including reserves for losses and bad debts. In addition, a national bank is prohibited from declaring a dividend on its shares of common stock until its surplus equals its stated capital, unless the bank has transferred to surplus no less than one-tenth of its net profits of the preceding two consecutive half-year periods (in the case of an annual dividend). The approval of the OCC is required if the total of all dividends declared by a national bank in any calendar year exceeds the total of its net profits for that year combined with its retained net profits for the preceding two years, less any required transfers to surplus. In addition, under FDICIA, the banks may not pay a dividend if, after paying the dividend, the bank would be undercapitalized. See "Capital Requirements" above.

Interstate Branching and Acquisitions. National banks are required by the National Bank Act to adhere to branch office banking laws applicable to state banks in the states in which they are located. Formerly, under the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, a bank's ability to branch into a particular state was largely dependent upon whether the state "opted in" to de novo interstate branching. Under the Dodd-Frank Act, de novo interstate branching by national banks is permitted if, under the laws of the state where the branch is to be located, a state bank chartered in that state would be permitted to establish a branch. Further, a bank headquartered in one state is authorized to merge with a bank headquartered in another state, as long as neither of the states have opted out of such interstate merger authority, and subject to any state requirement that the target bank shall have been in existence and operating for a minimum period of time, not to exceed five years and certain deposit market-share limitations. Under current Mississippi, Alabama, Louisiana and Florida law, The First may open branches or acquire existing banking operations throughout these states with the prior approval of the OCC. The Dodd-Frank Act permits out of state acquisitions by bank holding companies (subject to veto by new state law), interstate branching by banks if allowed by state law, interstate merging by banks, and de novo branching by national banks if allowed by state law. All branching in which The First may engage remains subject to regulatory approval and adherence to applicable legal and regulatory requirements.

Community Reinvestment Act. The Community Reinvestment Act (the "CRA") requires depository institutions to assist in meeting the credit needs of their market areas consistent with safe and sound banking practice. Under the Community Reinvestment Act, each depository institution is required to help meet the credit needs of its market areas by, among other things, providing credit to low- and moderate-income individuals and communities. Depository institutions are periodically examined for compliance with the CRA and are assigned ratings. In order for a financial holding company to commence new activity permitted by the BHCA, each insured depository institution subsidiary of the financial holding company must have received a rating of at least "satisfactory" in its most recent examination under the CRA. These factors are considered in evaluating mergers, acquisitions, and applications to open a branch or facility.

USA Patriot Act. In 2001, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the "USA Patriot Act") was signed into law. The USA Patriot Act broadened the application of anti-money laundering regulations to apply to additional types of financial institutions,

such as broker-dealers, and strengthened the ability of the U.S. government to detect and prosecute international money laundering and the financing of terrorism. The principal provisions of Title III of the USA Patriot Act require that regulated financial institutions, including banks: (i) establish an anti-money laundering program that includes training and audit components; (ii) comply with regulations regarding the verification of the identity of any person seeking to open an account; (iii) take additional required precautions with non-U.S. owned accounts; and (iv) perform certain verification and certification of money laundering risk for their foreign correspondent banking relationships. The USA Patriot Act also expanded the conditions under which funds in a U.S. interbank account may be subject to forfeiture and increased the penalties for violation of anti-money laundering regulations. Failure of a financial institution to comply with the USA Patriot Act's requirements could have serious legal and reputational consequences for the institution. The First has adopted policies, procedures and controls to address compliance with the requirements of the USA Patriot Act under the existing regulations and will continue to revise and update its policies, procedures and controls to reflect changes required by the USA Patriot Act and implementing regulations.

Office of Foreign Assets Control. The U.S. Treasury Department's Office of Foreign Assets Control ("OFAC") is responsible for administering and enforcing economic and trade sanctions against specified foreign parties, including countries and regimes, foreign individuals and other foreign organizations and entities. OFAC publishes lists of prohibited parties that are regularly consulted by our Bank in the conduct of its business in order to assure compliance. We are responsible for, among other things, blocking accounts of, and transactions with, prohibited parties identified by OFAC, avoiding unlicensed trade and financial transactions with such parties and reporting blocked transactions after their occurrence. Failure to comply with OFAC requirements could have serious legal, financial and reputational consequences for our Bank.

Consumer Protection Regulations. Interest and certain other charges collected or contracted for by The First are subject to state usury laws and certain federal laws concerning interest rates. The First's loan operations are subject to certain federal laws applicable to credit transactions, such as the federal Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers; the Home Mortgage Disclosure Act of 1975, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs community it serves; the Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, color, religion, national origin or other prohibited factors in extending credit; the Fair Credit Reporting Act of 1978, governing the use and provision of information to credit reporting agencies; the Fair Debt Collection Practices Act, concerning the manner in which consumer debts may be collected by collection agencies; and the rules and regulations of the various federal agencies charged with the responsibility of implementing such federal laws. The deposit operations of The First also are subject to the Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records, and the Electronic Funds Transfer Act and Regulation E issued by the Federal Reserve Board to implement that Act, which governs automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services.

Other Regulatory Matters

Risk-retention rules. Under the final risk-retention rules, banks that sponsor the securitization of asset-backed securities and residential-mortgage backed securities are required to retain 5% of any loan they sell or securitize, except for mortgages that meet low-risk standards to be developed by regulators.

Changes to federal preemption. The Dodd-Frank Act created a new independent supervisory body, the Consumer Financial Protection Bureau (the "CFPB") that is housed within the Federal Reserve. The CFPB is the primary regulator for federal consumer financial statutes. State attorneys general are authorized to enforce new regulations issued by the CFPB. Although the application of most state consumer financial laws to The First will continue to be preempted under the National Bank Act, OCC determinations of such preemption are made on a case-by-case basis. As a result, it is possible that state consumer financial laws enacted in the future may be held to apply to our business activities. The cost of complying with any such additional laws could have a negative impact on our financial results.

Mortgage Rules. During 2013, the CFPB finalized a series of rules related to the extension of residential mortgage loans by banks. Among these rules are requirements that a bank make a good faith determination that a borrower has the ability to repay a mortgage loan prior to extending such credit, a requirement that certain mortgage loans provide for escrow payments, new appraisal requirements, and specific rules regarding how loan originators may be compensated and the servicing of residential mortgage loans. The implementation of these new rules began in January 2014.

Volcker Rule. In December 2013, the Federal Reserve, the FDIC, the OCC, the Commission, and the Commodity Futures Trading Commission issued the “Prohibitions And Restrictions On Proprietary Trading And Certain Interests In, And Relationships With, Hedge Funds And Private Equity Funds,” commonly referred to as the Volcker Rule, which regulates and restricts investments which may be made by banks. The Volcker Rule was adopted to implement a portion of the Dodd-Frank Act and new Section 13 of the Bank Holding Company Act, which prohibits any banking entity from engaging in proprietary trading or from acquiring or retaining an ownership interest in, or sponsoring or having certain relationships with, a hedge fund or private equity fund (“covered funds”), subject to certain exemptions.

Debit Interchange Fees

Interchange fees, or “swipe” fees, are fees that merchants pay to credit card companies and card-issuing banks such as The First for processing electronic payment transactions on their behalf. The maximum permissible interchange fee that an issuer may receive for an electronic debit transaction is the sum of 21 cents per transaction and 5 basis points multiplied by the value of the transaction, subject to an upward adjustment of 1 cent if an issuer certifies that it has implemented policies and procedures reasonably designed to achieve the fraud-prevention standards set forth by the Federal Reserve.

In addition, the legislation prohibits card issuers and networks from entering into exclusive arrangements requiring that debit card transactions be processed on a single network or only two affiliated networks, and allows merchants to determine transaction routing. Due to the Company’s size, the Federal Reserve rule limiting debit interchange fees has not reduced our debit card interchange revenues.

Summary

The foregoing is a brief summary of certain statutes, rules and regulations affecting the Company and The First. It is not intended to be an exhaustive discussion of all statutes and regulations having an impact on the operations of such entities.

Increased regulation generally has resulted in increased legal and compliance expense.

Finally, additional bills may be introduced in the future in the U.S. Congress and state legislatures to alter the structure, regulation and competitive relationships of financial institutions. It cannot be predicted whether and in what form any of these proposals will be adopted or the extent to which the business of the Company and The First may be affected thereby.

Effect of Governmental Monetary and Fiscal Policies

The difference between the interest rate paid on deposits and other borrowings and the interest rate received on loans and securities comprises most of a bank’s earnings. In order to mitigate the interest rate risk inherent in the industry,

the banking business is becoming increasingly dependent on the generation of fee and service charge revenue.

The earnings and growth of a bank are affected by both general economic conditions and the monetary and fiscal policy of the U.S. government and its agencies, particularly the Federal Reserve. The Federal Reserve sets national monetary policy such as seeking to curb inflation and combat recession. This is accomplished by its open-market operations in U.S. government securities, adjustments in the amount of reserves that financial institutions are required to maintain and adjustments to the discount rates on borrowings and target rates for federal funds transactions. The actions of the Federal Reserve in these areas influence the growth of bank loans, investments and deposits and also affect interest rates on loans and deposits. The nature and timing of any future changes in monetary policies and their potential impact on the Company cannot be predicted.

ITEM 1A. RISK FACTORS

Making or continuing an investment in securities, including the Company's Common Stock, involves certain risks that you should carefully consider. The risks and uncertainties described below are not the only risks that may have a material adverse effect on the Company. Additional risks and uncertainties also could adversely affect the Company's business and results of operations. If any of the following risks actually occur, our business, financial condition or results of operations could be affected, the market price for your securities could decline, and you could lose all or a part of your investment. Further, to the extent that any of the information contained in this Annual Report on Form 10-K constitutes forward-looking statements, the risk factors set forth below also are cautionary statements identifying important factors that could cause the Company's actual results to differ materially from those expressed in any forward-looking statements made by or on behalf of the Company.

Risk Factors Associated With Our Business

General economic conditions in the areas where our operations or loans are concentrated may adversely affect our customers' ability to meet their obligations.

A sudden or severe downturn in the economy in the geographic markets we serve in the states of Mississippi, Louisiana, Alabama or Florida may affect the ability of our customers to meet loan payment obligations on a timely basis. The local economic conditions in these areas have a significant impact on our commercial, real estate, and construction loans, the ability of borrowers to repay these loans and the value of the collateral securing such loans. Any deterioration in the economic conditions of these market areas could negatively impact the financial results of the Company's banking operations, earnings, and profitability.

Additionally, adverse economic changes may cause customers to withdraw deposit balances, thereby causing a strain on our liquidity. We have historically had access to a number of alternative sources of liquidity, but if there is an increase in volatility in the credit and liquidity markets there is no assurance that we will be able to obtain such liquidity on terms that are favorable to us, or at all.

We may be vulnerable to certain sectors of the economy, including real estate.

A significant portion of our loan portfolio is secured by real estate. The market value of real estate can fluctuate significantly in a relatively short period of time as a result of market conditions in the geographic area in which the real estate is located. If the economy deteriorates and real estate values depress beyond a certain point, as happened during the last recession, the collateral value of the portfolio and the revenue stream from those loans could come under stress and additional loan loss accruals could be required which would negatively impact our earnings. Our ability to dispose of foreclosed real estate at prices above the respective carrying values could also be impacted, which could cause our results of operations to be adversely affected.

Unpredictable market conditions may adversely affect the industry in which we operate.

The capital and credit markets are subject to volatility and disruption. Dramatic declines in the housing market in years past caused home prices to fall and increased foreclosures, unemployment and under-employment. These events, if they were to happen again, could negatively impact the credit performance of mortgage loans and result in significant write-downs of asset values, including government-sponsored entities as well as major commercial and investment banks. Market turmoil and tightening of credit could lead to an increased level of commercial and consumer delinquencies, lack of consumer confidence and widespread reduction of business activity generally. A worsening of these conditions would have an adverse effect on us and others in the financial institution industry generally, particularly in our real estate markets, as lower home prices and increased foreclosures would result in higher charge-offs and delinquencies.

The state of the economy and various economic factors, including inflation, recession, unemployment, interest rates and the level of U.S. debt, as well as governmental action and uncertainty resulting from U.S. and global political trends, may directly and indirectly, have a destabilizing effect on our financial condition and results of operations. An unfavorable or uncertain national or regional political or economic environment could drive losses beyond those which are provided for in our allowance for loan losses and could negatively impact our results of operations

We must maintain an appropriate allowance for loan losses.

The First, as lender, is exposed to the risk that its customers will be unable to repay their loans in accordance with their terms and that any collateral securing the payment of their loans may not be sufficient to assure repayment. Credit losses are inherent in the business of making loans and could have a material adverse effect on operating results. Credit risk with respect to our real estate and construction loan portfolio relates principally to the creditworthiness of the borrower corporations and the value of the real estate serving as security for the repayment of loans. Credit risk with respect to our commercial and consumer loan portfolio will relate principally to the general creditworthiness of the borrower businesses and individuals within our local markets.

The First makes various assumptions and judgments about the collectability of its loan portfolio based on a number of factors. We maintain an allowance for loan losses, which is a reserve established through a provision for loan losses charged to expense each quarter, that is consistent with management's assessment of the collectability of the loan portfolio in light of the amount of loans committed and outstanding and current economic conditions and market trends. When specific loan losses are identified, the amount of the expected loss is removed, or charged-off, from the allowance. The First believes that its current allowance for loan losses is adequate. However, if our assumptions or judgments prove to be incorrect, the allowance for loan losses may not be sufficient to cover actual loan losses. We may have to increase the allowance in the future in response to the request of one of our primary banking regulators, to adjust for changing conditions and assumptions, or as a result of any deterioration in the quality of the loan portfolio. The actual amount of future provisions for loan losses cannot be determined at this time and may vary from the amounts of past provisions. Any increase in the allowance for loan losses or in the amount of loan charge-offs required by regulatory agencies or for other factors could have a negative effect on our results of operations and financial condition.

We are subject to risks related to changes in market interest rates.

Our assets and liabilities are primarily monetary in nature, and as a result we are subject to significant risks resulting from changes in interest rates. Our profitability is largely dependent upon net interest income. Unexpected movement in interest rates markedly changing the slope of the current yield curve could cause net interest margins to decrease, subsequently decreasing net interest income. In addition, such changes could adversely affect the valuation of our assets and liabilities.

At present the Company's one-year interest rate sensitivity position is asset sensitive. As with most financial institutions, the Company's results of operations are affected by changes in interest rates and the Company's ability to manage this risk. The difference between interest rates charged on interest-earning assets and interest rates paid on interest-bearing liabilities may be affected by changes in market interest rates, changes in relationships between interest rate indices, and/or changes in the relationships between long-term and short-term market interest rates. A change in this difference might result in an increase in interest expense relative to interest income, or a decrease in the Company's interest rate spread.

Certain changes in interest rates, inflation, or the financial markets could affect demand for our products and our ability to deliver products efficiently.

Loan originations, and therefore loan revenues, could be adversely impacted by rising interest rates. Increases in market interest rates can have negative impacts on our business, including reducing our customers' desire to borrow money from us or adversely affecting their ability to repay their outstanding loans by increasing their debt service obligations through the periodic reset of adjustable interest rate loans. If our borrowers' ability to repay their loans is

impaired by increasing interest payment obligations, our level of non-performing assets would increase, producing an adverse effect on operating results. Asset values, especially commercial real estate as collateral, securities or other fixed rate earning assets, can decline significantly with relatively minor changes in interest rates. Conversely, falling rates could increase prepayments within our loan and securities portfolio lowering interest earnings from those assets. An unanticipated increase in inflation could cause operating costs related to salaries and benefits, technology, and supplies to increase at a faster pace than revenues.

The fair market value of the securities portfolio and the investment income from these securities also fluctuates depending on general economic and market conditions. In addition, actual net investment income and/or cash flows from investments that carry prepayment risk, such as mortgage-backed and other asset-backed securities, may differ from those anticipated at the time of investment as a result of interest rate fluctuations.

Evaluation of investment securities for other-than-temporary impairment involves subjective determinations and could materially impact our results of operations and financial condition.

The evaluation of impairments is a quantitative and qualitative process, which is subject to risks and uncertainties, and is intended to determine whether declines in the fair value of investments should be recognized in current period earnings. The risks and uncertainties include changes in general economic conditions, the issuers' financial condition or future recovery prospects, the effects of changes in interest rates or credit spreads and the expected recovery period. Estimating future cash flows involves incorporating information received from third-party sources and making internal assumptions and judgments regarding the future performance of the underlying collateral and assessing the probability that an adverse change in future cash flows has occurred. The determination of the amount of other-than-temporary impairments is based upon the Company's quarterly evaluation and assessment of known and inherent risks associated with the respective asset class. Such evaluations and assessments are revised as conditions change and new information becomes available.

Additionally, our management considers a wide range of factors about the security issuer and uses its reasonable judgment in evaluating the cause of the decline in the estimated fair value of the security and in assessing the prospects for recovery. Inherent in management's evaluation of the security are assumptions and estimates about the operations of the issuer and its future earnings potential. Impairments to the carrying value of our investment securities may need to be taken in the future, which would have a material adverse effect on our results of operations and financial condition.

Changes in the policies of monetary authorities and other government action could adversely affect profitability.

The results of operations of the Company are affected by credit policies of monetary authorities, particularly the Board of Governors of the Federal Reserve System, which we refer to as the Federal Reserve Board. The instruments of monetary policy employed by the Federal Reserve Board include open market operations in U.S. government securities, changes in the discount rate or the federal funds rate on bank borrowings and changes in reserve requirements against bank deposits. In view of changing conditions in the national economy and monetary policy, we cannot predict the impact of future changes in interest rates, deposit levels, loan demand or the Company's business and earnings. Furthermore, the actions of the United States government and other governments in responding to developing situations or implementing new fiscal or trade policies may result in currency fluctuations, exchange controls, market disruption and other unanticipated economic effects. Such actions could have an adverse effect on our results of operations and profitability.

We are subject to regulation by various Federal and State entities.

The Company and The First are subject to extensive regulation by various regulatory agencies, including the Federal Reserve Board, the Federal Deposit Insurance Corporation, the OCC, the Consumer Financial Protection Bureau and the SEC. See *Supervision and Regulation* above for more information. New regulations issued by these agencies may adversely affect our ability to carry on our business activities. The Company is subject to various Federal and state laws and certain changes in these laws and regulations may adversely affect operations.

The Company and The First are also subject to the accounting rules and regulations of the SEC and the Financial Accounting Standards Board. Changes in accounting rules could adversely affect the reported financial statements or results of operations of the Company and may also require extraordinary efforts or additional costs to implement. Any of these laws or regulations may be modified or changed from time to time, and we cannot be assured that such modifications or changes will not adversely affect the Company.

The full impact of the Tax Cuts and Jobs Act (the "Tax Act") on us and our customers is unknown at present, creating uncertainty and risk related to our customers' future demand for credit and our future results.

Increased economic activity expected to result from the decrease in tax rates on businesses generally could spur additional economic activity that would encourage additional borrowing. At the same time, some customers may elect to use their additional cash flow from lower taxes to fund their existing levels of activity, decreasing borrowing needs. The elimination of the federal income tax deductibility of business interest expense for a significant number of our customers effectively increases the cost of borrowing and makes equity or hybrid funding relatively more attractive. This could have a long-term negative impact on business customer borrowing. We anticipate a significant increase in our after-tax net income available to stockholders in 2018 and future years as a result of the decrease in our effective tax rate. Some or all of this benefit could be lost to the extent that the banks and financial services companies we compete with elect to lower interest rates and fees and we are forced to respond in order to remain competitive. There is no assurance that presently anticipated benefits of the Tax Act for the Company will be realized.

We may be required to pay additional insurance premiums to the FDIC, which could negatively impact earnings.

Pursuant to the Dodd-Frank Act, the limit on FDIC coverage has been permanently increased to \$250,000, causing the premiums assessed to The First by the FDIC to increase. Depending upon any future losses that the FDIC insurance fund may suffer, there can be no assurance that there will not be additional premium increases in order to replenish the fund. The FDIC may need to set a higher base rate schedule or impose special assessments due to future financial institution failures and updated failure and loss projections. Potentially higher FDIC assessment rates than those currently projected could have an adverse impact on our results of operations.

We are subject to industry competition which may have an adverse impact upon our success.

The profitability of the Company depends on its ability to compete successfully with other financial services companies. We operate in a highly competitive financial services environment. Certain competitors are larger and may have more resources than we do. We face competition in our regional market areas from other commercial banks, savings institutions, credit unions, internet banks, finance companies, mutual funds, insurance companies, brokerage and investment banking firms, and other financial intermediaries that offer similar services. Some of the nonbank competitors are not subject to the same extensive regulations that govern the Company or The First and may have greater flexibility in competing for business.

Many of these competitors also have broader geographic markets and substantially greater resources and lending limits than The First and offer certain services such as trust banking that The First does not currently provide. In addition, many of these competitors have numerous branch offices located throughout the extended market areas of The First that may provide these competitors with an advantage in geographic convenience that The First does not have at present. Currently there are numerous other commercial banks, savings institutions, and credit unions operating in The First's primary service area.

We also compete with numerous financial and quasi-financial institutions for deposits and loans, including providers of financial services over the internet. Recent technology advances and other changes have allowed parties to effectuate financial transactions that previously required the involvement of banks. For example, consumers can maintain funds in brokerage accounts or mutual funds that would have historically been held as bank deposits. Consumers can also complete transactions such as paying bills and transferring funds directly without the assistance of banks. The process of eliminating banks as intermediaries, known as "disintermediation," could result in the loss of fee income, as well as the loss of customer deposits and the related income generated from those deposits. The loss of these revenue streams and access to lower cost deposits as a source of funds could have a material adverse effect on our financial condition and results of operations.

Our information systems may experience an interruption or breach in security.

We rely heavily on communications and information systems to conduct our business. Any failure, interruption or breach in security of these systems could result in failures or disruptions in our customer relationship management, deposit, loan and other systems. While we have policies and procedures designed to prevent or limit the effect of the failure, interruption or security breach of our information systems, there can be no assurance that we can prevent any such failures, interruptions, cyber security breaches or other security breaches or, if they do occur, that they will be adequately addressed. The occurrence of any failures, interruptions or security breaches of our information systems could damage our reputation, result in a loss of customer business, subject us to additional regulatory scrutiny, or expose us to civil litigation and possible financial liability, any of which could have a material adverse effect on our financial condition and results of operations.

Natural disasters, acts of war or terrorism and other external events could affect our ability to operate.

Our market areas are susceptible to natural disasters such as hurricanes and tornados. Natural disasters can disrupt operations, result in damage to properties that may be serving as collateral for our loan assets and negatively affect the local economies in which we operate. We cannot predict whether or to what extent damage caused by future hurricanes, tornados or other natural disasters will affect operations or the economies in our market areas, but such weather events could cause a decline in loan originations, a decline in the value or destruction of properties serving as collateral for our loans and an increase in the risk of delinquencies, foreclosures or loan losses. In addition, acts of war or terrorism and other external events could cause disruption in our operations. The occurrence of any of these events could have a material adverse effect on our business, financial condition and results of operations.

We must maintain effective internal control over financial reporting.

Management regularly monitors, reviews and updates our disclosure controls and procedures, including our internal control over financial reporting. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, assurances that the controls will be effective. Any failure or circumvention of our controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on our business, results of operations and financial condition.

Failure to achieve and maintain an effective internal control environment could prevent us from accurately reporting our financial results, preventing or detecting fraud, or providing timely and reliable financial information pursuant to our reporting obligations, which could have a material adverse effect on our business, financial condition, and results of operations.

Our business is susceptible to fraud.

Our business exposes us to fraud risk from our loan and deposit customers, the parties they do business with, as well as from our employees, contractors and vendors. We rely on financial and other data from new and existing customers which could turn out to be fraudulent when accepting such customers, executing their financial transactions and making and purchasing loans and other financial assets. In times of increased economic stress we are at increased risk of fraud losses. We believe we have underwriting and operational controls in place to prevent or detect such fraud, but we cannot provide assurance that these controls will be effective in detecting fraud or that we will not experience fraud losses or incur costs or other damage related to such fraud, at levels that adversely affect our financial results or reputation. Our lending customers may also experience fraud in their businesses which could adversely affect their ability to repay their loans or make use of our services. Our exposure and the exposure of our customers to fraud may increase our financial risk and reputation risk as it may result in unexpected loan losses that exceed those that have been provided for in our allowance for loan losses.

We may not be able to attract and retain skilled personnel.

Our success depends, in large part, on our ability to attract and retain key personnel. Competition for the best personnel in most activities we engage in can be intense, and we may not be able to hire personnel or to retain them. The unexpected loss of services of one or more of our key personnel could have a material adverse impact on our business because of their skills, knowledge of our market, relationships in the communities we serve, years of industry experience and the difficulty of promptly finding qualified replacement personnel. Although we have employment agreements with certain of our executive officers, there is no guarantee that these officers and other key

personnel will remain employed with the Company.

The failure of other financial institutions could adversely affect the Company.

Our ability to engage in routine funding transactions could be adversely affected by the actions and potential failures of other financial institutions. Financial institutions are interrelated as a result of trading, clearing, counterparty and other relationships. As a result, defaults by, or even rumors or concerns about, one or more financial institutions or the financial services industry generally have led to market-wide liquidity problems and could lead to losses or defaults by the Company or by other institutions.

Merger-Related Risks

We may engage in acquisitions of other businesses from time to time, which may adversely impact our results.

From time to time, we may engage in acquisitions of other businesses. Difficulty in integrating an acquired business or company may cause us not to realize expected revenue increases, cost savings, increases in geographic or product presence, or other anticipated benefits from any acquisition. The integration could result in higher than expected deposit attrition (run-off), loss of key employees, disruption of the Company's business or the business of the acquired company, or otherwise adversely affect the Company's ability to maintain relationships with customers and employees or achieve the anticipated benefits of the acquisition. The acquired companies may also have legal contingencies, beyond those that we are aware of, that could result in unexpected costs. The Company may need to make additional investment in equipment and personnel to manage higher asset levels and loan balances as a result of any significant acquisition, which may adversely impact earnings.

We may fail to realize the anticipated cost savings and other financial benefits of the First Community Bank Acquisition and Sunshine Community Bank acquisition on the anticipated schedule, if at all.

The First, First Community Bank, and Sunshine Community Bank have historically operated independently. The success of the mergers of First Community Bank and Sunshine Community Bank into The First will depend, in part, on our ability to successfully combine the businesses of The First, First Community Bank, and Sunshine Community Bank. To realize these anticipated benefits, The First expects to integrate First Community Bank's and Sunshine Community Bank's businesses with its own businesses. We may face significant challenges in integrating both First Community Bank's and Sunshine Community Bank's operations into our operations in a timely and efficient manner and in retaining key personnel from these two banks. Achieving the anticipated cost savings and financial benefits of the mergers will depend, in part, on whether we can successfully integrate these businesses. It is possible that the integration process could result in the loss of key employees, the disruption of each company's ongoing businesses or inconsistencies in standards, controls, procedures, and policies that adversely affect our ability to maintain relationships with clients, customers, depositors, and employees or to achieve the anticipated benefits of the merger. In addition, the integration of certain operations following the mergers will require the dedication of significant management resources, which may temporarily distract management's attention from the day-to-day business of the combined company. Any inability to realize the full extent of, or any of, the anticipated cost savings and financial benefits of the mergers, as well as any delays encountered in the integration process, could have an adverse effect on the business and results of operations of the combined company.

In addition, Sunshine's shareholders must approve the transaction before the acquisition of Sunshine Community Bank can be completed, and such shareholder approval may not be received. Failure to complete the acquisition could have a negative impact on our reputation and may affect the market price of our common stock.

We will incur significant transaction and merger-related costs in connection with the acquisition of Southwest and First Community Bank and the pending acquisition of Sunshine and Sunshine Community Bank.

We have incurred and expect to incur a number of non-recurring costs associated with the acquisition of Southwest and First Community Bank and the pending acquisition of Sunshine and Sunshine Community Bank. These costs and expenses include fees paid to financial, legal and accounting advisors, severance, retention bonus and other potential employment-related costs, filing fees, printing expenses and other related charges. Some of these costs are payable by us regardless of whether the acquisition is completed. There are also a large number of processes, policies, procedures, operations, technologies and systems that must be integrated in connection with the merger and the integration of these companies' businesses. While we have assumed that a certain level of expenses would be incurred in connection with the acquisitions, there are many factors beyond our control that could affect the total amount or the timing of the integration and implementation expenses.

There may also be additional unanticipated significant costs in connection with the acquisitions that we may not recoup. These costs and expenses could reduce the realization of efficiencies, strategic benefits and additional income we expect to achieve from the acquisition. Although we expect that these benefits will offset the transaction expenses and implementation costs over time, the net benefit may not be achieved in the near term or at all.

With the completion of the acquisitions of First Community Bank and Sunshine Community Bank, the market price of our common stock may be affected by factors different from those historically affecting our independent operations through The First.

The historic businesses of each of The First, First Community Bank, and Sunshine Community Bank differ in important respects, and accordingly, the results of operations of the combined company and the market price of the combined company's shares of common stock may be affected by factors different from those historically affecting the independent results of operations of The First, First Community Bank, and Sunshine Community Bank.

Risks Relating to Our Securities

The price of our common stock may fluctuate significantly, which may make it difficult for investors to resell shares of common stock at a time or price they find attractive.

Our stock price may fluctuate significantly as a result of a variety of factors, many of which are beyond our control. In addition to those described in "Special Cautionary Notice Regarding Forward-Looking Statements," these factors include, among others:

- actual or anticipated quarterly fluctuations in our operating results, financial condition or asset quality;

changes in financial estimates or the publication of research reports and recommendations by financial analysts or actions taken by rating agencies with respect to us or other financial institutions;

- failure to declare dividends on our common stock from time to time;

- failure to meet analysts' revenue or earnings estimates;

- failure to integrate acquisitions or realize anticipated benefits from acquisitions;

- strategic actions by us or our competitors, such as acquisitions, restructurings, dispositions or financings;

fluctuations in the stock price and operating results of our competitors or other companies that investors deem comparable to us;

- future sales of our common stock or other securities;

- proposed or final regulatory changes or developments;

- anticipated or pending regulatory investigations, proceedings, or litigation that may involve or affect us;

- reports in the press or investment community generally relating to our reputation or the financial services industry;

- domestic and international economic and political factors unrelated to our performance;

general market conditions and, in particular, developments related to market conditions for the financial services industry;

·adverse weather conditions, including floods, tornadoes and hurricanes; and

· geopolitical conditions such as acts or threats of terrorism or military conflicts.

In addition, in recent years, the stock market in general has experienced extreme price and volume fluctuations. This volatility has had a significant effect on the market price of securities issued by many companies, including for reasons unrelated to their operating performance. These broad market fluctuations may adversely affect our stock price, notwithstanding our operating results. We expect that the market price of our common stock will continue to fluctuate and there can be no assurances about the levels of the market prices for our common stock.

General market fluctuations, industry factors and general economic and political conditions and events, such as economic slowdowns or recessions, interest rate changes or credit loss trends, could also cause our stock price to decrease regardless of operating results.

We may need to rely on the financial markets to provide needed capital.

Our common stock is listed and traded on the Nasdaq stock market. Although we anticipate that our capital resources will be adequate for the foreseeable future to meet our capital requirements, at times we may depend on the liquidity of the capital markets to raise additional capital. Our historical ability to raise capital through the sale of capital stock and debt securities may be affected by economic and market conditions or regulatory changes that are beyond our control. Adverse changes in our operating performance or financial condition could make raising additional capital difficult or more expensive or limit our access to customary sources of funding. If the market should fail to operate, or if conditions in the capital markets are adverse, our efforts to raise capital could require the issuance of securities at times and with maturities, conditions and rates that are disadvantageous, and which could have a dilutive impact on our current stockholders. Should these risks materialize, the ability to further expand our operations through organic or acquisitive growth may be limited.

Securities issued by the Company, including the Company's common stock, are not FDIC insured.

Securities issued by the Company, including the Company's common stock, are not savings or deposit accounts or other obligations of any bank and are not insured by the FDIC, the Deposit Insurance Fund, or any other governmental agency or instrumentality, or any private insurer, and are subject to investment risk, including the possible loss of principal.

Anti-takeover laws and certain agreements and charter provisions may adversely affect share value.

Certain provisions of state and federal law and our articles of incorporation may make it more difficult for someone to acquire control of the Company. Under federal law, subject to certain exemptions, a person, entity, or group must notify the federal banking agencies before acquiring 10% or more of the outstanding voting stock of a bank holding company, including the Company's shares. Banking agencies review the acquisition to determine if it will result in a change of control. The banking agencies have 60 days to act on the notice, and take into account several factors, including the resources of the acquiror and the antitrust effects of the acquisition. There also are Mississippi statutory provisions and provisions in our articles of incorporation that may be used to delay or block a takeover attempt. As a result, these statutory provisions and provisions in our articles of incorporation could result in the Company being less attractive to a potential acquiror.

The trading volume in our common stock is less than that of other larger financial services companies.

Although our common stock is listed for trading on the Nasdaq Global Market, the trading volume for our common stock is low relative to other larger financial services companies, and you are not assured liquidity with respect to transactions in our common stock. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace of willing buyers and sellers of our common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which we have no control. Given the lower trading volume of our common stock, significant sales of our common stock, or the expectation of these sales, could cause our stock price to fall.

You may not receive dividends on our common stock.

Although we have historically declared quarterly cash dividends on our common stock, we are not required to do so and may reduce or cease to pay common stock dividends in the future. If we reduce or cease to pay common stock dividends, the market price of our common stock could be adversely affected.

The principal source of funds from which we pay cash dividends are the dividends received from The First. Federal banking laws and regulations restrict the amount of dividends and loans a bank may make to its parent company. Under certain conditions, dividends paid to us by The First are subject to approval by the OCC. A national bank may not pay dividends from its capital. All dividends must be paid out of undivided profits then on hand, after deducting expenses, including reserves for losses and bad debts. In addition, a national bank is prohibited from declaring a dividend on its shares of common stock until its surplus equals its stated capital, unless the bank has transferred to surplus no less than one-tenth of its net profits of the preceding two consecutive half-year periods (in the case of an annual dividend). The approval of the OCC is required if the total of all dividends declared by a national bank in any calendar year exceeds the total of its net profits for that year combined with its retained net profits for the preceding two years, less any required transfers to surplus. In addition, under The Federal Deposit Insurance Corporation Improvement Act of 1991, the banks may not pay a dividend if, after paying the dividend, the bank would be undercapitalized.

If we fail to pay dividends, capital appreciation, if any, of our common stock may be the sole opportunity for gains on an investment in our common stock. In addition, in the event The First becomes unable to pay dividends to us, we may not be able to service our debt or pay our other obligations or pay dividends on our common stock and preferred stock. Accordingly, our inability to receive dividends from The First could also have a material adverse effect on our business, financial condition and results of operations and the value of your investment in our common stock.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None

ITEM 2. PROPERTIES

Our company's main office, which is the holding company headquarters, is located at 6480 U.S. Hwy 98 West in Hattiesburg, Mississippi. As of year-end, we had 43 full service banking and financial services offices and one motor bank facility as well as four loan production offices. We lease the Hardy Court Branch, the Gulfport Downtown Branch, the Pascagoula Branch, the Ocean Springs Branch, the Fairhope Branch, the Bayley's Corner Branch, the

Theodore Branch, the Dauphin Island Branch, the Baton Rouge Branch, and the Pensacola Downtown Branch, which comprise ten of our full services banking and financial services offices. We also lease the Brandon, the Madison, the Ocean Springs and the Slidell loan production offices. Management ensures that all properties, whether owned or leased, are maintained in suitable condition.

ITEM 3. LEGAL PROCEEDINGS

From time to time the Company and/or The First may be named as defendants in various lawsuits arising out of the normal course of business. At present, the Company is not aware of any legal proceedings that it anticipates may materially adversely affect its business.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II**ITEM MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS
5. AND ISSUER PURCHASES OF EQUITY SECURITIES****Market Information**

Our common stock trades on the Nasdaq Global Market under the ticker symbol "FBMS". The following table sets forth the high and low sales price of the Company's common stock as reported on the NASDAQ Global Market. These prices do not reflect retail mark-ups, mark-downs or commissions.

	High Sale	Low Sale	Cash Dividends Paid
2017 4 th quarter	\$34.35	\$29.95	\$ 0.0375
3 rd quarter	30.35	26.35	0.0375
2 nd quarter	28.65	27.225	0.0375
1 st quarter	30.60	27.125	0.0375
2016 4 th quarter	\$28.50	\$17.10	\$ 0.0375
3 rd quarter	19.55	16.99	0.0375
2 nd quarter	17.72	15.50	0.0375
1 st quarter	18.50	15.32	0.0375

There were approximately 1,961 record holders of the Company's common stock at March 13, 2018 and 12,339,492 shares outstanding.

Payment of Dividends

The principal sources of funds to the Company to pay dividends are the dividends received from The First, National Banking Association, Hattiesburg, Mississippi. Consequently, dividends are dependent upon The First's earnings, capital needs, regulatory policies, as well as statutory and regulatory limitations. Federal and state banking laws and regulations restrict the amount of dividends and loans a bank may make to its parent company. Approval by the Company's regulators is required if the total of all dividends declared in any calendar year exceed the total of its net

income for that year combined with its retained net income of the preceding two years.

Issuer Purchases of Equity Securities

The following table sets forth shares of our common stock we repurchased during the period ended December 31, 2017.

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Current Program	
			Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
1 st Quarter 2017	10,403	\$ 27.65	-	-
2 nd Quarter 2017	1,464	28.65	-	-
3 rd Quarter 2017	-	-	-	-
4 th Quarter 2017	-	-	-	-
Total	11,867	(a) \$ 28.15	-	-

(a) Represents shares withheld by the Company in order to satisfy employee tax obligations for vesting of restricted stock awards.

Stock Performance Graph

The following performance graph and related information are neither “soliciting material” nor “filed” with the SEC, nor shall such information be incorporated by reference into any future filings under the Securities Act of 1933 or the Securities Exchange Act of 1934, each as amended, except to the extent the Company specifically incorporates it by reference to such filing.

The performance graph compares the cumulative five-year shareholder return on the Company’s common stock, assuming an investment of \$100 on December 31, 2011 and the reinvestment of dividends thereafter, to that of the common stocks of United States companies reported in the Nasdaq Composite-Total Returns Index and the common stocks of the Nasdaq OMX Banks Index. The Nasdaq OMX Banks Index contains securities of Nasdaq- listed companies classified according to the Industry Classification Benchmark as Banks. They include banks providing a broad range of financial services, including retail banking, loans and money transmissions.

ITEM 6. SELECTED FINANCIAL DATA

The following unaudited consolidated financial data is derived from The First Bancshares' audited consolidated financial statements as of and for the five years ended December 31, 2017.

SELECTED CONSOLIDATED FINANCIAL HIGHLIGHTS

(Dollars In Thousands, Except Per Share Data)

	December 31,				
	2017	2016	2015	2014	2013
Earnings:					
Net interest income	\$59,160	\$40,289	\$36,994	\$33,398	\$28,401
Provision for loan Losses	506	625	410	1,418	1,076
Non-interest income	14,363	11,247	7,588	7,803	7,083
Non-interest expense	55,446	36,862	32,161	30,734	28,165
Net income	10,616	10,119	8,799	6,614	4,639
Net income applicable to common Stockholders	10,616	9,666	8,456	6,251	4,215
Per common share data:					
Basic net income per Share	\$1.12	\$1.78	\$1.57	\$1.20	\$.98
Diluted net income per Share	1.11	1.57	1.55	1.19	.96
Per share data:					
Basic net income per share	\$1.12	\$1.86	\$1.64	\$1.27	\$1.07
Diluted net income per share	1.11	1.64	1.62	1.25	1.06
Selected Year End Balances:					
Total assets	\$1,813,238	\$1,277,367	\$1,145,131	\$1,093,768	\$940,890
Securities	372,862	255,799	254,959	270,174	258,023
Loans, net of allowance	1,221,808	865,424	769,742	700,540	577,574
Deposits	1,470,565	1,039,191	916,695	892,775	779,971
Stockholders' equity	222,468	154,527	103,436	96,216	85,108

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following provides a narrative discussion and analysis of The First Bancshares' financial condition and results of operations for the years ended December 31, 2017, 2016, and 2015. This discussion should be read in conjunction with the consolidated financial statements and the supplemental financial data included in Part II. Item 8.-Financial Statements and Supplementary Data – included elsewhere in this report.

Critical Accounting Policies

In the preparation of the Company's consolidated financial statements, certain significant amounts are based upon judgment and estimates. The most critical of these is the accounting policy related to the allowance for loan losses. The allowance is based in large measure upon management's evaluation of borrowers' abilities to make loan payments, local and national economic conditions, and other subjective factors. If any of these factors were to deteriorate, management would update its estimates and judgments which may require additional loss provisions.

Companies are required to perform periodic reviews of individual securities in their investment portfolios to determine whether decline in the value of a security is other than temporary. A review of other-than-temporary impairment requires companies to make certain judgments regarding the materiality of the decline, its effect on the financial statements and the probability, extent and timing of a valuation recovery and the company's intent and ability to hold the security. Pursuant to these requirements, Management assesses valuation declines to determine the extent to which such changes are attributable to fundamental factors specific to the issuer, such as financial condition, business prospects or other factors or market-related factors, such as interest rates. Declines in the fair value of securities below their cost that are deemed to be other-than-temporary are recorded in earnings as realized losses.

Goodwill is assessed for impairment both annually and when events or circumstances occur that make it more likely than not that impairment has occurred. As part of its testing, the Company first assesses qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If the Company determines the fair value of a reporting unit is less than its carrying amount using these qualitative factors, the Company then compares the fair value of goodwill with its carrying amount, and then measures impaired loss by comparing the implied fair value of goodwill with the carrying amount of that goodwill. Other intangibles are also assessed for impairment, both annually and when events or circumstances occur, that make it more likely than not that impairment has occurred. No impairment was indicated when the annual test was performed in December, 2017.

Overview

The First Bancshares, Inc. (the Company) was incorporated on June 23, 1995, and serves as a bank holding company for The First, A National Banking Association (“The First”), located in Hattiesburg, Mississippi. The First began operations on August 5, 1996, from its main office in the Oak Grove community, which is now incorporated within the city of Hattiesburg. Currently, the First has 57 locations in Mississippi, Louisiana, Alabama, and Florida. The Company and The First engage in a general commercial and retail banking business characterized by personalized service and local decision-making, emphasizing the banking needs of small to medium-sized businesses, professional concerns, and individuals.

The Company's primary source of revenue is interest income and fees, which it earns by lending and investing the funds which are held on deposit. Because loans generally earn higher rates of interest than investments, the Company seeks to employ as much of its deposit funds as possible in the form of loans to individuals, businesses, and other organizations. To ensure sufficient liquidity, the Company also maintains a portion of its deposits in cash, government securities, deposits with other financial institutions, and overnight loans of excess reserves (known as "Federal Funds Sold") to correspondent banks. The revenue which the Company earns (prior to deducting its overhead expenses) is essentially a function of the amount of the Company's loans and deposits, as well as the profit margin ("interest spread") and fee income which can be generated on these amounts.

Highlights for the year ended December 31, 2017 include:

On October 24, 2017, the Company announced the signing of an Agreement and Plan of Merger with Southwest Banc Shares, Inc. ("Southwest"), parent company of First Community Bank, headquartered in Chatom, Alabama. This acquisition closed March 1, 2018, and added 9 locations servicing southwest Alabama.

On October 31, 2017, the Company completed a sale of an aggregate of 2,012,500 shares of its common stock in a public offering. Net proceeds after underwriting discounts and estimated expenses were approximately \$55.2 million.

On December 6, 2017, the Company announced the signing of an Agreement and Plan of Merger with Sunshine Financial, Inc. ("Sunshine"), parent company of Sunshine Community Bank, headquartered in Tallahassee, Florida. Upon completion, the acquisition will add 5 locations servicing Tallahassee and is expected to close during the second quarter of 2018 subject to Sunshine shareholder approval and customary closing conditions. Regulatory approval was received February 27, 2018.

At December 31, 2017, the Company had approximately \$1.8 billion in total assets, an increase of \$0.5 billion

compared to \$1.3 billion at December 31, 2016. Loans net of the allowance for loan losses increased to \$1,221.8 million at December 31, 2017 from \$865.4 million at December 31, 2016. Deposits increased to \$1,470.6 million at December 31, 2017 from \$1,039.2 million at December 31, 2016. Stockholders' equity increased to \$222.5 million at December 31, 2017 from approximately \$154.5 million at December 31, 2016. The acquisitions of Iberville Bank and Gulf Coast Community Bank, which were completed on January 1, 2017, contributed \$402.6 million, \$237.3 million and \$355.6 million in assets, loans, and deposits, respectively.

The First reported net income of \$12.6 million, \$11.6 million and \$9.6 million for the years ended December 31, 2017, 2016, and 2015, respectively. For the years ended December 31, 2017, 2016 and 2015, the Company reported consolidated net income applicable to common stockholders of \$10.6 million, \$9.7 million and \$8.5 million, respectively. The following discussion should be read in conjunction with the "Selected Consolidated Financial Data" and the Company's consolidated financial statements and the Notes thereto and the other financial data included

elsewhere.

Results of Operations

The following is a summary of the results of operations by The First for the years ended December 31, 2017, 2016, and 2015.

	2017	2016	2015
	(In thousands)		
Interest income	\$66,061	\$44,535	\$40,196
Interest expense	6,049	4,094	3,022
Net interest income	60,012	40,441	37,174
Provision for loan losses	506	625	410
Net interest income after provision for loan losses	59,506	39,816	36,764
Other income	14,312	10,540	7,589
Other expense	52,999	33,941	31,032
Income tax expense	8,177	4,766	3,701
Net income	\$12,642	\$11,649	\$9,620

The following reconciles the above table to the amounts reflected in the consolidated financial statements of the Company at December 31, 2017, 2016, and 2015:

	2017	2016	2015
	(In thousands)		
Net interest income:			
Net interest income of The First	\$60,012	\$40,441	\$37,174
Intercompany eliminations	(852)	(152)	(180)
	\$59,160	\$40,289	\$36,994
Net income applicable to common stockholders:			
Net income of The First	\$12,642	\$11,649	\$9,620
Net loss of the Company, excluding intercompany accounts	(2,026)	(1,983)	(1,164)
	\$10,616	\$9,666	\$8,456

Consolidated Net Income

The Company reported consolidated net income applicable to common stockholders of \$10.6 million for the year ended December 31, 2017, compared to a consolidated net income of \$9.7 million for the year ended December 31, 2016, and consolidated net income of \$8.5 million for the year ended December 31, 2015. The increase in income was attributable to an increase in net interest income of \$18.9 million or 46.8%, an increase in other income of \$3.1 million, or 27.7%, which was offset by an increase in other expenses of \$18.6 million or 50.4%. The increase in other expense was primarily due to a charge of \$6.7 million related to the acquisitions completed in 2017 and a \$2.1 million charge to income tax expense related to a reduction in our deferred tax asset resulting from the change in tax rate under the Tax Cuts and Jobs Act enacted in December of 2017.

See Note C – Business Combinations in the accompanying notes to the consolidated financial statements included elsewhere in this report for more information on how the Company accounts for business combinations.

Consolidated Net Interest Income

The largest component of net income for the Company is net interest income, which is the difference between the income earned on assets and interest paid on deposits and borrowings used to support such assets. Net interest income is determined by the rates earned on the Company's interest-earning assets and the rates paid on its interest-bearing liabilities, the relative amounts of interest-earning assets and interest-bearing liabilities, and the degree of mismatch

and the maturity and repricing characteristics of its interest-earning assets and interest-bearing liabilities.

Consolidated net interest income was approximately \$59.2 for the year ended December 31, 2017, as compared to \$40.3 for the year ended December 31, 2016. This increase was the direct result of increased loan volumes during 2017 as compared to 2016. Average interest-bearing liabilities for the year 2017 were \$1,247.8 million compared to \$911.0 million for the year 2016. At December 31, 2017, the net interest spread, which is the difference between the yield on earning assets and the rates paid on interest-bearing liabilities, was 3.72% compared to 3.63% at December 31, 2016. The net interest margin, which is net interest income divided by average earning assets, was 3.83% for the year 2017 compared to 3.71% for the year 2016. Rates paid on average interest-bearing liabilities increased to 0.55% for the year 2017 compared to 0.47% for the year 2016. Interest earned on assets and interest accrued on liabilities is significantly influenced by market factors, specifically interest rates as set by Federal agencies. Average loans comprised 74.1% of average earnings assets for the year 2017 compared to 73.9% the year 2016.

Consolidated net interest income was approximately \$40.3 million for the year ended December 31, 2016, as compared to \$37.0 million for the year ended December 31, 2015. This increase was the direct result of increased loan volumes during 2016 as compared to 2015. Average interest-bearing liabilities for the year ended December 31, 2016 were \$911.0 million compared to \$822.7 million for the year ended December 31, 2015. At December 31, 2016, the net interest spread was 3.63% compared to 3.65% at December 31, 2015. The net interest margin was 3.71% for the year 2016 compared to 3.72% for the year 2015. Rates paid on average interest-bearing liabilities increased to 0.47% for the year 2016 compared to 0.39% for the year 2015. Average loans comprised 73.9% of average earnings assets for the year 2016 compared to 71.7% for the year 2015.

Average Balances, Income and Expenses, and Rates. The following tables depict, for the periods indicated, certain information related to the average balance sheet and average yields on assets and average costs of liabilities. Such yields are derived by dividing income or expense by the average balance of the corresponding assets or liabilities. Average balances have been derived from daily averages.

Average Balances, Income and Expenses, and Rates

	Years Ended December 31,			2016			2015		
	2017	Income/	Yield/	Average	Income/	Yield/	Average	Income/	Yield/
	Average	Expenses	Rate	Balance	Expenses	Rate	Balance	Expenses	Rate
	Balance								
	(Dollars in thousands)								
Assets									
Earning Assets									
Loans (1)(2)	\$1,168,882	\$56,827	4.86 %	\$820,881	\$38,497	4.69 %	\$730,326	\$34,242	4.69 %
Securities (4)	359,195	9,956	2.77 %	261,508	6,885	2.63 %	256,462	6,759	2.64 %
Federal funds sold (3)	47,534	390	.82 %	18,806	127	.68 %	24,582	64	.26 %
Other	2,515	163	.64 %	10,029	59	.59 %	7,585	93	1.23 %
Total earning assets	1,578,126	67,336	4.27 %	1,111,224	45,568	4.10 %	1,018,955	41,158	4.04 %
Other	185,277			117,735			103,237		
Total assets	\$1,763,403			\$1,228,959			\$1,122,192		
Liabilities									
Interest-bearing liabilities	\$1,247,823	\$6,909	.55 %	\$911,037	\$4,316	.47 %	\$822,708	\$3,208	.39 %
Demand deposits (1)	318,339			191,998			196,284		
Other liabilities	26,404			5,601			4,594		

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Stockholders' equity	170,837		120,323		98,606	
Total liabilities and stockholders' equity	\$1,763,403		\$1,228,959		\$1,122,192	
Net interest spread		3.72 %		3.63 %		3.65 %
Net yield on interest-earning assets	\$60,427	3.83 %	\$41,252	3.71 %	\$37,950	3.72 %

All loans and deposits were made to borrowers in the United States. Includes non-accrual loans of \$5,674, \$3,265, (1) and \$7,368, for the years ended December 31, 2017, 2016, and 2015, respectively. Loans include held for sale loans.

(2) Includes loan fees of \$1,333, \$857, and \$692, for the years ended December 31, 2017, 2016, and 2016, respectively.

(3) Includes Excess Balance Account-Mississippi National Banker's Bank and Federal Reserve – New Orleans.

(4) Tax equivalent yield assuming a 35% tax rate.

Analysis of Changes in Net Interest Income. The following table presents the consolidated dollar amount of changes in interest income and interest expense attributable to changes in volume and to changes in rate. The combined effect in both volume and rate which cannot be separately identified has been allocated proportionately to the change due to volume and due to rate.

Analysis of Changes in Consolidated Net Interest Income

	Year Ended December 31, 2017 versus 2016			Year Ended December 31, 2016 versus 2015		
	Increase (decrease) due to Volume	Increase (decrease) due to Rate	Increase (decrease) due to Net	Increase (decrease) due to Volume	Increase (decrease) due to Rate	Increase (decrease) due to Net
Earning Assets						
Loans	\$18,630	\$(300)	\$18,330	\$ 3,807	\$ 448	\$ 4,255
Securities	2,461	610	3,071	174	(48)	126
Federal funds sold	65	198	263	(63)	126	63
Other short-term investments	57	47	104	4	(38)	(34)
Total interest income	21,213	555	21,768	3,922	488	4,410
Interest-Bearing Liabilities						
Interest-bearing transaction accounts	609	562	1,171	207	215	422
Money market accounts and savings	155	(12)	143	(15)	54	39
Time deposits	448	55	503	108	313	421
Borrowed funds	(87)	863	776	77	149	226
Total interest expense	1,125	1,468	2,593	377	731	1,108
Net interest income	\$20,088	\$(913)	\$19,175	\$ 3,545	\$(243)	\$ 3,302

Interest Sensitivity. The Company monitors and manages the pricing and maturity of its assets and liabilities in order to diminish the potential adverse impact that changes in interest rates could have on its net interest income. A monitoring technique employed by the Company is the measurement of the Company's interest sensitivity "gap," which is the positive or negative dollar difference between assets and liabilities that are subject to interest rate repricing within a given period of time. The Company also performs asset/liability modeling to assess the impact varying interest rates and balance sheet mix assumptions will have on net interest income. Interest rate sensitivity can be managed by repricing assets or liabilities, selling securities available-for-sale, replacing an asset or liability at maturity, or adjusting the interest rate during the life of an asset or liability. Managing the amount of assets and liabilities repricing in the same time interval helps to hedge the risk and minimize the impact on net interest income of rising or falling interest rates. The Company evaluates interest sensitivity risk and then formulates guidelines regarding asset generation and repricing, funding sources and pricing, and off-balance sheet commitments in order to decrease interest rate sensitivity risk.

The following tables illustrate the Company's consolidated interest rate sensitivity and consolidated cumulative gap position at December 31, 2017, 2016, and 2015.

	December 31, 2017				Total
	Within Three Months	After Three Through Twelve Months	Within One Year	Greater Than One Year or Nonsensitive	
	(In thousands)				
Assets					
Earning Assets:					
Loans	\$214,687	\$ 119,492	\$334,179	\$ 895,917	\$1,230,096
Securities (2)	24,716	17,823	42,539	330,323	372,862
Funds sold and other	475	48,466	48,941	-	48,941
Total earning assets	\$239,878	\$ 185,781	\$425,659	\$ 1,226,240	\$1,651,899
Liabilities					
Interest-bearing liabilities:					
Interest-bearing deposits:					
NOW accounts (1)	\$-	\$ 601,694	\$601,694	\$ -	\$601,694
Money market accounts	149,715	-	149,715	-	149,715
Savings deposits (1)	-	133,864	133,864	-	133,864
Time deposits	43,171	109,100	152,271	131,032	283,303
Total interest-bearing deposits	192,886	844,658	1,037,544	131,032	1,168,576
Borrowed funds (3)	75,000	18,572	93,572	10,500	104,072
Total interest-bearing liabilities	267,886	863,230	1,131,116	141,532	1,272,648
Interest-sensitivity gap per period	\$(28,008)	\$(677,449)	\$(705,457)	\$ 1,084,708	\$379,251
Cumulative gap at December 31, 2017	\$(28,008)	\$(705,457)	\$(705,457)	\$ 379,251	\$379,251
Ratio of cumulative gap to total earning assets at December 31, 2017	(1.7)%	(42.7)%	(42.7)%	23.0 %	

	December 31, 2016				Total
	Within Three Months	After Three Through Twelve Months	Within One Year	Greater Than One Year or Nonsensitive	
	(In thousands)				
Assets					

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Earning Assets:						
Loans	\$ 121,391	\$ 88,433	\$ 209,824	\$ 663,110	\$ 872,934	
Securities (2)	10,092	21,376	31,468	224,331	255,799	
Funds sold and other	425	29,975	30,400	-	30,400	
Total earning assets	\$ 131,908	\$ 139,784	\$ 271,692	\$ 887,441	\$ 1,159,133	
Liabilities						
Interest-bearing liabilities:						
Interest-bearing deposits:						
NOW accounts (1)	\$-	\$ 430,903	\$ 430,903	\$ -	\$ 430,903	
Money market accounts	113,253	-	113,253	-	113,253	
Savings deposits (1)	-	69,540	69,540	-	69,540	
Time deposits	31,273	93,456	124,729	98,288	223,017	
Total interest-bearing deposits	144,526	593,899	738,425	98,288	836,713	
Borrowed funds (3)	30,000	26,000	56,000	13,000	69,000	
Total interest-bearing liabilities	174,526	619,899	794,425	111,288	905,713	
Interest-sensitivity gap per period	\$(42,618)	\$(480,115)	\$(522,733)	\$ 776,153	\$ 253,420	
Cumulative gap at December 31, 2016	\$(42,618)	\$(522,733)	\$(522,733)	\$ 253,420	\$ 253,420	
Ratio of cumulative gap to total earning assets at December 31, 2016	(3.7)%	(45.1)%	(45.1)%	21.9	%	

	December 31, 2015				Total
	Within Three Months	After Three Through Twelve Months	Within One Year	Greater Than One Year or Nonsensitive	
	(In thousands)				
Assets					
Earning Assets:					
Loans	\$101,160	\$76,996	\$178,156	\$598,333	\$776,489
Securities (2)	14,831	18,100	32,931	222,028	254,959
Funds sold and other	321	17,303	17,624	-	17,624
Total earning assets	\$116,312	\$112,399	\$228,711	\$820,361	\$1,049,072
Liabilities					
Interest-bearing liabilities:					
Interest-bearing deposits:					
NOW accounts (1)	\$-	\$373,686	\$373,686	\$-	\$373,686
Money market accounts	105,434	-	105,434	-	105,434
Savings deposits (1)	-	68,657	68,657	-	68,657
Time deposits	37,222	83,549	120,771	58,702	179,473
Total interest-bearing deposits	142,656	525,892	668,548	58,702	727,250
Borrowed funds (3)	81,130	21,191	102,321	8,000	110,321
Total interest-bearing liabilities	223,786	547,083	770,869	66,702	837,571
Interest-sensitivity gap per period	\$(107,474)	\$(434,684)	\$(542,158)	\$753,659	\$211,501
Cumulative gap at December 31, 2015	\$(107,474)	\$(542,158)	\$(542,158)	\$211,501	\$211,501
Ratio of cumulative gap to total earning assets at December 31, 2015	(10.2)%	(51.7)%	(51.7)%	20.2%	%

- NOW and savings accounts are subject to immediate withdrawal and repricing. These deposits do not tend to immediately react to changes in interest rates and the Company believes these deposits are fairly stable. Therefore,
- (1) these deposits are included in the repricing period that management believes most closely matches the periods in which they are likely to reprice rather than the period in which the funds can be withdrawn contractually.
 - (2) Securities include mortgage backed and other installment paying obligations based upon stated maturity dates.
 - (3) Does not include subordinated debentures of \$10,310,000.

The Company generally would benefit from increasing market rates of interest when it has an asset-sensitive gap and generally from decreasing market rates of interest when it is liability sensitive. The Company currently is asset sensitive within the one-year time frame. However, the Company's gap analysis is not a precise indicator of its interest sensitivity position. The analysis presents only a static view of the timing of maturities and repricing opportunities, without taking into consideration that changes in interest rates do not affect all assets and liabilities equally. For example, rates paid on a substantial portion of core deposits may change contractually within a relatively short time frame, but those rates are viewed by management as significantly less interest-sensitive than market-based rates such

as those paid on non-core deposits. Accordingly, management believes a liability sensitive-position within one year would not be as indicative of the Company's true interest sensitivity as it would be for an organization which depends to a greater extent on purchased funds to support earning assets. Net interest income is also affected by other significant factors, including changes in the volume and mix of earning assets and interest-bearing liabilities.

The following tables depict, for the periods indicated, certain information related to interest rate sensitivity in net interest income and market value of equity.

December 31, 2017

Change in Interest Rates	Net Interest Income at Risk			Market Value of Equity		
	% Change from Base	Bank Policy Limit	% Change from Base	Bank Policy Limit	% Change from Base	Bank Policy Limit
Up 400 bps	7.7 %	-20.0	% 40.3	% -40.0	%	%
Up 300 bps	7.7 %	-15.0	% 36.4	% -30.0	%	%
Up 200 bps	6.3 %	-10.0	% 28.8	% -20.0	%	%
Up 100 bps	3.8 %	-5.0	% 17.0	% -10.0	%	%
Down 100 bps	-6.2 %	-5.0	% -21.2	% -10.0	%	%
Down 200 bps	-9.2 %	-10.0	% -14.3	% -20.0	%	%

December 31, 2016

Change in Interest Rates	Net Interest Income at Risk			Market Value of Equity		
	% Change from Base	Bank Policy Limit	% Change from Base	Bank Policy Limit	% Change from Base	Bank Policy Limit
Up 400 bps	15.4 %	-20.0	% 22.9	% -40.0	%	%
Up 300 bps	11.8 %	-15.0	% 18.8	% -30.0	%	%
Up 200 bps	8.0 %	-10.0	% 13.7	% -20.0	%	%
Up 100 bps	4.0 %	-5.0	% 7.6	% -10.0	%	%
Down 100 bps	-4.8 %	-5.0	% -9.5	% -10.0	%	%
Down 200 bps	-6.6 %	-10.0	% -11.6	% -20.0	%	%

December 31, 2015

Net Interest

Change in Interest Rates	Income at Risk		Market Value of Equity			
	% Change from Base	Policy Limit	% Change from Base		Policy Limit	
Up 400 bps	11.2 %	-20.0	% 34.3	%	-40.0	%
Up 300 bps	8.6 %	-15.0	% 27.7	%	-30.0	%
Up 200 bps	5.8 %	-10.0	% 20.0	%	-20.0	%
Up 100 bps	2.9 %	-5.0	% 10.8	%	-10.0	%
Down 100 bps	-2.7 %	-5.0	% -11.5	%	-10.0	%
Down 200 bps	-4.7 %	-10.0	% -10.0	%	-20.0	%

Provision and Allowance for Loan Losses

The Company has developed policies and procedures for evaluating the overall quality of its credit portfolio and the timely identification of potential problem loans. Management's judgment as to the adequacy of the allowance for loan losses is based upon a number of assumptions about future events which it believes to be reasonable, but which may not prove to be accurate. Thus, there can be no assurance that charge-offs in future periods will not exceed the allowance for loan losses or that additional increases in the loan loss allowance will not be required.

The Company's allowance consists of two parts. The first part is determined in accordance with authoritative guidance issued by the FASB regarding the allowance. The Company's determination of this part of the allowance is based upon quantitative and qualitative factors. The Company uses a loan loss history based upon the prior nine years to determine the appropriate allowance. Historical loss factors are determined by criticized and uncriticized loans by loan type. These historical loss factors are applied to the loans by loan type to determine an indicated allowance. The loss factors of peer groups are considered in the determination of the allowance and are used to assist in the establishment of a long-term loss history for areas in which this data is unavailable and incorporated into the qualitative factors to be considered. The historical loss factors may also be modified based upon other qualitative factors including but not limited to local and national economic conditions, trends of delinquent loans, changes in lending policies and underwriting standards, concentrations, and management's knowledge of the loan portfolio. These factors require judgment on the part of management and are based upon state and national economic reports received from various institutions and agencies including the Federal Reserve Bank, United States Bureau of Economic Analysis, Bureau of Labor Statistics, meetings with the Company's loan officers and loan committees, and data and guidance received or obtained from the Company's regulatory authorities.

The second part of the allowance is determined in accordance with guidance issued by the FASB regarding impaired loans. Impaired loans are determined based upon a review by internal loan review and senior loan officers. Impaired loans are loans for which the Bank does not expect to receive contractual interest and/or principal by the due date. A specific allowance is assigned to each loan determined to be impaired based upon the value of the loan's underlying collateral. Appraisals are used by management to determine the value of the collateral.

The sum of the two parts constitutes management's best estimate of an adequate allowance for loan losses. When the estimated allowance is determined, it is presented to the Company's audit committee for review and approval on a quarterly basis.

Our allowance for loan losses model is focused on establishing a loss history within the Bank and relies on specific impairment to determine credits that the Bank feels the ultimate repayment source will be liquidation of the subject collateral. Our model takes into account other factors such as local and national economic factors, portfolio trends, non performing asset, charge off, and delinquency trends as well as underwriting standards and the experience of branch management and lending staff. These trends are measured in the following ways:

Local Trends: (Updated quarterly usually the month following quarter end)

Local Unemployment Rate

Insurance Issues (Windpool Areas)

Bankruptcy Rates (Increasing/Declining)

Local Commercial R/E Vacancy Rates

Established Market/New Market

Hurricane Threat

National Trends: (Updated quarterly usually the month following quarter end)

Gross Domestic Product (GDP)

Home Sales

Consumer Price Index (CPI)

Interest Rate Environment (Increasing/Steady/Declining)

Single Family Construction Starts

Inflation Rate

Retail Sales

Portfolio Trends: (Updated monthly as the allowance for loan loss is calculated)

Second Mortgages

Single Pay Loans

Non-Recourse Loans

Limited Guaranty Loans

Loan to Value Exceptions

Secured by Non-Owner Occupied Property

Raw Land Loans

Unsecured Loans

Measurable Bank Trends: (Updated quarterly)

Delinquency Trends

Non-Accrual Trends

Net Charge Offs

Loan Volume Trends

Non-Performing Assets

Underwriting Standards/Lending Policies

Experience/Depth of Bank Lending

Management

The bank wide information and metrics, along with the local and national economic trends listed above, are all measured quarterly. Typically, this review is performed during the second month of every quarter to facilitate the release of economic data from the reporting agencies. As of December 31, 2017, most economic indicators pointed to a stable and improving economy thus most factors were assigned a neutral or decreasing allocation factor. In contrast, bank wide factors including the acquisition of new loan portfolios and lending staff through mergers, increased loan production volume causing healthy organic loan portfolio growth, and increasing concentrations in loan types considered to carry higher risk by banking standards, resulted in an increase to the assigned allocation factors related

to these areas.

At December 31, 2017, the consolidated allowance for loan losses was approximately \$8.3 million, or 0.68% of outstanding loans excluding loans held for sale. Including valuation accounting adjustments on acquired loans, the total valuation plus allowance for loan losses was 1.11% of loans at December 31, 2017. At December 31, 2016, the allowance for loan losses amounted to approximately \$7.5 million, which was 0.87% of outstanding loans. The provision for loan losses is a charge to earnings to maintain the allowance for loan losses at a level consistent with management's assessment of the collectability of the loan portfolio in light of current economic conditions and market trends. The Company's provision for loan losses was \$506,000 for the year ended December 31, 2017, \$625,000 for the year ended December 31, 2016, and \$410,000 for the year ended December 31, 2015. The overall allowance for loan losses results from consistent application of our loan loss reserve methodology as described above.

At December 31, 2017, management believes the allowance is appropriate and has been derived from consistent application of our methodology. Should any of the factors considered by management in evaluating the appropriateness of the allowance for loan losses change, management's estimate of inherent losses in the portfolio could also change, which would affect the level of future provisions for loan losses.

Non-Performing Assets

A loan is reviewed for impairment when, based on all available information and events, it displays characteristics causing management to determine that the probability of collecting all principal, interest, and other related fees due according to the contractual terms of the loan agreement. Also at this time, the accrual of interest is discontinued. Along with these loans in non-accrual status, all loans determined by management to be labelled as "troubled debt restructure" based on regulatory guidance are reviewed for impairment. Loans that are identified as criticized or classified based on unsatisfactory repayment performance, or other evidence of deteriorating credit quality, are not reviewed until being placed in non-accrual status or when considered to be troubled debt restructure.

Once these loans are identified, they are analyzed to determine whether the ultimate repayment source will be liquidation of collateral or some future source of cash flow. If the only source of repayment will come from the liquidation of collateral, impairment worksheets are prepared to document the amount of impairment that exists. This method takes into account collateral exposure, as well as all expected expenses related to the disposal of the collateral. Specific allowances for these loans are then accounted for on a per loan basis.

The following tables illustrate the Company's past due and non-accrual loans at December 31, 2017, 2016 and 2015.

	December 31, 2017 (In thousands)		
	Past Due 30 to 89 Days	Past Due 90 days or more and still accruing	Non-Accrual
Real Estate-construction	\$ 192	\$ 27	\$ 92
Real Estate-mortgage	2,656	177	2,691
Real Estate-nonfarm nonresidential	1,487	82	1,724
Commercial	393	-	1,120
Consumer	57	-	46
Total	\$4,785	\$ 286	\$ 5,673

	December 31, 2016 (In thousands)		
	Past Due 30 to 89 Days	Past Due 90 days or more and still accruing	Non-Accrual
Real Estate-construction	\$204	\$ 96	\$ 658
Real Estate-mortgage	2,745	102	1,662
Real Estate-nonfarm nonresidential	269	-	909
Commercial	9	-	2
Consumer	22	-	33
Total	\$3,249	\$ 198	\$ 3,264

	December 31, 2015 (In thousands)		
	Past Due 30 to 89 Days	Past Due 90 days or more and still accruing	Non-Accrual
Real Estate-construction	\$311	\$ -	\$ 2,956
Real Estate-mortgage	3,339	29	2,055
Real Estate-nonfarm nonresidential	736	-	2,225
Commercial	97	-	100
Consumer	70	-	32
Total	\$4,553	\$ 29	\$ 7,368

Total non-accrual loans at December 31, 2017, were \$5.7 million, an increase of \$2.4 million compared to \$3.3 million at December 31, 2016. The majority of the increase was the result of loans acquired from Iberville Bank and Gulf Coast Community Bank. Total non-accrual loans at December 31, 2016 decreased \$4.1 million from \$7.4 million at December 31, 2015. The majority of the decrease was the result of loans moving to Other Real Estate Owned. Management believes these relationships were adequately reserved at December 31, 2017. Restructured loans not reported as past due or non-accrual at December 31, 2017, amounted to \$4.7 million. See Note E – Loans in the accompanying notes to the consolidated financial statements included elsewhere in this report for a description of restructured loans.

A potential problem loan is one in which management has serious doubts about the borrower's future performance under the terms of the loan contract and do not include the category of special mention. These loans are current as to principal and interest and, accordingly, they are not included in nonperforming asset categories. The level of potential problem loans is one factor used in the determination of the adequacy of the allowance for loan losses. At December 31, 2017, 2016 and December 31, 2015, The First had potential problem loans of \$18,206,000, \$12,297,000 and \$16,943,000, respectively. The increase of \$5.9 million during 2017 was largely attributable to the classified loans acquired in the Iberville Bank and Gulf Coast Community Bank transactions.

Summary of Loan Loss Experience**Consolidated Allowance For Loan Losses**

(In thousands)

	Years Ended December 31,				
	2017	2016	2015	2014	2013
Average loans outstanding	\$1,168,882	\$820,881	\$730,326	\$632,049	\$583,200
Loans outstanding at year end	\$1,230,096	\$872,934	\$776,489	\$706,635	\$583,302
Total non-accrual loans	\$5,673	\$3,264	\$7,368	\$6,056	\$3,181
Beginning balance of allowance	\$7,510	\$6,747	\$6,095	\$5,728	\$4,727
Loans charged-off	(405)	(771)	(843)	(1,459)	(759)
Total loans charged-off	(405)	(771)	(843)	(1,459)	(759)
Total recoveries	677	909	1,085	408	684
Net loans (charged-off) recoveries	272	138	242	(1,051)	(75)
Provision for loan losses	506	625	410	1,418	1,076
Balance at year end	\$8,288	\$7,510	\$6,747	\$6,095	\$5,728
Net charge-offs (recoveries) to average loans	(.02)%	(.02)%	(.03)%	.17 %	.01 %
Allowance as percent of total loans	.67 %	.86 %	.87 %	.86 %	.98 %
Nonperforming loans as a percentage of total loans	.46 %	.37 %	.95 %	.86 %	.55 %
Allowance as a multiple of non-accrual loans	1.5 X	2.3 X	.92 X	1.0 X	1.8 X

At December 31, 2017, the components of the allowance for loan losses consisted of the following:

Allowance (In thousands)	
Allocated:	
Impaired loans	\$ 661
Graded loans	7,627
	\$ 8,288

Graded loans are those loans or pools of loans assigned a grade by internal loan review.

The following table represents the activity of the allowance for loan losses for the years 2017, 2016, 2015, 2014, and 2013.

Analysis of the Allowance for Loan Losses

	Years Ended December 31,				
	2017	2016	2015	2014	2013
	(In thousands)				
Balance at beginning of year	\$7,510	\$6,747	\$6,095	\$5,728	\$4,727
Charge-offs:					
Real Estate-construction	(143)	(274)	(162)	(47)	(305)
Real Estate-mortgage	(119)	(353)	(372)	(1,156)	(152)
Real Estate-nonfarm nonresidential	(-)	(-)	(-)	(-)	(-)
Commercial	(62)	(71)	(183)	(89)	(105)
Consumer	(81)	(73)	(126)	(167)	(197)
Total	(405)	(771)	(843)	(1,459)	(759)
Recoveries:					
Real Estate-construction	280	229	63	96	133
Real Estate-mortgage	228	519	827	212	393
Real Estate-nonfarm nonresidential	14	7	15	17	74
Commercial	50	84	99	15	18
Consumer	105	70	81	68	66
Total	677	909	1,085	408	684
Net (Charge-offs) Recoveries	272	138	242	(1,051)	(75)
Provision for Loan Losses	506	625	410	1,418	1,076
Balance at end of year	\$8,288	\$7,510	\$6,747	\$6,095	\$5,728

The following tables represent how the allowance for loan losses is allocated to a particular loan type as well as the percentage of the category to total loans at December 31, 2017, 2016 and 2015.

Allocation of the Allowance for Loan Losses

December 31, 2017	
(Dollars in thousands)	
Amount	% of loans in each category to total loans

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Commercial Non Real Estate	\$ 1,608	14.0	%
Commercial Real Estate	4,644	64.8	%
Consumer Real Estate	1,499	18.9	%
Consumer	173	2.3	%
Unallocated	364	-	
Total	\$ 8,288	100	%

December 31, 2016

(Dollars in thousands)

	Amount	% of loans in each category <u>to total loans</u>	
Commercial Non Real Estate	\$ 1,118	15.6	%
Commercial Real Estate	4,071	61.6	%
Consumer Real Estate	1,589	20.3	%

Continued:

	Amount	% of loans in each category to total loans	
Consumer	155	2.4	%
Unallocated	577	0.1	%
Total	\$ 7,510	100	%

December 31, 2015 (Dollars in thousands)			
	Amount	% of loans in each category to total loans	
Commercial Non Real Estate	\$ 895	17.1	%
Commercial Real Estate	3,018	58.4	%
Consumer Real Estate	1,477	21.9	%
Consumer	141	2.5	%
Unallocated	1,216	0.1	%
Total	\$ 6,747	100	%

Non-interest Income and Expense

Non-interest Income. The Company's primary sources of noninterest income are mortgage banking operations as well as service charges on deposit accounts. Other sources of non-interest income include bankcard fees, commissions on check sales, safe deposit box rent, wire transfer fees, official check fees and bank owned life insurance income.

Non-interest income was \$14.4 million at December 31, 2017, an increase of \$3.1 million or 27.7% compared to December 31, 2016, primarily consisting of increases in service charges on deposit accounts, interchange fee income and other charges and fees. Non-interest income increased \$3.7 million or 48.2% for the year ended December 31, 2016 compared to \$7.6 million for the year ended December 31, 2015. Deposit activity fees were \$7.4 million for 2017 compared to \$5.1 million for 2016 and \$5.0 million for 2015. Other service charges increased by \$0.1 million or 17.4% for the year ended 2017 to \$0.6 million from \$0.5 million for the year ended December 31, 2016 and other service charges increased \$0.1 million or 12.8% for the year ended December 31, 2016, compared to \$0.5 million for the year ended December 31, 2015. Mortgage income increased \$3.4 million during 2016 due to increased volume from the acquisition of The Mortgage Connection, LLC in December, 2015.

Non-interest expense was \$55.4 million at December 31, 2017, an increase of \$18.6 million in year-over-year comparison primarily resulting from increases in salaries and benefits of \$8.4 million, of which \$6.7 million relates to the acquisitions of Gulf Coast Community Bank and Iberville Bank. Increases in professional services and other non-interest expense increased \$7.0 million which includes \$6.7 million in merger-related costs. Non-interest expense increased to \$36.9 million for the year ended December 31, 2016, from \$32.2 million for the year ended December 31, 2015. The Company experienced slight increases in most expense categories. Salaries and employee benefits increased \$3.6 million in 2016 as compared to 2015, due in part to a full year of the addition of the Mortgage Connection and the lending teams in Mobile, Alabama and Jackson, Mississippi.

The following table sets forth the primary components of non-interest expense for the periods indicated:

Non-interest Expense

	Years ended December 31,		
	2017	2016	2015
	(In thousands)		
Salaries and employee benefits	\$30,548	\$22,137	\$18,537
Occupancy	4,828	3,459	3,422
Equipment	1,225	1,262	1,199
Marketing and public relations	406	465	497
Data processing	1,039	535	150
Supplies and printing	640	287	300
Bank communications	1,296	782	631
Deposit and other insurance	1,252	1,020	1,051
Professional and consulting fees	6,757	1,805	1,332
Postage	546	396	400
ATM expense	1,188	883	763
Other	5,721	3,831	3,879
Total	\$55,446	\$36,862	\$32,161

Income Tax Expense

Income tax expense consists of two components. The first is the current tax expense which represents the expected income tax to be paid to taxing authorities. The Company also recognizes deferred tax for future income/deductible amounts resulting from differences in the financial statement and tax bases of assets and liabilities.

On December 22, 2017, the *Tax Cuts and Jobs Act* was enacted into law. This federal income tax reform, among other things, reduces the federal corporate income tax rate from 35% to 21%, effective January 1, 2018. As a result, the Company revalued its deferred tax assets which was recorded as additional income tax expense of \$2.1 in the Company's statement of operations in the fourth quarter of 2017.

Analysis of Financial Condition

Earning Assets

Loans. Loans typically provide higher yields than the other types of earning assets, and thus one of the Company's goals is for loans to be the largest category of the Company's earning assets. At December 31, 2017, 2016 and 2015, respectively, average loans accounted for 74.1%, 73.9% and 71.7% of average earning assets. Management attempts to control and counterbalance the inherent credit and liquidity risks associated with the higher loan yields without sacrificing asset quality to achieve its asset mix goals. Loans averaged \$1,168.9 million during 2017 and \$820.9 million during 2016, as compared to \$730.3 million during 2015.

The following table shows the composition of the loan portfolio by category:

Composition of Loan Portfolio

	December 31, 2017		2016		2015			
	Amount	Percent Of Total	Amount	Percent of Total	Amount	Percent Of Total		
	(Dollars in thousands)							
Mortgage loans held for sale	\$4,790	0.3	% \$5,880	0.6	% \$3,974	0.5	%	
Commercial, financial and agricultural	165,780	13.5	% 129,423	14.8	% 129,197	16.6	%	
Real Estate:								
Mortgage-commercial	467,484	38.0	% 314,359	36.0	% 253,309	32.6	%	
Mortgage-residential	385,099	31.3	% 289,640	33.2	% 272,180	35.1	%	
Construction	183,328	14.9	% 109,394	12.5	% 99,161	12.8	%	
Lease Financing Receivable	2,450	0.2	% 2,204	0.3	% 2,650	0.3	%	
Obligations of states and subdivisions	3,109	0.3	% 6,698	0.8	% 969	0.1	%	
Consumer and other	18,056	1.5	% 15,336	1.8	% 15,049	2.0	%	
Total loans	1,230,096	100	% 872,934	100	% 776,489	100	%	
Allowance for loan losses	(8,288)		(7,510)		(6,747)			
Net loans	\$1,221,808		\$865,424		\$769,742			

In the context of this discussion, a "real estate mortgage loan" is defined as any loan, other than loans for construction purposes, secured by real estate, regardless of the purpose of the loan. The Company follows the common practice of financial institutions in the Company's market area of obtaining a security interest in real estate whenever possible, in addition to any other available collateral. This collateral is taken to reinforce the likelihood of the ultimate repayment of the loan and tends to increase the magnitude of the real estate loan portfolio component. Generally, the Company limits its loan-to-value ratio to 80%. Management attempts to maintain a conservative philosophy regarding its underwriting guidelines and believes it will reduce the risk elements of its loan portfolio through strategies that diversify the lending mix.

Loans held for sale consist of mortgage loans originated by the Bank and sold into the secondary market. Commitments from investors to purchase the loans are obtained upon origination.

The following table sets forth the Company's commercial and construction real estate loans maturing within specified intervals at December 31, 2017.

Loan Maturity Schedule and Sensitivity to Changes in Interest Rates

Type	December 31, 2017			Total
	One Year or Less	Over One Year Through Five Years	Over Five Years	
	(In thousands)			
Commercial, financial and agricultural	\$42,780	\$ 98,452	\$ 24,241	\$165,473
Real estate – construction	78,917	79,460	24,951	183,328
	\$121,697	\$ 177,912	\$ 49,192	\$348,801
Loans maturing after one year with:				
Fixed interest rates				\$198,541
Floating interest rates				28,563
				\$227,104

The information presented in the above table is based on the contractual maturities of the individual loans, including loans which may be subject to renewal at their contractual maturity. Renewal of such loans is subject to review and credit approval, as well as modification of terms upon their maturity.

Investment Securities. The investment securities portfolio is a significant component of the Company's total earning assets. Total securities averaged \$359.2 million in 2017, as compared to \$261.5 million in 2016, and \$256.5 million in 2015. This represents 22.8%, 23.5%, and 25.2% of the average earning assets for the years ended December 31, 2017, 2016 and 2015, respectively. At December 31, 2017, investment securities, including equity securities, were \$372.9 million and represented 22.6% of earning assets. The Company attempts to maintain a portfolio of high quality, highly liquid investments with returns competitive with short-term U.S. Treasury or agency obligations. This objective is particularly important as the Company focuses on growing its loan portfolio. The Company primarily invests in securities of U.S. Government agencies, municipals, and corporate obligations with maturities up to five years.

The following table summarizes the carrying value of securities for the dates indicated.

Securities Portfolio

	December 31,		
	2017	2016	2015
	(In thousands)		
Available-for-sale			
U. S. Government agencies and Mortgage-backed Securities	\$201,570	\$123,334	\$118,536
States and municipal subdivisions	138,584	98,822	97,889
Corporate obligations	15,819	20,110	22,346
Mutual funds	920	940	961
Total available-for-sale	356,893	243,206	239,732
Held-to-maturity			
U.S. Government agencies	-	-	1,092
States and municipal subdivisions	6,000	6,000	6,000
Total held-to-maturity	6,000	6,000	7,092
Total	\$362,893	\$249,206	\$246,824

The following table shows, at carrying value, the scheduled maturities and average yields of securities held at December 31, 2017.

Investment Securities Maturity Distribution and Yields (1)

December 31, 2017

After One But

After Five But

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(Dollars in thousands)	Within One Year		Within Five Years		Within Ten Years		After Ten Years	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Held-to-maturity:								
States and municipal subdivisions	\$-	-	\$-	-	\$6,000,000	.93 %	\$-	-
Total investment securities held-to-maturity	\$-	-	-	-	\$6,000,000		\$-	-
Available-for-sale:								
U.S. Government agencies (2)	2,995,755	1.05 %	1,996,380	1.86 %	-	-	-	-
States and municipal subdivisions.	11,065,790	3.22 %	47,779,208	3.27 %	47,360,399	3.96 %	32,378,641	3.96 %
Corporate obligations and other	-		-		11,228,195	2.63 %	4,590,713	3.05 %
Total investment securities available-for-sale	\$14,061,545		\$49,775,588		\$58,588,594		\$36,969,354	

(1) Investments with a call feature are shown as of the contractual maturity date.

(2) Excludes mortgage-backed securities totaling \$196.6 million with a yield of 2.47% and mutual funds of \$0.9 million.

Short-Term Investments. Short-term investments, consisting of Federal Funds Sold, funds due from banks and interest-bearing deposits with banks, averaged \$47.5 million in 2017, \$18.8 million in 2016, and \$24.6 million in 2015. At December 31, 2017, 2016, and December 31, 2015, short-term investments totaled \$475,000, \$425,000 and \$321,000, respectively. These funds are a primary source of the Company's liquidity and are generally invested in an earning capacity on an overnight basis.

Deposits

Deposits. Average total deposits at December 31, 2017 were \$1,494.1 million, an increase of \$473.0 million, or 46.3% compared to 2016. Average total deposits at December 31, 2016 were \$1,021.1 million, an increase of \$69.5 million, or 7.3% compared to \$951.6 million in 2015. At December 31, 2017, total deposits were \$1,470.6 million, compared to \$1,039.2 million at December 31, 2016, an increase of \$431.4 million, or 41.5%, and \$916.7 million at December 31, 2015. Deposits of \$355.6 million were acquired in 2017 with the acquisitions of Iberville Bank and Gulf Coast Community Bank.

The following table sets forth the deposits of the Company by category for the period indicated.

(Dollars in thousands)	Deposits							
	December 31, 2017		2016		2015			
	Amount	Percent of Deposits	Amount	Percent of Deposits	Amount	Percent of Deposits		
Non-interest-bearing accounts	\$301,989	20.5 %	\$202,478	19.5 %	\$189,445	20.6 %		
NOW accounts	601,694	40.9 %	430,903	41.5 %	373,686	40.8 %		
Money market accounts	149,715	10.2 %	113,253	10.9 %	105,434	11.5 %		
Savings accounts	133,864	9.1 %	69,540	6.7 %	68,657	7.5 %		
Time deposits less than \$100,000	104,648	7.1 %	77,893	7.5 %	73,868	8.1 %		
Time deposits of \$100,000 or over	178,655	12.2 %	145,124	13.9 %	105,605	11.5 %		
Total deposits	\$1,470,565	100 %	\$1,039,191	100 %	\$916,695	100 %		

The Company's loan-to-deposit ratio was 83.3% at December 31, 2017, 83.4% at December 31, 2016 and 84.3% at December 31, 2015. The loan-to-deposit ratio averaged 78.2% during 2017. Core deposits, which exclude time deposits of \$100,000 or more, provide a relatively stable funding source for the Company's loan portfolio and other earning assets. The Company's core deposits were \$1,291.9 million at December 31, 2017, \$894.1 million at December 31, 2016, and \$811.1 million at December 31, 2015. Management anticipates that a stable base of deposits will be the Company's primary source of funding to meet both its short-term and long-term liquidity needs in the future. The Company has purchased brokered deposits from time to time to help fund loan growth. Brokered deposits and jumbo certificates of deposit generally carry a higher interest rate than traditional core deposits. Further, brokered deposit customers typically do not have loan or other relationships with the Company. The Company has adopted a policy not to permit brokered deposits to represent more than 10% of all of the Company's deposits.

Maturities of Certificates of Deposit**of \$100,000 or More**

(In thousands)	Within Three Months	After Three Through Twelve Months	After Twelve Months	Total
December 31, 2017	\$ 24,473	\$ 67,469	\$ 86,713	\$ 178,655

Borrowed Funds

Borrowed funds consist of advances from the Federal Home Loan Bank of Dallas, federal funds purchased and reverse repurchase agreements. At December 31, 2017, advances from the FHLB totaled \$88.1 million compared to \$48.0 million at December 31, 2016 and \$100.0 million at December 31, 2015. The advances are collateralized by a blanket lien on the first mortgage loans in the amount of the outstanding borrowings, FHLB capital stock, and amounts on deposit with the FHLB. There were \$0, \$0 and \$5.3 million in federal funds purchased at December 31, 2017, 2016, and 2015, respectively.

We had one reverse repurchase agreement in the amount of \$5,000,000. The agreement was secured by securities with a fair value of \$5,470,105 at December 31, 2016 and \$5,501,503 at December 31, 2015. On September 25, 2017, the underlying securities were repurchased and the agreement was terminated.

Subordinated Debentures

In 2006, the Company issued subordinated debentures of \$4,124,000 to The First Bancshares, Inc. Statutory Trust 2 (“Trust 2”). The Company is the sole owner of the equity of the Trust 2. The Trust 2 issued \$4,000,000 of preferred securities to investors. The Company makes interest payments and will make principal payments on the debentures to the Trust 2. These payments will be the source of funds used to retire the preferred securities, which are redeemable at any time beginning in 2011 and thereafter, and mature in 2036. The Company entered into this arrangement to provide funding for expected growth.

In 2007, the Company issued subordinated debentures of \$6,186,000 to The First Bancshares, Inc. Statutory Trust 3 (“Trust 3”). The Company is the sole owner of the equity of the Trust 3. The Trust 3 issued \$6,000,000 of preferred securities to investors. The Company makes interest payments and will make principal payments on the debentures to the Trust 3. These payments will be the source of funds used to retire the preferred securities, which are redeemable at any time beginning in 2012 and thereafter, and mature in 2037. The Company entered into this arrangement to provide funding for expected growth.

Capital

The Federal Reserve Board and bank regulatory agencies require bank holding companies and financial institutions to maintain capital at adequate levels based on a percentage of assets and off-balance sheet exposures, adjusted for risk weights ranging from 0% to 600%. Under the risk-based standard, capital is classified into two tiers. Tier 1 capital consists of common stockholders' equity, excluding the unrealized gain (loss) on available-for-sale securities, minus certain intangible assets. Tier 2 capital consists of the general reserve for loan losses, subject to certain limitations. An institution's total risk-based capital for purposes of its risk-based capital ratio consists of the sum of its Tier 1 and Tier 2 capital. The risk-based regulatory minimum requirements are 6% for Tier 1 and 8% for total risk-based capital.

Bank holding companies and banks are also required to maintain capital at a minimum level based on total assets, which is known as the leverage ratio. The minimum requirement for the leverage ratio is 4%. All but the highest rated institutions are required to maintain ratios 100 to 200 basis points above the minimum. The Company and The First exceeded their minimum regulatory capital ratios as of December 31, 2017, 2016 and 2015.

The Federal Reserve and the Federal Deposit Insurance Corporation approved final capital rules in July 2013, that substantially amended the existing capital rules for banks. These new rules reflect, in part, certain standards initially adopted by the Basel Committee on Banking Supervision in December 2010 (which standards are commonly referred to as “Basel III”) as well as requirements contemplated by the Dodd-Frank Act.

Under the Basel III capital rules, the Company is required to meet certain minimum capital requirements that differ from past capital requirements. The rules implement a new capital ratio of common equity Tier 1 capital to risk-weighted assets. Common equity Tier 1 capital generally consists of retained earnings and common stock (subject to certain adjustments) as well as accumulated other comprehensive income (“AOCI”), however, the Company exercised a one-time irrevocable option to exclude certain components of AOCI as of March 31, 2015. The Company will also be required to establish a “conservation buffer,” consisting of a common equity Tier 1 capital amount equal to 2.5% of risk-weighted assets to be phased in by 2019. An institution that does not meet the conservation buffer will be subject to restrictions on certain activities including payment of dividends, stock repurchases, and discretionary bonuses to executive officers.

The prompt corrective action rules have been modified to include the common equity Tier 1 capital ratio and to increase the Tier 1 capital ratio requirements for the various thresholds. For example, the requirements for the Company to be considered well-capitalized under the rules include a 5.0% leverage ratio, a 6.5% common equity Tier 1 capital ratio, an 8.0% Tier 1 capital ratio, and a 10.0% total capital ratio. To be adequately capitalized, those ratios are 4.0%, 4.5%, 6.0%, and 8.0%, respectively.

The rules modify the manner in which certain capital elements are determined. The rules make changes to the methods of calculating the risk-weighting of certain assets, which in turn affects the calculation of the risk-weighted capital ratios. Higher risk weights are assigned to various categories of assets, including commercial real estate loans, credit facilities that finance the acquisition, development or construction of real property, certain exposures or credit that are 90 days past due or are non-accrual, securitization exposures, and in certain cases mortgage servicing rights and deferred tax assets.

The Company was required to comply with the new capital rules on January 1, 2015, with a measurement date of March 31, 2015. The conservation buffer will be phased-in beginning in 2016, and will take full effect on January 1, 2019. Certain calculations under the rules will also have phase-in periods.

Analysis of Capital

<u>Capital Ratios</u>	Adequately Capitalized	Well Capitalized	The Company			The First		
			December 31, 2017	December 31, 2016	2015	December 31, 2017	December 31, 2016	2015
Leverage	4.0	% 5.0	% 11.7%	11.9%	8.7 %	11.4%	13.1%	8.6 %
Risk-based capital:								
Common equity Tier 1	4.5	% 6.5	% 14.2%	13.8%	8.1 %	14.5%	16.2%	11.0%
Tier 1	6.0	% 8.0	% 14.9%	14.7%	11.1%	14.5%	16.2%	11.0%
Total	8.0	% 10.0	% 15.5%	15.5%	11.9%	15.1%	17.0%	11.8%

Ratios

	2017	2016	2015
Return on assets (net income applicable to common stockholders divided by average total assets)	.60 %	.79 %	.75 %
	6.2 %	8.0 %	8.6 %

Return on equity (net income applicable to common stockholders divided by average equity)

Dividend payout ratio (dividends per share divided by net income per common share)	13.5%	9.6 %	9.7 %
Equity to asset ratio (average equity divided by average total assets)	9.7 %	9.8 %	8.8 %

Liquidity and Market Risk Management

Liquidity management involves monitoring the Company's sources and uses of funds in order to meet its day-to-day cash flow requirements while maximizing profits. Liquidity represents the ability of a company to convert assets into cash or cash equivalents without significant loss and to raise additional funds by increasing liabilities. Liquidity management is made more complicated because different balance sheet components are subject to varying degrees of management control. For example, the timing of maturities of the investment portfolio is very predictable and subject to a high degree of control at the time investment decisions are made; however, net deposit inflows and outflows are far less predictable and are not subject to the same degree of control. Asset liquidity is provided by cash and assets which are readily marketable, which can be pledged, or which will mature in the near future. Liability liquidity is provided by access to core funding sources, principally the ability to generate customer deposits in the Company's market area.

The Company's federal funds sold position, which includes funds due from banks and interest-bearing deposits with banks, is typically its primary source of liquidity. Federal funds sold averaged \$50.0 million during the year ended December 31, 2017 and totaled \$48.9 million at December 31, 2017. Also, the Company has available advances from the Federal Home Loan Bank. Advances available are generally based upon the amount of qualified first mortgage loans which can be used for collateral. At December 31, 2017, advances available totaled approximately \$556.4 million of which \$110.6 million had been drawn, or used for letters of credit.

As of December 31, 2017, the market value of unpledged debt securities plus pledged securities in excess of current pledging requirements comprised \$95.5 million of the Company's investment balances, compared to \$100.2 million at December 31, 2016. The increase in unpledged debt from December 2017 compared to December 2016 is primarily due to an increase in unpledged investments and letters of credit utilized for pledging purposes. Other forms of balance sheet liquidity include but are not necessarily limited to any outstanding federal funds sold and vault cash. The Company has a higher level of actual balance sheet liquidity than might otherwise be the case, since we utilize a letter of credit from the FHLB rather than investment securities for certain pledging requirements. That letter of credit, which is backed by loans that are pledged to the FHLB by the Company, totaled \$17.5 million at December 31, 2017. Management is of the opinion that available investments and other potentially liquid assets, along with the standby funding sources it has arranged, are more than sufficient to meet the Company's current and anticipated short-term liquidity needs.

The Company's liquidity ratio as of December 31, 2017 was 12.8%, as compared to internal liquidity policy guidelines of 10% minimum. Other liquidity ratios reviewed include the following along with policy guidelines for the periods indicated:

	December 31, 2017		Policy Maximum	
Loans to Deposits (including FHLB advances)	71.1	%	90.0	% In Policy
Net Non-core Funding Dependency Ratio	5.8	%	20.0	% In Policy
Fed Funds Purchased / Total Assets	0.0	%	10.0	% In Policy
FHLB Advances / Total Assets	4.9	%	20.0	% In Policy
FRB Advances / Total Assets	0.0	%	10.0	% In Policy
Pledged Securities to Total Securities	77.6	%	90.0	% In Policy

	December 31, 2016		Policy Maximum	
Loans to Deposits (including FHLB advances)	79.1	%	90.0	% In Policy
Net Non-core Funding Dependency Ratio	8.3	%	30.0	% In Policy
Fed Funds Purchased / Total Assets	0.4	%	10.0	% In Policy
FHLB Advances / Total Assets	3.9	%	20.0	% In Policy
FRB Advances / Total Assets	0.0	%	10.0	% In Policy
Pledged Securities to Total Securities	66.6	%	90.0	% In Policy

	December 31, 2015		Policy Maximum	
Loans to Deposits (including FHLB advances)	75.4	%	90.0	% In Policy
Net Non-core Funding Dependency Ratio	13.8	%	30.0	% In Policy
Fed Funds Purchased / Total Assets	0.9	%	10.0	% In Policy
FHLB Advances / Total Assets	8.9	%	20.0	% In Policy
FRB Advances / Total Assets	0.0	%	10.0	% In Policy
Pledged Securities to Total Securities	84.7	%	90.0	% In Policy

Continued growth in core deposits and relatively high levels of potentially liquid investments have had a positive impact on our liquidity position in recent periods, but no assurance can be provided that our liquidity will continue at current robust levels.

The holding company's primary uses of funds are ordinary operating expenses and stockholder dividends, and its primary source of funds is dividends from the Bank since the holding company does not conduct regular banking operations. Management anticipates that the Bank will have sufficient earnings to provide dividends to the holding company to meet its funding requirements for the foreseeable future.

Management regularly reviews the liquidity position of the Company and has implemented internal policies which establish guidelines for sources of asset-based liquidity and limit the total amount of purchased funds used to support the balance sheet and funding from non-core sources.

Commitments and Contractual Obligations

The following table presents, as of December 31, 2017, fixed and determinable contractual obligations to third parties by payment date. Amounts in the table do not include accrued or accruing interest. Payments related to leases are based on actual payments specified in the underlying contracts. Further discussion of the nature of each obligation is included in the referenced note to the consolidated financial statements included elsewhere in this Form 10-K.

(In thousands)	Note Reference	Within One Year	After One But Within Three Years	After Three But Within Five Years	After Five Years	Total
Deposits without a stated maturity	G	\$ 1,187,289	\$ -	\$ -	\$-	\$ 1,187,289
Time deposits	G	152,550	105,098	25,628	-	283,276
Borrowings	H	93,572	10,500	-	-	104,072
Operating lease obligations	I	586	257	343	312	1,498
Capital lease obligations	I	275	466	175	-	916
Trust preferred subordinated debentures	N	-	-	-	10,310	10,310
Total Contractual obligations		\$ 1,434,272	\$ 116,321	\$ 26,146	\$ 10,622	\$ 1,587,361

Subprime Assets

The Bank does not engage in subprime lending activities targeted towards borrowers in high risk categories.

Accounting Matters

Information on new accounting matters is set forth in Note B – Summary of Significant Accounting Policies in the accompanying notes to the consolidated financial statements included elsewhere in this report. This information is incorporated herein by reference.

Impact of Inflation

Unlike most industrial companies, the assets and liabilities of financial institutions such as the Company are primarily monetary in nature. Therefore, interest rates have a more significant effect on the Company's performance than do the effects of changes in the general rate of inflation and change in prices. In addition, interest rates do not necessarily move in the same direction or in the same magnitude as the prices of goods and services. As discussed previously, management seeks to manage the relationships between interest sensitive assets and liabilities in order to protect against wide interest rate fluctuations, including those resulting from inflation.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk Management

Market risk arises from changes in interest rates, exchange rates, commodity prices and equity prices. The Company does not engage in the trading of financial instruments, nor does it have exposure to currency exchange rates. Our market risk exposure is primarily that of interest rate risk, and we have established policies and procedures to monitor and limit our earnings and balance sheet exposure to changes in interest rates. The principal objective of interest rate risk management is to manage the financial components of the Company's balance sheet in a manner that will optimize the risk/reward equation for earnings and capital under a variety of interest rate scenarios.

To identify areas of potential exposure to interest rate changes, we utilize commercially available modeling software to perform earnings simulations and calculate the Company's market value of portfolio equity under varying interest rate scenarios every month. The model imports relevant information for the Company's financial instruments and incorporates Management's assumptions on pricing, duration, and optionality for anticipated new volumes. Various rate scenarios consisting of key rate and yield curve projections are then applied in order to calculate the expected effect of a given interest rate change on interest income, interest expense, and the value of the Company's financial instruments. The rate projections can be shocked (an immediate and parallel change in all base rates, up or down), ramped (an incremental increase or decrease in rates over a specified time period), economic (based on current trends and econometric models) or stable (unchanged from current actual levels).

We use seven standard interest rate scenarios in conducting our 12-month net interest income simulations: "static," upward shocks of 100, 200, 300 and 400 basis points, and downward shocks of 100, and 200 basis points. Pursuant to policy guidelines, we typically attempt to limit the projected decline in net interest income relative to the stable rate scenario to no more than 5% for a 100 basis point (bp) interest rate shock, 10% for a 200 bp shock, 15% for a 300 bp shock, and 20% for a 400 bp shock. As of December 31, 2017, the Company had the following estimated net interest income sensitivity profiles, without factoring in any potential negative impact on spreads resulting from competitive pressures or credit quality deterioration:

December 31, 2017 (\$ In Thousands)	Net Interest Income at Risk – Sensitivity Year 1							
	-200 bp	-100 bp	STATIC	+100 bp	+200 bp	+300 bp	+400 bp	
Net Interest Income	54,702	56,491	60,023	61,041	60,588	58,764	55,384	
Dollar Change	-5,321	-3,532		1,018	565	-1,259	-4,639	
NII @ Risk - Sensitivity Y1	-8.9 %	-5.9 %		1.7 %	0.9 %	-2.1 %	-7.7 %	

If there were an immediate and sustained downward adjustment of 200 basis points in interest rates, all else being equal, net interest income over the next twelve months would likely be approximately \$5.3 million lower than in a stable interest rate scenario, for a negative variance of 8.9%. The unfavorable variance increases if rates were to drop below 200 basis points, due to the fact that certain deposit rates are already relatively low (on NOW accounts and savings accounts, for example), and will hit a natural floor of close to zero while non-floored variable-rate loan yields continue to drop. This effect is exacerbated by accelerated prepayments on fixed-rate loans and mortgage-backed securities when rates decline, although rate floors on some of our variable-rate loans partially offset other negative pressures. While we view further interest rate reductions as highly unlikely, the potential percentage drop in net interest income exceeds our internal policy guidelines in declining interest rate scenarios and we will continue to monitor our interest rate risk profile and take corrective action as deemed appropriate.

Net interest income would likely improve by \$0.5 million, or 0.9%, if interest rates were to increase by 200 basis points relative to a stable interest rate scenario, with the favorable variance expanding the higher interest rates rise. The initial increase in rising rate scenarios will be limited to some extent by the fact that some of our variable-rate loans are currently at rate floors, resulting in a re-pricing lag while base rates are increasing to floored levels, but we

believe the Company still would benefit from a material upward shift in the yield curve.

The Company's one year cumulative GAP ratio was approximately 221.83% at December 31, 2017 and 199.4% at December 31, 2016, which means that there are more assets repricing than liabilities within the first year. The Company is "asset-sensitive." The Company's one year cumulative GAP ratio was approximately 168.3% at December 31, 2015, which meant that there were more liabilities repricing than assets within the first year. These results are based on cash flows from assumptions of assets and liabilities that reprice (maturities, likely calls, prepayments, etc.) Typically, the net interest income of asset-sensitive companies should improve with rising rates and decrease with declining rates.

In addition to the net interest income simulations shown above, we run stress scenarios modeling the possibility of no balance sheet growth, the potential runoff of "surge" core deposits which flowed into the Company in the most recent economic cycle, and potential unfavorable movement in deposit rates relative to yields on earning assets. Even though net interest income will naturally be lower with no balance sheet growth, the rate-driven variances projected for net interest income in a static growth environment are similar to the changes noted above for our standard projections. When a greater level of non-maturity deposit runoff is assumed or unfavorable deposit rate changes are factored into the model, projected net interest income in declining rate and flat rate scenarios does not change materially relative to standard growth projections. However, the benefit we would otherwise experience in rising rate scenarios is minimized and net interest income remains relatively flat.

The economic value (or “fair value”) of financial instruments on the Company’s balance sheet will also vary under the interest rate scenarios previously discussed. The difference between the projected fair value of the Company’s financial assets and the fair value of its financial liabilities is referred to as the economic value of equity (“EVE”), and changes in EVE under different interest rate scenarios are effectively a gauge of the Company’s longer-term exposure to interest rate risk. Fair values for financial instruments are estimated by discounting projected cash flows (principal and interest) at projected replacement interest rates for each account type, while the fair value of non-financial accounts is assumed to equal their book value for all rate scenarios. An economic value simulation is a static measure utilizing balance sheet accounts at a given point in time, and the measurement can change substantially over time as the characteristics of the Company’s balance sheet evolve and interest rate and yield curve assumptions are updated.

The change in economic value under different interest rate scenarios depends on the characteristics of each class of financial instrument, including stated interest rates or spreads relative to current or projected market-level interest