

MIDSOUTH BANCORP INC  
Form 10-Q  
November 06, 2015

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

FORM 10-Q

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

For the quarterly period ended September 30, 2015

OR

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

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

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

Louisiana  
(State or other jurisdiction of incorporation or  
organization)

72-1020809  
(I.R.S. Employer Identification No.)

102 Versailles Boulevard, Lafayette, Louisiana 70501  
(Address of principal executive offices, including zip code)  
(337) 237-8343  
(Registrant's telephone number, including area code)

Indicate by checkmark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES      NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YES      NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a small reporting company.

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

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

YES      NO

As of November 6, 2015, there were 11,362,149 shares of the registrant's Common Stock, par value \$0.10 per share, outstanding.

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|  |           |
|--|-----------|
| Part I – Financial Information   | <u>3</u>  |
| Item 1. <u>Financial Statements</u>  | <u>3</u>  |
| <u>Consolidated Balance Sheets</u>   | <u>3</u>  |
| <u>Consolidated Statements of Earnings (unaudited)</u>   | <u>4</u>  |
| <u>Consolidated Statements of Comprehensive Income (unaudited)</u>                                   | <u>5</u>  |
| <u>Consolidated Statement of Shareholders’ Equity (unaudited)</u>                                    | <u>6</u>  |
| <u>Consolidated Statements of Cash Flows (unaudited)</u>   | <u>7</u>  |
| <u>Notes to Interim Consolidated Financial Statements</u>  | <u>8</u>  |
| Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operation.</u> | <u>29</u> |
| <u>Forward-Looking Statements</u>  | <u>29</u> |
| <u>Critical Accounting Policies</u>  | <u>30</u> |
| <u>Results of Operations</u>   | <u>30</u> |
| <u>Analysis of Balance Sheet</u>   | <u>37</u> |
| <u>Liquidity and Capital</u>   | <u>38</u> |
| <u>Asset Quality</u>   | <u>40</u> |
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk.</u>                           | <u>43</u> |
| Item 4. <u>Controls and Procedures.</u>  | <u>43</u> |
| Part II – Other Information  | <u>44</u> |
| Item 1. <u>Legal Proceedings.</u>  | <u>44</u> |
| Item 1A. <u>Risk Factors.</u>  | <u>44</u> |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds.</u>                          | <u>44</u> |
| Item 3. <u>Defaults Upon Senior Securities.</u>  | <u>44</u> |
| Item 4. <u>Mine Safety Disclosures.</u>  | <u>44</u> |
| Item 5. <u>Other Information.</u>  | <u>44</u> |
| Item 6. <u>Exhibits.</u>   | <u>45</u> |

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Table of Contents

## Part I – Financial Information

## Item 1. Financial Statements.

## MidSouth Bancorp, Inc. and Subsidiaries

## Consolidated Balance Sheets

(dollars in thousands, except share data)

|  | September 30,<br>2015<br>(unaudited) | December 31,<br>2014<br>(audited) |
|--|--------------------------------------|-----------------------------------|
| Assets   |                                      |                                   |
| Cash and due from banks, including required reserves of \$8,782 and \$10,019, respectively   | \$38,386                             | \$45,142                          |
| Interest-bearing deposits in banks   | 82,538                               | 39,031                            |
| Federal funds sold   | 4,513                                | 2,699                             |
| Securities available-for-sale, at fair value (cost of \$281,885 at September 30, 2015 and \$272,588 at December 31, 2014)                                  | 285,485                              | 276,984                           |
| Securities held-to-maturity (fair value of \$122,488 at September 30, 2015 and \$141,593 at December 31, 2014)   | 121,043                              | 141,201                           |
| Other investments  | 12,063                               | 9,990                             |
| Loans  | 1,301,452                            | 1,284,431                         |
| Allowance for loan losses  | (18,939)                             | (11,226)                          |
| Loans, net   | 1,282,513                            | 1,273,205                         |
| Bank premises and equipment, net   | 68,718                               | 69,958                            |
| Accrued interest receivable  | 6,655                                | 6,635                             |
| Goodwill   | 42,171                               | 42,171                            |
| Intangibles  | 6,004                                | 6,834                             |
| Cash surrender value of life insurance   | 13,548                               | 13,659                            |
| Other real estate  | 4,661                                | 4,234                             |
| Other assets   | 6,010                                | 4,997                             |
| Total assets   | \$1,974,308                          | \$1,936,740                       |
| Liabilities and Shareholders' Equity   |                                      |                                   |
| Liabilities:   |                                      |                                   |
| Deposits:  |                                      |                                   |
| Non-interest-bearing   | \$406,118                            | \$390,863                         |
| Interest-bearing   | 1,137,303                            | 1,194,371                         |
| Total deposits   | 1,543,421                            | 1,585,234                         |
| Securities sold under agreements to repurchase   | 92,085                               | 62,098                            |
| Short-term Federal Home Loan Bank advances   | 70,000                               | 25,000                            |
| Long-term Federal Home Loan Bank advances  | 25,958                               | 26,277                            |
| Junior subordinated debentures   | 22,167                               | 22,167                            |
| Other liabilities  | 6,713                                | 6,952                             |
| Total liabilities  | 1,760,344                            | 1,727,728                         |
| Commitments and contingencies  |                                      |                                   |
| Shareholders' equity:  |                                      |                                   |
| Series B Preferred stock, no par value; 5,000,000 shares authorized, 32,000 shares issued and outstanding at September 30, 2015 and December 31, 2014      | 32,000                               | 32,000                            |
| Series C Preferred stock, no par value; 100,000 shares authorized, 91,256 shares issued and outstanding at September 30, 2015 and 93,680 shares issued and | 9,126                                | 9,368                             |

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outstanding at December 31, 2014

|   |             |             |
|---|-------------|-------------|
| Common stock, \$0.10 par value; 30,000,000 shares authorized, 11,361,839 and 11,340,736 shares issued and outstanding, respectively | 1,136       | 1,149       |
| Additional paid-in capital  | 110,482     | 112,744     |
| Unearned ESOP shares  | (1,155      | ) (250 )    |
| Accumulated other comprehensive income  | 2,340       | 2,857       |
| Treasury stock – 0 and 150,967 shares at September 30, 2015 and December 31, 2014, respectively                                     | —           | (3,295 )    |
| Retained earnings   | 60,035      | 54,439      |
| Total shareholders' equity  | 213,964     | 209,012     |
| Total liabilities and shareholders' equity  | \$1,974,308 | \$1,936,740 |

See notes to unaudited consolidated financial statements.

Table of Contents

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

|  | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|--|-------------------------------------|----------|------------------------------------|----------|
|  | 2015                                | 2014     | 2015                               | 2014     |
| Interest income:   |                                     |          |                                    |          |
| Loans, including fees  | \$17,992                            | \$18,273 | \$54,314                           | \$53,525 |
| Securities and other investments:                                  |                                     |          |                                    |          |
| Taxable  | 1,850                               | 1,965    | 5,628                              | 6,164    |
| Nontaxable   | 536                                 | 652      | 1,679                              | 2,007    |
| Federal funds sold   | 1                                   | 2        | 5                                  | 4        |
| Time and interest bearing deposits in other banks                  | 40                                  | 15       | 112                                | 42       |
| Other investments  | 113                                 | 109      | 273                                | 268      |
| Total interest income  | 20,532                              | 21,016   | 62,011                             | 62,010   |
| Interest expense:  |                                     |          |                                    |          |
| Deposits   | 883                                 | 859      | 2,751                              | 2,588    |
| Securities sold under agreements to repurchase                     | 249                                 | 210      | 721                                | 588      |
| Other borrowings and payables                                      | 109                                 | 108      | 309                                | 320      |
| Junior subordinated debentures                                     | 150                                 | 327      | 451                                | 994      |
| Total interest expense   | 1,391                               | 1,504    | 4,232                              | 4,490    |
| Net interest income  | 19,141                              | 19,512   | 57,779                             | 57,520   |
| Provision for loan losses  | 3,800                               | 1,175    | 10,900                             | 2,925    |
| Net interest income after provision for loan losses                | 15,341                              | 18,337   | 46,879                             | 54,595   |
| Non-interest income:   |                                     |          |                                    |          |
| Service charges on deposits  | 2,231                               | 2,556    | 6,488                              | 7,385    |
| Gain on sale of securities, net                                    | —                                   | —        | 1,243                              | 128      |
| ATM and debit card income  | 1,823                               | 1,808    | 5,529                              | 5,375    |
| Income from death benefit on BOLI/executive officer life insurance | —                                   | —        | 160                                | 3,000    |
| Other charges and fees   | 786                                 | 1,830    | 2,553                              | 3,484    |
| Total non-interest income  | 4,840                               | 6,194    | 15,973                             | 19,372   |
| Non-interest expenses:   |                                     |          |                                    |          |
| Salaries and employee benefits                                     | 7,653                               | 8,287    | 23,792                             | 25,588   |
| Occupancy expense  | 3,815                               | 3,834    | 11,365                             | 11,314   |
| FDIC insurance   | 391                                 | 269      | 1,003                              | 783      |
| Other  | 4,705                               | 5,467    | 13,696                             | 14,997   |
| Total non-interest expenses  | 16,564                              | 17,857   | 49,856                             | 52,682   |
| Income before income taxes   | 3,617                               | 6,674    | 12,996                             | 21,285   |
| Income tax expense   | 1,028                               | 2,202    | 3,817                              | 5,839    |
| Net earnings   | 2,589                               | 4,472    | 9,179                              | 15,446   |
| Dividends on preferred stock                                       | 172                                 | 174      | 517                                | 524      |
| Net earnings available to common shareholders                      | \$2,417                             | \$4,298  | \$8,662                            | \$14,922 |
| Earnings per share:  |                                     |          |                                    |          |

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|   |        |        |        |        |
|---|--------|--------|--------|--------|
| Basic   | \$0.22 | \$0.38 | \$0.77 | \$1.32 |
| Diluted   | \$0.21 | \$0.37 | \$0.75 | \$1.28 |
| Weighted average number of shares outstanding:            |        |        |        |        |
| Basic   | 11,312 | 11,314 | 11,321 | 11,283 |
| Diluted   | 11,831 | 11,955 | 11,848 | 11,904 |
| Dividends declared per common share                       | \$0.09 | \$0.09 | \$0.27 | \$0.26 |
| See notes to unaudited consolidated financial statements. |        |        |        |        |

4

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Table of Contents

## MidSouth Bancorp, Inc. and Subsidiaries

## Consolidated Statements of Comprehensive Income (unaudited)

(in thousands)

|   | Three Months Ended |         | Nine Months Ended |          |
|---|--------------------|---------|-------------------|----------|
|   | September 30,      |         | September 30,     |          |
|   | 2015               | 2014    | 2015              | 2014     |
| Net earnings  | \$2,589            | \$4,472 | \$9,179           | \$15,446 |
| Other comprehensive income (loss), net of tax:  |                    |         |                   |          |
| Unrealized gains (losses) on securities available-for-sale:                           |                    |         |                   |          |
| Unrealized holding gains (losses) arising during the year                             | 1,717              | (405    | ) 447             | 4,116    |
| Less: reclassification adjustment for gains on sales of securities available-for-sale | —                  | —       | (1,243            | ) (128   |
| Total other comprehensive income (loss), before tax                                   | 1,717              | (405    | ) (796            | ) 3,988  |
| Income tax effect related to items of other comprehensive income (loss)               | (601               | ) 142   | 279               | (1,396   |
| Total other comprehensive income (loss), net of tax                                   | 1,116              | (263    | ) (517            | ) 2,592  |
| Total comprehensive income  | \$3,705            | \$4,209 | \$8,662           | \$18,038 |
| See notes to unaudited consolidated financial statements.                             |                    |         |                   |          |



Table of Contents

MidSouth Bancorp, Inc. and Subsidiaries  
Consolidated Statement of Shareholders' Equity (unaudited)  
For the Nine Months Ended September 30, 2015  
(in thousands, except share and per share data)

|   | Preferred<br>Stock<br>Shares | Preferred<br>Amount | Common<br>Stock<br>Shares | Common<br>Amount | Additional<br>Paid-in<br>Capital | Unearned<br>ESOP<br>Shares | Accumulated<br>Other<br>Comprehensive<br>Income | Treasury<br>Stock | Retained<br>Earnings | Total     |
|---|------------------------------|---------------------|---------------------------|------------------|----------------------------------|----------------------------|---|-------------------|----------------------|-----------|
| Balance -<br>December 31,<br>2014   | 125,680                      | \$41,368            | 11,491,703                | \$1,149          | \$112,744                        | \$(250 )                   | \$2,857   | \$(3,295)         | \$54,439             | \$209,012 |
| Net earnings  | —                            | —                   | —                         | —                | —                                | —                          | —   | —                 | 9,179                | 9,179     |
| Dividends on<br>Series B and<br>Series C<br>preferred stock   | —                            | —                   | —                         | —                | —                                | —                          | —   | —                 | (517 )               | (517 )    |
| Dividends on<br>common stock,<br>\$0.27 per share   | —                            | —                   | —                         | —                | —                                | —                          | —   | —                 | (3,066 )             | (3,066 )  |
| Conversion of<br>Series C<br>preferred stock<br>to common<br>stock                                  | (2,424 )                     | (242 )              | 13,448                    | 1                | 241                              | —                          | —   | —                 | —                    | —         |
| Reclassification<br>of treasury<br>stock per the<br>LBCA <sup>(1)</sup>                             | —                            | —                   | (150,967 )                | (15 )            | (3,280 )                         | —                          | 3,295   | —                 | —                    | —         |
| Increase in<br>ESOP<br>obligation, net<br>of repayments   | —                            | —                   | —                         | —                | —                                | (905 )                     | —   | —                 | —                    | (905 )    |
| Exercise of<br>stock options  | —                            | —                   | 7,655                     | 1                | 98                               | —                          | —   | —                 | —                    | 99        |
| Tax benefit<br>resulting from<br>distribution<br>from Directors<br>Deferred<br>Compensation<br>Plan | —                            | —                   | —                         | —                | 420                              | —                          | —   | —                 | —                    | 420       |
| Stock option<br>and restricted<br>stock<br>compensation<br>expense                                  | —                            | —                   | —                         | —                | 259                              | —                          | —   | —                 | —                    | 259       |
| Change in<br>accumulated<br>other   | —                            | —                   | —                         | —                | —                                | —                          | (517 )  | —                 | —                    | (517 )    |

comprehensive  
income

Balance –

|               |         |          |            |         |           |           |         |     |          |           |
|---------------|---------|----------|------------|---------|-----------|-----------|---------|-----|----------|-----------|
| September 30, | 123,256 | \$41,126 | 11,361,839 | \$1,136 | \$110,482 | \$(1,155) | \$2,340 | \$— | \$60,035 | \$213,964 |
|---------------|---------|----------|------------|---------|-----------|-----------|---------|-----|----------|-----------|

2015

See notes to unaudited consolidated financial statements.

<sup>(1)</sup> See Note 1 for an explanation of the elimination of treasury stock under the Louisiana Business Corporation Act.

6

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Table of Contents

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

|   | For the Nine Months<br>Ended September 30, |            |
|---|--|------------|
|   | 2015                                       | 2014       |
| Cash flows from operating activities:   |  |            |
| Net earnings  | \$9,179                                    | \$15,446   |
| Adjustments to reconcile net earnings to net cash provided by operating activities: |  |            |
| Depreciation  | 4,652                                      | 4,518      |
| Accretion of purchase accounting adjustments  | (1,003                                     | ) (1,924   |
| Provision for loan losses   | 10,900                                     | 2,925      |
| Deferred tax (benefit) expense  | (1,633                                     | ) 2,034    |
| Amortization of premiums on securities, net   | 2,141                                      | 2,432      |
| (Accretion) amortization of other investments                                       | (1   | ) 4        |
| Stock option expense  | 253  | 355        |
| Restricted stock expense  | 6  | —          |
| Net gain on sale of investment securities   | (1,243                                     | ) (128     |
| Net gain on sale of other real estate owned   | (13  | ) (1,081   |
| Net write down of other real estate owned   | 111  | 31         |
| Net (gain) loss on sale/disposal of premises and equipment                          | (8   | ) 232      |
| Income recognized from death benefit on bank owned life insurance                   | (160                                       | ) —        |
| Change in accrued interest receivable   | (20  | ) 45       |
| Change in accrued interest payable  | (48  | ) (240     |
| Change in other assets & other liabilities, net                                     | 481  | (2,006     |
| Net cash provided by operating activities   | 23,594                                     | 22,643     |
| Cash flows from investing activities:   |  |            |
| Proceeds from maturities and calls of securities available-for-sale                 | 55,874                                     | 33,466     |
| Proceeds from maturities and calls of securities held-to-maturity                   | 19,299                                     | 10,778     |
| Proceeds from sale of securities available-for-sale                                 | 40,277                                     | 22,153     |
| Purchases of securities available-for-sale  | (105,486                                   | ) —        |
| Purchases of securities held-to-maturity  | —  | (1,104     |
| Proceeds from redemptions of other investments                                      | —  | 150        |
| Redemption of Capital Securities related to MidSouth Statutory Trust I              | —  | 217        |
| Proceeds from sale of other investments   | 898  | —          |
| Purchases of other investments  | (2,970                                     | ) (567     |
| Net change in loans   | (20,669                                    | ) (111,329 |
| Proceeds from bank owned life insurance death benefit                               | 498  | —          |
| Purchases of premises and equipment   | (3,439                                     | ) (4,265   |
| Proceeds from sale of premises and equipment  | 35   | 743        |
| Proceeds from sale of other real estate owned                                       | 857  | 3,315      |
| Purchase of other real estate owned   | (351                                       | ) —        |
| Net cash used in investing activities   | (15,177                                    | ) (46,443  |
| Cash flows from financing activities:   |  |            |
| Change in deposits  | (41,728                                    | ) 2,244    |
| Change in securities sold under agreements to repurchase                            | 29,987                                     | 17,048     |
| Borrowings on Federal Home Loan Bank advances                                       | 150,000                                    | 10,000     |

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|   |           |          |   |
|---|-----------|----------|---|
| Repayments of Federal Home Loan Bank advances                                     | (105,047  | ) (45    | ) |
| Redemption of MidSouth Statutory Trust I  | —         | (7,217   | ) |
| Repayments of notes payable   | —         | (1,000   | ) |
| Purchase of treasury stock  | —         | (9       | ) |
| Proceeds and tax benefit from exercise of stock options                           | 99        | 611      |   |
| Tax benefit resulting from distribution from Directors Deferred Compensation Plan | 420       | —        |   |
| Payment of dividends on preferred stock   | (519      | ) (530   | ) |
| Payment of dividends on common stock  | (3,064    | ) (2,818 | ) |
| Net cash provided by financing activities   | 30,148    | 18,284   |   |
| Net increase (decrease) in cash and cash equivalents                              | 38,565    | (5,516   | ) |
| Cash and cash equivalents, beginning of period                                    | 86,872    | 59,731   |   |
| Cash and cash equivalents, end of period  | \$125,437 | \$54,215 |   |
| Supplemental cash flow information:   |           |          |   |
| Interest paid   | \$4,280   | \$4,730  |   |
| Income taxes paid   | 5,180     | 5,815    |   |
| Noncash investing and financing activities:                                       |           |          |   |
| Transfer of loans to other real estate  | 1,031     | 317      |   |
| Change in accrued common stock dividends  | 3         | 121      |   |
| Change in accrued preferred stock dividends                                       | (2        | ) (6     | ) |
| Financed sales of other real estate   | —         | 84       |   |
| Net change in loan to ESOP  | (905      | ) (267   | ) |

See notes to unaudited consolidated financial statements.

Table of Contents

MidSouth Bancorp, Inc. and Subsidiaries  
Notes to Interim Consolidated Financial Statements  
September 30, 2015  
(Unaudited)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements and notes thereto contain all adjustments, consisting only of normal recurring adjustments, necessary to present fairly, in accordance with accounting principles generally accepted in the United States of America (“GAAP”), the financial position of MidSouth Bancorp, Inc. (the “Company”) and its subsidiaries as of September 30, 2015 and the results of their operations and their cash flows for the periods presented. The interim financial information should be read in conjunction with the annual consolidated financial statements and the notes thereto included in the Company’s 2014 Annual Report on Form 10-K.

The results of operations for the nine-month period ended September 30, 2015 are not necessarily indicative of the results to be expected for the entire year.

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

Summary of Significant Accounting Policies — The accounting and reporting policies of the Company conform with GAAP and general practices within the banking industry. There have been no material changes or developments in the application of accounting principles or in our evaluation of the accounting estimates and the underlying assumptions or methodologies that we believe to be Critical Accounting Policies and Estimates as disclosed in our 2014 Annual Report on Form 10-K.

Recent Accounting Pronouncements — ASU 2015-01, Income Statement - Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items was issued as part of the FASB's simplification initiative. ASU 2015-01 eliminates the concept of extraordinary items. The effective date of this Update is for fiscal years beginning on or after December 15, 2015 and interim periods within those annual periods. Adoption of this Update is not expected to have a material effect on the Company’s consolidated financial statements or the interim notes to the consolidated financial statements.

ASU 2015-03, Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs was also issued as part of the FASB's simplification initiative. The amendments in this ASU require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. Currently, debt issuance costs are presented as an asset on the balance sheet. The FASB notes within the ASU, capitalized debt issuance costs do not meet the definition of an asset and are more akin to a debt discount, thereby reducing the carrying amount of the proceeds received. The effective date of this Update is for fiscal years beginning on or after December 15, 2015 and interim periods within those annual periods. Adoption of this Update is not expected to have a material effect on the Company’s consolidated financial statements or the interim notes to the consolidated financial statements.

Louisiana Business Corporation Act — Effective January 1, 2015, companies incorporated under Louisiana law became subject to the Louisiana Business Corporation Act. Provisions of the Louisiana Business Corporation Act eliminate the concept of treasury stock. Rather, shares purchased by the Company constitute authorized but unissued shares. Accounting principles generally accepted in the United States of America state that accounting for treasury stock shall

conform to state law. The Company's consolidated financial statements as of September 30, 2015 reflect this change. The cost of shares purchased by the Company has been allocated to common stock and additional paid-in capital balances.

Table of Contents

## 2. Investment Securities

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

|  | September 30, 2015 |                              |                               |            |
|--|--------------------|------------------------------|-------------------------------|------------|
|  | Amortized<br>Cost  | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair Value |
| Available-for-sale:                              |                    |                              |                               |            |
| Obligations of state and political subdivisions  | \$36,500           | \$979                        | \$48                          | \$37,431   |
| GSE mortgage-backed securities                   | 88,813             | 2,981                        | 55                            | 91,739     |
| Collateralized mortgage obligations: residential | 148,819            | 690                          | 927                           | 148,582    |
| Collateralized mortgage obligations: commercial  | 5,653              | 9                            | 45                            | 5,617      |
| Mutual funds                                     | 2,100              | 16                           | —                             | 2,116      |
|  | \$281,885          | \$4,675                      | \$1,075                       | \$285,485  |
| December 31, 2014                                |                    |                              |                               |            |
|  | Amortized<br>Cost  | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair Value |
| Available-for-sale:                              |                    |                              |                               |            |
| U.S. Government sponsored enterprises            | \$10,339           | \$—                          | \$112                         | \$10,227   |
| Obligations of state and political subdivisions  | 43,079             | 1,555                        | 29                            | 44,605     |
| GSE mortgage-backed securities                   | 106,208            | 3,183                        | 288                           | 109,103    |
| Collateralized mortgage obligations: residential | 62,093             | 266                          | 1,520                         | 60,839     |
| Collateralized mortgage obligations: commercial  | 24,462             | 190                          | 107                           | 24,545     |
| Other asset-backed securities                    | 24,041             | 321                          | 19                            | 24,343     |
| Collateralized debt obligation                   | 266                | 952                          | —                             | 1,218      |
| Mutual funds                                     | 2,100              | 4                            | —                             | 2,104      |
|  | \$272,588          | \$6,471                      | \$2,075                       | \$276,984  |
| September 30, 2015                               |                    |                              |                               |            |
|  | Amortized<br>Cost  | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair Value |
| Held-to-maturity:                                |                    |                              |                               |            |
| Obligations of state and political subdivisions  | \$43,933           | \$552                        | \$38                          | \$44,447   |
| GSE mortgage-backed securities                   | 58,420             | 1,212                        | 82                            | 59,550     |
| Collateralized mortgage obligations: residential | 11,284             | —                            | 250                           | 11,034     |
| Collateralized mortgage obligations: commercial  | 7,406              | 51                           | —                             | 7,457      |
|  | \$121,043          | \$1,815                      | \$370                         | \$122,488  |
| December 31, 2014                                |                    |                              |                               |            |
|  | Amortized<br>Cost  | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair Value |
| Held-to-maturity:                                |                    |                              |                               |            |
| Obligations of state and political subdivisions  | \$45,914           | \$267                        | \$192                         | \$45,989   |
| GSE mortgage-backed securities                   | 67,268             | 1,080                        | 164                           | 68,184     |

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|  |            |          |          |            |
|--|------------|----------|----------|------------|
| Collateralized mortgage obligations: residential | 12,709     | —        | 479      | 12,230     |
| Collateralized mortgage obligations: commercial  | 15,310     | 53       | 173      | 15,190     |
|  | \$ 141,201 | \$ 1,400 | \$ 1,008 | \$ 141,593 |

9

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Table of Contents

With the exception of two private-label collateralized mortgage obligations (“CMOs”) with a combined balance remaining of \$34,000 at September 30, 2015, all of the Company’s CMOs are government-sponsored enterprise (“GSE”) securities.

The amortized cost and fair value of debt securities at September 30, 2015 by contractual maturity are shown in the following table (in thousands) with the exception of other asset-backed securities, mortgage-backed securities, CMOs, and the collateralized debt obligation. Expected maturities may differ from contractual maturities for mortgage-backed securities and CMOs because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

|   | Amortized<br>Cost | Fair<br>Value |
|---|-------------------|---------------|
| Available-for-sale:   |                   |               |
| Due in one year or less   | \$5,074           | \$5,114       |
| Due after one year through five years                               | 19,498            | 20,120        |
| Due after five years through ten years                              | 9,540             | 9,832         |
| Due after ten years   | 2,388             | 2,365         |
| Mortgage-backed securities and collateralized mortgage obligations: |                   |               |
| Residential   | 237,632           | 240,321       |
| Commercial  | 5,653             | 5,617         |
| Mutual funds  | 2,100             | 2,116         |
|   | \$281,885         | \$285,485     |
|   | Amortized<br>Cost | Fair<br>Value |
| Held-to-maturity:   |                   |               |
| Due in one year or less   | \$473             | \$475         |
| Due after one year through five years                               | 2,923             | 2,960         |
| Due after five years through ten years                              | 11,105            | 11,273        |
| Due after ten years   | 29,432            | 29,739        |
| Mortgage-backed securities and collateralized mortgage obligations: |                   |               |
| Residential   | 69,704            | 70,584        |
| Commercial  | 7,406             | 7,457         |
|   | \$121,043         | \$122,488     |

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

|  | September 30, 2015                        |  | September 30, 2015                        |  | Total         |                             |
|--|---|--|---|--|---------------|-----------------------------|
|  | Securities with losses<br>under 12 months | Securities with losses<br>over 12 months | Securities with losses<br>under 12 months | Securities with losses<br>over 12 months | Total         | Total                       |
|  | Fair<br>Value                             | Gross<br>Unrealized<br>Loss              | Fair<br>Value                             | Gross<br>Unrealized<br>Loss              | Fair<br>Value | Gross<br>Unrealized<br>Loss |
| Available-for-sale:                                |   |  |   |  |               |                             |
| Obligations of state and<br>political subdivisions | \$3,190                                   | \$48                                     | \$—                                       | \$—                                      | \$3,190       | \$48                        |
| GSE mortgage-backed<br>securities                  | 15,860                                    | 45                                       | 3,754                                     | 10                                       | 19,614        | 55                          |

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|  |          |       |          |       |          |         |
|--|----------|-------|----------|-------|----------|---------|
| Collateralized mortgage obligations: residential | 33,689   | 128   | 31,772   | 799   | 65,461   | 927     |
| Collateralized mortgage obligations: commercial  | —        | —     | 3,073    | 45    | 3,073    | 45      |
|  | \$52,739 | \$221 | \$38,599 | \$854 | \$91,338 | \$1,075 |

10

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Table of Contents

|  | December 31, 2014                         |                             | Securities with losses<br>over 12 months |                             | Total         | Gross<br>Unrealized<br>Loss |
|--|---|-----------------------------|--|-----------------------------|---------------|-----------------------------|
|  | Securities with losses<br>under 12 months |                             | Fair<br>Value                            | Gross<br>Unrealized<br>Loss |               |                             |
|  | Fair<br>Value                             | Gross<br>Unrealized<br>Loss | Fair<br>Value                            | Gross<br>Unrealized<br>Loss | Fair<br>Value | Gross<br>Unrealized<br>Loss |
| Available-for-sale:                              |   |                             |  |                             |               |                             |
| U.S. Government sponsored enterprises            | \$4,973                                   | \$32                        | \$5,254                                  | \$80                        | \$10,227      | \$112                       |
| Obligations of state and political subdivisions  | 2,029                                     | 29                          | —  | —                           | 2,029         | 29                          |
| GSE mortgage-backed securities                   | 6,668                                     | 25                          | 21,538                                   | 263                         | 28,206        | 288                         |
| Collateralized mortgage obligations: residential | 9,366                                     | 53                          | 37,997                                   | 1,467                       | 47,363        | 1,520                       |
| Collateralized mortgage obligations: commercial  | —   | —                           | 3,747                                    | 107                         | 3,747         | 107                         |
| Other asset-backed securities                    | 6,401                                     | 19                          | —  | —                           | 6,401         | 19                          |
|  | \$29,437                                  | \$158                       | \$68,536                                 | \$1,917                     | \$97,973      | \$2,075                     |
|  |   |                             |  |                             |               |                             |
|  | September 30, 2015                        |                             | Securities with losses<br>over 12 months |                             | Total         | Gross<br>Unrealized<br>Loss |
| Securities with losses<br>under 12 months        |   | Fair<br>Value               | Gross<br>Unrealized<br>Loss              |                             |               |                             |
|  | Fair<br>Value                             | Gross<br>Unrealized<br>Loss | Fair<br>Value                            | Gross<br>Unrealized<br>Loss | Fair<br>Value | Gross<br>Unrealized<br>Loss |
| Held-to-maturity:                                |   |                             |  |                             |               |                             |
| Obligations of state and political subdivisions  | \$6,544                                   | \$19                        | \$1,302                                  | \$19                        | \$7,846       | \$38                        |
| GSE mortgage-backed securities                   | —   | —                           | 7,309                                    | 82                          | 7,309         | 82                          |
| Collateralized mortgage obligations: residential | —   | —                           | 11,034                                   | 250                         | 11,034        | 250                         |
|  | \$6,544                                   | \$19                        | \$19,645                                 | \$351                       | \$26,189      | \$370                       |
|  |   |                             |  |                             |               |                             |
|  | December 31, 2014                         |                             | Securities with losses<br>over 12 months |                             | Total         | Gross<br>Unrealized<br>Loss |
| Securities with losses<br>under 12 months        |   | Fair<br>Value               | Gross<br>Unrealized<br>Loss              |                             |               |                             |
|  | Fair<br>Value                             | Gross<br>Unrealized<br>Loss | Fair<br>Value                            | Gross<br>Unrealized<br>Loss | Fair<br>Value | Gross<br>Unrealized<br>Loss |
| Held-to-maturity:                                |   |                             |  |                             |               |                             |
| Obligations of state and political subdivisions  | \$11,761                                  | \$35                        | \$13,263                                 | \$157                       | \$25,024      | \$192                       |
| GSE mortgage-backed securities                   | —   | —                           | 8,142                                    | 164                         | 8,142         | 164                         |
| Collateralized mortgage obligations: residential | —   | —                           | 12,230                                   | 479                         | 12,230        | 479                         |
| Collateralized mortgage obligations: commercial  | 7,599                                     | 173                         | —  | —                           | 7,599         | 173                         |
|  | \$19,360                                  | \$208                       | \$33,635                                 | \$800                       | \$52,995      | \$1,008                     |

Management evaluates each quarter whether unrealized losses on securities represent impairment that is other than temporary. For debt securities, the Company considers its intent to sell the securities or if it is more likely than not the Company will be required to sell the securities. If such impairment is identified, based upon the intent to sell or the more likely than not threshold, the carrying amount of the security is reduced to fair value with a charge to earnings. Upon the result of the aforementioned review, management

11

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Table of Contents

then reviews for potential other than temporary impairment based upon other qualitative factors. In making this evaluation, management considers changes in market rates relative to those available when the security was acquired, changes in market expectations about the timing of cash flows from securities that can be prepaid, performance of the debt security, and changes in the market's perception of the issuer's financial health and the security's credit quality. If determined that a debt security has incurred other than temporary impairment, then the amount of the credit related impairment is determined. If a credit loss is evident, the amount of the credit loss is charged to earnings and the non-credit related impairment is recognized through other comprehensive income.

As of September 30, 2015, 42 securities had unrealized losses totaling 1.21% of the individual securities' amortized cost basis and 0.36% of the Company's total amortized cost basis. Of the 42 securities, 20 had been in an unrealized loss position for over twelve months at September 30, 2015. These 20 securities had an amortized cost basis and unrealized loss of \$59.4 million and \$1.2 million, respectively. The unrealized losses on debt securities at September 30, 2015 resulted from changing market interest rates over the yields available at the time the underlying securities were purchased. Management identified no impairment related to credit quality. At September 30, 2015, management had the intent and ability to hold impaired securities and no impairment was evaluated as other than temporary. As a result, no other than temporary impairment losses were recognized during the three months ended September 30, 2015.

During the nine months ended September 30, 2015, the Company sold 21 securities classified as available-for-sale at a net gain of \$1.2 million. Of the 21 securities sold, 11 were sold with gains totaling \$1.4 million and 10 securities were sold at a loss of \$135,000. During the nine months ended September 30, 2014, the Company sold 4 securities classified as available-for-sale at a net gain of \$128,000. All of the securities were sold at a gain.

Securities with an aggregate carrying value of approximately \$287.2 million and \$279.8 million at September 30, 2015 and December 31, 2014, respectively, were pledged to secure public funds on deposit and for other purposes required or permitted by law.

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

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

|  | September 30,<br>2015 | December 31,<br>2014 |
|--|-----------------------|----------------------|
| Commercial, financial and agricultural | \$482,452             | \$467,147            |
| Real estate - construction             | 74,279                | 68,577               |
| Real estate – commercial               | 473,319               | 467,172              |
| Real estate – residential              | 151,667               | 154,602              |
| Installment loans to individuals       | 113,199               | 119,328              |
| Lease financing receivable             | 4,790                 | 4,857                |
| Other                                  | 1,746                 | 2,748                |
|  | 1,301,452             | 1,284,431            |
| Less allowance for loan losses         | (18,939)              | (11,226)             |
|  | \$1,282,513           | \$1,273,205          |

The Company monitors loan concentrations and evaluates individual customer and aggregate industry leverage, profitability, risk rating distributions, and liquidity for each major standard industry classification segment. At September 30, 2015, one industry segment concentration, the oil and gas industry, constituted more than 10% of the loan portfolio. The Company's exposure in the oil and gas industry, including related service and manufacturing industries, totaled approximately \$295.6 million, or 22.7% of total loans. Additionally, the Company's exposure to loans secured by commercial real estate is monitored. At September 30, 2015, loans secured by commercial real

estate (including commercial construction, farmland and multifamily loans) totaled approximately \$529.0 million. Of the \$529.0 million, \$473.3 million represent CRE loans, 53% of which are secured by owner-occupied commercial properties. Of the \$529.0 million in loans secured by commercial real estate, \$20.0 million, or 3.8%, were on nonaccrual status at September 30, 2015.

#### Allowance for Loan Losses

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

Table of Contents

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

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

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

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

A rollforward of the activity within the allowance for loan losses by loan type and recorded investment in loans for the nine months ended September 30, 2015 and 2014 is as follows (in thousands):

Table of Contents

|   | September 30, 2015      |               |            |             |  |                                  |         |             |
|---|-------------------------|---------------|------------|-------------|--|----------------------------------|---------|-------------|
|   | Real Estate             |               |            |             |  |                                  |         |             |
|   | Coml, Fin,<br>and Agric | Construc-tion | Commercial | Residential | Installment<br>loans to<br>individuals | Lease<br>financing<br>receivable | Other   | Total       |
| Allowance for<br>loan losses:   |                         |               |            |             |  |                                  |         |             |
| Beginning<br>balance  | \$5,729                 | \$954         | \$2,402    | \$810       | \$1,311                                | \$16                             | \$4     | \$11,226    |
| Charge-offs   | (2,310 )                | (76 )         | (169 )     | (45 )       | (883 )                                 | —                                | —       | (3,483 )    |
| Recoveries  | 185                     | 1             | 20         | 10          | 80                                     | —                                | —       | 296         |
| Provision   | 8,016                   | (62 )         | 2,107      | (104 )      | 923                                    | 13                               | 7       | 10,900      |
| Ending<br>balance   | \$11,620                | \$817         | \$4,360    | \$671       | \$1,431                                | \$29                             | \$11    | \$18,939    |
| Ending<br>balance:<br>individually<br>evaluated for<br>impairment           | \$2,569                 | \$26          | \$1,739    | \$147       | \$216                                  | \$—                              | \$—     | \$4,697     |
| Ending<br>balance:<br>collectively<br>evaluated for<br>impairment           | \$9,051                 | \$791         | \$2,621    | \$524       | \$1,215                                | \$29                             | \$11    | \$14,242    |
| Loans:  |                         |               |            |             |  |                                  |         |             |
| Ending<br>balance   | \$482,452               | \$74,279      | \$473,319  | \$151,667   | \$113,199                              | \$4,790                          | \$1,746 | \$1,301,452 |
| Ending<br>balance:<br>individually<br>evaluated for<br>impairment           | \$29,185                | \$212         | \$19,928   | \$1,796     | \$386                                  | \$—                              | \$—     | \$51,507    |
| Ending<br>balance:<br>collectively<br>evaluated for<br>impairment           | \$453,267               | \$74,067      | \$452,758  | \$149,788   | \$112,813                              | \$4,790                          | \$1,746 | \$1,249,229 |
| Ending<br>balance: loans<br>acquired with<br>deteriorated<br>credit quality | \$—                     | \$—           | \$633      | \$83        | \$—                                    | \$—                              | \$—     | \$716       |



Table of Contents

|  | September 30, 2014      |               |            |             |  |                                  |         |             |
|--|-------------------------|---------------|------------|-------------|--|----------------------------------|---------|-------------|
|  | Real Estate             |               |            |             |  |                                  |         |             |
|  | Coml, Fin,<br>and Agric | Constr-uction | Commercial | Residential | Installment<br>loans to<br>individuals | Lease<br>financing<br>receivable | Other   | Total       |
| Allowance<br>for loan<br>losses:   |                         |               |            |             |  |                                  |         |             |
| Beginning<br>balance   | \$3,906                 | \$1,046       | \$1,389    | \$1,141     | \$1,273                                | \$21                             | \$3     | \$8,779     |
| Charge-offs  | (2,084 )                | (1 )          | (93 )      | (188 )      | (566 )                                 | —                                | —       | (2,932 )    |
| Recoveries   | 101                     | —             | 398        | 44          | 110                                    | —                                | —       | 653         |
| Provision  | 2,731                   | 103           | (345 )     | (8 )        | 450                                    | (6 )                             | —       | 2,925       |
| Ending<br>balance  | \$4,654                 | \$1,148       | \$1,349    | \$989       | \$1,267                                | \$15                             | \$3     | \$9,425     |
| Ending<br>balance:<br>individually<br>evaluated for<br>impairment              | \$853                   | \$3           | \$55       | \$87        | \$140                                  | \$—                              | \$—     | \$1,138     |
| Ending<br>balance:<br>collectively<br>evaluated for<br>impairment              | \$3,801                 | \$1,145       | \$1,294    | \$902       | \$1,127                                | \$15                             | \$3     | \$8,287     |
| Loans:   |                         |               |            |             |  |                                  |         |             |
| Ending<br>balance  | \$452,065               | \$86,315      | \$430,930  | \$153,915   | \$116,340                              | \$5,285                          | \$3,523 | \$1,248,373 |
| Ending<br>balance:<br>individually<br>evaluated for<br>impairment              | \$2,662                 | \$106         | \$3,312    | \$1,073     | \$426                                  | \$—                              | \$—     | \$7,579     |
| Ending<br>balance:<br>collectively<br>evaluated for<br>impairment              | \$449,403               | \$86,209      | \$426,942  | \$152,742   | \$115,914                              | \$5,285                          | \$3,523 | \$1,240,018 |
| Ending<br>balance:<br>loans<br>acquired with<br>deteriorated<br>credit quality | \$—                     | \$—           | \$676      | \$100       | \$—                                    | \$—                              | \$—     | \$776       |

## Non-Accrual and Past Due Loans

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

Table of Contents

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

|  | September 30, 2015        |                              |  |                      |             |             |  |
|--|---------------------------|------------------------------|--|----------------------|-------------|-------------|--|
|  | 30-59<br>Days<br>Past Due | 60-89<br>Days<br>Past<br>Due | Greater<br>than 90<br>Days<br>Past Due | Total<br>Past<br>Due | Current     | Total Loans | Recorded<br>Investment<br>> 90 days<br>and<br>Accruing |
| Commercial, financial,<br>and agricultural | \$4,065                   | \$3,124                      | \$3,879                                | \$11,068             | \$471,384   | \$482,452   | \$23   |
| Commercial real estate -<br>construction   | 93                        | 99                           | 12                                     | 204                  | 55,484      | 55,688      | —  |
| Commercial real estate -<br>other          | 7,252                     | 2,745                        | 16,999                                 | 26,996               | 446,323     | 473,319     | —  |
| Residential -<br>construction              | —                         | —                            | 172                                    | 172                  | 18,419      | 18,591      | —  |
| Residential - prime                        | 1,383                     | 264                          | 1,378                                  | 3,025                | 148,642     | 151,667     | —  |
| Consumer - credit card                     | 38                        | 11                           | 27                                     | 76                   | 5,683       | 5,759       | 27   |
| Consumer - other                           | 1,228                     | 162                          | 329                                    | 1,719                | 105,721     | 107,440     | 32   |
| Lease financing<br>receivable              | —                         | —                            | —                                      | —                    | 4,790       | 4,790       | —  |
| Other loans                                | 148                       | —                            | —                                      | 148                  | 1,598       | 1,746       | —  |
|  | \$14,207                  | \$6,405                      | \$22,796                               | \$43,408             | \$1,258,044 | \$1,301,452 | \$82   |
|  | December 31, 2014         |                              |  |                      |             |             |  |
|  | 30-59<br>Days<br>Past Due | 60-89<br>Days<br>Past<br>Due | Greater<br>than 90<br>Days<br>Past Due | Total<br>Past<br>Due | Current     | Total Loans | Recorded<br>Investment<br>> 90 days<br>and<br>Accruing |
| Commercial, financial,<br>and agricultural | \$2,179                   | \$654                        | \$2,556                                | \$5,389              | \$461,758   | \$467,147   | \$26   |
| Commercial real estate -<br>construction   | 15                        | —                            | 105                                    | 120                  | 43,390      | 43,510      | 97   |
| Commercial real estate -<br>other          | 4,989                     | 270                          | 2,464                                  | 7,723                | 459,449     | 467,172     | —  |
| Residential -<br>construction              | 431                       | —                            | —                                      | 431                  | 24,636      | 25,067      | —  |
| Residential - prime                        | 1,843                     | 523                          | 704                                    | 3,070                | 151,532     | 154,602     | —  |
| Consumer - credit card                     | 5                         | 19                           | 18                                     | 42                   | 5,970       | 6,012       | 18   |
| Consumer - other                           | 671                       | 392                          | 107                                    | 1,170                | 112,146     | 113,316     | 46   |
| Lease financing<br>receivable              | —                         | —                            | —                                      | —                    | 4,857       | 4,857       | —  |
| Other loans                                | 134                       | —                            | —                                      | 134                  | 2,614       | 2,748       | —  |
|  | \$10,267                  | \$1,858                      | \$5,954                                | \$18,079             | \$1,266,352 | \$1,284,431 | \$187  |

Table of Contents

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

|   | September 30,<br>2015 | December 31, 2014 |
|---|-----------------------|-------------------|
| Commercial, financial, and agricultural | \$29,171              | \$2,642           |
| Commercial real estate – construction   | 39                    | 54                |
| Commercial real estate - other          | 19,952                | 6,429             |
| Residential - construction              | 172                   | —                 |
| Residential - prime                     | 1,896                 | 1,194             |
| Consumer - credit card                  | —                     | —                 |
| Consumer - other                        | 386                   | 382               |
| Lease financing receivable              | —                     | —                 |
| Other                                   | —                     | —                 |
|   | \$51,616              | \$10,701          |

The amount of interest that would have been recorded on non-accrual loans, had the loans not been classified as non-accrual, totaled approximately \$1.3 million and \$392,000 for the nine months ended September 30, 2015 and 2014, respectively. Interest actually received on non-accrual loans subsequent to their transfer to non-accrual status totaled at September 30, 2015 and 2014 was \$19,000 and \$93,000, respectively.

**Impaired Loans**

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

Table of Contents

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

|   | September 30, 2015     |                                |                      |                                   |                                  |
|---|------------------------|--------------------------------|----------------------|-----------------------------------|----------------------------------|
|   | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
| With no related allowance recorded:     |                        |                                |                      |                                   |                                  |
| Commercial, financial, and agricultural | \$22,149               | \$22,412                       | \$—                  | \$21,863                          | \$703                            |
| Commercial real estate – construction   | 39                     | 39                             | —                    | 40                                | —                                |
| Commercial real estate – other          | 5,440                  | 5,440                          | —                    | 6,244                             | 47                               |
| Residential – prime                     | 1,144                  | 1,164                          | —                    | 1,211                             | 11                               |
| Residential – construction              | 55                     | 55                             | —                    | 273                               | 1                                |
| Consumer – other                        | 30                     | 30                             | —                    | 33                                | —                                |
| Subtotal:                               | 28,857                 | 29,140                         | —                    | 29,664                            | 762                              |
| With an allowance recorded:             |                        |                                |                      |                                   |                                  |
| Commercial, financial, and agricultural | 7,036                  | 7,036                          | 2,569                | 4,604                             | 159                              |
| Commercial real estate – other          | 14,488                 | 14,488                         | 1,739                | 12,932                            | 33                               |
| Residential – prime                     | 652                    | 652                            | 147                  | 599                               | 5                                |
| Residential – construction              | 118                    | 118                            | 26                   | 59                                | —                                |
| Consumer – other                        | 356                    | 371                            | 216                  | 322                               | 4                                |
| Subtotal:                               | 22,650                 | 22,665                         | 4,697                | 18,516                            | 201                              |
| Totals:                                 |                        |                                |                      |                                   |                                  |
| Commercial                              | 49,152                 | 49,415                         | 4,308                | 45,683                            | 942                              |
| Residential                             | 1,969                  | 1,989                          | 173                  | 2,142                             | 17                               |
| Consumer                                | 386                    | 401                            | 216                  | 355                               | 4                                |
| Grand total:                            | \$51,507               | \$51,805                       | \$4,697              | \$48,180                          | \$963                            |

Table of Contents

|   | December 31, 2014      |                                |                      |                                   |                                  |
|---|------------------------|--------------------------------|----------------------|-----------------------------------|----------------------------------|
|   | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
| With no related allowance recorded:     |                        |                                |                      |                                   |                                  |
| Commercial, financial, and agricultural | \$438                  | \$521                          | \$—                  | \$554                             | \$—                              |
| Commercial real estate – construction   | 54                     | 54                             | —                    | 58                                | —                                |
| Commercial real estate – other          | 1,921                  | 1,921                          | —                    | 1,885                             | 17                               |
| Residential – prime                     | 543                    | 543                            | —                    | 534                               | 15                               |
| Consumer – other                        | 78                     | 78                             | —                    | 72                                | —                                |
| Subtotal:                               | 3,034                  | 3,117                          | —                    | 3,103                             | 32                               |
| With an allowance recorded:             |                        |                                |                      |                                   |                                  |
| Commercial, financial, and agricultural | 2,218                  | 2,333                          | 1,010                | 1,394                             | 35                               |
| Commercial real estate – construction   | —                      | —                              | —                    | 19                                | —                                |
| Commercial real estate – other          | 4,467                  | 4,467                          | 1,484                | 2,416                             | 220                              |
| Residential – prime                     | 529                    | 548                            | 68                   | 452                               | 3                                |
| Consumer – other                        | 299                    | 313                            | 179                  | 252                               | 4                                |
| Subtotal:                               | 7,513                  | 7,661                          | 2,741                | 4,533                             | 262                              |
| Totals:                                 |                        |                                |                      |                                   |                                  |
| Commercial                              | 9,098                  | 9,296                          | 2,494                | 6,326                             | 272                              |
| Residential                             | 1,072                  | 1,091                          | 68                   | 986                               | 18                               |
| Consumer                                | 377                    | 391                            | 179                  | 324                               | 4                                |
| Grand total:                            | \$10,547               | \$10,778                       | \$2,741              | \$7,636                           | \$294                            |

## Credit Quality

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

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

Table of Contents

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

September 30, 2015

Commercial Credit Exposure  
Credit Risk Profile by  
Creditworthiness Category

|                 | Commercial,<br>financial, and<br>agricultural | Commercial<br>real estate -<br>construction | Commercial<br>real estate -<br>other | Total       | % of<br>Total |   |
|-----------------|---|---|--------------------------------------|-------------|---------------|---|
| Pass            | \$417,600                                     | \$55,525                                    | \$417,095                            | \$890,220   | 88.02         | % |
| Special mention | 23,104  | 34  | 20,277                               | 43,415      | 4.29          | % |
| Substandard     | 41,521  | 129   | 35,947                               | 77,597      | 7.67          | % |
| Doubtful        | 227   | —   | —                                    | 227         | 0.02          | % |
|                 | \$482,452                                     | \$55,688                                    | \$473,319                            | \$1,011,459 | 100.00        | % |

Residential Credit Exposure  
Credit Risk Profile by  
Creditworthiness Category

|                 | Residential -<br>construction | Residential<br>- prime | Total     | % of<br>Total |   |
|-----------------|-------------------------------|------------------------|-----------|---------------|---|
| Pass            | \$18,419                      | \$147,721              | \$166,140 | 97.58         | % |
| Special mention | —                             | 1,326                  | 1,326     | 0.78          | % |
| Substandard     | 172                           | 2,620                  | 2,792     | 1.64          | % |
|                 | \$18,591                      | \$151,667              | \$170,258 | 100.00        | % |

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

|               | Consumer -<br>credit card | Consumer -<br>other | Lease<br>financing<br>receivable | Other   | Total     | % of<br>Total |
|---------------|---------------------------|---------------------|----------------------------------|---------|-----------|---------------|
| Performing    | \$5,721                   | \$107,022           | \$4,790                          | \$1,746 | \$119,279 | 99.62 %       |
| Nonperforming | 38                        | 418                 | —                                | —       | 456       | 0.38 %        |
|               | \$5,759                   | \$107,440           | \$4,790                          | \$1,746 | \$119,735 | 100.00 %      |

Table of Contents

December 31, 2014

Commercial Credit Exposure  
Credit Risk Profile by  
Creditworthiness Category

|                 | Commercial,<br>financial, and<br>agricultural | Commercial<br>real estate -<br>construction | Commercial<br>real estate -<br>other | Total     | %<br>of Total |   |
|-----------------|---|---|--------------------------------------|-----------|---------------|---|
| Pass            | \$456,221                                     | \$43,320                                    | \$440,281                            | \$939,822 | 96.11         | % |
| Special mention | 4,861   | 132   | 7,120                                | 12,113    | 1.24          | % |
| Substandard     | 5,541   | 58  | 19,771                               | 25,370    | 2.60          | % |
| Doubtful        | 524   | —   | —                                    | 524       | 0.05          | % |
|                 | \$467,147                                     | \$43,510                                    | \$467,172                            | \$977,829 | 100.00        | % |

Residential Credit Exposure  
Credit Risk Profile by  
Creditworthiness Category

|                 | Residential -<br>construction | Residential<br>- prime | Total     | %<br>of Total |   |
|-----------------|-------------------------------|------------------------|-----------|---------------|---|
| Pass            | \$25,067                      | \$150,664              | \$175,731 | 97.81         | % |
| Special mention | —                             | 1,184                  | 1,184     | 0.66          | % |
| Substandard     | —                             | 2,754                  | 2,754     | 1.53          | % |
|                 | \$25,067                      | \$154,602              | \$179,669 | 100.00        | % |

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

|               | Consumer -<br>credit card | Consumer -<br>other | Lease<br>financing<br>receivable | Other   | Total     | %<br>of Total |   |
|---------------|---------------------------|---------------------|----------------------------------|---------|-----------|---------------|---|
| Performing    | \$5,995                   | \$112,893           | \$4,857                          | \$2,748 | \$126,493 | 99.65         | % |
| Nonperforming | 17                        | 423                 | —                                | —       | 440       | 0.35          | % |
|               | \$6,012                   | \$113,316           | \$4,857                          | \$2,748 | \$126,933 | 100.00        | % |

## Troubled Debt Restructurings

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

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



Table of Contents

|  | September 30, 2015 |                                     |                    |               |
|--|--------------------|-------------------------------------|--------------------|---------------|
|  | Current            | Past Due<br>Greater Than<br>30 Days | Nonaccrual<br>TDRs | Total<br>TDRs |
| Commercial, financial and agricultural | \$ 18              | \$—                                 | \$21,324           | \$21,342      |
| Real estate - commercial               | —                  | 150                                 | —                  | 150           |
|  | \$ 18              | \$ 150                              | \$21,324           | \$21,492      |
|  | December 31, 2014  |                                     |                    |               |
|  | Current            | Past Due<br>Greater Than<br>30 Days | Nonaccrual<br>TDRs | Total<br>TDRs |
| Commercial, financial and agricultural | \$21               | \$—                                 | \$234              | \$255         |
| Real estate - commercial               | 155                | —                                   | —                  | 155           |
|  | \$ 176             | \$—                                 | \$234              | \$410         |

During the three months ended September 30, 2015, there were no loans identified as a TDR. There was one TDR totaling \$21.1 million that defaulted on the modified terms during the three months ended September 31, 2015. During the three months ended September 30, 2014, there were no loans identified as a TDR, and there were no defaults on any loans that were modified as TDRs during the preceding twelve months. During the nine months ended September 30, 2015, there was one loan relationship with a pre-modification balance of \$21.4 million identified as a TDR after conversion of the loans to interest only for a limited amount of time. There was one TDR totaling \$21.1 million that defaulted on the modified terms during the nine months ended September 31, 2015. During the nine months ended September 30, 2014, there was one loan relationship with a pre-modification balance of \$1.2 million identified as a TDR through a modification of the original loan terms, and there were no defaults on any loans that were modified as TDRs during the preceding twelve months. For purposes of the determination of an allowance for loan losses on these TDRs, as an identified TDR, the Company considers a loss probable on the loan and, as a result is reviewed for specific impairment in accordance with the Company's allowance for loan loss methodology. If it is determined losses are probable on such TDRs, either because of delinquency or other credit quality indicator, the Company establishes specific reserves for these loans. As of September 30, 2015, there were no commitments to lend additional funds to debtors owing sums to the Company whose terms have been modified in TDRs.

## 4. Intangibles

A summary of core deposit intangible assets as of September 30, 2015 and December 31, 2014 is as follows (in thousands):

|                               | September 30, 2015 | December 31, 2014 |
|-------------------------------|--------------------|-------------------|
| Gross carrying amount         | \$ 11,674          | \$ 11,674         |
| Less accumulated amortization | (5,670             | ) (4,840          |
| Net carrying amount           | \$6,004            | \$6,834           |

## 5. Other Comprehensive Income

Table of Contents

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

|   | Three Months Ended September 30,<br>2015 |            |                      | 2014                 |            |                      |
|---|--|------------|----------------------|----------------------|------------|----------------------|
|   | Before Tax<br>Amount                     | Tax Effect | Net of Tax<br>Amount | Before Tax<br>Amount | Tax Effect | Net of Tax<br>Amount |
| Other comprehensive income (loss):                              |  |            |                      |                      |            |                      |
| Securities available-for-sale:                                  |  |            |                      |                      |            |                      |
| Change in unrealized gains (losses)<br>during period            | \$ 1,717                                 | \$(601 )   | \$ 1,116             | \$(405 )             | \$ 142     | \$(263 )             |
| Reclassification adjustment for gains<br>included in net income | —  | —          | —                    | —                    | —          | —                    |
| Total other comprehensive income<br>(loss)                      | \$ 1,717                                 | \$(601 )   | \$ 1,116             | \$(405 )             | \$ 142     | \$(263 )             |

|   | Nine Months Ended September 30,<br>2015 |            |                      | 2014                 |            |                      |
|---|---|------------|----------------------|----------------------|------------|----------------------|
|   | Before Tax<br>Amount                    | Tax Effect | Net of Tax<br>Amount | Before Tax<br>Amount | Tax Effect | Net of Tax<br>Amount |
| Other comprehensive (loss) income:                              |   |            |                      |                      |            |                      |
| Securities available-for-sale:                                  |   |            |                      |                      |            |                      |
| Change in unrealized gains during<br>period                     | \$ 447                                  | \$(156 )   | \$ 291               | \$ 4,116             | \$(1,441 ) | \$ 2,675             |
| Reclassification adjustment for gains<br>included in net income | (1,243 )                                | 435        | (808 )               | (128 )               | 45         | (83 )                |
| Total other comprehensive (loss)<br>income                      | \$(796 )                                | \$ 279     | \$(517 )             | \$ 3,988             | \$(1,396 ) | \$ 2,592             |

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

|  | Three Months Ended September 30,<br>2015                                       |                                    | 2014   |                                    |
|--|--|------------------------------------|--|------------------------------------|
| Details about<br>Accumulated Other<br>Comprehensive Income<br>Components | Reclassifications<br>Out of<br>Accumulated<br>Other<br>Comprehensive<br>Income | Income Statement<br>Line Item      | Reclassifications<br>Out of<br>Accumulated<br>Other<br>Comprehensive<br>Income | Income Statement<br>Line Item      |
| Unrealized gains and losses on<br>securities available-for-sale:         |  |                                    |  |                                    |
|  | \$—  | Gain on sale of<br>securities, net | \$—  | Gain on sale of<br>securities, net |
|  | —  | Tax expense                        | —  | Tax expense                        |
|  | \$—  | Net of tax                         | \$—  | Net of tax                         |



Table of Contents

| Details about<br>Accumulated Other<br>Comprehensive Income<br>Components | Nine Months Ended September 30,<br>2015  |                                      | 2014   |                                      |
|--|--|--------------------------------------|--|--------------------------------------|
|  | Reclassifications<br>Out of<br>Accumulated<br>Other<br>Comprehensive<br>Income | Income Statement<br>Line Item        | Reclassifications<br>Out of<br>Accumulated<br>Other<br>Comprehensive<br>Income | Income Statement<br>Line Item        |
| Unrealized gains and losses on<br>securities available-for-sale:         |  |                                      |  |                                      |
|  | \$ (1,243  | ) Gain on sale of<br>securities, net | \$ (128  | ) Gain on sale of<br>securities, net |
|  | 435  | Tax expense                          | 45   | Tax expense                          |
|  | \$ (808  | ) Net of tax                         | \$ (83   | ) Net of tax                         |

## 6. Declaration of Dividends

A first quarter dividend of \$0.09 per share for holders of common stock of record on March 13, 2015 was declared on January 21, 2015, and was paid on April 1, 2015. On January 21, 2015, the Company also declared a 1.00% dividend for holders of its Series C preferred stock of record on April 1, 2015, which was paid on April 15, 2015. On April 15, 2015, the Company declared a second quarter dividend of \$0.09 per share for holders of common stock of record on June 15, 2015, and was paid on July 1, 2015. On April 15, 2015, the Company also declared a 1.00% dividend for holders of its Series C preferred stock of record on July 1, 2015, which was paid on July 15, 2015. On July 15, 2015, the Company declared a third quarter dividend of \$0.09 per share for holders of common stock of record on September 15, 2015 to be paid on October 1, 2015. On July 15, 2015, the Company also declared a 1.00% dividend for holders of its Series C preferred stock of record on October 1, 2015 to be paid on October 15, 2015. On October 21, 2015, the Company declared a fourth quarter dividend of \$0.09 per share for holders of common stock of record on December 15, 2015 to be paid on January 4, 2016. On October 21, 2015, the Company also declared a 1.00% dividend for holders of its Series C preferred stock of record on January 4, 2016 to be paid on January 15, 2016.

## 7. Earnings Per Common Share

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

|   | Three Months Ended<br>September 30, |         | Nine Months Ended<br>September 30, |          |
|---|-------------------------------------|---------|------------------------------------|----------|
|   | 2015                                | 2014    | 2015                               | 2014     |
| Net earnings available to common shareholders   | \$2,417                             | \$4,298 | \$8,662                            | \$14,922 |
| Dividends on Series C preferred stock   | 92                                  | 94      | 277                                | 284      |
| Adjusted net earnings available to common shareholders  | \$2,509                             | \$4,392 | \$8,939                            | \$15,206 |
| Weighted average number of common shares outstanding used in<br>computation of basic earnings per common share                                    | 11,312                              | 11,314  | 11,321                             | 11,283   |
| Effect of dilutive securities:  |                                     |         |                                    |          |
| Stock options   | 12                                  | 92      | 20                                 | 77       |
| Convertible preferred stock and warrants  | 507                                 | 549     | 507                                | 544      |
| Weighted average number of common shares outstanding plus<br>effect of dilutive securities – used in computation of diluted<br>earnings per share | 11,831                              | 11,955  | 11,848                             | 11,904   |

Options and warrants on 234,206 shares of common stock and 11,250 shares of restricted stock were not included in computing diluted earnings per share for the quarter and nine months ended September 30, 2015 because the effects of these shares were anti-dilutive as a result of the exercise price of such options. Options to acquire 7,355 and 24,855 shares of common stock were not included in computing diluted earnings per share for the quarter and nine months ended September 30, 2014, respectively, because the effects of these shares were anti-dilutive as a result of the exercise price of such options.

Table of Contents

8. Fair Value Measurement

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

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

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

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

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

Cash and Due From Banks, Interest-Bearing Deposits in Banks and Federal Funds Sold—The carrying value of these short-term instruments is a reasonable estimate of fair value.

Securities Available-for-Sale—Securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange and U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter market funds. Securities are classified as Level 2 within the valuation hierarchy when the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information, and the bond's terms and conditions, among other things. Level 2 inputs are used to value U.S. Agency securities, mortgage-backed securities, asset-backed securities, municipal securities, single issue trust preferred securities, certain pooled trust preferred securities, collateralized debt obligations and certain equity securities that are not actively traded.

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

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

Loans—For disclosure purposes, the fair value of fixed rate loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings. For variable rate loans, the carrying amount is a reasonable estimate of fair value. The Company does not record loans at fair value on a recurring basis. No adjustment to fair value is taken related to illiquidity discounts. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management uses one of three methods to measure impairment, which, include collateral value, market value of similar debt, and discounted cash flows. Those

impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. Impaired loans where an allowance is established based on the fair value of collateral or where the loan balance has been charged down to fair value require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the impaired loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and adjusts the appraisal value by taking an additional discount for market conditions and there is no observable market price, the Company records the impaired loan as nonrecurring Level 3.

For non-performing loans, collateral valuations currently in file are reviewed for acceptability in terms of timeliness and applicability. Although each determination is made based on the facts and circumstances of each credit, generally valuations are no longer considered acceptable when there has been physical deterioration of the property from when it was last appraised, or there has been a significant change in the underlying assumptions of the appraisal. If the valuation is deemed to be unacceptable,

## Table of Contents

a new appraisal is ordered. New appraisals are typically received within 4-6 weeks. While awaiting new appraisals, the valuation in the file is utilized, net of discounts. Discounts are derived from available relevant market data, selling costs, taxes, and insurance. Any perceived collateral deficiency utilizing the discounted value is specifically reserved (as required by ASC Topic 310) until the new appraisal is received or charged off. Thus, provisions or charge-offs are recognized in the period the credit is identified as non-performing.

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

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

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

**Deposits**—The fair value of demand deposits, savings accounts, NOW accounts, and money market deposits is the amount payable on demand at the reporting date. The fair value of fixed maturity certificates of deposit is estimated by discounting the future cash flows using the rates currently offered for deposits of similar remaining maturities. The estimated fair value does not include customer related intangibles.

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

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

**Long-term Federal Home Loan Bank Advances**—The fair value of long-term FHLB advances is estimated using a discounted cash flow analysis that applies interest rates currently being offered on similar types of borrowings with similar terms.

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

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



Assets Recorded at Fair Value

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

26

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Table of Contents

| Description                                      | Assets / Liabilities                               | Fair Value Measurements |          |         |
|--|--|-------------------------|----------|---------|
|  | Measured at Fair Value<br>at<br>September 30, 2015 | Level 1                 | Level 2  | Level 3 |
| Available-for-sale securities:                   |  |                         |          |         |
| Obligations of state and political subdivisions  | \$37,431   | \$—                     | \$37,431 | \$—     |
| GSE mortgage-backed securities                   | 91,739   | —                       | 91,739   | —       |
| Collateralized mortgage obligations: residential | 148,582  | —                       | 148,582  | —       |
| Collateralized mortgage obligations: commercial  | 5,617  | —                       | 5,617    | —       |
| Mutual funds                                     | 2,116  | 2,116                   | —        | —       |
| Description                                      | Assets / Liabilities                               | Fair Value Measurements |          |         |
|  | Measured at Fair Value<br>at<br>December 31, 2014  | Level 1                 | Level 2  | Level 3 |
| Available-for-sale securities:                   |  |                         |          |         |
| U.S. Government sponsored enterprises            | \$10,227   | \$—                     | \$10,227 | \$—     |
| Obligations of state and political subdivisions  | 44,605   | —                       | 44,605   | —       |
| GSE mortgage-backed securities                   | 109,103  | —                       | 109,103  | —       |
| Collateralized mortgage obligations: residential | 60,839   | —                       | 60,839   | —       |
| Collateralized mortgage obligations: commercial  | 24,545   | —                       | 24,545   | —       |
| Other asset-backed securities                    | 24,343   | —                       | 24,343   | —       |
| Collateralized debt obligation                   | 1,218  | —                       | 1,218    | —       |
| Mutual funds                                     | 2,104  | 2,104                   | —        | —       |

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

| Description       | Assets / Liabilities                               | Fair Value Measurements |          |         |
|-------------------|--|-------------------------|----------|---------|
|                   | Measured at Fair Value<br>at<br>September 30, 2015 | Level 1                 | Level 2  | Level 3 |
| Impaired loans    | \$14,966   | \$—                     | \$14,966 | \$—     |
| Other real estate | 4,661  | —                       | 4,661    | —       |
| Description       | Assets / Liabilities                               | Fair Value Measurements |          |         |
|                   | Measured at Fair Value<br>at<br>December 31, 2014  | Level 1                 | Level 2  | Level 3 |
| Impaired loans    | \$5,051  | \$—                     | \$5,051  | \$—     |
| Other real estate | 4,234  | —                       | 4,234    | —       |

## Limitations

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

be determined with precision. Changes in assumptions could significantly affect the estimates.

Table of Contents

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

The carrying amounts and estimated fair values of the Company's financial instruments are as follows at September 30, 2015 and December 31, 2014 (in thousands):

|  | Carrying Value | Fair Value Measurements at September 30, 2015 Using: |         |           |
|--|----------------|--|---------|-----------|
|  |                | Level 1  | Level 2 | Level 3   |
| Financial assets:  |                |  |         |           |
| Cash and due from banks, interest-bearing deposits in banks and federal funds sold | \$125,437      | \$125,437  | \$—     | \$—       |
| Securities available-for-sale  | 285,485        | 2,116  | 283,369 | —         |
| Securities held-to-maturity  | 121,043        | —  | 122,488 | —         |
| Other investments  | 12,063         | 12,063   | —       | —         |
| Loans, net   | 1,282,513      | —  | 14,966  | 1,282,506 |
| Cash surrender value of life insurance policies                                    | 13,548         | —  | 13,548  | —         |
| Financial liabilities:   |                |  |         |           |
| Non-interest-bearing deposits  | 406,118        | —  | 406,118 | —         |
| Interest-bearing deposits  | 1,137,303      | —  | 918,792 | 218,328   |
| Securities sold under agreements to repurchase                                     | 92,085         | 92,085   | —       | —         |
| Short-term Federal Home Loan Bank advances   | 70,000         | —  | 70,000  | —         |
| Long-term Federal Home Loan Bank advances  | 25,958         | —  | —       | 26,956    |
| Junior subordinated debentures   | 22,167         | —  | 22,167  | —         |
|  |                |  |         |           |
|  | Carrying Value | Fair Value Measurements at December 31, 2014 Using:  |         |           |
|  |                | Level 1  | Level 2 | Level 3   |
| Financial assets:  |                |  |         |           |
| Cash and due from banks, interest-bearing deposits in banks and federal funds sold | \$86,872       | \$86,872   | \$—     | \$—       |
| Securities available-for-sale  | 276,984        | 2,104  | 274,880 | —         |
| Securities held-to-maturity  | 141,201        | —  | 141,593 | —         |
| Other investments  | 9,990          | 9,990  | —       | —         |
| Loans, net   | 1,273,205      | —  | 5,051   | 1,277,882 |
| Cash surrender value of life insurance policies                                    | 13,659         | —  | 13,659  | —         |
| Financial liabilities:   |                |  |         |           |
| Non-interest-bearing deposits  | 390,863        | —  | 390,863 | —         |
| Interest-bearing deposits  | 1,194,371      | —  | 943,255 | 251,291   |
| Securities sold under agreements to repurchase                                     | 62,098         | 62,098   | —       | —         |
| Short-term Federal Home Loan Bank advances   | 25,000         | —  | 25,000  | —         |
| Long-term Federal Home Loan Bank advances  | 26,277         | —  | —       | 27,193    |
| Junior subordinated debentures   | 22,167         | —  | 22,167  | —         |



## Table of Contents

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

MidSouth Bancorp, Inc. (the "Company") is a financial holding company headquartered in Lafayette, Louisiana that conducts substantially all of its business through its wholly owned subsidiary bank, MidSouth Bank, N.A. (the "Bank"). We offer complete banking services to commercial and retail customers in Louisiana and south and central Texas with 58 locations and are connected to a worldwide ATM network that provides customers with access to more than 55,000 surcharge-free ATMs. We are community oriented and focus primarily on offering commercial and consumer loan and deposit services to individuals, small businesses, and middle market businesses.

The following discussion and analysis identifies significant factors that have affected our financial position and operating results during the periods included in the financial statements accompanying this report. We encourage you to read this discussion in conjunction with our consolidated financial statements and the notes thereto presented herein and with the financial statements, the notes thereto, and related Management's Discussion and Analysis of Financial Condition and Results of Operation in the Company's Annual Report on Form 10-K for the year ended December 31, 2014.

#### Forward-Looking Statements

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

The words "anticipate," "believe," "estimate," "expect," "intend," "may," "plan," "will," "would," "could," "should," "guidance," "continue," "project," "forecast," "confident," and similar expressions are typically used to identify forward-looking statements. These statements are based on assumptions and assessments made by management in light of their experience and their perception of historical trends, current conditions, expected future developments and other factors they believe to be appropriate. Any forward-looking statements are not guarantees of our future performance and are subject to risks and uncertainties and may be affected by various factors that may cause actual results, developments and business decisions to differ materially from those in the forward-looking statements. Some of the factors that may cause actual results, developments and business decisions to differ materially from those contemplated by such forward-looking statements include the factors discussed under the caption "Risk Factors" in our 2014 Annual Report on form 10-K and under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this Report and the following:

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

the timing, ability to complete and the impact of proposed and/or future efficiency initiatives;

the ability to acquire, operate, and maintain effective and efficient operating systems;

increased asset levels and changes in the composition of assets that would impact capital levels and regulatory capital ratios;

loss of critical personnel and the challenge of hiring qualified personnel at reasonable compensation levels;

legislative and regulatory changes, including the changes in the regulatory capital framework under the Federal Reserve Board's Basel III regulatory capital reforms, the impact of regulations under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"), including the implementation of the Consumer Financial Protection Bureau, and other changes in banking, securities and tax laws and regulations and their application by our regulators, changes in the scope and cost of Federal Deposit Insurance Corporation ("FDIC") insurance and other coverage;

## Table of Contents

regulations and restrictions resulting from our participation in government sponsored programs such as the U.S. Treasury's Small Business Lending Fund, including potential retroactive changes in such programs; changes in accounting principles, policies, and guidelines applicable to financial holding companies and banking; acts of war, terrorism, cyber intrusion, weather, or other catastrophic events beyond our control; and the ability to manage the risks involved in the foregoing.

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

### Critical Accounting Policies

Certain critical accounting policies affect the more significant judgments and estimates used in the preparation of the consolidated financial statements. Our significant accounting policies are described in the notes to the consolidated financial statements included in this report. The accounting principles we follow and the methods of applying these principles conform to accounting principles generally accepted in the United States of America ("GAAP") and general banking practices. Our most critical accounting policy relates to the determination of the allowance for loan losses, which reflects the estimated losses resulting from the inability of its borrowers to make loan payments. The determination of the adequacy of the allowance involves significant judgment and complexity and is based on many factors. If the financial condition of our borrowers were to deteriorate, resulting in an impairment of their ability to make payments, the estimates would be updated and additional provisions for loan losses may be required. See Asset Quality – Nonperforming Assets and Allowance for Loan Losses and Note 1 and Note 3 of the footnotes to the consolidated financial statements.

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

A third critical accounting policy relates to deferred tax assets and liabilities. We record deferred tax assets and deferred tax liabilities for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Future tax benefits, such as net operating loss carry forwards, are recognized to the extent that realization of such benefits is more likely than not. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which the assets and liabilities are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income tax expense in the period that includes the enactment date. In the event the future tax consequences of differences between the financial reporting bases and the tax bases of our assets and liabilities results in deferred tax assets, an evaluation of the probability of being able to realize the future benefits indicated by such assets is required. A valuation allowance is provided when it is more likely than not that a portion



or the full amount of the deferred tax asset will not be realized. In assessing the ability to realize the deferred tax assets, management considers the scheduled reversals of deferred tax liabilities, projected future taxable income, and tax planning strategies. A deferred tax liability is not recognized for portions of the allowance for loan losses for income tax purposes in excess of the financial statement balance. Such a deferred tax liability will only be recognized when it becomes apparent that those temporary differences will reverse in the foreseeable future. A tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% more likely of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded.

#### Results of Operations

30

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Table of Contents

## Earnings Analysis

We reported net earnings available to common shareholders of \$2.4 million for the third quarter of 2015, compared to net earnings available to common shareholders of \$4.3 million reported for the third quarter of 2014. Diluted earnings for the third quarter of 2015 were \$0.21 per common share, compared to \$0.37 per common share reported for the third quarter of 2014. The third quarter of 2014 included efficiency consultant expenses of \$200,000, \$394,000 of losses on disposal of fixed assets, a \$258,000 loss on redemption of Trust Preferred Securities and a \$1.1 million gain on the sale of a commercial property held as ORE. Excluding these non-operating income and expenses, operating earnings per share for the third quarter of 2014 was \$0.36.

Operating revenues from consolidated operations decreased \$646,000 in quarterly comparison. Net interest income decreased \$371,000 in quarterly comparison primarily due to a \$281,000 decrease in interest income earned on loans and a \$231,000 decrease in interest income on investment securities which declined in volume. The decrease in interest income on loans and investment securities was partially offset by a \$177,000 decrease in interest expense on junior subordinated debentures. Excluding non-operating income of \$1.1 million for the third quarter of 2014, noninterest income decreased \$275,000 in quarterly comparison, from \$5.1 million for the three months ended September 30, 2014 to \$4.8 million for the three months ended September 30, 2015. The decrease in noninterest income resulted primarily from a \$325,000 reduction in service charges on deposit accounts, including NSF fees.

Excluding non-operating expenses of \$852,000 in the third quarter of 2014, noninterest expenses decreased \$441,000 in quarterly comparison. A decrease of \$634,000 in salaries and benefits costs was partially offset by increases of \$122,000 in FDIC premiums and \$73,000 in expenses on ORE and other repossessed assets. The provision for loan losses increased \$2.6 million in quarterly comparison primarily due to increases in classified assets and specific reserves on impaired loans. Income tax expense decreased \$1.2 million in quarterly comparison.

Dividends paid on the Series B Preferred Stock issued to the Treasury resulting from our participation in the Small Business Lending Fund (“SBLF”) totaled \$80,000 for the third quarter of 2015 based on a dividend rate of 1.00%. The dividend rate is set at 1.00% through February 25, 2016. The Series C Preferred Stock issued with the December 28, 2012 acquisition of PSB Financial Corporation (“PSB”) paid dividends totaling \$92,000 for the three months ended September 30, 2015.

In year-over-year comparison, net earnings available to common shareholders decreased \$6.3 million, from \$14.9 million at September 30, 2014 to \$8.7 million at September 30, 2015. The decrease resulted primarily from a \$8.0 million increase in the provision for loan losses. The first nine months of 2014 included \$3.0 million of executive officer life insurance proceeds, \$1.1 million in gain on sale of ORE, \$128,000 in gain on sales of securities, \$360,000 of efficiency consultant expenses, \$189,000 of expenses related to the loss of an executive officer, \$394,000 in losses on disposal of fixed assets and a \$258,000 loss on redemption of Trust Preferred Securities. The first nine months of 2015 included \$1.2 million in gain on sales of securities and \$160,000 of income from a death benefit on bank owned life insurance. Excluding these non-operating revenues and expenses, net earnings available to common shareholders decreased \$4.3 million in year-over-year comparison. In addition to the increase in loan loss provision, a decrease of \$595,000 in noninterest income contributed to the decrease in operating earnings. The increase in the provision for loan losses and the decrease in noninterest income were partially offset by a \$259,000 increase in net interest income, a \$1.6 million decrease in operating noninterest expenses and a \$2.3 million decrease in income tax expense.

Excluding non-operating income, decreases in noninterest income consisted primarily of \$897,000 in service charges on deposit accounts (primarily NSF fees), which was partially offset by a \$154,000 increase in ATM and debit card income and a \$235,000 increase in mortgage banking fees. Excluding the non-operating expenses in 2014, decreases in noninterest expense primarily included \$1.7 million in salaries and benefits costs, \$173,000 in credit reporting expense and \$126,000 in the cost of printing and supplies. The decreased expenses were partially offset by a \$156,000

increase in legal and professional fees and a \$221,000 increase in FDIC premiums.

#### Net Interest Income

Our primary source of earnings is net interest income, which is the difference between interest earned on loans and investments and interest paid on deposits and other interest-bearing liabilities. Changes in the volume and mix of earning assets and interest-bearing liabilities combined with changes in market rates of interest greatly affect net interest income. Our net interest margin on a taxable equivalent basis, which is net interest income as a percentage of average earning assets, was 4.34% and 4.61% for the three months ended September 30, 2015 and 2014, respectively. Tables 1 and 3 and tables 2 and 4 below analyze the changes in net interest income in the three months ended September 30, 2015 and 2014 and the nine months ended September 30, 2015 and 2014, respectively.

Table of Contents

Fully taxable-equivalent (“FTE”) net interest income totaled \$19.4 million and \$19.9 million for the quarters ended September 30, 2015 and 2014, respectively. The FTE net interest income decreased \$433,000 in prior year quarterly comparison primarily due to a \$281,000 decrease in interest income on loans. Despite a \$53.8 million increase in the average volume on loans, interest income on loans decreased due to a decrease in the average yield on loans of 33 basis points, from 5.88% to 5.55%. The purchase accounting adjustments added 20 basis points to the average yield on loans for the third quarter of 2015 and 22 basis points to the average yield on loans for the third quarter of 2014. Excluding the impact of the purchase accounting adjustments, average loan yields declined 31 basis points in prior year quarterly comparison, from 5.66% to 5.35%. Loan yields have declined primarily as the result of a sustained low interest rate environment.

Investment securities totaled \$406.5 million, or 20.6% of total assets at September 30, 2015, versus \$433.4 million, or 22.9% of total assets at September 30, 2014. The investment portfolio had an effective duration of 3.5 years and a net unrealized gain of \$3.6 million at September 30, 2015. The average volume of investment securities decreased \$23.5 million in prior year quarterly comparison. The average tax equivalent yield on investment securities decreased 13 basis points, from 2.70% to 2.57%. The \$23.5 million decrease in the average volume of investment securities was used to fund loan growth during the same period.

The average yield on all earning assets decreased 31 basis points in prior year quarterly comparison, from 4.96% for the third quarter of 2014 to 4.65% for the third quarter of 2015. Excluding the impact of purchase accounting adjustments, the average yield on total earning assets decreased 29 basis points, from 4.80% to 4.51% for the three month periods ended September 30, 2014 and 2015, respectively, primarily due to the decline in the average rate earned on loans and investment securities.

The impact to interest expense of a \$34.0 million increase in the average volume of interest-bearing liabilities was offset by a 4 basis point decrease in the average rate paid on interest-bearing liabilities, from 0.46% at September 30, 2014 to 0.42% at September 30, 2015. Excluding purchase accounting adjustments on acquired certificates of deposit and FHLB borrowings, the average rate paid on interest-bearing liabilities was 0.51% for the third quarter of 2014 and declined to 0.45% for the third quarter of 2015.

The average volume of notes payable for the three months ended September 30, 2015 of \$26.0 million consisted of long-term FHLB advances. The average volume of notes payable of \$26.6 million for the three months ended September 30, 2014 consisted of long-term FHLB advances and a note payable with First National Bankers Bank. The FHLB advances are fixed rate advances with rates ranging from 1.99% to 5.06% and have a range of maturities from October 2015 to January 2019. The FHLB advances are collateralized by a blanket lien on first mortgages and other qualifying loans. The note payable with First National Bankers Bank was paid off in the third quarter of 2014. The interest rate on the note was equal to New York Prime. Short-term FHLB advances totaled \$70.0 million at September 30, 2015. The advances mature in October 2015 and January 2016 and bear interest rates ranging from 0.10% to 0.30%.

As a result of these changes in volume and yield on earning assets and interest-bearing liabilities, the FTE net interest margin decreased 27 basis points, from 4.61% for the third quarter of 2014 to 4.34% for the third quarter of 2015. Excluding purchase accounting adjustments on loans, deposits and FHLB borrowings, the FTE margin decreased 25 basis points, from 4.42% for the third quarter of 2014 to 4.17% for the third quarter of 2015.

In year-to-date comparison, FTE net interest income increased \$89,000. Interest income on loans increased \$789,000 despite an \$803,000 reduction in purchase accounting adjustments on acquired loans. The average volume of loans increased \$103.5 million in year-over-year comparison, and the average yield on loans decreased 40 basis points, from 5.99% to 5.59%. The increase in interest income on loans was offset by a \$1.0 reduction in interest income on

investment securities. The average volume of investment securities decreased \$47.5 million in year-over-year comparison, as cash flows from the portfolio were used to fund loan growth. The average yield on total earning assets decreased in year-over-year comparison, from 4.97% at September 30, 2014 to 4.70% at September 30, 2015. The purchase accounting adjustments added 29 basis points to the average yield on loans for the nine months ended September 30, 2014 and 17 basis points for the nine months ended September 30, 2015. Excluding purchase accounting adjustments, the average yield on earning assets decreased 19 basis points, from 4.77% at September 30, 2014 to 4.58% at September 30, 2015.

Interest expense decreased \$258,000 in year-over-year comparison primarily due to the redemption of \$7.2 million of the Company's Statutory Trust 1 and Capital Securities in the third quarter of 2014 that resulted in a decrease in the volume of junior subordinated debentures and the average rate paid on the debentures. The average rate paid on total interest-bearing liabilities decreased 5 basis points, from 0.47% at September 30, 2014 to 0.42% at September 30, 2015. Excluding purchase accounting adjustments, the average rate paid on interest-bearing liabilities decreased 6 basis points, from 0.52% at September

Table of Contents

30, 2014 to 0.46% at September 30, 2015. The FTE net interest margin decreased 24 basis points, from 4.62% for the nine months ended September 30, 2014 to 4.38% for the nine months ended September 30, 2015. Excluding purchase accounting adjustments, the FTE net interest margin decreased 14 basis points, from 4.38% to 4.24% for the nine months ended September 30, 2014 and 2015, respectively, primarily due to a decline in the average rate earned on loans.

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

|  | Three Months Ended September 30,<br>2015 |          |                       | 2014              |          |                       |   |  |
|--|--|----------|-----------------------|-------------------|----------|-----------------------|---|--|
|  | Average<br>Volume                        | Interest | Average<br>Yield/Rate | Average<br>Volume | Interest | Average<br>Yield/Rate |   |  |
| Assets   |  |          |                       |                   |          |                       |   |  |
| Investment securities <sup>1</sup>                   |  |          |                       |                   |          |                       |   |  |
| Taxable  | \$341,192                                | \$1,850  | 2.17                  | % \$351,645       | \$1,965  | 2.24                  | % |  |
| Tax exempt <sup>2</sup>                              | 73,523                                   | 818      | 4.45                  | % 86,528          | 996      | 4.60                  | % |  |
| Total investment securities                          | 414,715                                  | 2,668    | 2.57                  | % 438,173         | 2,961    | 2.70                  | % |  |
| Federal funds sold                                   | 3,349                                    | 1        | 0.12                  | % 3,143           | 2        | 0.25                  | % |  |
| Time and interest bearing<br>deposits in other banks | 62,086                                   | 40       | 0.25                  | % 22,922          | 15       | 0.26                  | % |  |
| Other investments                                    | 10,508                                   | 113      | 4.30                  | % 12,090          | 109      | 3.61                  | % |  |
| Total loans <sup>3</sup>                             | 1,285,991                                | 17,992   | 5.55                  | % 1,232,196       | 18,273   | 5.88                  | % |  |
| Total earning assets                                 | 1,776,649                                | 20,814   | 4.65                  | % 1,708,524       | 21,360   | 4.96                  | % |  |
| Allowance for loan losses                            | (15,853 )                                |          |                       | (8,978 )          |          |                       |   |  |
| Nonearning assets                                    | 188,556                                  |          |                       | 193,063           |          |                       |   |  |
| Total assets   | \$1,949,352                              |          |                       | \$1,892,609       |          |                       |   |  |
| Liabilities and shareholders'<br>equity              |  |          |                       |                   |          |                       |   |  |
| Total interest bearing deposits                      | \$1,150,190                              | \$883    | 0.30                  | % \$1,132,132     | \$859    | 0.30                  | % |  |
| Securities sold under<br>repurchase agreements       | 89,025                                   | 249      | 1.11                  | % 70,587          | 210      | 1.18                  | % |  |
| Federal funds purchased                              | —  | —        | —                     | 70                | —        | —                     | % |  |
| Short-term FHLB advances                             | 31,196                                   | 16       | 0.20                  | % 28,913          | 13       | 0.18                  | % |  |
| Notes payable  | 26,007                                   | 93       | 1.40                  | % 26,640          | 95       | 1.40                  | % |  |
| Junior subordinated debentures                       | 22,167                                   | 150      | 2.65                  | % 26,247          | 327      | 4.88                  | % |  |
| Total interest bearing liabilities                   | 1,318,585                                | 1,391    | 0.42                  | % 1,284,589       | 1,504    | 0.46                  | % |  |
| Demand deposits                                      | 409,118                                  |          |                       | 392,927           |          |                       |   |  |
| Other liabilities                                    | 7,026                                    |          |                       | 9,802             |          |                       |   |  |
| Shareholders' equity                                 | 214,623                                  |          |                       | 205,291           |          |                       |   |  |
| Total liabilities and<br>shareholders' equity        | \$1,949,352                              |          |                       | \$1,892,609       |          |                       |   |  |
| Net interest income and net<br>interest spread       |  | \$19,423 | 4.23                  | %                 | \$19,856 | 4.50                  | % |  |
| Net interest margin                                  |  |          | 4.34                  | %                 |          | 4.61                  | % |  |

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

Table of Contents

2. Interest income of \$282,000 for 2015 and \$344,000 for 2014 is added to interest earned on tax-exempt obligations to reflect tax equivalent yields using a tax rate of 35%.
3. Interest income includes loan fees of \$1,394,000 for 2015 and \$1,580,000 for 2014. Nonaccrual loans are included in average balances and income on such loans is recognized on a cash basis.

Table 2

## Consolidated Average Balances, Interest and Rates

(in thousands)

|  | Nine Months Ended September 30,<br>2015 |           |                       | 2014              |           |                       |   |  |
|--|---|-----------|-----------------------|-------------------|-----------|-----------------------|---|--|
|  | Average<br>Volume                       | Interest  | Average<br>Yield/Rate | Average<br>Volume | Interest  | Average<br>Yield/Rate |   |  |
| <b>Assets</b>  |   |           |                       |                   |           |                       |   |  |
| Investment securities <sup>1</sup>                     |   |           |                       |                   |           |                       |   |  |
| Taxable  | \$ 340,898                              | \$ 5,628  | 2.20                  | % \$ 375,969      | \$ 6,164  | 2.19                  | % |  |
| Tax exempt <sup>2</sup>                                | 76,281                                  | 2,564     | 4.48                  | % 88,742          | 3,062     | 4.60                  | % |  |
| Total investment securities                            | 417,179                                 | 8,192     | 2.62                  | % 464,711         | 9,226     | 2.65                  | % |  |
| Federal funds sold                                     | 3,463                                   | 5         | 0.19                  | % 2,775           | 4         | 0.19                  | % |  |
| Time and interest bearing<br>deposits in other banks   | 59,151                                  | 112       | 0.25                  | % 21,857          | 42        | 0.25                  | % |  |
| Other investments                                      | 10,109                                  | 273       | 3.60                  | % 11,767          | 268       | 3.04                  | % |  |
| Total loans <sup>3</sup>                               | 1,298,844                               | 54,314    | 5.59                  | % 1,195,357       | 53,525    | 5.99                  | % |  |
| Total earning assets                                   | 1,788,746                               | 62,896    | 4.70                  | % 1,696,467       | 63,065    | 4.97                  | % |  |
| Allowance for loan losses                              | (14,176 )                               |           |                       | (8,734 )          |           |                       |   |  |
| Nonearning assets                                      | 189,244                                 |           |                       | 192,087           |           |                       |   |  |
| Total assets   | \$ 1,963,814                            |           |                       | \$ 1,879,820      |           |                       |   |  |
| <b>Liabilities and shareholders'<br/>equity</b>        |   |           |                       |                   |           |                       |   |  |
| Total interest bearing deposits                        | \$ 1,174,399                            | \$ 2,751  | 0.31                  | % \$ 1,147,843    | \$ 2,588  | 0.30                  | % |  |
| Securities sold under<br>repurchase agreements         | 84,434                                  | 721       | 1.14                  | % 60,522          | 588       | 1.30                  | % |  |
| Federal funds purchased                                | —                                       | —         | —                     | 305               | 2         | 0.86                  | % |  |
| Short-term FHLB advances                               | 28,956                                  | 37        | 0.17                  | % 26,356          | 31        | 0.16                  | % |  |
| Notes payable  | 26,113                                  | 272       | 1.37                  | % 26,540          | 272       | 1.35                  | % |  |
| Other borrowings/payables                              | —                                       | —         | —                     | % 602             | 15        | 3.29                  | % |  |
| Junior subordinated debentures                         | 22,167                                  | 451       | 2.68                  | % 28,327          | 994       | 4.63                  | % |  |
| Total interest bearing liabilities                     | 1,336,069                               | 4,232     | 0.42                  | % 1,290,495       | 4,490     | 0.47                  | % |  |
| Demand deposits  | 407,077                                 |           |                       | 380,590           |           |                       |   |  |
| Other liabilities                                      | 7,752                                   |           |                       | 8,188             |           |                       |   |  |
| Shareholders' equity                                   | 212,916                                 |           |                       | 200,547           |           |                       |   |  |
| Total liabilities and<br>shareholders' equity          | \$ 1,963,814                            |           |                       | \$ 1,879,820      |           |                       |   |  |
| <b>Net interest income and net<br/>interest spread</b> |   |           |                       |                   |           |                       |   |  |
|  |   | \$ 58,664 | 4.28                  | %                 | \$ 58,575 | 4.50                  | % |  |
| <b>Net interest margin</b>                             |   |           |                       |                   |           |                       |   |  |
|  |   |           | 4.38                  | %                 |           | 4.62                  | % |  |



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

Table of Contents

2. Interest income of \$885,000 for 2015 and \$1,055,000 for 2014 is added to interest earned on tax-exempt obligations to reflect tax equivalent yields using a tax rate of 35%.
3. Interest income includes loan fees of \$3,945,000 for 2015 and \$4,322,000 for 2014. Nonaccrual loans are included in average balances and income on such loans is recognized on a cash basis.

Table 3

Changes in Taxable-Equivalent Net Interest Income  
(in thousands)

|   | Three Months Ended                                   |                 |          |
|---|--|-----------------|----------|
|   | September 30, 2015 compared to<br>September 30, 2014 |                 |          |
|   | Total  | Change          |          |
|   | Increase   | Attributable To |          |
|   | (Decrease)   | Volume          | Rates    |
| Taxable-equivalent earned on:                     |  |                 |          |
| Investment securities                             |  |                 |          |
| Taxable   | \$(115 )   | \$(58 )         | \$(57 )  |
| Tax exempt  | (178 )   | (146 )          | (32 )    |
| Federal funds sold                                | (1 )   | —               | (1 )     |
| Time and interest bearing deposits in other banks | 25   | 25              | —        |
| Other investments                                 | 4  | (15 )           | 19       |
| Loans, including fees                             | (281 )   | 778             | (1,059 ) |
| Total   | (546 )   | 584             | (1,130 ) |
| Interest paid on:                                 |  |                 |          |
| Interest bearing deposits                         | 24   | 14              | 10       |
| Securities sold under repurchase agreements       | 39   | 53              | (14 )    |
| Federal funds purchased                           | —  | —               | —        |
| Short-term FHLB advances                          | 3  | 1               | 2        |
| Notes payable                                     | (2 )   | (2 )            | —        |
| Junior subordinated debentures                    | (177 )   | (44 )           | (133 )   |
| Total   | (113 )   | 22              | (135 )   |
| Taxable-equivalent net interest income            | \$(433 )   | \$562           | \$(995 ) |

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

Table of Contents

Table 4  
Changes in Taxable-Equivalent Net Interest Income  
(in thousands)

|   | Nine Months Ended<br>September 30, 2015 compared to<br>September 30, 2014 |                                     |            |
|---|---|-------------------------------------|------------|
|   | Total<br>Increase<br>(Decrease)   | Change<br>Attributable To<br>Volume | Rates      |
| Taxable-equivalent earned on:                     |   |                                     |            |
| Investment securities                             |   |                                     |            |
| Taxable   | \$(536 )  | \$(579 )                            | \$43 )     |
| Tax exempt  | (498 )  | (421 )                              | (77 )      |
| Federal funds sold                                | 1   | 1                                   | —          |
| Time and interest bearing deposits in other banks | 70  | 71                                  | (1 )       |
| Other investments                                 | 5   | (41 )                               | 46 )       |
| Loans, including fees                             | 789   | 4,460                               | (3,671 )   |
| Total   | (169 )  | 3,491                               | (3,660 )   |
| Interest paid on:                                 |   |                                     |            |
| Interest bearing deposits                         |   |                                     |            |
| Securities sold under repurchase agreements       | 133   | 210                                 | (77 )      |
| Federal funds purchased                           | (2 )  | (2 )                                | —          |
| Short-term FHLB advances                          | 6   | 4                                   | 2          |
| Notes payable                                     | —   | (2 )                                | 2 )        |
| Other borrowings/payables                         | (15 )   | (15 )                               | —          |
| Junior subordinated debentures                    | (543 )  | (182 )                              | (361 )     |
| Total   | (258 )  | 74                                  | (332 )     |
| Taxable-equivalent net interest income            | \$89  | \$3,417                             | \$(3,328 ) |

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

## Non-interest Income

Non-interest income decreased \$1.4 million in quarterly comparison, from \$6.2 million for the three months ended September 30, 2014 to \$4.8 million for the three months ended September 30, 2015. The third quarter of 2014 included a \$1.1 million gain on the sale of a commercial property held as ORE. Excluding this non-operating item, noninterest income decreased \$275,000 in quarterly comparison. The decrease in noninterest income resulted primarily from a \$325,000 reduction in service charges on deposit accounts. For the nine-month period ended September 30, 2015, non-interest income totaled \$16.0 million compared to \$19.4 million for the nine months ended September 30, 2014, a net decrease of \$3.4 million year-over-year. The first nine months of 2015 included \$1.2 million of gain on sales of securities and \$160,000 of income recognized from a death benefit on bank owned life insurance recorded in non-interest income. The first nine months of 2014 included \$3.0 million of executive officer life insurance proceeds and a \$1.1 million gain on the sale of ORE. Excluding non-operating income, decreases in noninterest income consisted primarily of \$897,000 in service charges on deposit accounts, which was partially offset by a \$154,000 increase in ATM and debit card income and a \$235,000 increase in mortgage banking fees.

The decreases in service charges on deposit accounts of \$325,000 in quarterly comparison and \$897,000 in year-over-year comparison resulted primarily from a declining trend in the volume of NSF transactions. The \$154,000

increase in ATM and debit card income in year-over-year comparison is primarily due to an increase in interchange fee income as a result of higher transaction volume.

Mortgage banking fees increased \$235,000 for the first nine months of 2015 compared to the first nine months of 2014. In January 2014, we restructured our mortgage lending department and as a result were able to offer more competitive mortgage loan products to our customers and generate more volume in correspondent and brokered mortgage loans.

Table of Contents

## Non-interest Expense

Third quarter 2015 noninterest expenses decreased \$1.3 million compared to third quarter 2014. The second quarter of 2014 included efficiency consultant expenses of \$200,000, \$394,000 of losses on disposal of fixed assets and a \$258,000 loss on redemption of Trust Preferred Securities. Excluding these non-operating items, noninterest expenses decreased \$441,000 in quarterly comparison. A decrease of \$634,000 in salaries and benefits costs was partially offset by increases of \$122,000 in FDIC premiums and \$73,000 in expenses on ORE and other repossessed assets.

Noninterest expense decreased \$2.8 million in year-to-date comparison, from \$52.7 for the nine months ended September 30, 2014 to \$49.9 million for the nine months ended September 30, 2015. The first nine months of 2014 included \$1.2 million of non-operating expenses. In addition to the \$852,000 of non-operating expenses recorded in the third quarter of 2014 as described above, 2014 non-operating costs included \$160,000 in additional efficiency consultant expenses and \$189,000 in expenses associated with the death of an executive officer. Excluding the non-operating expenses in 2014, decreases in noninterest expense primarily included \$1.7 million in salaries and benefits costs, \$173,000 in credit reporting expense and \$126,000 in the cost of printing and supplies. The decreased expenses were partially offset by a \$156,000 increase in legal and professional fees and a \$221,000 increase in FDIC premiums.

A reduction in the number of full-time equivalent (“FTE”) employees from 560 FTE employees at September 30, 2014 to 535 FTE employees at September 30, 2015 reduced salaries expense by \$1.1 million year-over-year, which included a \$450,000 reduction in annual incentive compensation accruals. The 25 FTE employee decrease was achieved primarily through attrition and process improvement initiatives over the twelve month period. The \$1.7 million decrease in salaries and benefits costs also included a \$625,000 decrease in group health costs.

## Analysis of Balance Sheet

Total consolidated assets at September 30, 2015 and December 31, 2014 were \$2.0 billion and \$1.9 billion, respectively. Deposits totaled \$1.5 billion at September 30, 2015 and December 31, 2014. Our stable core deposit base, which excludes time deposits, decreased \$10.4 million and accounted for 85.7% of deposits at September 30, 2015 compared to 84.1% of deposits at year end 2014.

Securities available-for-sale totaled \$285.5 million at September 30, 2015, an increase of \$8.5 million from \$277.0 million at December 31, 2014. The securities available-for-sale portfolio increased primarily due to \$105.5 million in purchases of securities, which were offset by \$55.9 million in calls, maturities and pay-downs and \$40.3 million in sales of securities. During the nine months ended September 30, 2015, we sold lower yielding asset backed securities and US Government sponsored enterprises securities and reinvested those funds primarily in higher yielding CMOs. Securities held-to-maturity decreased \$20.2 million, from \$141.2 million at December 31, 2014 to \$121.0 million at September 30, 2015. The investment securities portfolio had an effective duration of 3.5 years and a net unrealized gain of \$3.6 million at September 30, 2015.

Total loans grew \$17.0 million, or 1.3% for the nine months ended September 30, 2015. The first nine months of 2015 included a \$10.8 million decline in the balance of loans in the indirect auto loan program, which the Bank exited at the end of 2014. Net of the decrease in the indirect auto loan program and excluding a CD secured loan of \$20.0 million, loans increased \$7.8 million, or 0.6% for the nine months ended September 30, 2015.

Table of Contents

Table 5  
Composition of Loans  
(in thousands)

|   | September 30,<br>2015 | December 31,<br>2014 |
|---|-----------------------|----------------------|
| Commercial, financial, and agricultural (C&I) | \$482,452             | \$467,147            |
| Real estate – construction                    | 74,279                | 68,577               |
| Real estate – commercial (CRE)                | 473,319               | 467,172              |
| Real estate – residential                     | 151,667               | 154,602              |
| Installment loans to individuals              | 113,199               | 119,328              |
| Lease financing receivable                    | 4,790                 | 4,857                |
| Other   | 1,746                 | 2,748                |
|   | \$1,301,452           | \$1,284,431          |
| Less allowance for loan losses                | (18,939)              | (11,226)             |
| Net loans                                     | \$1,282,513           | \$1,273,205          |

Our energy-related loan portfolio at September 30, 2015 totaled \$295.6 million, or 22.7% of total loans, including a \$20.0 million CD secured loan, up from \$266.4 million at June 30, 2015. The majority of MidSouth's energy lending is focused on oil field service companies. Of the 442 total relationships in our energy-related loan portfolio, 18 relationships totaling \$41.2 million were classified, with \$29.1 million on nonaccrual status at September 30, 2015. Substantial paydown activity after September 30, 2015 reduced the energy-related loan portfolio by approximately \$35.8 million.

At September 30, 2015, reserves for potential energy-related loan losses approximated 2.4% of energy loans. Included in the 2.4% is 0.4% reserved for potential yet unidentified losses in the energy-related portfolio. During the second quarter of 2015, one energy-related credit relationship totaling \$21.4 million was classified as a troubled debt restructuring ("TDR") by conversion of the loans to interest only for a limited amount of time. The TDR defaulted on its restructured terms during the third quarter of 2015 and was subsequently placed on nonaccrual.

Within the \$473.3 million commercial real estate portfolio, \$440.8 million is secured by commercial property, \$16.4 million is secured by multi-family property, and \$16.1 million is secured by farmland. Of the \$440.8 million secured by commercial property, \$252.3 million, or 57.2%, is owner-occupied. Of the \$151.7 million residential real estate portfolio, 87.7% represented loans secured by first liens.

#### Off-Balance Sheet Arrangements

In the normal course of operations, the Company engages in a variety of financial transactions that, in accordance with GAAP, are not recorded in the financial statements. These transactions involve, to varying degrees, elements of credit, interest rate, and liquidity risk. Such transactions are used primarily to manage customers' requests for funding and take the form of loan commitments, letters of credit and lines of credit. For the period ended September 30, 2015, we did not engage in any off-balance sheet transactions reasonably likely to have a material impact on our financial condition, results of operations, or cash flows.

#### Liquidity and Capital

##### Bank Liquidity

Liquidity is the availability of funds to meet maturing contractual obligations and to fund operations. The Bank's primary liquidity needs involve its ability to accommodate customers' demands for deposit withdrawals as well as

customers' requests for credit. Liquidity is deemed adequate when sufficient cash to meet these needs can be promptly raised at a reasonable cost to the Bank.

Liquidity is provided primarily by three sources: a stable base of funding sources, an adequate level of assets that can be readily converted into cash, and borrowing lines with correspondent banks. Although the Bank historically has not utilized brokered deposits, this is a fourth potential source of liquidity, albeit one that is more costly and volatile. Our core deposits are our most stable and important source of funding. Cash deposits at other banks, federal funds sold, and principal payments received on loans and mortgage-backed securities provide additional primary sources of liquidity. Approximately \$17.1 million in projected cash flows from securities repayments for the remainder of 2015 provides an additional source of liquidity.

## Table of Contents

The Bank also has significant borrowing capacity with the FRB-Atlanta and with the FHLB-Dallas. As of September 30, 2015, we had no borrowings with the FRB-Atlanta. Long-term FHLB-Dallas advances totaled \$26.0 million at September 30, 2015 and are fixed rate advances with rates ranging from 1.99% to 5.06% and have a range of maturities from October 2015 to January 2019. Two short-term FHLB-Dallas advances totaled \$70.0 million at September 30, 2015. The advances mature in October 2015 and January 2016 and bear interest rates ranging from 0.10% to 0.30%. Under existing agreements with the FHLB-Dallas, our borrowing capacity totaled \$289.5 million at September 30, 2015. The Bank has the ability to post additional collateral of approximately \$118.5 million if necessary to meet liquidity needs. Additionally, \$240.2 million in loan collateral is pledged under a Borrower-in-Custody line with the FRB-Atlanta. Unsecured borrowing lines totaling \$33.5 million are available through correspondent banks. We utilize these contingency funding alternatives to meet deposit volatility, which is more likely in the current environment, given unusual competitive offerings within our markets.

## Company Liquidity

At the Company level, cash is needed primarily to meet interest payments on the junior subordinated debentures, dividends on our common stock and dividend payments on the Series B and Series C Preferred Stocks. The dividend rate on the \$32.0 million of Series B Preferred Stock issued to the U.S. Treasury for participation in the Small Business Lending Fund ("SBLF") was 1.00% for the three month periods ended September 30, 2015 and December 31, 2014. The dividend rate was set at 1.00% for the fourth quarter of 2013 due to attaining the target 10% growth rate in qualified small business loans during the second quarter of 2013. Beginning February 2016, the dividend rate will increase to 9% per annum. Management is reviewing options to repay all or a portion on the \$32.0 million prior to the rate reset.

On December 28, 2012, the Company issued 756,511 shares of common stock and 99,971 shares of Series C Preferred Stock in connection with the PSB acquisition. During the first nine months of 2015, 2,424 shares of Series C Preferred Stock were converted into 13,448 shares of the Company's common stock. As of September 30, 2015, there were 91,256 shares of Series C Preferred Stock issued and outstanding. The Series C Preferred Stock is entitled to the payment of noncumulative dividends, if and when declared by the Company's Board of Directors, at the rate of 4.00% per annum, payable quarterly in arrears on January 15, April 15, July 15 and October 15 of each year. The Series C Preferred Stock paid dividends totaling \$92,000 for the three months ended September 30, 2015.

Dividends from the Bank totaling \$6.0 million provided additional liquidity for the Company during the nine months ended September 30, 2015. As of September 30, 2015, the Bank had the ability to pay dividends to the Company of approximately \$12.8 million without prior approval from its primary regulator. As a publicly traded company, the Company also has the ability, subject to market conditions, to issue additional shares of common stock and other securities to provide funds as needed for operations and future growth of the Company. The Company renewed a \$75.0 million Universal Shelf Registration during the third quarter of 2015.

## Capital

The Company and the Bank are required to maintain certain minimum capital levels. Risk-based capital requirements are intended to make regulatory capital more sensitive to the risk profile of an institution's assets. Effective January 1, 2015, The Company and the Bank adopted the Basel III rules which included new minimum risk-based and leverage ratios, and modified capital and asset definitions for purposes of calculating these ratios. These rules also created a new regulatory capital standard based on Tier 1 common equity and increased the minimum leverage and risk-based capital ratios applicable to all banking organizations.



In addition, the Basel III rules subject banking organizations to certain limitations on capital distributions and discretionary bonus payments to executive officers if the organization does not maintain a capital conservation buffer phased in by 2019 of 2.5% above the new regulatory minimum capital ratios. The effect of the capital conservation buffer once fully implemented in 2019 will be to increase the minimum common equity Tier 1 capital ratio to 7.0%, the minimum Tier 1 risk-based capital ratio to 8.5% and the minimum total risk-based capital ratio to 10.5%, for banking organizations seeking to avoid the limitations on capital distributions and discretionary bonus payments to executive officers. The new minimum capital requirements were effective on January 1, 2015 for community banking organizations, such as MidSouth, whereas other requirements of the Basel III rules including the conservation buffer phase in over time.

At September 30, 2015, the Company and the Bank were in compliance with statutory minimum capital requirements and were classified as “well capitalized.” Minimum capital requirements include a total risk-based capital ratio of 8.0%, with Tier 1 capital not less than 6.0%, a Tier 1 leverage ratio (Tier 1 to total average adjusted assets) of 4.0% based upon the regulators latest composite rating of the institution, and a common equity Tier 1 capital to total risk-weighted assets of 4.5%. As of September 30, 2015, the

## Table of Contents

Company's Tier 1 leverage ratio was 9.98%, Tier 1 capital to risk-weighted assets was 12.86%, total capital to risk-weighted assets was 14.11% and common equity Tier 1 capital to risk-weighted assets was 8.62%. The Bank had a Tier 1 leverage capital ratio of 9.34% at September 30, 2015.

### Asset Quality

### Credit Risk Management

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

Credit concentrations are monitored and reported quarterly whereby individual customer and aggregate industry leverage, profitability, risk rating distributions, and liquidity are evaluated for each major standard industry classification segment. At September 30, 2015, one industry segment concentration, the oil and gas industry, aggregated more than 10% of our loan portfolio. Our exposure in the oil and gas (energy-related) industry, including related service and manufacturing industries, totaled approximately \$295.6 million, or 22.7% of total loans. Of the 442 credit relationships in the energy-related loan portfolio, 18 relationships totaling \$41.2 million were classified with \$29.1 million on nonaccrual status at September 30, 2015.

Additionally, we monitor our exposure to loans secured by commercial real estate. At September 30, 2015, loans secured by commercial real estate (including commercial construction, farmland and multifamily loans) totaled approximately \$529.0 million. Of the \$529.0 million, \$473.3 million represent CRE loans, 53% of which are secured by owner-occupied commercial properties. Of the \$529.0 million in loans secured by commercial real estate, \$20.0 million, or 3.8%, were on nonaccrual status at September 30, 2015. Additional information regarding credit quality by loan classification is provided in Note 3 – Credit Quality of Loans and Allowance for Loan Losses and Note 8 – Fair Value Measurement in the notes to the interim consolidated financial statements.

### Nonperforming Assets and Allowance for Loan Loss

Table 6 summarizes the Company's nonperforming assets for the quarters ending September 30, 2015 and 2014, and December 31, 2014.

Table of Contents

Table 6

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

|   | September 30,<br>2015 | December 31,<br>2014 | September 30,<br>2014 |   |
|---|-----------------------|----------------------|-----------------------|---|
| Nonaccrual loans  | \$51,616              | \$10,701             | \$7,750               |   |
| Loans past due 90 days and over and still accruing                      | 82                    | 187                  | 23                    |   |
| Total nonperforming loans   | 51,698                | 10,888               | 7,773                 |   |
| Other real estate   | 4,661                 | 4,234                | 4,663                 |   |
| Other foreclosed assets   | —                     | —                    | 19                    |   |
| Total nonperforming assets  | \$56,359              | \$15,122             | \$12,455              |   |
| Troubled debt restructurings, accruing                                  | \$168                 | \$176                | \$180                 |   |
| Nonperforming assets to total assets                                    | 2.85                  | % 0.78               | % 0.66                | % |
| Nonperforming assets to total loans + ORE + other assets<br>repossessed | 4.32                  | % 1.17               | % 0.99                | % |
| ALL to nonperforming loans  | 36.63                 | % 103.10             | % 121.25              | % |
| ALL to total loans  | 1.46                  | % 0.87               | % 0.75                | % |
| QTD charge-offs   | \$1,000               | \$985                | \$1,253               |   |
| QTD recoveries  | 91                    | 86                   | 428                   |   |
| QTD net charge-offs   | \$909                 | \$899                | \$825                 |   |
| Annualized net charge-offs to total loans                               | 0.28                  | % 0.28               | % 0.26                | % |

Nonperforming assets totaled \$56.4 million at September 30, 2015, an increase of \$41.2 million from the \$15.1 million reported at year-end 2014 and an increase of \$43.9 million from the \$12.5 million reported at September 30, 2014. The increase in the first nine months of 2015 resulted primarily from the addition of five energy-related credits totaling \$28.4 million that were placed on nonaccrual status during the third quarter of 2015. In addition, a \$10.1 million commercial real estate (CRE) relationship unrelated to energy was placed on nonaccrual status during the second quarter of 2015. The \$21.1 million commercial energy-related relationship was identified as a TDR during the second quarter of 2015 by conversion of the loans to interest only for a limited amount of time. The credit relationship defaulted on the modified terms during the third quarter of 2015 and was subsequently placed on nonaccrual.

Allowance coverage for nonperforming loans was 36.63% at September 30, 2015 compared to 103.10% at December 31, 2014 and 121.25% at September 30, 2014. The ALL/total loans ratio increased to 1.46% at September 30, 2015, compared to 0.87% at year-end 2014 and 0.75% at September 30, 2014. The increase in the ALL/total loans ratio resulted from a \$10.9 million loan loss provision recorded during the first nine months of 2015, the majority of which resulted from downgrades of energy-related credits in the oil and gas portfolio. Including valuation accounting adjustments on acquired loans, the total adjustments and ALL was 1.76% of loans at September 30, 2015. The ratio of annualized net charge-offs to total loans was 0.28% for the three months ended September 30, 2015, compared to 0.28% for the three months ended December 31, 2014, and 0.26% for the three months ended September 30, 2014. No energy-related charge-offs were recognized in the third quarter of 2015 and year to date energy-related charge-offs totaled \$557,000.

Total nonperforming assets to total loans plus ORE and other assets repossessed increased to 4.32% at September 30, 2015 from 1.17% at December 31, 2014 and 0.99% at September 30, 2014. Performing troubled debt restructurings (“TDRs”) totaled \$168,000 at September 30, 2015 compared to \$176,000 at December 31, 2014 and \$180,000 at September 30, 2014. Classified assets, including ORE, increased \$10.2 million, or 13.5%, to \$85.8 million at

September 30, 2015 compared to \$75.6 million at June 30, 2015. Additional information regarding impaired loans is included in Note 3 – Credit Quality of Loans and Allowance for Loan Losses and Note 8 – Fair Value Measurement in the notes to the interim consolidated financial statements.

Quarterly evaluations of the allowance for loan losses are performed in accordance with GAAP and regulatory guidelines. The ALL is comprised of specific reserves assigned to each impaired loan for which a probable loss has been identified as well as general reserves to maintain the allowance at an acceptable level for other loans in the portfolio where historical loss experience is available that indicates certain probable losses may exist. Factors considered in determining provisions include estimated losses

Table of Contents

in significant credits; known deterioration in concentrations of credit; historical loss experience; trends in nonperforming assets; volume, maturity and composition of the loan portfolio; off-balance sheet credit risk; lending policies and control systems; national and local economic conditions; the experience, ability and depth of lending management; and the results of examinations of the loan portfolio by regulatory agencies and others. The processes by which we determine the appropriate level of the ALL, and the corresponding provision for probable credit losses, involves considerable judgment; therefore, no assurance can be given that future losses will not vary from current estimates. We believe the \$18.9 million in the ALL as of September 30, 2015 is sufficient to cover probable losses in the loan portfolio.

Impact of Inflation and Changing Prices

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

Table of Contents

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

There have been no significant changes from the information regarding market risk disclosed under the heading “Funding Sources - Interest Rate Sensitivity” in the Company’s Annual Report on Form 10-K for the year ended December 31, 2014.

Item 4. Controls and Procedures.

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

During the third quarter of 2015, there was no change in the Company’s internal controls over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting.

Table of Contents

Part II – Other Information

Item 1. Legal Proceedings.

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

Item 1A. Risk Factors.

There have been no material changes from the risk factors previously disclosed in our Form 10-K for the year ended December 31, 2014.

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

The Company did not sell any unregistered equity securities or repurchase any equity securities during the quarter ended September 30, 2015.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

None.

Item 5. Other Information.

None.

Table of Contents

Item 6. Exhibits.

| Exhibit<br>Number | Document Description   |
|-------------------|--|
| 3.1               | Amended and Restated Articles of Incorporation of MidSouth Bancorp, Inc. (restated solely for purposes of Item 601(b)(3) of Regulation S-K) (filed as Exhibit 3.1 to MidSouth's Annual Report on Form 10-K filed on March 18, 2013 and incorporated herein by reference).  |
| 3.2               | Amended and Restated By-laws of MidSouth Bancorp, Inc. effective as of September 26, 2012 (restated solely for purposes of Item 601(b)(3) of Regulation S-K (filed as Exhibit 3.3 to MidSouth's Quarterly Report on Form 10-Q for the quarter ended September 30, 2012 and incorporated herein by reference).  |
| 10.1              | Form of Restricted Stock Award Agreement   |
| 31.1              | Certification pursuant to Exchange Act Rules 13(a) – 14(a)   |
| 31.2              | Certification pursuant to Exchange Act Rules 13(a) – 14(a)   |
| 32.1              | Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002  |
| 32.2              | Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002  |
| 101               | The following financial information from the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2015, formatted in Extensible Business Reporting Language ("XBRL"): (i) Consolidated Statements of Operations, (ii) Consolidated Balance Sheets, (iii) Consolidated Statements of Cash Flows and (iv) Notes to Consolidated Financial Statements.* |

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



Table of Contents

Signatures

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

MidSouth Bancorp, Inc.  
(Registrant)

Date: November 6, 2015

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

/s/ James R. McLemore  
James R. McLemore, CFO  
(Principal Financial Officer)

/s/ Teri S. Stelly  
Teri S. Stelly, Controller  
(Principal Accounting Officer)