

**BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM**

Washington, D.C. 20551

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2009

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

For the Transition Period from _____ to _____

FDIC Certificate No. 57659

MIDSOUTH BANK

(Exact name of registrant as specified in its charter)

Tennessee

(State or Other Jurisdiction of
Incorporation or Organization)

75-3143086

(IRS Employer Identification Number)

One East College Street, Murfreesboro, TN 37133-7100

(Address of principal executive offices)

(615) 278-7100

(Registrant's telephone number)

N/A

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark 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 (§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 smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Accelerated filer

Smaller 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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:
Common stock, \$1.00 par value, outstanding: 3,841,935 shares at November 19, 2009

MIDSOUTH BANK

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

The unaudited consolidated financial statements of the Registrant, MidSouth Bank (the “Bank”), which are included in this Report are as follows:

Consolidated Balance Sheets - September 30, 2009 and December 31, 2008.

Consolidated Statements of Operations - For the three and nine months ended September 30, 2009 and 2008.

Consolidated Statements of Comprehensive Earnings (Loss) - For the three and nine months ended September 30, 2009 and 2008.

Consolidated Statements of Cash Flows - For the nine months ended September 30, 2009 and 2008.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Item 4T. Controls and Procedures

Certain information for this part of the Report is incorporated by reference to Item 2 of Part I of this Report, entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

Item 1A. Risk Factors

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

Item 3. Defaults Upon Senior Securities

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

Item 5. Other Information

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

MIDSOUTH BANK

Consolidated Balance Sheets

September 30, 2009 and December 31, 2008

(Unaudited)

	<u>September 30,</u> <u>2009</u>	<u>December 31,</u> <u>2008</u>
	<i>(In Thousands, except share amounts)</i>	
<u>Assets</u>		
Loans, less allowance for loan losses of \$9,876,000 and \$5,784,000, respectively	\$ 201,608	\$ 216,730
Securities available-for-sale, at market (amortized cost of \$25,107,000 and \$32,116,000, respectively)	25,324	33,146
Loans held for sale	411	594
Restricted equity securities	1,495	1,581
Interest-bearing accounts at other financial institutions	<u>3,782</u>	<u>132</u>
Total earning assets	<u>232,620</u>	<u>252,183</u>
Cash and due from banks	1,320	5,694
Bank premises and equipment, net	9,766	10,099
Accrued interest receivable	710	969
Foreclosed assets	1,306	1,487
Other assets	<u>427</u>	<u>405</u>
Total assets	<u>\$ 246,149</u>	<u>\$ 270,837</u>
<u>Liabilities and Stockholders' Equity</u>		
Deposits	\$ 221,569	\$ 222,930
Advances from Federal Home Loan Bank	1,614	13,467
Federal funds purchased	-	4,693
Securities sold under agreement to repurchase	1,818	836
Accrued interest payable	285	349
Accounts payable and other liabilities	<u>589</u>	<u>434</u>
Total liabilities	<u>225,875</u>	<u>242,709</u>
Stockholders' equity:		
Preferred stock, no par, authorized 20,000,000 shares, no shares issued	-	-
Common stock, par value \$1 per share, authorized 20,000,000 shares, 3,841,935 and 3,762,161 shares issued and outstanding, respectively	3,842	3,762
Additional paid-in capital	34,715	33,983
Deficit	(18,500)	(10,647)
Net unrealized gains on available-for-sale securities	<u>217</u>	<u>1,030</u>
Total stockholders' equity	<u>20,274</u>	<u>28,128</u>
COMMITMENTS AND CONTINGENCIES		
Total liabilities and stockholders' equity	<u>\$ 246,149</u>	<u>\$ 270,837</u>

See accompanying notes to consolidated financial statements (unaudited).

MIDSOUTH BANK

Consolidated Statements of Operations

Three Months and Nine Months Ended September 30, 2009 and 2008

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(In Thousands, Except Per Share Amounts)			
Interest income:				
Interest and fees on loans	\$ 2,972	\$ 3,184	\$ 9,063	\$ 9,521
Interest and dividends on taxable securities	254	408	943	1,252
Interest on Federal funds sold	-	-	2	7
Interest on balances due from depository institutions	1	-	3	-
Interest and dividends on restricted equity securities	<u>21</u>	<u>23</u>	<u>62</u>	<u>65</u>
Total interest income	<u>3,248</u>	<u>3,615</u>	<u>10,073</u>	<u>10,845</u>
Interest expense:				
Interest on negotiable order of withdrawal accounts	29	30	71	113
Interest on money market and other savings accounts	95	197	254	650
Interest on certificates of deposit	812	1,011	2,667	3,525
Interest on advances from Federal Home Loan Bank	21	90	89	198
Interest on Federal funds purchased	-	-	10	-
Interest on securities sold under agreement to repurchase	<u>4</u>	<u>24</u>	<u>9</u>	<u>34</u>
Total interest expense	<u>961</u>	<u>1,352</u>	<u>3,100</u>	<u>4,520</u>
Net interest income before provision for loan losses	2,287	2,263	6,973	6,325
Provision for loan losses	<u>6,425</u>	<u>365</u>	<u>9,705</u>	<u>994</u>
Net interest income (loss) after provision for loan losses	<u>(4,138)</u>	<u>1,898</u>	<u>(2,732)</u>	<u>5,331</u>
Non-interest income:				
Service charges on deposits	129	127	363	334
Other fees and commissions	106	107	325	282
Fees on mortgage originations	79	131	320	366
Fees from brokerage operations	96	138	278	407
Gain on sales of available-for-sale securities	335	-	1,017	-
Gain on sales of bank premises and equipment, net	-	-	4	-
Gain on sales of foreclosed assets, net	-	-	-	4
Gain on sales of other assets	<u>-</u>	<u>-</u>	<u>12</u>	<u>-</u>
Total non-interest income	<u>745</u>	<u>503</u>	<u>2,319</u>	<u>1,393</u>
Non-interest expense:				
Employee salaries and benefits	1,173	1,284	3,620	3,853
Occupancy expenses, net	213	223	641	659
Furniture and equipment expense	107	120	324	381
FDIC insurance	203	42	509	126
Advertising expense	55	100	179	317
Professional fees	175	106	440	350
Data processing expense	102	148	324	460
Directors fees	-	31	21	93
Loss on sales of foreclosed assets, net	52	37	107	-
Other operating expenses	<u>438</u>	<u>403</u>	<u>1,275</u>	<u>1,146</u>
Total non-interest expense	<u>2,518</u>	<u>2,494</u>	<u>7,440</u>	<u>7,385</u>
Loss before income taxes	(5,911)	(93)	(7,853)	(661)
Income taxes	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Net loss	<u>\$ (5,911)</u>	<u>\$ (93)</u>	<u>\$ (7,853)</u>	<u>\$ (661)</u>
Basic loss per common share	<u>\$ (1.54)</u>	<u>\$ (0.02)</u>	<u>\$ (2.05)</u>	<u>\$ (0.18)</u>
Diluted loss per common share	<u>\$ (1.54)</u>	<u>\$ (0.02)</u>	<u>\$ (2.05)</u>	<u>\$ (0.18)</u>

See accompanying notes to consolidated financial statements (unaudited).

MIDSOUTH BANK

Consolidated Statements of Comprehensive Earnings (Loss)

Three and Nine Months Ended September 30, 2009 and 2008

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
	<i>(In Thousands)</i>			
Net loss	\$ (5,911)	\$ (93)	\$ (7,853)	\$ (661)
Other comprehensive earnings (loss):				
Change in unrealized gains (losses) on available-for-sale securities arising during period	314	472	204	(104)
Less: Reclassification adjustment for gains included in net loss	<u>(335)</u>	<u>-</u>	<u>(1,017)</u>	<u>-</u>
Comprehensive earnings (loss)	<u>\$ (5,932)</u>	<u>\$ 379</u>	<u>\$ (8,666)</u>	<u>\$ (765)</u>

See accompanying notes to consolidated financial statements (unaudited).

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Consolidated Statements of Cash Flows

Nine Months Ended September 30, 2009 and 2008

Increase (Decrease) in Cash and Cash Equivalents

(Unaudited)

	<u>2009</u>	<u>2008</u>
	<i>(In Thousands)</i>	
Cash flows from operating activities:		
Interest received	\$ 9,939	\$ 10,936
Fees received	967	1,023
Proceeds from sale of loans	26,055	29,886
Origination of loans held for sale	(25,552)	(28,073)
Interest paid	(3,164)	(4,875)
Cash paid to suppliers and employees	<u>(7,091)</u>	<u>(6,651)</u>
Net cash provided by operating activities	<u>1,154</u>	<u>1,616</u>
Cash flows from investing activities:		
Purchase of available-for-sale securities	(19,502)	(7,490)
Sales of available-for-sale securities	22,242	-
Repayments of mortgage-backed securities	4,613	3,092
Purchase of restricted equity securities	(37)	(172)
Sale of restricted equity securities	123	-
Maturities of available-for-sale securities	1,065	5,909
Loans made to customers, net of repayments	-	(18,571)
Repayments on loans, net of loans made to customers	5,132	-
Capitalized cost of foreclosed assets	-	(64)
Proceeds from sales of foreclosed assets	732	1,024
Sales of premises and equipment	26	-
Purchase of premises and equipment	<u>(145)</u>	<u>(74)</u>
Net cash provided by (used in) investing activities	<u>14,249</u>	<u>(16,346)</u>
Cash flows from financing activities:		
Net (decrease) increase in non-interest bearing, savings and NOW deposit accounts	(69)	5,279
Net (decrease) increase in time deposits	(1,324)	7,871
Net increase in mortgage escrow deposits	32	34
Proceeds from advances from the Federal Home Loan Bank	10,200	71,584
Repayments of advances from the Federal Home Loan Bank	(22,053)	(71,465)
Increases in securities sold under agreement to repurchase	982	1,632
Net decrease in Federal funds purchased	(4,693)	(226)
Proceeds from sale of common stock	<u>798</u>	<u>62</u>
Net cash (used in) provided by financing activities	<u>(16,127)</u>	<u>14,771</u>
Net (decrease) increase in cash and cash equivalents	(724)	41
Cash and cash equivalents at beginning of period	<u>5,826</u>	<u>8,858</u>
Cash and cash equivalents at end of period	<u>\$ 5,102</u>	<u>\$ 8,899</u>

See accompanying notes to consolidated financial statements (unaudited).

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Consolidated Statements of Cash Flows, Continued

Nine Months Ended September 30, 2009 and 2008

Increase (Decrease) in Cash and Cash Equivalents

(Unaudited)

	<u>2009</u>	<u>2008</u>
	<i>(In Thousands)</i>	
Reconciliation of loss to net cash provided by operating activities:		
Net loss	\$ (7,853)	\$ (661)
Adjustments to reconcile loss to net cash provided by operating activities:		
Depreciation	456	559
Provision for loan losses	9,705	994
Loss on sales of foreclosed assets	107	-
Gain on sale of premises and equipment	(4)	-
Gain on sale of available-for-sale securities	(1,017)	-
Stock option compensation expense	14	22
Amortization and accretion, net	(392)	(49)
Valuation adjustment on foreclosed assets	38	-
Decrease in loans held for sale	183	817
Decrease in accrued interest receivable	259	140
Increase in other assets	(433)	(12)
Decrease in accrued interest payable	(64)	(355)
Increase in accounts payable and other liabilities	<u>155</u>	<u>165</u>
Total adjustments	<u>9,007</u>	<u>2,277</u>
Net cash provided by operating activities	<u>\$ 1,154</u>	<u>\$ 1,616</u>
Supplemental Schedule of Non-Cash Activities:		
Unrealized gain (loss) in value of securities available-for-sale	<u>\$ 204</u>	<u>\$ (104)</u>
Transfer of loans to foreclosed assets	<u>\$ 696</u>	<u>\$ 1,172</u>

See accompanying notes to consolidated financial statements (unaudited).

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Notes to Consolidated Financial Statements

(Unaudited)

Basis of Presentation

The accompanying consolidated financial statements have been prepared, without audit, pursuant to the rules and regulations of the Board of Governors of the Federal Reserve System. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. The consolidated financial statements include the financial results of MidSouth Bank and its wholly-owned subsidiary, MSB Services, Inc. (collectively, "the Bank"). All intercompany accounts have been eliminated in consolidation.

In the opinion of management, the consolidated financial statements contain all adjustments (consisting of only normal recurring adjustments) and disclosures necessary to summarize fairly the financial position of the Bank as of September 30, 2009 and December 31, 2008 and the results of operations for the three and nine months ended September 30, 2009 and 2008, comprehensive earnings (loss) for the three and nine months ended September 30, 2009 and 2008 and changes in cash flows for the nine months ended September 30, 2009 and 2008. The interim consolidated financial statements should be read in conjunction with the notes to the consolidated financial statements presented in the Bank's Annual Report on Form 10-K as filed with the Board of Governors of the Federal Reserve System. The results for interim periods are not necessarily indicative of results to be expected for the complete fiscal year.

Certain reclassifications have been made to 2008 financial information to conform to the 2009 presentation.

Critical Accounting Policies

Our accounting and reporting policies are in accordance with accounting principles generally accepted in the United States of America as defined by the Public Company Accounting Oversight Board and conform to general practices accepted within the banking industry. Our most significant accounting policies are presented in the Bank's December 31, 2008 Form 10-K and the notes to the audited consolidated financial statements contained therein. Certain accounting policies require management to make significant estimates and assumptions that have a material effect on the carrying value of certain assets and liabilities, and we consider these to be critical accounting policies. The estimates and assumptions used are based on historical experience and other factors that management believes to be reasonable under the circumstances. Actual results could differ significantly from these estimates and assumptions, which could have a material impact on the carrying value of assets and liabilities at the balance sheet dates and on our results of operations for the reporting periods.

Allowance for Loan Losses

Transactions in the allowance for loan losses were as follows:

	Nine Months Ended September 30,	
	<u>2009</u>	<u>2008</u>
	<i>(In Thousands)</i>	
Balance, January 1, 2009 and 2008, respectively	\$ 5,784	\$ 2,032
Add (deduct):		
Losses charged to allowance	(5,613)	(761)
Recoveries credited to allowance	-	4
Provision for loan losses	<u>9,705</u>	<u>994</u>
Balance, September 30, 2009 and 2008, respectively	<u>\$ 9,876</u>	<u>\$ 2,269</u>

The provision for loan losses represents a charge to earnings necessary, after loan charge-offs and recoveries, to maintain the allowance for loan losses at an appropriate level which is adequate to absorb estimated

MIDSOUTH BANK

Notes to Consolidated Financial Statements, Continued

(Unaudited)

losses inherent in the loan portfolio. Such estimated losses arise primarily from the loan portfolio but may also result from other sources, including commitments to extend credit and letters of credit. The level of the allowance is determined on a monthly basis using procedures which include: (1) categorizing commercial and commercial real estate loans into risk categories to estimate loss probabilities based primarily on the historical loss experience of those risk categories and current economic conditions; (2) analyzing significant commercial and commercial real estate credits and calculating specific reserves as necessary; (3) assessing various homogeneous consumer loan categories to estimate loss probabilities based primarily on historical loss experience; and (4) considering various other factors, such as changes in credit concentrations, loan mix, and economic conditions which may not be specifically quantified in the loan analysis process.

The provision for loan losses was \$9,705,000 and \$994,000 for the first nine months of 2009 and 2008, respectively. The increase in the provision from 2008 to 2009 is primarily due to several factors, but the primary reasons for the increased provisions were: (1) recording provisions of \$2 million for a specific loan relationship involving a bank holding company in which the Bank participated; (2) recording significant provisions on a number of other impaired loan relationships that have either declined in quality or have had the values of their underlying collateral positions deteriorate; and (3) additional provisions recorded as a result of a recent regulatory examination. The latter two factors resulted in recording additional provisions of around \$6 million in the third quarter, as described below. Additional provisions have also been recorded to account for changes in local economic factors, i.e., house inventory levels, unemployment, concentrations of credit, etc.

The provision for loan losses was \$6,425,000 and \$365,000 for the third quarter of 2009 and 2008, respectively. During the third quarter, the Bank went through an intensive loan review process, resulting in a number of loans being identified as impaired. Bank management has been actively reviewing each of those relationships to determine if any potential provisions were needed. The increase in the provision from 2008 to 2009 is primarily due to the increase in impaired loan relationships that were identified in the loan review process that have either declined in credit quality or have had the values of their underlying collateral deteriorate.

The allowance for loan losses consists of an allocated portion and an unallocated or general portion. The allocated portion is maintained to cover estimated losses applicable to specific relationships in the loan portfolio. The unallocated portion is maintained to absorb losses which probably exist as of the evaluation date but are not identified by the more objective processes used for the allocated portion of the allowance due to risk of errors or imprecision. While the total allowance consists of an allocated portion and an unallocated portion, these terms are primarily used to describe a process. Both portions of the allowance are available to provide for inherent loss in the entire portfolio.

The allowance for loan losses is increased by provisions for loan losses charged to expense and is reduced by loans charged off net of recoveries on loans previously charged off. The provision is based on management's determination of the amount of the allowance necessary to provide for estimated loan losses based on its evaluation of the loan portfolio. Determining the appropriate level of the allowance and the amount of the provision involves uncertainties and matters of judgment and therefore cannot be determined with precision. At September 30, 2009, the allowance represented 4.67% of total loans as compared with 2.60% at December 31, 2008.

Stock Option Arrangement

In October, 2004, the Shareholders of the Bank approved the MidSouth Bank's 2004 Stock Option Arrangement (the "Arrangement"). The Arrangement provides for the granting of stock options, and authorizes the issuance of common stock upon the exercise of such options, for up to 380,000 shares of common stock to employees and organizers of the Bank and up to 143,080 shares of common stock for future use as decided by the Directors of the Bank. As of September 30, 2009, 470,000 options had been granted of which 41,700 have been exercised and 6,500 have been forfeited. Options that are forfeited revert to the Arrangement and can be granted again in the future. As of September 30, 2009, 374,892 options were exercisable. The weighted average exercise prices of outstanding and exercisable stock options as of September 30, 2009 were \$10.03 and \$10.01 per share, respectively. The weighted average remaining contractual terms of outstanding and exercisable stock options as of September 30, 2009 were 5.0 years and 4.9 years, respectively. There was no aggregate intrinsic value of

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Notes to Consolidated Financial Statements, Continued

(Unaudited)

outstanding and exercisable stock options at September 30, 2009 since the average price of the stock was less than the average exercise price. As of September 30, 2009, there were total unrecognized compensation costs of \$37,000 related to non-vested share-based compensation arrangements granted under the Arrangement. Those costs are expected to be recognized over a remaining weighted average period of 1.3 years. Compensation expense related to stock options totaled \$14,000 and \$22,000 for the nine months ended September 30, 2009 and 2008, respectively. Compensation expense related to stock options totaled \$5,000 and \$4,000 for the three months ended September 30, 2009 and 2008, respectively.

Under the Stock Option Arrangement, stock option awards may be granted in the form of incentive stock options or non-statutory stock options, with a ten-year option to purchase. Exercise prices of incentive stock options must be equal to or greater than 100% of the fair market value of the common stock on the grant date and otherwise in compliance with the requirements of the Internal Revenue Code applicable to incentive stock options and the terms of the Plan.

Stock Warrants

As part of the Bank's initial offering of its common stock, any shares purchased received non-detachable warrants which provided the stockholder the ability to purchase one additional whole share of common stock for every two shares of common stock purchased. The purchase price for the additional shares was equal to the greater of \$10 or 110% of the book value of the stock at the date of exercise. For each recipient, one half of the warrants received were required to be exercised within three years from January 20, 2004 (the date of issuance) and the other half within five years of the date of issuance. Any warrants that were not exercised expired on January 20, 2009. During January 2009, 79,574 warrants were exercised, and the remaining 430,357 unexercised warrants were forfeited. As of January 20, 2009 (date of expiration), 699,939 of these warrants had been exercised, and 559,047 had been forfeited or cancelled. The Bank currently has no outstanding warrants.

Earnings Per Share

The following is a summary of the components comprising basic and diluted loss per common share of stock (EPS):

<i>(In Thousands, except share and per share amounts)</i>	Three Months Ended		Nine Months Ended	
	September 30, 2009	September 30, 2008	September 30, 2009	September 30, 2008
Basic EPS Computation:				
Numerator – Loss for the period	\$ (5,911)	\$ (93)	\$ (7,853)	\$ (661)
Denominator - Weighted average number of common shares outstanding	3,841,935	3,746,441	3,837,900	3,743,655
Basic loss per common share	\$ (1.54)	\$ (0.02)	\$ (2.05)	\$ (0.18)
Diluted EPS Computation:				
Numerator – Loss for the period	\$ (5,911)	\$ (93)	\$ (7,853)	\$ (661)
Denominator - Weighted average number of common shares outstanding	3,841,935	3,746,441	3,837,900	3,743,655
Dilutive effect of stock options	-	-	-	-
Dilutive effect of warrants	-	-	-	-
	3,841,935	3,746,441	3,837,900	3,743,655
Diluted loss per common share	\$ (1.54)	\$ (0.02)	\$ (2.05)	\$ (0.18)

The effect of stock options was considered to be zero for the three and nine months ended September 30, 2009 and 2008 since the impact of the exercise of these derivative securities would be anti-dilutive. There was no effect of stock purchase warrants at September 30, 2009 and 2008 since there were no warrants outstanding at September 30, 2009, and the effect of exercising stock purchase warrants would have been anti-dilutive at September 30, 2008.

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Notes to Consolidated Financial Statements, Continued

(Unaudited)

Fair Value Measurements and Fair Value of Financial Instruments

During the first quarter of 2008, the Bank adopted ASC 820, “Fair Value Measurements and Disclosures,” which established a fair value hierarchy and required an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) or identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in market that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity’s own assumptions about the assumptions that market participants would use in pricing an asset or liability.

Assets and Liabilities Measured on a Recurring Basis

Assets and liabilities measured at fair value on a recurring basis are summarized below:

(in 000's)	Carrying Value at September 30, 2009	Fair Value Measurements at September 30, 2009 Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<u>Assets:</u>				
Available-for-sale securities	\$ 25,324	-	25,324	-
Loans held for sale	\$ 411	-	411	-

Available-for-sale securities are measured on a recurring basis and are obtained from an independent pricing service. The fair values are based on quoted market prices of comparable securities, broker quotes or comprehensive interest rate tables and pricing matrices.

Loans held for sale, which are carried at the lower of cost or fair value, did not have an impairment charge for the first nine months of 2009.

Assets and Liabilities Measured on a Non-Recurring Basis

(in 000's)	Carrying Value at September 30, 2009	Fair Value Measurements at September 30, 2009 Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<u>Assets:</u>				
Impaired loans	\$ 19,201	-	-	19,201
Foreclosed assets	\$ 1,306	-	-	1,306

Impaired loan balances in the table above represent those collateral-dependent loans where management has estimated the credit loss by comparing the loans’ carrying values against the expected realized fair values of the collateral securing those loans. As of September 30, 2009, impaired loans had a carrying amount of \$25,848,000, with a valuation allowance of \$6,647,000.

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Notes to Consolidated Financial Statements, Continued

(Unaudited)

Foreclosed assets are valued at the time the loan is foreclosed upon, and the asset is transferred to foreclosed assets. The value is based primarily on third party appraisals, less costs to sell. The appraisals are generally discounted based on management's historical knowledge, changes in market conditions from the time of valuation, and/or management's expertise and knowledge of the customer and the customer's business. Such discounts are typically significant and result in a Level 3 classification of the inputs for determining fair value. Foreclosed assets are reviewed and evaluated on at least an annual basis for additional impairment and adjusted accordingly, based on the same factors identified above.

Fair Value of Financial Instruments

Fair value estimates, methods, and assumptions are set forth below for the Bank's financial instruments.

Cash and short-term investments

For those short-term instruments, the carrying amount is a reasonable estimate of fair value.

Securities

The carrying amounts for short-term securities approximate fair value because they mature in 90 days or less and do not present unanticipated credit concerns. The fair value of longer-term securities and mortgage-backed securities, except certain state and municipal securities, is estimated based on bid prices published in financial newspapers or bid quotations received from securities dealers. The fair value of certain state and municipal securities is not readily available through market sources other than dealer quotations, so fair value estimates are based on quoted market prices of similar instruments, adjusted for differences between the quoted instruments and the instruments being valued.

Fair values should be calculated based on the value of one unit without regard to any premium or discount that may result from concentrations of ownership of a financial instrument, possible tax ramifications, or estimated transaction costs. Accordingly, these considerations have not been incorporated into the fair value estimates.

Loans

Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type such as commercial, mortgage and other consumer. Each loan category is further segmented into fixed and adjustable rate interest terms.

The fair value of the various categories of 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 and for the same remaining average estimated maturities.

The estimated maturity for mortgages is modified from the contractual terms to give consideration to management's experience with prepayments. Management has made estimates of fair value discount rates that it believes to be reasonable. However, because there is no market for many of these financial instruments, management has no basis to determine whether the fair value presented below would be indicative of the value negotiated in an actual sale.

The value of the loan portfolio is also discounted in consideration of the credit quality of the loan portfolio as would be the case between willing buyers and sellers. Particular emphasis has been given to loans on the Bank's internal watch list. Valuation of these loans is based upon borrower performance, collateral values (including external appraisals), etc.

MIDSOUTH BANK

Notes to Consolidated Financial Statements, Continued

(Unaudited)

Loans Held for Sale

These instruments are carried in the consolidated balance sheet at the lower of cost or market value. The fair values of these instruments are based on subsequent liquidation values of the instruments which did not result in any significant gains or losses.

Deposit Liabilities

The fair value of demand deposits, savings accounts and certain money market deposits is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is estimated using the rates currently offered for deposits of similar remaining maturities. The fair value estimates for deposits does not include the benefit that results from the low cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market.

Federal Funds Purchased and Sold

The carrying amounts approximate fair values as Federal funds are overnight borrowings or investments.

Advances from Federal Home Loan Bank

Short-Term Advances

The carrying amounts of short-term advances approximate fair value as they mature within 90 days.

Long-Term Advances

The fair values of the Bank's long-term advances are estimated using discounted cash flow analyses based on the Bank's current incremental borrowing rates for similar types of borrowing arrangements.

Commitments to Extend Credit, Standby Letters of Credit and Financial Guarantees Written

Loan commitments are made to customers generally for a period not to exceed one year and at the prevailing interest rates in effect at the time the loan is closed. Commitments to extend credit related to construction loans are made for a period not to exceed one year with interest rates at the current market rate at the date of closing. In addition, standby letters of credit are issued for periods extending from one to two years with rates to be determined at the date the letter of credit is funded. Fees are only charged for the construction loans and the standby letters of credit and the amounts unearned at September 30, 2009, are insignificant. Accordingly, these commitments have no carrying value and management estimates the commitments to have no significant fair value.

MIDSOUTH BANK

Notes to Consolidated Financial Statements, Continued

(Unaudited)

The carrying values and estimated fair values of the Bank's financial instruments at September 30, 2009 and December 31, 2008 are as follows:

<i>(In Thousands)</i>	September 30, 2009		December 31, 2008	
	<i>Carrying Amount</i>	<i>Fair Value</i>	<i>Carrying Amount</i>	<i>Fair Value</i>
Financial assets:				
Cash and short-term investments.....	\$ 5,102	\$ 5,102	\$ 5,826	\$ 5,826
Securities	25,324	25,324	33,146	33,146
Restricted equity securities.....	1,495	1,495	1,581	1,581
Loans held for sale	411	411	594	594
Loans	211,484		222,514	
Less: allowance for loan losses	(9,876)		(5,784)	
Loans, net of allowance.....	201,608	193,590	216,730	210,039
Financial liabilities:				
Deposits.....	221,569	219,942	222,930	221,914
Advances from Federal Home Loan Bank	1,614	1,741	13,467	13,640
Federal funds purchased.....	-	-	4,693	4,693
Securities sold under agreement to repurchase	1,818	1,818	836	836
Unrecognized financial instruments:				
Commitments to extend credit	-	-	-	-
Standby letters of credit.....	-	-	-	-

Limitations

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instruments. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Bank's entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Bank's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on estimating 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. Other significant assets and liabilities that are not considered financial assets or liabilities include deferred tax assets and liabilities and property, plant 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.

MIDSOUTH BANK

Notes to Consolidated Financial Statements, Continued

(Unaudited)

Recent Accounting Pronouncements

In April 2009, the FASB issued ASC 820-10-65-4, “*Fair Value Measurements and Disclosures*,” which provides additional guidance for estimating fair value in accordance with FASB ASC 820 when the volume and level of activity for the asset or liability have decreased significantly. FASB ASC 820-10-65-4 also provides guidance on identifying circumstances that indicate a transaction is not orderly. The provisions of FASB ASC 820-10-65-4 were effective for the Bank’s interim period ending on June 30, 2009. The adoption of this guidance did not have a material impact on the Bank’s consolidated financial position, results of operations or cash flows.

In April 2009, the FASB issued ASC 825-10-65-1, “*Financial Instruments*,” which requires disclosures about fair value of financial instruments in interim reporting periods of publicly traded companies that were previously only required to be disclosed in annual financial statements. The provisions of ASC 825-10-65-1 were effective for the Bank’s interim period ending on June 30, 2009. As ASC 825-10-65-1 amends only the disclosure requirements about fair value of financial instruments in interim periods, the adoption of ASC 825-10-65-1 did not affect the Bank’s statements of operation and condition.

In April 2009, the FASB issued ASC 320-10-65-1, “*Investments – Debt and Equity Securities*,” which amends current other-than-temporary impairment guidance in GAAP for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. This ASC does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. The provisions of ASC 320-10-65-1 were effective for the Bank’s interim period ending on June 30, 2009. The adoption of this guidance did not have a material impact on the Bank’s consolidated financial position, results of operations or cash flows.

In May 2009, the FASB issued ASC 855, “*Subsequent Events*.” The statement sets forth guidance concerning the recognition or disclosure of events or transactions that occur subsequent to the balance sheet date but prior to the release of the financial statements. The statement also defines “available to be issued” financial statements as financial statements that have received all the required approvals from management and other constituents. The statement sets forth that management of a public company must evaluate subsequent events for recognition and/or disclosure through the date of issuance, whereas private companies need only evaluate subsequent events through the date the financial statements became available to be issued. The statement also delineates between and defines the recognition and disclosure requirements for Recognized Subsequent Events and Non-Recognized Subsequent Events. Recognized Subsequent Events provide additional evidence about conditions that existed as of the balance sheet date and will be recognized in the entity’s financial statements. Non-Recognized Subsequent Events provide evidence about conditions that did not exist as of the balance sheet date and if material will warrant disclosure of the nature of the subsequent event and the financial impact. An entity shall disclose the date through which subsequent events have been evaluated and whether that date is the date the financial statements were issued or available to be issued. This statement was effective for interim and annual reporting periods ending after June 15, 2009. The adoption of this guidance did not have a material impact on the Bank’s consolidated financial position, results of operations or cash flows. We evaluated all events or transactions that occurred after September 30, 2009, through November 19, 2009, the date we issued these financial statements. During this period we did not have any material recognizable subsequent events that required recognition in or disclosures to the September 30, 2009 financial statements.

In June 2009, the FASB issued SFAS No. 166, “*Accounting for the Transfer of Financial Assets and Amendment of FASB Statement No. 140 Instruments*.” Under FASB’s Codification at ASC 105-10-65-1-d, SFAS No. 166 will remain authoritative until integrated into the FASB Codification. The statement removes the concept of a special purpose entity (SPE) from SFAS No. 140 and removes the exception of applying FASB Interpretation 46 Variable Interest Entities, to Variable Interest Entities that are SPEs. It limits the circumstances in which a transferor derecognizes a financial asset. The statement amends the requirements for the transfer of a financial asset to meet the requirements for “sale” accounting. The statement is effective for all interim and annual periods beginning after November 15, 2009. The Bank does not expect the adoption to have a material impact on its consolidated financial position, results of operations or cash flows.

MIDSOUTH BANK

Notes to Consolidated Financial Statements, Continued

(Unaudited)

In June 2009, the FASB issued SFAS No. 167, “*Amendments to FASB Interpretation No. 46(R)*.” Under FASB’s Codification at ASC 105-10-65-1-d, SFAS No. 167 will remain authoritative until integrated into the FASB Codification. This Statement amends Interpretation No. 46(R) to require an enterprise to perform an analysis to determine whether the enterprise’s variable interest give it a controlling financial interest in the variable interest entity. The statement is effective for all interim and annual periods beginning after November 15, 2009. The Bank does not expect the adoption to have a material impact on its consolidated financial position, results of operations or cash flows.

On July 1, 2009, the FASB’s GAAP Codification became effective as the sole authoritative source of US GAAP. This codification was issued under SFAS No. 168, “*The FASB Accounting Standards CodificationTM and the Hierarchy of Generally Accepted Accounting Principles — a replacement of FASB Statement No. 162.*” This Codification reorganizes current GAAP for non-governmental entities into a topical index to facilitate accounting research and to provide users additional assurance that they have referenced all related literature pertaining to a given topic. Existing GAAP prior to the Codification was not altered in compilation of the GAAP Codification. The GAAP Codification encompasses all FASB Statements of Financial Accounting Standards (SFAS), Emerging Issues Task Force (EITF) statements, FASB Staff Positions (FSP), FASB Interpretations (FIN), FASB Derivative Implementation Guides (DIG), American Institute of Certified Public Accountants (AICPA) Statement of Positions (SOPS), Accounting Principals Board (APB) Opinions and Accounting Research Bulletins (ARBs) along with the remaining body of GAAP effective as of September 30, 2009. Financial Statements issued for all interim and annual periods ending after September 15, 2009 will need to reference accounting guidance embodied in the Codification as opposed to referencing the previously authoritative pronouncements. Accounting literature included in the codification is referenced by Topic, Subtopic, Section and Paragraph.

MIDSOUTH BANK

FORM 10-Q

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

General

MidSouth Bank began operations on January 20, 2004 as a full-service community bank chartered under the laws of the State of Tennessee with deposits insured through the Deposit Insurance Fund administered by the Federal Deposit Insurance Corporation (FDIC). It is a member of the Federal Reserve System, and its primary federal regulator is the Board of Governors of the Federal Reserve System (Federal Reserve). The Bank offers a wide range of banking services including checking, savings, money market accounts, certificates of deposit and loans for consumers and businesses. The Bank has trust powers and has an active trust department that provides both trust services and (as agent) alternative investment products for its customers. The Bank is subject to regulation, supervision, and examination by the Tennessee Department of Financial Institutions and the Federal Reserve; however, such regulation, supervision and examination are for the protection of consumers, the Deposit Insurance Fund administered by the FDIC, and the banking system and not for the protection of investors or other stakeholders. The area served by MidSouth Bank is Rutherford County in Tennessee and adjacent geographic areas in Middle Tennessee. Services are provided at the main office, three full-service banking offices in Murfreesboro, Tennessee and two full-service banking offices located in Smyrna, Tennessee.

The Bank has targeted commercial business lending, commercial residential real estate lending and consumer lending as potential growth areas in its highly competitive markets. The Bank seeks to build a loan portfolio which is capable of adjusting to swings in the interest rate market, and it is the Bank's policy to maintain a diverse loan portfolio not dependent on any particular market or industrial segment.

The purpose of this discussion is to provide insight into the financial condition and results of operations of the Bank. This discussion should be read in conjunction with the annual consolidated financial statements filed in conjunction with the Bank's Annual Report on Form 10-K for the year ended December 31, 2008 as filed with the Federal Reserve in March of 2009. The Annual Report on Form 10-K also contains important information concerning the Bank, its operations, applicable laws and regulations, and other matters.

Recent Developments

The U. S. and global economies have experienced and are experiencing significant stress and disruptions in the financial sector. Dramatic slowdowns in the housing industry, with falling home prices and increasing foreclosures and unemployment, have resulted in significant and prolonged problems for financial institutions, including government-sponsored entities and investment banks. As the impact of financial declines ripples through the economy, it can be expected that many or most economic sectors will be adversely affected, thus impacting many or most components of the Bank's customer base. These issues have caused many financial institutions to seek additional capital, to merge with larger and stronger institutions and, in some cases, to fail.

The Bank, with the approval and support of its Board of Directors, intends to raise additional capital to work through this difficult economic period and to position the Bank to support its future growth once the local economy stabilizes and begins to recover. The Bank's capital plan has been preliminarily approved by state and federal regulators pending final draft of the offering circular. This offering will be a convertible preferred stock instrument that will qualify as tier 1 capital. It will be made available to existing shareholders first, and then after a designated period of time, it will be made available to the general public. The offering is expected to begin during the fourth quarter of 2009 and to continue into the first quarter of 2010. The range of tier 1 capital that the Bank will seek to raise in this offering is between \$5 million and \$15 million. The Bank intends to also offer \$5 million of convertible, 6% fixed rate debentures to investors in the preferred stock. Such investments would be considered tier 2 capital and will be more fully described in an offering circular expected to be available in December of 2009, assuming regulatory approval of these securities.

In response to the financial crisis affecting the banking and financial markets, in October 2008, the Emergency Economic Stabilization Act of 2008 (EESA) was signed into law. Pursuant to the EESA, the U. S. Treasury (Treasury) has the authority to, among other things, purchase up to \$700 billion of mortgages, mortgage-backed securities and certain other financial instruments from financial institutions for the purpose of stabilizing and

MIDSOUTH BANK

FORM 10-Q, CONTINUED

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued

providing liquidity to the U. S. financial markets.

In addition, the Treasury has been authorized to purchase equity positions in U. S. financial institutions. Under this program, known as the Troubled Assets Relief Program Capital Purchase Program (TARP Capital Purchase Program), from the funds authorized by the EESA, the Treasury has been allowed to purchase senior preferred stock in a number of U. S. financial institutions. In conjunction with the purchase of senior preferred stock, the Treasury received warrants to purchase common stock with an aggregate market price equal to 15% of the total amount of the senior preferred investment. Participating financial institutions were required to adopt the Treasury's standards for executive compensation and corporate governance for the period during which the Treasury holds equity issued under the TARP Capital Purchase Program, and they will be restricted from increasing dividends to common shareholders or repurchasing common stock for three years without the consent of the Treasury.

Further, after receiving a recommendation from the boards of the FDIC and the Federal Reserve, the Treasury signed the systemic risk exception to the FDIC Act, enabling the FDIC to temporarily provide a 100% guarantee of the senior debt of all FDIC-insured institutions and their holding companies, as well as deposits in non-interest bearing transaction deposit accounts under a Temporary Liquidity Guarantee Program. Coverage under the Temporary Liquidity Guarantee Program was available for 30 days without charge and thereafter at a cost of 75 basis points per annum for senior unsecured debt and 10 basis points per annum for non-interest bearing transaction deposits.

The Bank decided to participate in the Temporary Liquidity Guarantee Program as it relates to noninterest-bearing deposit accounts but elected not to participate in the program covering senior unsecured debt issues. The Bank initially applied for participation in the TARP Capital Purchase Program, but management, with Board of Director approval, withdrew its application.

It is not clear at this time what impact the EESA, the TARP Capital Purchase Program, the Temporary Liquidity Guarantee Program, other liquidity and funding initiatives of the Federal Reserve and other agencies that have been previously announced, and any additional programs that may be initiated in the future will have on the Bank and the U. S. and global financial markets.

Forward-Looking Statements

Management's discussion of the Bank and management's analysis of the Bank's operations and prospects, and other matters, may include forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and other provisions of federal and state securities laws. Although the Bank believes that the assumptions underlying such forward-looking statements contained in this Report are reasonable, any of the assumptions could be inaccurate and, accordingly, there can be no assurance that the forward-looking statements included herein will prove to be accurate. The use of such words as expect, anticipate, forecast, project and comparable terms should be understood by the reader to indicate that the statement is "forward-looking" and thus subject to change in a manner that can be unpredictable. Factors that could cause actual results to differ from the results anticipated, but not guaranteed, in this Report, include (without limitation) economic and social conditions, relative declines in residential real estate construction in the United States, issues related to "subprime" mortgages, competition for loans, mortgages, and other financial services and products, changes in interest rates, unforeseen changes in liquidity, results of operations, and financial conditions affecting the Bank's customers, as well as other risks that cannot be accurately quantified or completely identified. Many factors affecting the Bank's financial condition and profitability, including changes in economic conditions, the volatility of interest rates, political events and competition from other providers of financial services simply cannot be predicted. Because these factors are unpredictable and beyond the Bank's control, earnings may fluctuate from period to period. The purpose of this type of information is to provide readers with information relevant to understanding and assessing the financial condition and results of operations of the Bank, and not to predict the future or to guarantee results. The Bank is unable to predict the types of circumstances, conditions, and factors that can cause anticipated results to change. The Bank undertakes no obligation to publish revised forward-looking statements to reflect the occurrence of changes or unanticipated events, circumstances, or results.

MIDSOUTH BANK

FORM 10-Q, CONTINUED

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued

Results of Operations

The Bank had a loss of \$7,853,000 for the first nine months of 2009, compared to a loss of \$661,000 for the same period of 2008. On a per share basis, the loss was \$2.05 per common share of stock for the first nine months of 2009 compared to the loss of \$0.18 per common share of stock for the first nine months of 2008.

The Bank had a loss of \$5,911,000 for the third quarter of 2009, compared to a loss of \$93,000 for the same period of 2008. On a per share basis, the loss was \$1.54 per common share of stock for the third quarter of 2009 compared to the loss of \$0.02 per common share of stock for the same period of 2008.

The primary reason for the Bank's loss for the first nine months of 2009 is due to management's recording provisions for loan losses of approximately \$9.7 million. This was offset by gains on sales of available-for-sale securities during the second and third quarters of 2009 totaling a little more than \$1 million. A large portion of the provision relates to the Bank's \$2 million participation in a loan to a bank holding company, a loan that was originated by another larger commercial bank in our local market. Another portion of the provision relates to management's aggressive and conservative evaluation of the loan portfolio and the underlying collateral supporting the portfolio, a large portion of which is real estate. A number of recent appraisals that have been received by the Bank indicate that real estate values have significantly declined over the past 12 to 18 months, so management has attempted to properly assess those results and act in a prudent manner to properly provide for potential loan losses. The remainder of the provision was booked as a result of recommendations from the Bank's regulators.

Management considers the local economy to be weak but showing some signs of stabilizing based on current inventories of residential real estate; however, with unemployment rates in Tennessee exceeding 10%, we believe that any improvement in the local economy, once it begins, will occur gradually.

Net Interest Income

Net interest income represents the amount by which interest earned on various earning assets exceeds interest paid on deposits and other interest-bearing liabilities and is the most significant component of the Bank's earnings. Total interest income for the nine months ended September 30, 2009 was \$10,073,000 and total interest expense was \$3,100,000. Net interest income for the first nine months of 2009 totaled \$6,973,000. For the same period in 2008 total interest income was \$10,845,000 and total interest expense was \$4,520,000. This represents a 7.1% decrease in total interest income and a 31.4% decrease in interest expense from 2008 to 2009. Net interest income for the first nine months of 2008 was \$6,325,000. This represents an increase of 10.2% in net interest income from 2008 to 2009. The decrease in interest income was due to several factors: (1) the reduction of loan balances during the period (2) the reduction of loan yields based on the number of loans that have been placed on nonaccrual status; and (3) the reduction of principal balances and rates in the investment portfolio due to sales of securities and reinvesting in securities at lower interest rates. The decrease in interest expense was primarily due to the downward pricing of the Bank's deposit portfolio, especially in brokered time deposits, the majority of which were priced 125 to 150 basis points below the Bank's local market. That decrease in interest expense was the primary reason that net interest income for the first nine months of 2009 increased by nearly \$650,000 in comparison with the same period in 2008. In addition, since the Federal Reserve was lowering Prime rates very quickly during 2008, management focused its attention on the variable rate segment of the loan portfolio, and by adding rate "floors" to those loans as they renewed, the Bank's net interest margin was stabilized in a quickly declining rate environment. Management has also taken actions to reduce the Bank's funding costs during 2009, especially in relation to the Bank's short-term borrowings and time deposits. All of those efforts have been very effective as evidenced by the significant reduction in interest expense noted above.

Total interest income for the three months ended September 30, 2009 was \$3,248,000 and total interest expense was \$961,000. Net interest income for the third quarter of 2009 totaled \$2,287,000. For the same period in 2008 total interest income was \$3,615,000 and total interest expense was \$1,352,000. This represents a 10.2% decrease in total interest income and a 28.9% decrease in interest expense when comparing the same quarters from 2008 to 2009. Net interest income for the third quarter of 2008 was \$2,263,000. This represents an increase of 1.1% in net interest income when comparing the third quarter of 2008 with the same period in 2009. When comparing the variances related to interest income and interest expense for the third quarter of 2009 and the third quarter of 2008, the

MIDSOUTH BANK

FORM 10-Q, CONTINUED

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued

same explanations apply from the year-to-date variance discussion in the previous paragraph. The only exception to that relates to net interest income, which had only a small variance when comparing the third quarters of 2009 and 2008.

The Federal Reserve has not changed interest rates over the past several months, and management understands that the Federal Reserve has indicated that interest rates will remain unchanged for the foreseeable future. In a Federal Reserve press release dated November 4, 2009, the Federal Open Market Committee stated that it "will maintain the target range for the federal funds rate at 0 to 1/4 percent and continues to anticipate that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels of the federal funds rate for an extended period." Based on that report and others like it, management believes that the Bank's net interest margin should remain relatively stable over the remainder of 2009, depending upon rates offered by competitors in its local markets and depending upon the stability of the Bank's loan portfolio.

Provision for Loan Losses

The provision for loan losses represents a charge to earnings necessary to establish an allowance for loan losses that, in management's evaluation, is adequate to provide coverage for estimated losses on outstanding loans and to provide for uncertainties in the economy. The provision for loan losses and the amount added to the allowance for loan losses was \$9,705,000 for the first nine months of 2009 and \$994,000 for the same period in 2008. The provision for loan losses and the amount added to the allowance for loan losses was \$6,425,000 for the third quarter of 2009 and \$365,000 for the same period in 2008. The level of the allowance and the amount of the provision involve evaluation of uncertainties and matters of judgment. Management believes the allowance for loan losses at September 30, 2009 and December 31, 2008 to be adequate. The total allowance for loan losses was \$9,876,000, or 4.7% of loans, at September 30, 2009 and \$5,784,000, or 2.6% of loans, at December 31, 2008.

The provision for loan losses has increased during 2009 primarily due to management's recording large provisions for loan losses for several reasons. Approximately \$2 million of the provision relates to a loan to a bank holding company that was originated by another bank in which the Bank was a participant. The remainder of the provision increase relates to management's evaluation of the loan portfolio based on the results of a loan review completed in the third quarter and based on input received during the recently completed joint regulatory examination conducted by the Federal Reserve Bank of Atlanta and the Tennessee Department of Financial Institutions. It is also based on management's assessment of the local economy, which it considers to be weak but showing signs of stabilizing. Until the economy begins to recover, management recognized that there may be more borrowers that develop cash flow issues that will affect their ability to fully pay back their loans. Our reserve analysis and our provisions to the allowance for loan losses factor in these considerations, but if the economy continues to weaken or does not begin to recover, then the Bank may have to record even more loan loss provisions during the remainder of 2009.

Non-Interest Income

The Bank's non-interest income primarily consists of service charges on deposits, fees on mortgage originations, fees from brokerage operations, gains on sales of available-for-sale securities and other fees and commissions. Total non-interest income for the nine months ended September 30, 2009 was \$2,319,000 and was \$1,393,000 for the same period in 2008, which is an increase of \$926,000, or 66.5%. The primary reason for the increase was the sale of available-for-sale securities in the second and third quarters of 2009 that resulted in realized gains of \$1,017,000. Beyond that gain, the Bank's deposit service charges and other fees and commissions increased when comparing the first nine months of 2009 with same period in 2008, while brokerage fee income declined by \$129,000, or 31.7%, reflecting the decline in the value of the national stock markets in the first three quarters of 2009 as compared with the same period of 2008.

For the three months ended September 30, 2009 non-interest income was \$745,000, compared with \$503,000 for the same period in 2008, which is an increase of \$242,000, or 48.1%. The primary reason for the increase was the sale of available-for-sale securities in the third quarter of 2009 that resulted in realized gains of \$335,000. Beyond that gain, the Bank's deposit service charges and other fees and commissions decreased slightly when comparing the

MIDSOUTH BANK

FORM 10-Q, CONTINUED

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued

third quarter of 2009 with same period in 2008, mortgage loan fees declined by \$52,000, or 39.7%, and brokerage fee income declined by \$42,000, or 30.4%.

Management believes that service charges on deposit accounts, other fees and commissions and mortgage origination fees will be fairly stable for the remainder of 2009 and will continue to enhance earnings, while net interest income will continue to provide the core earnings for the Bank. If the national stock markets continue to increase in value, the Bank's brokerage income will be enhanced, since many of the Bank's fee opportunities in brokerage directly correlate to the stock markets' increases or decreases.

Non-Interest Expense

Non-interest expenses consist primarily of employee costs, occupancy expenses, FDIC insurance premiums, and other operating expenses. Non-interest expense for the nine months ended September 30, 2009 was \$7,440,000, and it was \$7,385,000 for the same period in 2008, an increase of \$55,000, or 0.7%. The increase primarily relates to increases in FDIC insurance premiums of \$383,000, or 304.0% and professional fees of \$90,000, or 25.7%. Included in the other operating expenses are approximately \$90,000 in debit card fraud losses. The Bank also incurred \$107,000 in losses on the sales of foreclosed assets. These increases were offset by decreases in salaries and employee benefits of \$233,000, or 6.0%, advertising expense of \$138,000, or 43.5%, data processing expense of \$136,000, or 29.6%, furniture and equipment expenses of \$57,000, or 15.0%, and directors' fees of \$72,000, or 77.4%. Many of these decreases were due to specific actions that have been taken by management to reduce the Bank's non-interest expenses.

Non-interest expense for the three months ended September 30, 2009 was \$2,518,000, compared to \$2,494,000 for the same period in 2008, an increase of \$24,000, or 1.0%. The increase relates primarily to increases in FDIC insurance premiums of \$161,000, or 383.3% and professional fees of \$69,000, or 65.1%. In addition, the Bank also realized approximately \$52,000 in losses on the sales of foreclosed assets during the third quarter of 2009. These increases were offset by decreases in salaries and employee benefits of \$111,000, or 8.6%, advertising expense of \$45,000, or 45.0%, data processing expense of \$46,000, or 31.1%, furniture and equipment expenses of \$13,000, or 10.8%, and directors' fees of \$31,000, or 100.0%. Many of these decreases were due to specific actions that have been taken by management to reduce the Bank's non-interest expenses.

Income Taxes

The Bank will record no income tax expense for 2009 due to the Bank's cumulative losses from the previous years of operation.

MIDSOUTH BANK

FORM 10-Q, CONTINUED

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued

Financial Condition

Balance Sheet Summary

The Bank's total assets were \$246,149,000 at September 30, 2009 and \$270,837,000 at December 31, 2008. Loans, net of allowance for loan losses, totaled \$201,608,000 at September 30, 2009 and \$216,730,000 at December 31, 2008. Investment securities totaled \$25,324,000 at September 30, 2009 and \$33,146,000 at December 31, 2008. Restricted equity securities totaled \$1,495,000 and \$1,581,000 at September 30, 2009 and December 31, 2008, respectively. Interest bearing accounts at other financial institutions totaled \$3,782,000 and \$132,000 at September 30, 2009 and December 31, 2008. The percentage changes for these assets are a 9.1% decrease in total assets, a 7.0% decrease in loans net of allowance for loan losses, a 23.6% decrease in investment securities, and a 5.4% decrease in restricted equity securities. The increase in interest bearing accounts at other financial institutions is related to a change in the bank's correspondent relationship to the Federal Reserve Bank.

Total liabilities decreased by 6.9% to \$225,875,000 at September 30, 2009 from \$242,709,000 at December 31, 2008. Stockholders' equity decreased 27.9% to \$20,274,000 at September 30, 2009 from \$28,128,000 at December 31, 2008. A more detailed discussion of assets, liabilities and capital follows.

Loans

Loan categories are as follows:

	September 30, 2009		December 31, 2008	
	<u>Amount</u>	<u>Percentage</u>	<u>Amount</u>	<u>Percentage</u>
	<i>(In Thousands)</i>		<i>(In Thousands)</i>	
Commercial, financial and agricultural	\$ 126,810	60.0%	\$ 130,342	58.6%
Consumer	3,675	1.7	3,644	1.6
Real estate – mortgage	47,931	22.7	46,124	20.7
Real estate – construction	<u>33,068</u>	<u>15.6</u>	<u>42,404</u>	<u>19.1</u>
Total	<u>\$ 211,484</u>	<u>100.0%</u>	<u>\$ 222,514</u>	<u>100.0%</u>

Loans are a large component of the Bank's assets and are a primary source of income. The loan portfolio is composed of four primary loan categories: commercial, financial and agricultural; consumer; real estate - mortgage; and real estate - construction. The table above sets forth the loan categories and the percentage of such loans in the portfolio at September 30, 2009 and December 31, 2008.

As represented in the table, loans declined by approximately five percent during the first nine months of 2009. At September 30, 2009, residential real estate loans are 38.3% of total loans. Accordingly, the Bank has a significant concentration of credit that is dependent on the continuing strength of the local real estate market. Management is focused on making loans in an orderly fashion to maintain quality, especially in these strained economic times. Since construction loans are particularly risky in the current economic environment, management does not expect to originate a significant amount of this type of loan, except where the risk to the Bank has been significantly mitigated.

The Bank follows the provisions of ASC 310-10 and ASC 310-40. These standards apply to impaired loans except for large groups of smaller-balance homogeneous loans that are collectively evaluated for impairment including residential mortgage and consumer installment loans.

The Federal regulatory agencies issued two "guidances" that have a significant impact on real-estate related lending and, thus, on the operation of the Bank. One part of the guidance could require lenders to restrict lending secured primarily by certain categories of commercial real estate to a level of 300% of their capital or to raise additional capital. This factor, combined with the current economic environment, has affected the Bank's loan strategy away from, or to limit its expansion of, commercial real estate lending, which has been a material part of the Bank's lending strategy. This could also have a negative impact on the Bank's lending and profitability. Management

MIDSOUTH BANK

FORM 10-Q, CONTINUED

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued

actively monitors the composition of the Bank's loan portfolio, focusing on concentrations of credit, and the results of that monitoring activity is periodically reported to the Board of Directors.

The other guidance relates to the structuring of certain types of mortgages that allows negative amortization of consumer mortgage loans. Although the Bank does not engage at present in a significant amount of lending using these types of instruments, the guidance could have the effect of making the Bank less competitive in consumer mortgage lending if the local market is driving the demand for such an offering.

A loan is impaired when it is probable that the Bank will be unable to collect the scheduled payments of principal and interest due under the contractual terms of the loan agreement. Impaired loans are measured at the present value of expected future cash flows discounted at the loan's effective interest rate, at the loan's observable market price, or the fair value of the collateral if the loan is collateral dependent. If the measure of the impaired loan is less than the recorded investment in the loan, the Bank shall recognize an impairment by creating a valuation allowance with a corresponding charge to the provision for loan losses or by adjusting an existing valuation allowance for the impaired loan with a corresponding charge or credit to the provision for loan losses.

The Bank's single family residential and consumer loans which total approximately \$44,737,000 and \$3,675,000, respectively at September 30, 2009, are divided into various groups of smaller-balance homogeneous loans that are collectively evaluated for impairment. Substantially all other loans of the Bank are evaluated for specific impairment.

The Bank considers all loans subject to the provisions of ASC 310-10 and ASC 310-40 that are on nonaccrual status to be impaired. Loans are placed on nonaccrual status when doubt as to timely collection of principal or interest exists, or when principal or interest is past due 90 days or more unless such loans are well-secured and in the process of collection. Delays or shortfalls in loan payments are evaluated with various other factors to determine if a loan is impaired. Generally, delinquencies under 90 days are considered insignificant unless certain other factors are present which indicate impairment is probable. The decision to place a loan on nonaccrual status is also based on an evaluation of the borrower's financial condition, collateral, liquidation value, and other factors that affect the borrower's ability to pay.

Generally, at the time a loan is placed on nonaccrual status, all interest accrued on the loan in the current fiscal year is reversed from income, and all interest accrued and uncollected from the prior year is charged off against the allowance for loan losses. Thereafter, interest on nonaccrual loans is recognized as interest income only to the extent that cash is received and future collection of principal is not in doubt. If the collectability of outstanding principal is doubtful, such interest received is applied as a reduction of principal. A nonaccrual loan may be restored to accruing status when principal and interest is no longer past due and unpaid and future collection of principal and interest on a timely basis is not in doubt. At September 30, 2009 there were 35 non-accrual loans totaling \$16,182,000, and there were five non-accrual loans totaling \$2,338,000 at December 31, 2008.

Other loans may be classified as impaired when the current net worth and financial capacity of the borrower or the collateral pledged, if any, is viewed as inadequate. In those cases, such loans have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt, and if such deficiencies are not corrected, there is a probability that the Bank will sustain some loss. In such cases, interest income continues to accrue as long as the loan does not meet the Bank's criteria for nonaccrual status.

Generally the Bank also classifies as impaired any loans the terms of which have been modified in a troubled debt restructuring. Interest is accrued on such loans that continue to meet the modified terms of their loan agreements. At September 30, 2009 the Bank had two loans that have had the terms modified in a troubled debt restructuring and at December 31, 2008, the Bank had no loans that have had the terms modified in a troubled debt restructuring.

The Bank's charge-off policy for impaired loans is similar to its charge-off policy for all loans in that loans are charged-off in the month when they are considered uncollectible.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued

Impaired loans and related allowance for loan loss allocation amounts at September 30, 2009 and December 31, 2008 were as follows:

	September 30, 2009	December 31, 2008
	<i>(In Thousands)</i>	
Recorded investment	\$ 20,185	\$ 7,879
Loan loss allocation	\$ 6,647	\$ 3,603

Impaired loans without allowance for loan loss allocation amounts at September 30, 2009 and December 31, 2008 were as follows:

	September 30, 2009	December 31, 2008
	<i>(In Thousands)</i>	
Recorded investment	\$ 5,663	\$ 1,983

The average recorded investment in impaired loans for September 30, 2009 and December 31, 2008 was \$14,778,000 and \$6,308,000, respectively. The related total amount of interest income recognized on the accrual basis for the period that such loans were impaired was \$803,000 for the first nine months of 2009 and \$384,000 for year-end 2008. The Bank's level of impaired loans increased over the past quarter as a result of several commercial customers' cash flow issues within that segment of the loan portfolio. As the current economic recession has continued, it has affected a number of business customers and commercial real estate owners in addition to the borrowers in the real estate construction industry. Bank management believes that existing loan loss reserves are adequate to absorb potential losses that may occur in these segments of the portfolio.

At September 30, 2009 and December 31, 2008, there were \$45,715,000 and \$24,082,000, respectively, in loans included in the Bank's internal classified loan list. Loans are listed as classified when information obtained about possible credit problems of the borrower has prompted management to question the ability of the borrower to comply with the agreed repayment terms of the loan agreement. The loan classifications could represent or result from trends or uncertainties which management expects will materially impact future operating results, liquidity or capital resources.

The allowance for loan losses is discussed under "Provision for Loan Losses". The Bank maintains its allowance for loan losses at an amount considered by management to be adequate to provide for the possibility of loan losses in the loan portfolio.

Essentially all of the Bank's loans originate from Rutherford and adjacent counties in Tennessee. The Bank seeks to exercise prudent risk management in lending, including diversification by loan category and industry segment, as well as by identification of credit risks.

The Bank's management believes there is a significant opportunity to continue to increase the loan portfolio in the Bank's primary market area. The Bank has targeted commercial business lending, commercial and residential real estate lending and consumer lending. The Bank seeks to build a loan portfolio which is capable of adjusting to swings in the interest rate market, and it is the Bank's policy to maintain a diverse loan portfolio not dependent on any particular market or industrial segment. Management has set a goal for loans to approximate 100% of deposits.

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FORM 10-Q, CONTINUED

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued

Securities

Securities are a primary component of the Bank's earning assets. Securities totaled \$25,324,000 at September 30, 2009. This represents a 23.6% decrease from the December 31, 2008 total of \$33,146,000. The reduction in securities is due to the Bank's selling two blocks of securities in the second and third quarters of 2009 to take advantage of the gains that were in the portfolio at those times in order to replenish capital to the extent there were gain in the portfolio. Restricted equity securities totaled \$1,495,000 and \$1,581,000 at September 30, 2009 and December 31, 2008, respectively.

The Bank applies the provisions of ASC 320, "*Investments – Debt and Equity Securities.*" Under the provisions of the Statement, securities are classified in three categories and accounted for as follows:

- Debt securities that the enterprise has the positive intent and ability to hold to maturity are classified as held-to-maturity securities and reported at amortized costs.
- Debt and equity securities that are bought and held principally for the purpose of selling them in the near term are classified as trading securities and reported at fair value, with unrealized gains and losses included in earnings.
- Debt and equity securities not classified as either held-to-maturity securities or trading securities are classified as available-for-sale securities and reported at fair value, with unrealized gains and losses excluded from earnings and reported as a separate component of stockholders' equity.

The Bank has classified all its securities as available-for-sale. The investment securities portfolio is the second largest component of the Bank's earning assets and represented 10.3% of total assets at September 30, 2009. The Bank uses the investment securities portfolio to provide cash flow and to meet pledging requirements for deposits of public funds, securities sold under agreement to repurchase and secured Fed Funds lines of credit. The average yield on the investment securities portfolio during the first nine months of 2009 was 4.56%.

Deposits

Deposits are the principal source of funds for the Bank. Total deposits were \$221,569,000 and \$222,930,000 at September 30, 2009 and December 31, 2008, respectively, a decrease of 0.6%. The Bank has targeted local consumers, professionals, local governments and commercial businesses as its central customers; therefore, deposit instruments in the form of demand deposits, savings accounts, money market demand accounts, certificates of deposit and individual retirement accounts are offered to customers.

Management believes Rutherford County and the surrounding area is a growing economic market offering growth opportunities for the Bank; however, the Bank competes with several of the larger bank holding companies that have bank offices in this area, as well as other community banks; and therefore, no assurances of market growth can be given. Even though the Bank is in a very competitive market, management currently believes that its market share will be expanded. Management firmly believes that its position as a locally-owned financial institution that offers personalized service will contribute significantly to quality loans and deposit growth and profitability.

Non-interest bearing deposits decreased 13.5% from \$28,595,000 at December 31, 2008 to \$24,722,000 at September 30, 2009. Total interest-bearing deposits increased by 1.3% from \$194,335,000 at December 31, 2008 to \$196,847,000 at September 30, 2009.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued

The table below sets forth the total balances of our deposits by type as of September 30, 2009 and December 31, 2008, and the percent change in balances over the intervening period:

	<u>September 30,</u> <u>2009</u>	<u>December 31,</u> <u>2008</u>	<u>% Change</u>
<i>(In Thousands)</i>			
Non-interest bearing accounts	\$ 24,722	\$ 28,595	(13.5)%
NOW accounts	24,732	22,703	8.9
Money market accounts	40,670	39,330	3.4
Savings accounts	2,214	1,747	26.7
Certificates of deposit	122,923	125,068	(1.7)
Individual retirement accounts	<u>6,308</u>	<u>5,487</u>	<u>15.0</u>
Total deposits	<u>\$ 221,569</u>	<u>\$ 222,930</u>	<u>(0.6)%</u>

Liquidity and Asset Management

The Bank's management seeks to maximize net interest income by managing the Bank's assets and liabilities within appropriate constraints on capital, liquidity and interest rate risk. Liquidity is the ability to maintain sufficient cash levels necessary to fund operations, meet the requirements of depositors and borrowers and fund attractive investment opportunities. The Bank's primary source of liquidity is expected to be a stable core deposit base. In addition, short-term investments, loan payments and investment security maturities provide a secondary source. Higher levels of liquidity bear corresponding costs, measured in terms of lower yields on short-term more liquid earning assets and higher interest expense involved in extending liability maturities.

The Bank maintains a formal asset and liability management process to quantify, monitor and control interest rate risk and to assist management in maintaining stability in the net interest margin under varying interest rate environments. The Bank accomplishes this process through the development and implementation of lending, funding and pricing strategies designed to maximize net interest income under varying interest rate environments subject to specific liquidity and interest rate risk guidelines.

Analysis of rate sensitivity and rate gap analysis are the primary tools used to assess the direction and magnitude of changes in net interest income resulting from changes in interest rates. Included in the analysis are cash flows and maturities of financial instruments held for purposes other than trading, changes in market conditions, loan volumes and pricing and deposit volume and mix. These assumptions are inherently uncertain, and, as a result, net interest income cannot be precisely estimated nor can the impact of higher or lower interest rates on net interest income be precisely predicted. Actual results will differ due to timing, magnitude and frequency of interest rate changes and changes in market conditions and management's strategies, among other factors.

The Bank's securities portfolio consists of earning assets that provide interest income. Securities classified as available-for-sale include securities intended to be used as part of the Bank's asset/liability strategy and/or securities that may be sold in response to changes in interest rate, prepayment risk, the need or desire to increase capital and similar economic factors. Securities totaling \$470,000 mature or will be subject to rate adjustments within the next 12 months.

A secondary source of liquidity is the Bank's loan portfolio. At September 30, 2009, loans of approximately \$106.5 million either will become due or will be subject to rate adjustments within 12 months from the respective date.

As for liabilities, certificates of deposit of \$100,000 or greater of approximately \$63.3 million will become due during the next 12 months. Management anticipates that there will be no significant reductions from deposit accounts that allow withdrawals, such as negotiable order of withdrawal accounts, money market demand accounts, demand deposits and regular savings accounts in the future.

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FORM 10-Q, CONTINUED

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued

Capital Position and Dividends

At September 30, 2009 and December 31, 2008, total stockholders' equity was \$20,274,000 and \$28,128,000 or 8.2% and 10.4%, respectively, of total assets.

The Bank's principal regulators have established minimum risk-based capital requirements and leverage capital requirements for the Bank. These guidelines classify capital into two categories of Tier I and Total risk-based capital. Total risk-based capital consists of Tier I (or core) capital (essentially common equity less intangible assets) and Tier II capital (essentially qualifying long-term debt, of which the Bank has none, and a part of the allowance for loan losses). In determining risk-based capital requirements, assets are assigned risk-weights of 0% to 100%, depending on regulatory assigned levels of credit risk associated with such assets.

There are statutory, regulatory and prudential limitations on the payment of dividends by the Bank. Tennessee law restricts the amount of dividends that may be paid by the Bank. In no event is a Tennessee-chartered bank permitted to pay dividends in any calendar year that exceed the total of its net income of that year combined with its retained net income of the preceding two years without the prior approval of the Commissioner of the Tennessee Department of Financial Institutions. Prior regulatory approval must be obtained before declaring any dividends if the amount of the Bank's capital and surplus is below certain statutory limits. Dividends can also be restricted under federal law, and under state safety and soundness considerations, as a result of a declining or inadequate capital level. Future dividends may be paid at the discretion of the board of directors consistent with the regulatory, legal and prudential considerations discussed elsewhere in this document.

The table below sets forth the Bank's capital ratios as of the periods indicated.

	September 30, 2009	December 31, 2008
Tier I Leverage	7.78%	10.20%
Regulatory Minimum	4.00%	4.00%
Well-capitalized Minimum	5.00%	5.00%
Tier I Risk-Based Capital	8.76%	10.82%
Regulatory Minimum	4.00%	4.00%
Well-capitalized Minimum	6.00%	6.00%
Total Risk-Based Capital	10.05%	12.08%
Regulatory Minimum	8.00%	8.00%
Well-capitalized Minimum	10.00%	10.00%

The Bank is considered well-capitalized based on its regulatory capital ratios, although those ratios have decreased as we have continued to experience asset quality deterioration in the loan portfolio. The currently planned emphasis for the short-term is on raising additional capital through a preferred stock offering that is expected to be initiated during the fourth quarter of 2009. The Bank's profitability is also a focus, but in the short run that will be primarily driven by asset quality. Due to the current economic downturn, asset quality is the main issue being faced by MidSouth Bank, and the banking industry as a whole, since a number of the Bank's customers are being impacted and may be unable to repay their loans.

The Bank has entered into an agreement with the Bank's regulatory agencies that provides for periodic reporting of the Bank's earnings, projections, annual budgets, strategic plans, capital plans and plans for the reduction of classified assets. The agreement also provides for additions of, or enhancements to, certain policies related to the Bank's lending and audit functions and for limitations on extensions of credit for certain classified borrower relationships. Based on a recent joint examination conducted by the Federal Reserve Bank of Atlanta in conjunction with the Tennessee Department of Financial Institutions, the Bank will most likely be asked to enter into a letter of agreement with the regulators, with terms to be stipulated once the examiners' report is issued sometime in the first quarter of 2010. It can be expected that such an agreement with the regulatory agencies will impose specific requirements concerning capital, liquidity, loan losses and the loan loss reserve, the Bank's reliance on "non-core"

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued

deposits, the Bank's use of certain brokered funds, expense levels, the Bank's budget and profit plan and, perhaps, other matters.

Off Balance Sheet Arrangements

At September 30, 2009, the Bank had unfunded loan commitments outstanding of \$46.4 million and outstanding standby letters of credit of \$1.9 million. Because these commitments generally have fixed expiration dates and many will expire without being drawn upon, the total commitment level does not necessarily represent future cash requirements. If needed to fund these outstanding commitments, the Bank has the ability to liquidate Federal funds sold or securities available-for-sale or borrow funds from the Federal Home Loan Bank or purchase Federal funds from other financial institutions. Additionally, the Bank could sell participations in these or other loans to correspondent banks. As mentioned above, the Bank has been able to fund its ongoing liquidity needs through its stable core deposit base, loan payments, its investment security maturities and short-term borrowings.

Impact of Inflation

Although interest rates are significantly affected by inflation, the inflation rate is immaterial when reviewing the Bank's results of operations.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

Pursuant to Item 305(e) of Regulation S-K, the Registrant is not required to provide this information.

Item 4T. Controls and Procedures

Within the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our Chief Executive Officer and the Chief Financial Officer, of the design and operation of our disclosure controls and procedures. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective for gathering, analyzing and disclosing the information that we are required to disclose in the reports we file under the Securities Exchange Act of 1934, as amended ("Exchange Act") within the time periods specified in the Federal Reserve's rules and forms. Our Chief Executive Officer and Chief Financial Officer also concluded that our disclosure controls and procedures are effective in timely alerting them to material information relating to our Bank required to be included in our periodic Federal Reserve filings. In connection with the new rules, we are in the process of further reviewing and documenting our disclosure controls and procedures, including our internal controls and procedures for financial reporting, and may from time to time make changes designed to enhance their effectiveness and to ensure that our systems evolve with our business.

The Bank's common stock is registered under Section 12(g) of the Exchange Act, and is therefore subject to the requirements of Section 404, and other provision, of the Sarbanes-Oxley Act of 2002 ("SOX"). Under SOX, the Public Company Accounting Oversight Board has imposed significant internal procedures, internal controls, and other requirements on public companies such as the Bank, and compliance with these requirements may prove expensive to the Bank.

Please refer also to Item 2 of Part I of this Report for additional information concerning controls and procedures.

Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)) during the quarter ended September 30, 2009 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

MIDSOUTH BANK

PART II. OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

None.

Item 1A. RISK FACTORS

The following Risk Factors should be considered in addition to and in conjunction with those specified in our Annual Report on Form 10-K for the year ended December 31, 2008, which is available from our website. (Although we make reference to our website, we do not incorporate any of the information posted there as part of this Report.)

Our operations may require us to raise additional capital in the future, but that capital may not be available or may not be on terms acceptable to us when it is needed. We are required by federal regulatory authorities to maintain adequate levels of capital to support our operations. As part of the memorandum of understanding, we agreed that the Bank would maintain a minimum Tier 1 leverage ratio and tangible stockholder's equity to total tangible assets ratio of not less than 8.0 percent. We have also committed to the Federal Reserve and to the Tennessee Department of Financial Institutions to adopt a consolidated capital plan to augment and maintain a sufficient capital position. Our existing capital resources may not satisfy our capital requirements for the foreseeable future and may not be sufficient to offset any problem assets identified in the fourth quarter of 2009 and thereafter. Further, should our asset quality erode and require significant additional provision for credit losses, resulting in consistent net operating losses at the Bank, our capital levels will decline and we will need to raise capital to maintain our well-capitalized status and satisfy our agreements with the Federal Reserve and the Department of Financial Institutions.

Our ability to raise additional capital, if needed, will depend on conditions in the capital markets at that time, which are outside our control, and on our financial performance. Accordingly, we cannot be certain of our ability to raise additional capital if needed or on terms acceptable to us. If we cannot raise additional capital when needed, our ability to continue with our current business plan, or even to maintain our independence, could be materially impaired. Although the Bank met the requirements to be deemed well-capitalized as of September 30, 2009, there can be no assurance that we will continue to meet these requirements.

Our Board has recently approved an offering of up to \$15 million of convertible preferred stock and up to \$5 million of convertible, 6% fixed rate debentures intended to provide additional Tier 1 capital (in the form of the preferred stock) and additional operating capital (in the form of the debentures). The preferred stock will be offered on a pro rata basis to existing shareholders of the Bank (unless they live in a state that would require significant securities or corporate registrations by the Bank) and then to other investors. The Bank has been advised that the Board will purchase at least its proportionate share of the preferred stock. It is expected that an investment in the preferred stock will be a precondition to being allowed to invest in the debentures. The preferred shares and debentures offerings are subject to prior regulatory approval and, if approved, would be offered pursuant to a detailed offering circular that the Bank expects to publish in December of 2009. There can be no assurance that these offerings will be successful. The failure of those offerings could have a material adverse effect on the Bank's ability to remain in the regulatory "well capitalized" category. As described in our Annual Report on Form 10-K for the year ended December 31, 2008, the failure to remain in the "well capitalized" category can be expected to have a materially adverse impact on the Bank's operations, especially in its ability to fund its operations through certain kinds of deposits.

We may be unable to retain or replace brokered deposits as they mature. Under FDICIA, banks may be restricted in their ability to accept broker deposits, depending on their capital classification. "Well-capitalized" banks are permitted to accept broker deposits, but all banks that are not well-capitalized could be restricted to accept such deposits. The FDIC may, on a case-by-case basis, permit banks that are adequately capitalized to accept broker deposits if the FDIC determines that acceptance of such deposits would not constitute an unsafe or unsound banking practice with respect to the bank; however, that

institution would generally be prohibited from accepting brokered deposits and offering interest rates on deposits “significantly higher” than the prevailing rate in its market.

Although the Bank has historically maintained capital ratios above the minimum levels required to be qualified as “well-capitalized” under the regulatory framework for prompt corrective action as of September 30, 2009, the Bank is only marginally above the minimum “well capitalized” level. Our financial flexibility could be severely constrained if we are unable to renew our wholesale funding or if adequate financing is not available in the future at acceptable rates of interest. We may not have sufficient liquidity to continue to fund new loan originations, and we may need to liquidate loans or other assets rapidly and/or unexpectedly in order to repay obligations as they mature. If we were to fall below the “well capitalized” threshold, our ability to accept or renew brokered deposits could have a material adverse effect on our business, financial condition, results of operations, cash flows and/or future prospects.

We expect that the Bank will become subject to a formal administrative action that we expect will place additional restrictions on its operations. The Bank is currently subject to an informal supervisory agreement (a memorandum of understanding) with the Federal Reserve Bank of Atlanta and the Tennessee Department of Financial Institutions (“Department of Financial Institutions”) to address certain issues raised in the Bank’s regulatory examination. In general, the terms of the memorandum of understanding involve capital, loan quality, enhanced reporting, budgeting, liquidity, asset quality, overhead expenses, and the need for the Bank to develop and achieve a profit plan. As a result of the Bank’s recently completed examination by the Federal Reserve and the Department of Financial Institutions, we expect that the Bank will become subject to the issuance of a formal administrative action, which could take the form of a formal agreement or similar administrative action, primarily due to the high level of non-performing assets, loan losses, and lack of profitability, and the resulting impact on its financial condition. Any administrative action proposed by the Federal Reserve and the Department of Financial Institutions would be designed to remedy the deficiencies noted in their formal report of examination. This report of examination is expected in early 2010. Administrative actions generally require certain corrective steps, impose limits on activities, prescribe lending parameters and require additional capital to be raised. In many cases, policies must be revised by the institution and submitted to the regulatory authority for approval within time frames prescribed by the regulatory authorities. We would expect that any administrative action would have performance metrics related to asset quality, commercial real estate concentration, profitability, regulatory capital levels, core funding that we would be required to satisfy within a prescribed period of time to comply with the order. The failure or inability to comply with the administrative action could subject the bank and its directors to additional regulatory actions and could have a material adverse effect on our financial condition, results of operations and prospects, could impact the Bank’s ability to continue with our current business plan or could result in a disposition of the Bank. Generally, these enforcement actions will be lifted only after subsequent examinations substantiate complete correction of the underlying issues.

Future loan losses may exceed our allowance for loan losses. We are subject to credit risk, which is the risk of losing principal or interest due to borrowers’ failure to repay loans in accordance with their terms. During 2008 and 2009, the Bank has experienced losses in its loan portfolio, and made significant provisions to its reserve for loan losses due, in large part, to the ongoing downturn in the economy, particularly in the real estate market in Rutherford County, Tennessee, and in surrounding areas. Continued declines in the local real estate market, unforeseen changes or fluctuations in interest rates, and a variety of other economic factors (such as increased unemployment levels), have and can be expected to have a negative effect on collateral values and borrowers’ ability to repay. Any continuing and significant deterioration in local, regional, national or international economic conditions could result in additional losses to our Bank in excess of our current reserve for loan losses. To the extent loans are not paid timely by borrowers, the loans are placed on non-accrual, thereby reducing interest income. To the extent loan charge-offs exceed our financial models, increased amounts charged to the provision for loan losses would reduce income. Please refer to the Financial Statements for more information about the Bank’s capital, loans, reserve for loan losses, deposits, and other financial information.

The level of existing and any new capital that we raise may be inadequate for our needs. As noted above, the Bank’s capital level currently falls within the regulatory capital level called “well capitalized.” This is the highest regulatory category for bank capital. The Bank wants to raise additional capital for three primary, interrelated purposes. As losses have mounted, there has been downward pressure on the Bank’s capital. As the Bank’s capital as a percentage of its assets is lowered, there is less growth that it

can achieve and it will become more difficult for the Bank to become profitable. If the Bank's capital falls below the "well capitalized" level, there will be significant regulatory restraints on its funding sources (such as a prohibition or limitation on the Bank's ability to use brokered deposits) and its growth. The Bank has constrained its growth during 2009 largely as a result of capital considerations. The Bank believes that continued growth is in its best interests in today's market as new opportunities for market penetration develop. However, without additional capital, it cannot expect to take full or even significant advantage of those opportunities. Thus the Bank has decided to raise capital in the preferred stock and debentures offering described above. If the Bank fails to achieve at least the minimum goals of its offering, then it will have to consider rapidly and significantly shrinking its asset size in order to maintain its capital in the "well capitalized" category, with a resultant lessening of the Bank's ability to achieve sustained profitability. If the Bank raises capital only at or somewhat above the minimum planned offering, then it should be expected that the Bank will put growth plans on hold until such time as it can raise significantly more capital than it would then have. On the other hand, if the Bank is able to raise capital approximating the maximum offering, then it should be able to seek to take advantage of what management believes will be significant and profitable growth opportunities. There can be no assurance that the Bank will be able to achieve the goals of remaining "well capitalized" and obtaining significant growth in its chosen markets.

Further growth and other factors can require us to raise additional capital and a failure to raise significant capital could negatively affect the Bank. Our management desires to pursue perceived opportunities in the Bank's market area. During our history, the Bank has grown, invested in six full-service banking offices, and made loans that have frequently been secured by real estate. Recent declines in real estate values, including the values of the Bank's collateral, have put pressure on the Bank's earnings and on its capital levels. However, the Bank desires to continue to expand its base of quality loans. Further growth could require the Bank to raise additional capital and may expose the Bank to additional losses. No assurance can be given that the Bank could, in the future, raise all needed additional capital (or raise it at non-punitive costs). There can be no assurance that the Bank will be able to achieve its goals in this regard.

We have a concentration of our assets in commercial real estate in the Nashville-Murfreesboro MSA. Continued softness in the Nashville-Murfreesboro MSA real estate market could adversely affect our earnings by increasing our need to fund our reserve for loan and lease losses. We primarily focus on customers located in the Nashville-Davidson -Murfreesboro-Franklin Metropolitan Statistical Area (the "Nashville-Murfreesboro MSA"), particularly those in Rutherford County, Tennessee. Accordingly, much of the real estate collateral securing our loans is located in the Nashville-Murfreesboro MSA, the value of which is significantly dependent upon the growth in population, rates of employment and unemployment, income levels, deposits and housing starts in the Nashville-Murfreesboro MSA, along with the continued expansion of existing and new business in the area. The value of this collateral helps us determine if there will be any shortfall should our customer go into default. Any potential shortfall helps us determine if there will be a potential charge off against our allocated loan loss provisions. This, in turn, directly affects the amount of loan loss provisions we deem sufficient to cover any potential losses in our loan portfolio. Making provisions to our allowance for loan losses directly and adversely affects the profitability of the Bank. The economic downturn and the decline in real estate values have caused the Bank to take charge offs in its loan portfolio, to add to its loan loss reserve, and to restrict loan growth as a result of tightened underwriting standards and general economic weakness in the marketplace. The continuation or worsening of the current downturn in the market for commercial real estate could significantly and negatively affect the quality of our assets and reduce our anticipated earnings. We cannot be sure that further declines in collateral value and loan losses will not be incurred as a result of continued softness in the Nashville-Murfreesboro MSA real estate market.

Rapidly changing interest rate environments could reduce our net interest margin, net interest income, fee income and net income. Interest and fees on loans and securities, net of interest paid on deposits and borrowings, are a large part of our net income. Interest rates are key components of our net interest margin and subject to many factors beyond the control of management. As interest rates change, net interest income is affected. In general, we plan and budget to anticipate a certain range of interest rate fluctuations. However, rapid changes or volatility in interest rates in the future could result in interest expense increasing faster than interest income because of mismatches in financial instrument maturities. Further, substantially higher interest rates generally reduce loan demand and could be expected to lead to slower loan growth and increases in troubled loans. Decreases or increases in interest rates could have a

negative effect on the spreads between the interest rates earned on assets and the rates of interest paid on liabilities, and therefore decrease net interest income.

Slower than anticipated growth in new product and service offerings could result in reduced net income. We rely substantially on providing cost-effective, user-friendly products and services and we have placed great emphasis on expanding our branch network and product offerings in strategic new locations. Executing this strategy carries risks of slower than anticipated growth both in new branches and new products. New branches and products require a significant investment of both capital and staff. Lower than expected loan and deposit growth can decrease anticipated revenues and net income generated by those investments, and opening new branches and introducing new products could result in more expenses than anticipated and divert resources from core operations.

The cost of FDIC Insurance to the Bank has increased substantially during 2009 and is expected to increase significantly in the future. The Bank provides insurance coverage on deposits through the Federal Deposit Insurance Corporation (“FDIC”) to the maximum extent permitted by law. The Bank pays premiums to the FDIC for this coverage. The premiums for FDIC insurance have increased significantly in 2009 and are expected to continue to increase for the immediately foreseeable future. Further, the Bank will be required to pre-pay three years of FDIC insurance premiums in December of 2009. Presently, the exact amount of future increases cannot be predicted. Such increases in FDIC insurance premiums can be expected to apply to all banks, but they have already increased, and can be expected in the future to further increase, the operating costs of the Bank that may amount to several hundred thousand dollars.

Except as described above, we do not believe that there are other material changes in the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2008.

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

- (a) Shares of the Bank’s common stock were issued during the third quarter of 2009 pursuant to the exercise of stock options issued by the Bank in its 2004 Stock Option Arrangement, as follows:

<u>Date of Sale</u>	<u>Number of Shares of Common Stock Sold</u>	<u>Price Per Share</u>
None		

The Bank’s common stock is exempt from registration under applicable state and federal securities law.

- (b) Not Applicable.
- (c) No repurchases for our securities were made during the quarter ended September 30, 2009. The only restrictions on working capital and/or dividends are those reported in Part I of this Report on Form 10-Q, as well as those discussed with respect to dividends in the Bank’s Annual Report on Form 10-K, particularly in the section “Supervision and Regulation” and in the discussion of the Bank’s common stock.

Item 3. DEFAULTS UPON SENIOR SECURITIES

- (a) None.
- (b) Not Applicable.

MIDSOUTH BANK

PART II. OTHER INFORMATION, CONTINUED

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

Item 5. OTHER INFORMATION

None.

Item 6. EXHIBITS

Unless otherwise specifically noted, any exhibit furnished in this Quarterly Report shall not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, (15 U.S.C. 78r), or otherwise subject to the liability of that section. Further, any exhibit furnished in this Quarterly Report shall not be deemed to be incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, except to the extent that the registrant specifically incorporates it by reference.

- (1) Exhibit 31.1 and 31.2 – Rule 13a-14(a)/15d-14(a) Certifications.
- (2) Exhibit 32 – 18 U.S.C. Section 1350 Certification.

CERTIFICATIONS

I, Lee M. Moss, certify that:

1. I have reviewed this Form 10-Q of MidSouth Bank;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects, the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal controls over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

November 19, 2009

/s/ Lee M. Moss
Lee M. Moss
Chairman and Chief Executive Officer

CERTIFICATIONS

I, Kevin D. Busbey, certify that:

1. I have reviewed this Form 10-Q of MidSouth Bank;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects, the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal controls over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

November 19, 2009

/s/ Kevin D. Busbey
Kevin D. Busbey
Senior Vice President and Chief Financial Officer

**CERTIFICATION
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002***

In connection with the Quarterly Report of MidSouth Bank (the “Bank”) on Form 10-Q for the period ended September 30, 2009 as filed with the Federal Reserve on, or about, the date hereof (the “Report”), the undersigned, Lee M. Moss and Kevin D. Busbey, to the best of our knowledge certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Bank.

/s/ Lee M. Moss
Lee M. Moss
Chairman and Chief Executive Officer
November 19, 2009

/s/ Kevin D. Busbey
Kevin D. Busbey
Senior Vice President and Chief Financial Officer
November 19, 2009

* As set forth in Item 601 of Regulation S-K, any certification furnished pursuant to this Item will not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934 (15 U.S.C. 78r), or otherwise subject to the liability of that section. Further, any certification will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent that the registrant specifically incorporates it by reference.