

**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 June 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 August 10, 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 - June 30, 2009 and December 31, 2008.

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

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

Consolidated Statements of Cash Flows - For the six months ended June 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**

**Item 6. Exhibits**

**Signatures**

**PART I – FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**MIDSOUTH BANK**

**Consolidated Balance Sheets**

**June 30, 2009 and December 31, 2008**

**(Unaudited)**

	<u>June 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 \$5,541,000 and \$5,784,000, respectively	\$ 214,676	\$ 216,730
Securities available-for-sale, at market (amortized cost of \$24,315,000 and \$32,116,000, respectively)	24,553	33,146
Loans held for sale	1,551	594
Restricted equity securities	1,507	1,581
Interest-bearing accounts at other financial institutions	<u>5,734</u>	<u>132</u>
Total earning assets	<u>248,021</u>	<u>252,183</u>
Cash and due from banks	1,240	5,694
Bank premises and equipment, net	9,851	10,099
Accrued interest receivable	809	969
Foreclosed assets	1,136	1,487
Other assets	<u>386</u>	<u>405</u>
Total assets	<u>\$ 261,443</u>	<u>\$ 270,837</u>
<u>Liabilities and Stockholders' Equity</u>		
Deposits	\$ 229,044	\$ 222,930
Advances from Federal Home Loan Bank	2,328	13,467
Federal funds purchased	-	4,693
Securities sold under agreement to repurchase	2,012	836
Accrued interest payable	391	349
Accounts payable and other liabilities	<u>1,467</u>	<u>434</u>
Total liabilities	<u>235,242</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	34,710	33,983
Deficit	(12,589)	(10,647)
Net unrealized gains on available-for-sale securities	<u>238</u>	<u>1,030</u>
Total stockholders' equity	<u>26,201</u>	<u>28,128</u>
<b>COMMITMENTS AND CONTINGENCIES</b>		
Total liabilities and stockholders' equity	<u>\$ 261,443</u>	<u>\$ 270,837</u>

See accompanying notes to consolidated financial statements (unaudited).

**MIDSOUTH BANK**

**Consolidated Statements of Operations**

**Three Months and Six Months Ended June 30, 2009 and 2008**

**(Unaudited)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
	<i>(In Thousands, Except Per Share Amounts)</i>			
<b>Interest income:</b>				
Interest and fees on loans	\$ 3,060	\$ 3,101	\$ 6,091	\$ 6,337
Interest and dividends on taxable securities	292	425	689	844
Interest on Federal funds sold	1	1	2	7
Interest on balances due from depository institutions	2	-	2	-
Interest and dividends on restricted equity securities	<u>20</u>	<u>21</u>	<u>41</u>	<u>42</u>
Total interest income	<u>3,375</u>	<u>3,548</u>	<u>6,825</u>	<u>7,230</u>
<b>Interest expense:</b>				
Interest on negotiable order of withdrawal accounts	25	33	42	83
Interest on money market and other savings accounts	82	208	159	453
Interest on certificates of deposit	870	1,142	1,855	2,514
Interest on advances from Federal Home Loan Bank	31	70	68	108
Interest on Federal funds purchased	2	4	10	6
Interest on securities sold under agreement to repurchase	<u>3</u>	<u>2</u>	<u>5</u>	<u>4</u>
Total interest expense	<u>1,013</u>	<u>1,459</u>	<u>2,139</u>	<u>3,168</u>
Net interest income before provision for loan losses	2,362	2,089	4,686	4,062
Provision for loan losses	<u>610</u>	<u>380</u>	<u>3,280</u>	<u>629</u>
Net interest income after provision for loan losses	<u>1,752</u>	<u>1,709</u>	<u>1,406</u>	<u>3,433</u>
<b>Non-interest income:</b>				
Service charges on deposits	121	112	234	207
Other fees and commissions	127	86	231	175
Fees on mortgage originations	116	143	241	235
Fees from brokerage operations	97	127	182	269
Gain on sales of available-for-sale securities	682	-	682	-
Gain on sales of bank premises and equipment	4	-	4	-
Gain on sales of foreclosed assets, net	<u>-</u>	<u>2</u>	<u>-</u>	<u>41</u>
Total non-interest income	<u>1,147</u>	<u>470</u>	<u>1,574</u>	<u>927</u>
<b>Non-interest expense:</b>				
Employee salaries and benefits	1,205	1,317	2,447	2,569
Occupancy expenses, net	216	217	428	436
Furniture and equipment expense	104	141	217	261
FDIC insurance	153	42	306	84
Advertising expense	59	118	124	217
Professional fees	153	129	265	244
Data processing expense	103	148	222	312
Directors fees	6	33	21	62
Loss on sales of foreclosed assets, net	35	-	55	-
Other operating expenses	<u>377</u>	<u>374</u>	<u>837</u>	<u>743</u>
Total non-interest expense	<u>2,411</u>	<u>2,519</u>	<u>4,922</u>	<u>4,928</u>
Earnings (loss) before income taxes	488	(340)	(1,942)	(568)
Income taxes	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Earnings (loss)	<u>\$ 488</u>	<u>\$ (340)</u>	<u>\$ (1,942)</u>	<u>\$ (568)</u>
Basic earnings (loss) per common share	<u>\$ 0.13</u>	<u>\$ (0.09)</u>	<u>\$ (0.51)</u>	<u>\$ (0.15)</u>
Diluted earnings (loss) per common share	<u>\$ 0.13</u>	<u>\$ (0.09)</u>	<u>\$ (0.51)</u>	<u>\$ (0.15)</u>

See accompanying notes to consolidated financial statements (unaudited).

**MIDSOUTH BANK**

**Consolidated Statements of Comprehensive Earnings (Loss)**

**Three and Six Months Ended June 30, 2009 and 2008**

**(Unaudited)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
	<i>(In Thousands)</i>			
Net earnings (loss)	\$ 488	\$ (340)	\$ (1,942)	\$ (568)
Other comprehensive loss:				
Change in unrealized losses on available-for-sale securities arising during period	(228)	(1,117)	(110)	(576)
Less: Reclassification adjustment for gains included in net earnings (loss)	<u>(682)</u>	<u>-</u>	<u>(682)</u>	<u>-</u>
Comprehensive loss	<u>\$ (422)</u>	<u>\$ (1,457)</u>	<u>\$ (2,734)</u>	<u>\$ (1,144)</u>

See accompanying notes to consolidated financial statements (unaudited).

**MIDSOUTH BANK**

*Consolidated Statements of Cash Flows*

*Six Months Ended June 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	\$ 6,800	\$ 7,318
Fees received	647	631
Proceeds from sale of loans	18,640	19,676
Origination of loans held for sale	(19,356)	(19,046)
Interest paid	(2,097)	(3,315)
Cash paid to suppliers and employees	<u>(3,490)</u>	<u>(4,527)</u>
Net cash provided by operating activities	<u>1,144</u>	<u>737</u>
Cash flows from investing activities:		
Purchase of available-for-sale securities	(8,842)	(7,490)
Sale of available-for-sale securities	13,298	-
Repayments of mortgage-backed securities	3,147	2,245
Purchase of restricted equity securities	(37)	(164)
Sale of restricted equity securities	111	-
Maturities of available-for-sale securities	1,065	5,374
Loans made to customers, net of repayments	(1,391)	(11,951)
Capitalized cost of foreclosed assets	-	(60)
Proceeds from sale of foreclosed assets	453	762
Sale of premises and equipment	21	-
Purchase of premises and equipment	<u>(77)</u>	<u>(52)</u>
Net cash provided by (used in) investing activities	<u>7,748</u>	<u>(11,336)</u>
Cash flows from financing activities:		
Net increase in non-interest bearing, savings and NOW deposit accounts	10,102	7,271
Net decrease in time deposits	(4,006)	(8,102)
Net increase in mortgage escrow deposits	18	20
Proceeds from advances from the Federal Home Loan Bank	2,100	57,994
Repayments of advances from the Federal Home Loan Bank	(13,239)	(51,057)
Increases in securities sold under agreement to repurchase	1,176	1,246
Net (decrease) increase in Federal funds purchased	(4,693)	204
Proceeds from sale of common stock	<u>798</u>	<u>15</u>
Net cash (used in) provided by financing activities	<u>(7,744)</u>	<u>7,591</u>
Net increase (decrease) in cash and cash equivalents	1,148	(3,008)
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>\$ 6,974</u>	<u>\$ 5,850</u>

See accompanying notes to consolidated financial statements (unaudited).

**MIDSOUTH BANK**

*Consolidated Statements of Cash Flows, Continued*

*Six Months Ended June 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:		
Loss	\$ (1,942)	\$ (568)
Adjustments to reconcile loss to net cash provided by operating activities:		
Depreciation	308	369
Provision for loan losses	3,280	629
Loss (gain) on sale of foreclosed assets	55	(41)
Gain on sale of premises and equipment	(4)	-
Gain on sale of available-for-sale securities	(682)	-
Stock option compensation expense	9	18
Amortization and accretion, net	(185)	(29)
Valuation adjustment on foreclosed assets	8	-
(Increase) decrease in loans held for sale	(957)	395
Decrease in accrued interest receivable	160	117
Decrease (increase) in other assets	19	(13)
Increase (decrease) in accrued interest payable	42	(147)
Increase in other liabilities	<u>1,033</u>	<u>7</u>
Total adjustments	<u>3,086</u>	<u>1,305</u>
Net cash provided by operating activities	<u>\$ 1,144</u>	<u>\$ 737</u>

Supplemental Schedule of Non-Cash Activities:

Unrealized gain in value of securities available-for-sale	<u>\$ 110</u>	<u>\$ (576)</u>
Transfer of loans to foreclosed assets	<u>\$ 165</u>	<u>\$ 230</u>

See accompanying notes to consolidated financial statements (unaudited).

# MIDSOUTH BANK

## 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 June 30, 2009 and December 31, 2008 and the results of operations for the three and six months ended June 30, 2009 and 2008, comprehensive earnings (loss) for the three and six months ended June 30, 2009 and 2008 and changes in cash flows for the six months ended June 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:

	Six Months Ended June 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	(3,524)	(404)
Recoveries credited to allowance	1	4
Provision for loan losses	<u>3,280</u>	<u>629</u>
Balance, June 30, 2009 and 2008, respectively	<u>\$ 5,541</u>	<u>\$ 2,261</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 losses inherent in the loan portfolio. Such estimated losses arise primarily from the loan portfolio but may also

## **MIDSOUTH BANK**

### ***Notes to Consolidated Financial Statements, Continued***

***(Unaudited)***

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 \$3,280,000 and \$629,000 for the first six months of 2009 and 2008, respectively. The increase in the provision from 2008 to 2009 is primarily due to recording provisions for a \$2 million loan relationship involving a bank holding company in which the Bank participated and several other impaired loan relationships that have either declined in quality or have had the values of their underlying collateral deteriorate. Additional provisions have also been recorded to account for the decline in the local economy.

The provision for loan losses was \$610,000 and \$380,000 for the second quarter of 2009 and 2008, respectively. The increase in the provision from 2008 to 2009 is primarily due to the increase in impaired loan relationships that have either declined in quality or have had the values of their underlying collateral deteriorate. Additional provisions have also been recorded to account for the decline in the local economy.

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.

During the fourth quarter of 2008, the Bank recorded provisions in excess of \$3 million to account for a number of loan relationships that quickly deteriorated during that quarter due to the weakening local economy. The Bank added another \$2.7 million in provisions during the first quarter of 2009 to account for the continued decline in the local market, but to primarily account for one loan relationship that was a participation loan to a bank holding company that was originated by another financial institution. That holding company's underlying subsidiary bank was placed in receivership by the Office of the Comptroller of the Currency, thereby rendering its stock value worthless. The Bank held a participation of \$2 million in that loan. During the second quarter of 2009, the Bank recorded provisions of \$610,000, bringing the total provisions for the six months ended June 30, 2009, to \$3,280,000. At June 30, 2009, the allowance represented 2.52% 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 June 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 June 30, 2009, 357,036 options were exercisable. The weighted average exercise prices of outstanding and exercisable stock options as of June 30, 2009 were \$10.03 and \$10.01 per share, respectively. The

**MIDSOUTH BANK**

**Notes to Consolidated Financial Statements, Continued**

**(Unaudited)**

weighted average remaining contractual terms of outstanding and exercisable stock options as of June 30, 2009 were 5.3 years and 5.2 years, respectively. There was no aggregate intrinsic value of outstanding and exercisable stock options at June 30, 2009 since the average price of the stock was less than the average exercise price. As of June 30, 2009, there were total unrecognized compensation costs of \$42,000 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 1.6 years. Compensation expense related to stock options totaled \$10,000 and \$18,000 for the six months ended June 30, 2009 and 2008, respectively. Compensation expense related to stock options totaled \$5,000 and \$11,000 for the three months ended June 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 earnings (loss) per common share of stock (EPS):

<i>(In Thousands, except share and per share amounts)</i>	Three Months Ended		Six Months Ended	
	June 30, 2009	June 30, 2008	June 30, 2009	June 30, 2008
Basic EPS Computation:				
Numerator – Earnings (loss) for the year	\$ 488	\$ (340)	\$ (1,942)	\$ (568)
Denominator - Weighted average number of common shares outstanding	3,841,794	3,742,682	3,835,849	3,742,247
Basic earnings (loss) per common share	\$ 0.13	\$ (0.09)	\$ (0.51)	\$ (0.15)
Diluted EPS Computation:				
Numerator – Earnings (loss) for the year	\$ 488	\$ (340)	\$ (1,942)	\$ (568)
Denominator - Weighted average number of common shares outstanding	3,841,794	3,742,682	3,835,849	3,742,247
Dilutive effect of stock options	-	-	-	-
Dilutive effect of warrants	-	-	-	-
	3,841,794	3,742,682	3,835,849	3,742,247
Diluted earnings (loss) per common share	\$ 0.13	\$ (0.09)	\$ (0.51)	\$ (0.15)

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

**MIDSOUTH BANK**

**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 Statement of Financial Accounting Standards (“SFAS”) No. 157, 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 June 30, 2009	Fair Value Measurements at June 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	\$ 24,553	-	24,553	-
Loans held for sale	\$ 1,551	-	1,551	-

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 six months of 2009.

**Assets and Liabilities Measured on a Non-Recurring Basis**

(in 000's)	Carrying Value at June 30, 2009	Fair Value Measurements at June 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	\$ 12,939	-	-	12,939
Foreclosed assets	\$ 1,136	-	-	1,136

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 June 30, 2009, impaired loans had a carrying amount of \$16,272,000, with a valuation allowance of \$3,333,000.

## **MIDSOUTH BANK**

### ***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 factor 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.

SFAS No. 107 specifies that 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. Under the provision of SFAS No. 107 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 June 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 June 30, 2009 and December 31, 2008 are as follows:

<i>(In Thousands)</i>	June 30, 2009		December 31, 2008	
	<i>Carrying Amount</i>	<i>Fair Value</i>	<i>Carrying Amount</i>	<i>Fair Value</i>
<b>Financial assets:</b>				
Cash and short-term investments.....	\$ 6,974	\$ 6,974	\$ 5,826	\$ 5,826
Securities .....	24,553	24,553	33,146	33,146
Restricted equity securities.....	1,507	1,507	1,581	1,581
Loans held for sale .....	1,551	1,551	594	594
Loans .....	220,217		222,514	
Less: allowance for loan losses .....	(5,541)		(5,784)	
Loans, net of allowance.....	214,676	206,687	216,730	210,039
<b>Financial liabilities:</b>				
Deposits .....	229,044	227,758	222,930	221,914
Advances from Federal Home Loan Bank .....	2,328	2,448	13,467	13,640
Federal funds purchased.....	-	-	4,693	4,693
Securities sold under agreement to repurchase .....	2,012	2,012	836	836
<b>Unrecognized financial instruments:</b>				
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 December 2007, the FASB issued Statement of Financial Accounting Standards (“SFAS”) No. 141R, “*Business Combinations*” (found at ASC 805-10 in the FASB’s GAAP Codification). SFAS No. 141R clarifies the definitions of both a business combination and a business. All business combinations will be accounted for under the acquisition method (previously referred to as the purchase method). This standard defines the acquisition date as the only relevant date for recognition and measurement of the fair value of consideration paid. SFAS No. 141R requires the acquirer to expense all acquisition related costs. SFAS No. 141R will also require acquired loans to be recorded net of the allowance for loan losses on the date of acquisition. SFAS No. 141R defines the measurement period as the time after the acquisition date during which the acquirer may make adjustments to the “provisional” amounts recognized at the acquisition date. This period cannot exceed one year, and any subsequent adjustments made to provisional amounts are done retrospectively and restate prior period data. The provisions of this statement are effective for business combinations during fiscal years beginning after December 15, 2008. The Bank does not expect the impact of SFAS No. 141R on its financial position and results of operations to be material.

In December 2007, the FASB issued SFAS No. 160, “*Noncontrolling Interests in Consolidated Financial Statements — An Amendment of ARB No. 51*” (found at ASC 810-10). SFAS No. 160 requires noncontrolling interests to be treated as a separate component of equity, not as a liability or other item outside of equity. Disclosure requirements include net income and comprehensive income to be displayed for both the controlling and noncontrolling interests and a separate schedule that shows the effects of any transactions with the noncontrolling interests on the equity attributable to the controlling interest. The provisions of this statement are effective for fiscal years beginning after December 15, 2008. This statement should be applied prospectively except for the presentation and disclosure requirements which shall be applied retrospectively for all periods presented. The adoption of this standard did not have a material impact on the Bank’s consolidated financial position, results of operations or cash flows.

In March 2008, the FASB issued SFAS No. 161, “*Disclosures about Derivative Instruments and Hedging Activities*” (found at ASC 815-10 in the FASB’s GAAP Codification). SFAS No. 161 requires companies with derivative instruments to disclose information that should enable financial-statement users to understand how and why a company uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS No. 133, “*Accounting for Derivative Instruments and Hedging Activities*,” and how derivative instruments and related hedged items affect a company’s financial position, financial performance and cash flows. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The adoption of this standard 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 Staff Position (“FSP”) FAS 157-4, “*Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*” (found at ASC 820-10-65-4 in the FASB’s GAAP Codification), provides additional guidance for estimating fair value in accordance with SFAS No. 157 when the volume and level of activity for the asset or liability have decreased significantly. FSP FAS 157-4 also provides guidance on identifying circumstances that indicate a transaction is not orderly. The provisions of FSP FAS 157-4 are 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 FSP FAS 107-1 and Accounting Principles Board (“APB”) 28-1, “*Interim Disclosures about Fair Value of Financial Instruments*” (found at ASC 320-10-50 in the FASB’s GAAP Codification), 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 FSP FAS 107-1 and APB 28-1 are effective for the Bank’s interim period ending on June 30, 2009. As FSP FAS 107-1 and APB 28-1 amends only the disclosure requirements about fair value of financial instruments in interim periods, the adoption of FSP FAS 107-1 and APB 28-1 did not affect the Bank’s statements of operation and condition.

## MIDSOUTH BANK

### *Notes to Consolidated Financial Statements, Continued*

*(Unaudited)*

In April 2009, the FASB issued FSP FAS 115-2 and FAS 124-2, “*Recognition and Presentation of Other-Than-Temporary Impairments*” (found at ASC 320-10-35 in the FASB’s GAAP Codification), 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 FSP does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. The provisions of FSP FAS 115-2 and FAS 124-2 are 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 SFAS No. 165, “*Subsequent Events*” (found at ASC 855 in the FASB’s GAAP Codification). 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 is 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 June 30, 2009, through August 11, 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 June 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.

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 Codification<sup>TM</sup> 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

**MIDSOUTH BANK**

***Notes to Consolidated Financial Statements, Continued***

***(Unaudited)***

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 June 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 major issues 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.

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 providing liquidity to the U. S. financial markets.

In addition, the Treasury announced that it 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 \$700 billion authorized by the EESA, the Treasury will be allowed to purchase up to \$250 billion of senior preferred stock in U. S. financial institutions. In conjunction with the purchase of senior preferred stock, the Treasury will receive 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 will be 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.

**MIDSOUTH BANK**

**FORM 10-Q, CONTINUED**

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

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 is 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 not 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, has since withdrawn 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.

**Results of Operations**

The Bank had a loss of \$1,942,000 for the first six months of 2009, compared to a loss of \$568,000 for the same period of 2008. On a per share basis, the loss was \$0.51 per common share of stock for the first six months of 2009 compared to the net loss of \$0.15 per common share of stock for the first six months of 2008.

The Bank had earnings of \$488,000 for the second quarter of 2009, compared to a loss of \$340,000 for the same period of 2008. On a per share basis, the earnings were \$0.13 per common share of stock for the second quarter of 2009 compared to the net loss of \$0.09 per common share of stock for the same period of 2008.

The primary reason for the Bank's loss for the first six months of 2009 is due to management's recording provisions for loan losses of nearly \$3.3 million. This was offset by gains on sales of available-for-sale securities of \$682,000. The large provision relates primarily to the Bank's \$2 million participation in a loan to a bank holding

**MIDSOUTH BANK**

**FORM 10-Q, CONTINUED**

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

company, a loan that was originated by another larger commercial bank in our local market. The remainder of the provision relates to management's evaluation of the loan portfolio and the local economy. Management considers the local economy to be weak but showing some signs of stabilizing.

**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 six months ended June 30, 2009 was \$6,825,000 and total interest expense was \$2,139,000. Net interest income for the first six months of 2009 totaled \$4,686,000. For the same period in 2008 total interest income was \$7,230,000 and total interest expense was \$3,168,000. This represents a 5.6% decrease in total interest income and a 32.5% decrease in interest expense from 2008 to 2009. Net interest income for the first six months of 2008 was \$4,062,000. This represents an increase of 15.4% in net interest income from 2008 to 2009.

Total interest income for the three months ended June 30, 2009 was \$3,375,000 and total interest expense was \$1,013,000. Net interest income for the second quarter of 2009 totaled \$2,362,000. For the same period in 2008 total interest income was \$3,548,000 and total interest expense was \$1,459,000. This represents a 4.9% decrease in total interest income and a 30.6% decrease in interest expense when comparing the same quarters from 2008 to 2009. Net interest income for the second quarter of 2008 was \$2,089,000. This represents an increase of 13.1% in net interest income when comparing the second quarter of 2008 with the same period in 2009.

The main reasons for the increase in net interest income were: (1) the introduction of rate "floors" on our variable rate loans; and (2) the reduction of the Bank's interest expense, which decreased \$1,029,000, or 32.5%, from \$3,168,000 for the first six months of 2008 to \$2,139,000 for the same period of 2009. Since the Federal Reserve was lowering Prime rates very quickly during 2008, management focused its attention on that segment of the loan portfolio, and by adding rate "floors" to those loans as they renewed, that action helped stabilize MidSouth Bank's net interest margin in a quickly declining rate environment. Management also took actions to reduce the Bank's funding costs, especially in relation to the Bank's short-term borrowings and interest-bearing deposits. All of those efforts have been very effective as evidenced by the significant reduction in interest expense.

The Bank's net interest margin has stabilized as 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. One national news agency recently reported that the Federal Reserve, at its April 2009 Federal Open Market Committee meeting, "pledged to keep its key bank lending rate at a record low 'for an extended period.'" That agency also reported that "economists are predicting that the Federal Reserve will keep the rate there well into next year." 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.

**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 \$3,280,000 for the first six months of 2009 and \$629,000 for the same period in 2008. The provision for loan losses and the amount added to the allowance for loan losses was \$610,000 for the second quarter of 2009 and \$380,000 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 June 30, 2009 and December 31, 2008 to be adequate. The total allowance for loan losses was \$5,541,000, or 2.5% of loans, at June 30, 2009 and \$5,784,000, or 2.6% of loans, at December 31, 2008.

The provision for loan losses increased during 2009 primarily due to management's recording large provisions for loan losses for several reasons. The primary reason relates to a \$2 million 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 local economy, which it considers to be weak but showing signs of stabilizing. Until the economy begins to recover, management expects there to be more borrowers that develop cash flow issues

**MIDSOUTH BANK**

**FORM 10-Q, CONTINUED**

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

that will affect their ability to 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, then the Bank may have to record higher than expected 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 and other fees and commissions. Total non-interest income for the six months ended June 30, 2009 was \$1,574,000 and was \$927,000 for the same period in 2008, which is an increase of \$647,000, or 69.8%. The primary reason for the increase was the sale of available-for-sale securities in the second quarter that resulted in realized gains of \$682,000. Beyond that gain, the Bank's mortgage origination fees, deposit service charges and other fees and commissions all increased when comparing the first six months of 2009 with same period in 2008, while brokerage fee income declined by \$87,000, or 32.3%, reflecting the decline in the value of the national stock markets in the first half of 2009 as compared with the same period of 2008.

For the three months ended June 30, 2009 non-interest income was \$1,147,000, compared with \$470,000 for the same period in 2008, which is an increase of \$677,000, or 144.0%. The primary reason for the increase was the sale of available-for-sale securities in the second quarter that resulted in realized gains of \$682,000. Beyond that gain, the Bank's mortgage origination fees, deposit service charges and other fees and commissions all increased when comparing the second quarter of 2009 with same period in 2008, and brokerage fee income declined by \$30,000, or 23.6%.

Management believes that service charges on deposit accounts, other fees and commissions and mortgage origination fees will continue to increase throughout the remainder of 2009 and will continue to enhance earnings, although net interest income will continue to provide the core earnings for the Bank. If the national stock markets can 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. In addition, management fully expects to have additional opportunities during the third quarter of 2009 to recapture some of the equity lost in the loan loss provision recorded through June 30, 2009.

**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 six months ended June 30, 2009 was \$4,922,000, and it was \$4,928,000 for the same period in 2008, a decrease of \$6,000, or 0.1%. The decrease primarily relates to salaries and employee benefits of \$122,000, or 4.7%, advertising expense of \$93,000, or 42.9%, data processing expense of \$90,000, or 28.8%, furniture and equipment expenses of \$44,000, or 16.9%, and directors' fees of \$41,000, or 66.1%. Many of these decreases were due to specific actions that have been taken by management to reduce the Bank's non-interest expenses. These decreases were offset by increases in FDIC insurance premiums of \$222,000, or 264.3% and professional fees of \$21,000, or 8.6%. Included in the other operating expenses are about \$85,000 in debit card fraud losses. The Bank also incurred \$55,000 in losses on the sales of foreclosed assets.

Non-interest expense for the three months ended June 30, 2009 was \$2,411,000, compared to \$2,519,000 for the same period in 2008, a decrease of \$108,000, or 4.3%. The decrease primarily relates to salaries and employee benefits of \$112,000, or 8.5%, advertising expense of \$59,000, or 50.0%, data processing expense of \$45,000, or 30.4%, furniture and equipment expenses of \$37,000, or 26.2%, and directors' fees of \$27,000, or 81.8%. Many of these decreases were due to specific actions that have been taken by management to reduce the Bank's non-interest expenses. These decreases were offset by increases in FDIC insurance premiums of \$111,000, or 264.3% and professional fees of \$24,000, or 18.6%. In addition, the Bank also realized about \$35,000 in losses on the sales of foreclosed assets during the second quarter of 2009.

**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 \$261,443,000 at June 30, 2009 and \$270,837,000 at December 31, 2008. Loans, net of allowance for loan losses, totaled \$214,676,000 at June 30, 2009 and \$216,730,000 at December 31, 2008. Investment securities totaled \$24,553,000 at June 30, 2009 and \$33,146,000 at December 31, 2008. Restricted equity securities totaled \$1,507,000 and \$1,581,000 at June 30, 2009 and December 31, 2008, respectively. The percentage changes for these assets are a 3.5% decrease in total assets, a 0.9% decrease in loans net of allowance for loan losses, a 25.9% decrease in investment securities and a 4.7% decrease in restricted equity securities.

Total liabilities decreased by 3.1% to \$235,242,000 at June 30, 2009 from \$242,709,000 at December 31, 2008. Stockholders' equity decreased 6.9% to \$26,201,000 at June 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:

	June 30, 2009		December 31, 2008	
	Amount	Percentage	Amount	Percentage
	<i>(In Thousands)</i>		<i>(In Thousands)</i>	
Commercial, financial and agricultural	\$ 130,449	59.2%	\$ 130,342	58.6%
Consumer	3,379	1.5	3,644	1.6
Real estate – mortgage	48,177	21.9	46,124	20.7
Real estate – construction	38,212	17.4	42,404	19.1
Total	\$ 220,217	100.0%	\$ 222,514	100.0%

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 June 30, 2009 and December 31, 2008.

As represented in the table, loans declined slightly during the first six months of 2009. At June 30, 2009, residential real estate loans are 39.3% 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.

The Bank follows the provisions of Statement of Financial Accounting Standards ("SFAS") No. 114, "Accounting by Creditors for Impairment of a Loan" and SFAS No. 118, "Accounting by Creditors for Impairment of a Loan - Income Recognition and Disclosures." These pronouncements 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 could have the effect of causing the Bank to reorient its 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 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.

**MIDSOUTH BANK**

**FORM 10-Q, CONTINUED**

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

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 \$44,848,000 and \$3,379,000, respectively at June 30, 2009, are divided into various groups of smaller-balance homogeneous loans that are collectively evaluated for impairment and thus are not subject to the provisions of SFAS Nos. 114 and 118. Substantially all other loans of the Bank are evaluated for impairment under the provisions of SFAS Nos. 114 and 118.

The Bank considers all loans subject to the provisions of SFAS Nos. 114 and 118 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 June 30, 2009 there were 31 non-accrual loans totaling \$5,021,000, 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 June 30, 2009 and 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.

**MIDSOUTH BANK**

**FORM 10-Q, CONTINUED**

**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 June 30, 2009 and December 31, 2008 were as follows:

	<u>June 30,</u> <u>2009</u>	<u>December 31,</u> <u>2008</u>
	<i>(In Thousands)</i>	
Recorded investment	\$ 16,272	\$ 7,879
Loan loss allocation	\$ 3,333	\$ 3,603

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

	<u>June 30,</u> <u>2009</u>	<u>December 31,</u> <u>2008</u>
	<i>(In Thousands)</i>	
Recorded investment	\$ 4,213	\$ 1,983

The average recorded investment in impaired loans for June 30, 2009 and December 31, 2008 was \$12,888,000 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 \$703,000 for the first six 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 June 30, 2009 and December 31, 2008, there were \$26,354,000 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 do not 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.

**Securities**

Securities are a primary component of the Bank's earning assets. Securities totaled \$24,553,000 at June 30, 2009. This represents a 25.9% decrease from the December 31, 2008 total of \$33,146,000. Restricted equity securities totaled \$1,507,000 and \$1,581,000 at June 30, 2009 and December 31, 2008, respectively.

**MIDSOUTH BANK**

**FORM 10-Q, CONTINUED**

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

The Bank applies the provisions of SFAS No. 115, "Accounting for Certain Investments in 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 9.4% of total assets at June 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 six months of 2009 was 4.94%.

**Deposits**

Deposits are the principal source of funds for the Bank. Total deposits were \$229,044,000 and \$222,930,000 at June 30, 2009 and December 31, 2008, respectively, an increase of 2.7%. 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 increased 10.8% from \$28,595,000 at December 31, 2008 to \$31,687,000 at June 30, 2009. Total interest-bearing deposits increased by 1.6% from \$194,335,000 at December 31, 2008 to \$197,357,000 at June 30, 2009.

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

	<u>June 30,</u> <u>2009</u>	<u>December 31,</u> <u>2008</u>	<u>% Change</u>
<i>(In Thousands)</i>			
Non-interest bearing accounts	\$ 31,687	\$ 28,595	10.8%
NOW accounts	25,014	22,703	10.2
Money market accounts	43,962	39,330	11.8
Savings accounts	1,832	1,747	4.9
Certificates of deposit	120,458	125,068	(3.7)
Individual retirement accounts	<u>6,091</u>	<u>5,487</u>	<u>11.0</u>
Total deposits	<u>\$ 229,044</u>	<u>\$ 222,930</u>	<u>2.7%</u>

**MIDSOUTH BANK**

**FORM 10-Q, CONTINUED**

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

**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 \$1.1 million 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 June 30, 2009, loans of approximately \$111.6 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 \$56.9 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.

**Capital Position and Dividends**

At June 30, 2009 and December 31, 2008, total stockholders' equity was \$26,201,000 and \$28,128,000 or 10.0% 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

**MIDSOUTH BANK**

**FORM 10-Q, CONTINUED**

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

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.

	June 30, 2009	December 31, 2008
Tier I Leverage	9.81%	10.20%
Regulatory Minimum	4.00%	4.00%
Well-capitalized Minimum	5.00%	5.00%
Tier I Risk-Based Capital	10.79%	10.82%
Regulatory Minimum	4.00%	4.00%
Well-capitalized Minimum	6.00%	6.00%
Total Risk-Based Capital	12.05%	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. The currently planned emphasis for the short-term is on profitability, which 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.

**Off Balance Sheet Arrangements**

At June 30, 2009, the Bank had unfunded loan commitments outstanding of \$43.8 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.

**MIDSOUTH BANK**

**FORM 10-Q**

**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 June 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**

Please refer to the discussion of “Risk Factors” 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 second 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>
06/04/2009	200	\$ 10.00

The shares were sold for cash in the amount of \$2,000.

There were no underwriters and no underwriting discounts or commissions. All sales were for cash.

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

The shares of common stock issued pursuant to the exercise of the Bank’s stock options are not convertible or exchangeable into other equity securities.

The proceeds of the sales are being used by the Bank for general corporate purposes.

- (b) Not Applicable.
- (c) No repurchases for our securities were made during the quarter ended June 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**

- (a) The annual meeting of stockholders was held May 28, 2009.
- (b) Election of members of the board of directors are as listed in Item 4(c)(1).
- (c)(1) Each of the directors listed below was reelected for a three-year term as follows:

<u>Name</u>	Number of Shares <u>Voting</u>	<u>For</u>	<u>Against</u>	<u>Withheld</u>	Broker <u>Non-Votes</u>
Roseann H. Barton	1,999,546	1,973,521	26,025	-	-
D. Gerald Coggin, Sr.	1,999,546	1,987,771	11,775	-	-
Percy E. Dempsey, III	1,999,546	1,995,646	3,900	-	-
Lee M. Moss	1,999,546	1,986,346	13,200	-	-
Dr. George W. Smith	1,999,546	1,987,846	11,700	-	-
Gregory E. Waldron	1,999,546	1,998,421	1,125	-	-

Donald Alexander, Jimmy E. Allen, Daniel B. Decker, Dallas G. Caudle, Jr., John D. Floyd, Donald R. Gintzig, A. Franks Johns, Jr., Matthias B. Murfree, III, Beth S. O'Brien, Robert A. Parks, Jack O. Weatherford, Sr. and J. Ben Weatherford also serve as directors of the Bank, and each of their terms continued after the annual meeting of stockholders.

- (2) The ratification of the Audit Committee's selection of Maggart & Associates, P.C. as independent registered public accounting firm for the Bank for the year ending December 31, 2009 was follows:

Number of Shares <u>Voting</u>	<u>For</u>	<u>Against</u>	<u>Withheld</u>	Broker <u>Non-Votes</u>
1,999,546	1,984,896	12,650	2,000	-

- (d) Not Applicable

**Item 5. OTHER INFORMATION**

- (a) Retirement of Mr. Jack O. Weatherford as Senior Chairman.

Effective August 10, 2009, Mr. Jack O. Weatherford retired as Senior Chairman of the Bank. There was no employment agreement between the Bank and Mr. Jack O. Weatherford. The Notice of Retirement delivered to the Bank is attached as Exhibit 99.1. The press release announcing his retirement is attached as Exhibit 99.3.

- (b) Resignation of Mr. J. Ben Weatherford as President and Chief Operating Officer.

Effective August 10, 2009, Mr. J. Ben Weatherford resigned as President and Chief Operating Officer of the Bank. There was no employment agreement between the Bank and Mr. J. Ben Weatherford. The Resignation delivered to the Bank is attached as Exhibit 99.2. The press release announcing his resignation is attached as Exhibit 99.3.

**MIDSOUTH BANK**

**PART II. OTHER INFORMATION, CONTINUED**

- (c) Appointment of Mr. Dallas G. Caudle, Jr. as President and Chief Operating Officer.

Effective August 10, 2009, the Board of Directors appointed Mr. Dallas G. Caudle, Jr. as the Bank's President and Chief Operating Officer. Mr. Caudle has served as the Bank's Executive Vice President since it initially opened for business in January of 2004. Mr. Caudle will continue to serve as the Bank's Corporate Secretary. There is no employment agreement between the Bank and Mr. Dallas G. Caudle, Jr. The press release announcing his appointment is attached as Exhibit 99.3.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.
- (3) Exhibit 99.1 – Notice of Retirement.
- (4) Exhibit 99.2 – Resignation.
- (5) Exhibit 99.3 – Press Release.

**MIDSOUTH BANK**

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

\_\_\_\_\_  
MIDSOUTH BANK

(Registrant)

DATE: \_\_\_\_\_ August 10, 2009 \_\_\_\_\_

/s/ Lee M. Moss \_\_\_\_\_

Lee M. Moss  
Chairman and Chief Executive Officer

DATE: \_\_\_\_\_ August 10, 2009 \_\_\_\_\_

/s/ Kevin D. Busbey \_\_\_\_\_

Kevin D. Busbey  
Senior Vice President and Chief Financial Officer

**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.

August 10, 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.

August 10, 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 ending June 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  
August 10, 2009

/s/ Kevin D. Busbey  
Kevin D. Busbey  
Senior Vice President and Chief Financial Officer  
August 10, 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.