FIRST BANCSHARES INC /MS/
Form 10-Q
May 10, 2013

U. S. SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM 10-Q

x QUARTERLY REPORT UNDER SECTION 13 OR 15 (D)

OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED: March 31, 2013

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (D)

OF THE SECURITIES EXCHANGE ACT OF 1934

COMMISSION FILE NUMBER: 33-94288

THE FIRST BANCSHARES, INC.

(EXACT NAME OF ISSUER AS SPECIFIED IN ITS CHARTER)

MISSISSIPPI	64-0862173
(STATE OF INCORPORATION)	(I.R.S. EMPLOYER IDENTIFICATION NO.)

6480 U.S. HIGHWAY 98 WEST	
HATTIESBURG, MISSISSIPPI	39402
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)	(ZIP CODE)

(601) 268-8998
(ISSUER'S TELEPHONE NUMBER, INCLUDING AREA CODE)

NONE
(FORMER NAME, ADDRESS AND FISCAL YEAR, IF CHANGED SINCE LAST REPORT)

INDICATE BY CHECK MARK WHETHER THE ISSUER: (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 x NO ¨

INDICATE BY CHECK MARK WHETHER THE REGISTRANT IS A LARGE ACCELERATED FILER, AN ACCELERATED FILER, OR A NON-ACCELERATED FILER. SEE DEFINITION OF “ACCELERATED FILER AND LARGE ACCELERATED FILER” IN RULE 12B-2 OF THE EXCHANGE ACT.

LARGE ACCELERATED FILER ¨ ACCELERATED FILER ¨ NON-ACCELERATED FILER x

ON March 31, 2013, 3,142,235 SHARES OF THE ISSUER'S COMMON STOCK, PAR VALUE $1.00 PER SHARE, WERE ISSUED AND OUTSTANDING.

TRANSITIONAL DISCLOSURE FORMAT (CHECK ONE):

YES ¨ NO x

INDICATE BY CHECK MARK WHETHER THE REGISTRANT IS A SHELL COMPANY (AS DEFINED IN RULE 12B-2 OF THE EXCHANGE ACT): YES ¨ NO x

PART I - FINANCIAL INFORMATION

ITEM NO. 1. FINANCIAL STATEMENTS

THE FIRST BANCSHARES, INC.

CONSOLIDATED BALANCE SHEETS

($ amounts in thousands)

	(Unaudited) March 31, 2013	December 31, 2012
ASSETS		
Cash and due from banks	$ 24,994	$ 20,225
Interest-bearing deposits with banks	59,237	9,588
Federal funds sold	7,221	1,064
Total cash and cash equivalents	91,452	30,877
Securities held-to-maturity, at amortized cost	8,462	8,470
Securities available-for-sale, at fair value	212,263	214,393
Other securities	3,056	3,438
Total securities	223,781	226,301
Loans held for sale	3,677	5,586
Loans	421,691	408,112
Allowance for loan losses	(4,918)	(4,727)
Loans, net	420,450	408,971
Premises and equipment	22,253	22,243
Interest receivable	2,936	2,887
Cash surrender value of life insurance	6,482	6,441
Goodwill	9,362	9,362
Other assets	5,471	7,522

Other real estate owned	6,696	6,782
TOTAL ASSETS	$ 788,883	$ 721,386
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES:		
Deposits:		
Noninterest-bearing	$ 111,492	$ 109,625
Interest-bearing	551,787	487,002
TOTAL DEPOSITS	663,279	596,627
Interest payable	198	212
Borrowed funds	16,760	36,771
Subordinated debentures	10,310	10,310
Other liabilities	11,268	11,580
TOTAL LIABILITIES	701,815	655,500
STOCKHOLDERS' EQUITY:		
Preferred stock, Series D, par value $10.25, 1,951,220 issued and outstanding at March 31, 2013 and 0 issued and outstanding at December 31, 2012	20,000	-
Preferred stock, no par value, $1,000 per share liquidation, 10,000,000 shares authorized; 17,123 issued and outstanding at March 31, 2013 and December 31, 2012, respectively	17,041	17,021
Common stock, par value $1 per share, 10,000,000 shares authorized; 3,168,729 shares issued at March 31, 2013 and 3,133,596 at December 31, 2012, respectively	3,169	3,134
Additional paid-in capital	23,753	23,711
Retained earnings	20,954	19,951
Accumulated other comprehensive income	2,615	2,533
Treasury stock, at cost, 26,494 shares at March 31, 2013 and at December 31, 2012	(464)	(464)
TOTAL STOCKHOLDERS' EQUITY	87,068	65,886
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 788,883	$ 721,386

THE FIRST BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF INCOME

($ amounts in thousands, except earnings and dividends per share)

	(Unaudited) Three Months Ended March 31,	
	2013	2012
INTEREST INCOME:		
Interest and fees on loans	$ 5,231	$ 5,454
Interest and dividends on securities:		
Taxable interest and dividends	903	694
Tax exempt interest	504	507
Interest on federal funds sold	12	11
TOTAL INTEREST INCOME	6,650	6,666
INTEREST EXPENSE:		
Interest on deposits	618	892
Interest on borrowed funds	141	289
TOTAL INTEREST EXPENSE	759	1,181
NET INTEREST INCOME	5,891	5,485
PROVISION FOR LOAN LOSSES	311	152
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	5,580	5,333
OTHER INCOME:		
Service charges on deposit accounts	844	870
Other service charges and fees	1,086	605
TOTAL OTHER INCOME	1,930	1,475
OTHER EXPENSES:		
Salaries and employee benefits	3,183	2,938
Occupancy and equipment	956	960
Other	1,840	1,624

TOTAL OTHER EXPENSES	5,979	5,522
INCOME BEFORE INCOME TAXES	1,531	1,286
INCOME TAXES	306	315
NET INCOME	1,225	971
PREFERRED STOCK ACCRETION AND DIVIDENDS	106	106
NET INCOME APPLICABLE TO COMMON STOCKHOLDERS	$ 1,119	$ 865
NET INCOME APPLICABLE TO COMMON STOCKHOLDERS:		
BASIC	$ .36	$ .28
DILUTED	.35	.28
DIVIDENDS PER SHARE – COMMON	.0375	.0375

THE FIRST BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

($ amounts in thousands)

	(Unaudited) Three Months Ended March 31,	
	2013	2012
Net income per consolidated statements of income	$ 1,225	$ 971
Other comprehensive income:		
Unrealized holding gains arising during the period on available-for-sale securities	105	556
Unrealized holding gains (losses) on loans held for sale	20	(27)
Income tax expense	(43)	(180)
Other Comprehensive Income	82	349
Comprehensive Income	$ 1,307	$ 1,320

THE FIRST BANCSHARES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(unaudited)

($ in thousands)

	Common Stock	Preferred Stock	Stock Warrants	Additional Paid-in Capital	Retained Earnings	Accumulated Other Compre- hensive Income	Treasury Stock	Total
Balance, January 1, 2012	$ 3,093	$ 16,939	$ 284	$ 23,220	$ 16,791	$ 562	$ (464)	$ 60,425
Net income	-	-	-	-	971	-	-	971
Other compre- hensive income	-	-	-	-	-	349	-	349
Accretion and dividends on preferred Stock	-	20	-	-	(106)	-	-	(86)
Dividends on common stock, $.0375 per Share	-	-	-	-	(114)	-	-	(114)
Restricted stock grant	42	-	-	(42)	-	-	-	-
Compensation expense	-	-	-	43	-	-	-	43
Balance, March 31, 2012	$ 3,135	$ 16,959	$ 284	$ 23,221	$ 17,542	$ 911	$ (464)	$ 61,588
Balance, January 1, 2013	$ 3,134	$ 17,021	$ 284	$ 23,427	$ 19,951	$ 2,533	$ (464)	$ 65,886
Net income	-	-	-	-	1,225	-	-	1,225
Other compre- hensive income	-	-	-	-	-	82	-	82
Accretion and dividends on preferred Stock	-	20	-	-	(106)	-	-	(86)
Dividends on common stock, $.0375 per Share	-	-	-	-	(116)	-	-	(116)
Issuance of 1,951,220 preferred shares	-	20,000	-	-	-	-	-	20,000
Restricted stock grant	35	-	-	(35)	-	-	-	-
Compensation expense	-	-	-	77	-	-	-	77
Balance, March 31, 2013	$ 3,169	$ 37,041	$ 284	$ 23,469	$ 20,954	$ 2,615	$ (464)	$ 87,068

THE FIRST BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

($ Amounts in Thousands)

	(Unaudited) Three Months Ended March 31,	
	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES:		
NET INCOME	$ 1,225	$ 971
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and accretion	421	631
Provision for loan losses	311	152
Loss on sale/writedown of ORE	10	143
Restricted stock expense	77	43
Increase in cash value of life insurance	(41)	(44)
Federal Home Loan Bank stock dividends	(1)	(1)
Changes in:		
Interest receivable	(49)	(314)
Loans held for sale, net	1,889	578
Interest payable	(14)	(22)
Other, net	1,805	2,649
NET CASH PROVIDED BY OPERATING ACTIVITIES	5,633	4,786
CASH FLOWS FROM INVESTING ACTIVITIES:		
Maturities and calls of securities available- for-sale	18,278	7,716
Purchases of securities available-for-sale and held-to-maturity	(16,135)	(27,744)
Net redemptions of other securities	382	(157)
Net increase in loans	(13,719)	1,924
Net additions in premises and equipment	(306)	(234)
NET CASH USED IN INVESTING ACTIVITIES	(11,500)	(18,495)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Increase in deposits	66,652	37,867
Net decrease in borrowed funds	(20,011)	(231)
Dividends paid on common stock	(113)	(113)
Dividends paid on preferred stock	(86)	(86)
Issuance of 1,951,220 shares preferred series D	20,000	-
NET CASH PROVIDED BY FINANCING ACTIVITIES	66,442	37,437
NET INCREASE IN CASH	60,575	23,728

CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	30,877	23,181
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$91,452	$46,909
SUPPLEMENTAL DISCLOSURES:		
CASH PAYMENTS FOR INTEREST	$773	$1,203
CASH PAYMENTS FOR INCOME TAXES	189	174
LOANS TRANSFERRED TO OTHER REAL ESTATE	96	2,438
ISSUANCE OF RESTRICTED STOCK GRANTS	35	42

THE FIRST BANCSHARES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE A — BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial statements and with the instructions to Form 10-Q of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. However, in the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the three months ended March 31, 2013, are not necessarily indicative of the results that may be expected for the year ending December 31, 2013. For further information, please refer to the consolidated financial statements and footnotes thereto included in the Company's Form 10-K for the year ended December 31, 2012.

NOTE B — SUMMARY OF ORGANIZATION

The First Bancshares, Inc., Hattiesburg, Mississippi (the "Company"), was incorporated June 23, 1995, under the laws of the State of Mississippi for the purpose of operating as a bank holding company. The Company’s primary asset is its interest in its wholly-owned subsidiary, The First, A National Banking Association (the “Bank”).

At March 31, 2013, the Company had approximately $788.9 million in assets, $425.4 million in loans, $663.3 million in deposits, and $87.1 million in stockholders' equity. For the three months ended March 31, 2013, the Company reported net income of $1.2 million ($1.1 million applicable to common stockholders).

In the first quarter of 2013, the Company declared and paid a dividend of $.0375 per common share.

NOTE C – BUSINESS COMBINATION

The Company entered into an Acquisition Agreement dated January 31, 2013, as amended (the "Agreement") with First Baldwin Bancshares, Inc., an Alabama corporation ("Baldwin"). The Agreement provided that, upon the terms and subject to the conditions set forth in the Agreement, the Company would acquire all of the outstanding shares (the "Acquisition") of Baldwin's wholly-owned subsidiary, First National Bank of Baldwin County, A National Banking Association ("FNB"). Subject to the terms and conditions of the Agreement, as amended, which was approved by both the Company's Board of Directors and the Board of Directors of Baldwin, on February 21, 2013, Baldwin filed a voluntary bankruptcy petition under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Southern District of Alabama ("Bankruptcy Court") and sought Bankruptcy Court approval of the Agreement and the Acquisition through a Chapter 11 plan. Upon approval by the Bankruptcy Court and consummation of the Acquisition, all outstanding FNB common stock would be sold to the Company for cash consideration of $3,300,000 (the "Purchase Price"). Each outstanding share of FNB common stock will remain outstanding and be unaffected by the Acquisition.

The Company has recently completed its Acquisition of FNB. On April 23, 2013, the Bankruptcy Court confirmed the Chapter 11 Plan of Reorganization for Baldwin pursuant to which Baldwin had agreed to sell all of the outstanding voting stock of its subsidiary, FNB, under the Agreement. The Bankruptcy Court's approval received was the last required regulatory approval regarding the Acquisition. Previously, both the Board of Governors of the Federal Reserve System and the Office of the Comptroller of the Currency had granted the requisite approvals to the Acquisition by the Company of all of the outstanding voting stock of FNB on March 28, 2013, and April 4, 2013, respectively. The Acquisition closed and was completed on April 30, 2013. There was no vote required of shareholders of FNB to approve the Acquisition.

No further additional action or regulatory approval is required with respect to the Acquisition. As of the closing on April 30, 2013, FNB became a wholly-owned subsidiary of the Company and subsequently was merged with and into the Company's bank subsidiary, The First, A National Banking Association.

NOTE D – PREFERRED STOCK AND WARRANT

On February 6, 2009, as part of the U.S. Department of Treasury's ("Treasury") Capital Purchase Program ("CPP"), the Company received a $5.0 million equity investment by issuing 5 thousand shares of Series A, no par value preferred stock to the Treasury pursuant to a Letter Agreement and Securities Purchase Agreement that was previously disclosed by the Company. The Company also issued a warrant to the Treasury allowing it to purchase 54,705 shares of the Company's common stock at an exercise price of $13.71. The warrant can be exercised immediately and has a term of 10 years.

The Company allocated the proceeds received from the Treasury, net of transaction costs, on a pro rata basis to the Series A preferred stock and the warrant based on their relative fair values. The Company assigned $.3 million and $4.7 million to the warrant and the Series A preferred stock, respectively. The resulting discount on the Series A preferred stock is being accreted up to the $5.0 million liquidation amount at the time of the exchange that is described in the following paragraphs.

On September 29, 2010, and pursuant to the terms of the letter agreement between the Company and the United States Department of the Treasury ("Treasury"), the Company closed a transaction whereby Treasury exchanged its 5,000 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series UST, (the "CPP Preferred Shares") for 5,000 shares of a new series of preferred stock designated Fixed Rate Cumulative Perpetual Preferred Stock, Series CD (the "CDCI Preferred Shares"). On the same day, and pursuant to the terms of the letter agreement between the Company and Treasury, the Company issued an additional 12,123 CDCI Preferred Shares to Treasury for a purchase price of $12,123,000. As a result of the CDCI Transactions, the Company is no longer participating in the TARP Capital Purchase Program being administered by Treasury and is now participating in Treasury's TARP Community Development Capital Initiative (the "CDCI"). The terms of the CDCI Transactions are more fully set forth in the Exchange Letter Agreement and the Purchase Letter Agreement.

The Letter Agreement, pursuant to which the Preferred Shares were exchanged, contains limitations on the payment of dividends on the common stock to no more than 100% of the aggregate per share dividend and distributions for the immediate prior fiscal year (dividends of $0.15 per share were declared and paid in 2010, 2011, and 2012) and on the Company's ability to repurchase its common stock, and continues to subject the Company to certain of the executive compensation limitations included in the Emergency Economic Stabilization Act of 2008 (EESA), as previously disclosed by the Company.

The most significant difference in terms between the CDCI Preferred Shares and the CPP Preferred Shares is the dividend rate applicable to each. The CPP Preferred Shares entitled the holder to an annual dividend of 5% increasing to 9% after 5 years of the liquidation value of the shares, payable quarterly in arrears; by contrast, the CDCI Preferred Shares entitle the holder to an annual dividend of 2% for 8 years of the liquidation value of the shares, payable quarterly in arrears. Other differences in terms between the CDCI Preferred Shares and the CPP Preferred Shares, including, without limitation, the restrictions on common stock dividends and on redemption of common stock and other securities exist. The terms of the CDCI Preferred Shares are more fully set forth in the Articles of Amendment creating the CDCI Preferred Shares, which Articles of Amendment were filed with the Mississippi Secretary of State on September 27, 2010.

As a condition to participate in the CDCI, the Company was required to obtain certification as a Community Development Financial Institution (a "CDFI") from the Treasury's Community Development Financial Fund. On September 28, 2010, the Company was notified that its application for CDFI certification had been approved. In order to become certified and maintain its certification as a CDFI, the Company is required to meet the CDFI eligibility requirements set forth in 12 C.F.R. 1805.201(b).

On March 22, 2013, the Company raised $20,000,005 in a private placement of 1,951,220 shares of newly authorized Series D Nonvoting Convertible Preferred Stock ("Convertible Preferred Stock") at a purchase price of $10.25 per share. The terms of the Convertible Preferred Stock provide for mandatory conversion into the Company's common stock upon approval. The Company paid $921,487.43 in fees to its financial advisors who acted as placement agents in the private placement.

The Company intends to use the net proceeds from the private placement to increase its equity capital and for general corporate purposes, which includes, among other things, support for organic and acquisition-based growth. The private placement was exempt from Securities and Exchange Commission registration pursuant to Section 4(2) of the Securities Act of 1933, as amended, and Rule 506 of Regulation D promulgated thereunder.

Upon conversion of the Convertible Preferred Stock, the Company will issue up to 1,951,220 shares of common stock. On April 24, 2013, the Company had 3,142,235 shares of common stock outstanding.

NOTE E — EARNINGS APPLICABLE TO COMMON STOCKHOLDERS

Basic per share data is calculated based on the weighted-average number of common shares outstanding during the reporting period. Diluted per share data includes any dilution from potential common stock outstanding, such as stock options.

	For the Three Months Ended March 31, 2013		
	Net Income (Numerator)	Shares (Denominator)	Per Share Data
Basic per share	$1,119,000	3,117,480	$ .36
Effect of dilutive shares:			
Restricted stock grants		39,360	
Diluted per share	$1,119,000	3,156,840	$ .35

	For the Three Months Ended March 31, 2012		
	Net Income (Numerator)	Shares (Denominator)	Per Share Data
Basic per share	$865,000	3,079,337	$ .28
Effect of dilutive shares:			
Restricted stock grants		16,591	
Diluted per share	$865,000	3,095,928	$ .28

The Company granted 35,133 shares of restricted stock in the first quarter of 2013 and 42,795 shares of restricted stock in the first quarter of 2012.

NOTE F — FAIR VALUE OF ASSETS AND LIABILITIES

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

Level 1: Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2: Valuations for assets and liabilities traded in less active dealer or broker markets. Valuations are obtained from third party pricing services for identical or comparable assets or liabilities which use observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets and liabilities

Level 3:	Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis and recognized in the accompanying balance sheets.

Available-for-Sale Securities

The fair value of available-for-sale securities is determined by various valuation methodologies. Where quoted market prices are available in an active market, securities are classified within Level 1. If quoted market prices are not available, then fair values are estimated by using pricing models or quoted prices of securities with similar characteristics. Level 2 securities include U.S. Treasury securities, obligations of U.S. government corporations and agencies, obligations of states and political subdivisions, mortgage-backed securities and collateralized mortgage obligations. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy.

The following table presents the Company’s assets that are measured at fair value on a recurring basis and the level within the hierarchy in which the fair value measurements fell as of March 31, 2013 and December 31, 2012 (in thousands):

March 31, 2013

		Fair Value Measurements Using		
	Fair Value	Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Obligations of U. S. Government Agencies	$ 27,893	$ -	$ 27,893	$ -
Municipal securities	98,520	-	98,520	-
Mortgage-backed securities	67,975	-	67,975	-
Corporate obligations	16,907	-	14,093	2,814
Other	968	968	-	-
Total	$ 212,263	$ 968	$ 208,481	$ 2,814

December 31, 2012

	Fair Value	Fair Value Measurements Using Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Obligations of U. S. Government Agencies	$ 36,359	$ -	$ 36,359	$ -
Municipal securities	98,910	-	98,910	-
Mortgage-backed securities	61,967	-	61,967	-
Corporate obligations	16,187	-	13,519	2,668
Other	970	970	-	-
Total	$ 214,393	$ 970	$ 210,755	$ 2,668

The following is a reconciliation of activity for assets measured at fair value based on significant unobservable (non-market) information.

	Bank-Issued Trust Preferred Securities	
(*Dollars in thousands*)	2013	2012
Balance, January 1	2,668	2,252
Transfers into Level 3	-	-
Transfers out of Level 3	-	-
Other-than-temporary impairment loss included in earnings	-	-
Unrealized gain included in comprehensive income	146	416
Balance at March 31, 2013 and December 31, 2012	2,814	2,668

Following is a description of the valuation methodologies used for assets measured at fair value on a non-recurring basis and recognized in the accompanying balance sheets, as well as the general classification of such assets pursuant to the valuation hierarchy.

Impaired Loans

Loans for which it is probable that the Company will not collect all principal and interest due according to contractual terms are measured for impairment. Allowable methods for estimating fair value include using the fair value of the collateral for collateral dependent loans or, where a loan is determined not to be collateral dependent, using the discounted cash flow method.

If the impaired loan is identified as collateral dependent, then the fair value method of measuring the amount of impairment is utilized. This method requires obtaining a current independent appraisal of the collateral and applying a discount factor to the value. If the impaired loan is determined not to be collateral dependent, then the discounted cash flow method is used. This method requires the impaired loan to be recorded at the present value of expected future cash flows discounted at the loan’s effective interest rate. The effective interest rate of a loan is the contractual interest rate adjusted for any net deferred loan fees or costs, or premium or discount existing at origination or acquisition of the loan. Impaired loans are classified within Level 2 of the fair value hierarchy.

Other Real Estate Owned

Other real estate owned acquired through loan foreclosure is initially recorded at fair value less estimated costs to sell, establishing a new cost basis. The adjustment at the time of foreclosure is recorded through the allowance for loan losses. Due to the subjective nature of establishing the fair value, the actual fair value of the other real estate owned or foreclosed asset could differ from the original estimate. If it is determined the fair value declines subsequent to foreclosure, a valuation allowance is recorded through non-interest expense. Operating costs associated with the assets are also recorded as non-interest expense. Gains and losses on the disposition of other real estate owned and foreclosed assets are netted and posted to other non-interest expense. Other real estate owned measured at fair value on a non-recurring basis at March 31, 2013, amounted to $6.7 million. Other real estate owned is classified within Level 2 of the fair value hierarchy.

The following table presents the fair value measurement of assets measured at fair value on a nonrecurring basis and the level within the fair value hierarchy in which the fair value measurements fell at March 31, 2013 and December 31, 2012.

($ in thousands)

March 31, 2013

		Fair Value Measurements Using		
	Fair Value	Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans	$ 4,091	$ -	$ 4,091	$ -
Other real estate owned	6,696	-	6,696	-

December 31, 2012

		Fair Value Measurements Using		
	Fair Value	Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans	$ 3,589	$ -	$ 3,589	$ -
Other real estate owned	6,782	-	6,782	-

The following methods and assumptions were used to estimate the fair value of each class of financial instrument for which it is practicable to estimate that value:

Cash and Cash Equivalents – For such short-term instruments, the carrying amount is a reasonable estimate of fair value.

Investment in securities available-for-sale and held-to-maturity – The fair value measurement for securities available-for-sale was discussed earlier. The same measurement approach was used for securities held-to-maturity.

Loans – The fair value 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 maturities.

Deposits – The fair values of demand deposits are, as required by ASC Topic 825, equal to the carrying value of such deposits. Demand deposits include noninterest-bearing demand deposits, savings accounts, NOW accounts, and money market demand accounts. The fair value of variable rate term deposits, those repricing within six months or less, approximates the carrying value of these deposits. Discounted cash flows have been used to value fixed rate term deposits and variable rate term deposits repricing after six months. The discount rate used is based on interest rates currently being offered on comparable deposits as to amount and term.

Short-Term Borrowings – The carrying value of any federal funds purchased and other short-term borrowings approximates their fair values.

FHLB and Other Borrowings – The fair value of the fixed rate borrowings are estimated using discounted cash flows, based on current incremental borrowing rates for similar types of borrowing arrangements. The carrying amount of any variable rate borrowing approximates its fair value.

Subordinated Debentures – The subordinated debentures bear interest at a variable rate and the carrying value approximates the fair value.

Off-Balance Sheet Instruments – Fair values of off-balance sheet financial instruments are based on fees charged to enter into similar agreements. However, commitments to extend credit do not represent a significant value until such commitments are funded or closed. Management has determined that these instruments do not have a distinguishable fair value and no fair value has been assigned.

As of March 31, 2013		As of December 31, 2012	
Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
(In thousands)			

Financial Instruments:				
Assets:				
Cash and cash equivalents	$91,452	$91,452	$30,877	$30,877
Securities available-for-sale	212,263	212,263	214,393	214,393
Securities held-to-maturity	8,462	10,212	8,470	7,055
Other securities	3,056	3,056	3,438	3,438
Loans, net	420,450	434,814	408,971	422,029
Liabilities:				
Noninterest-bearing Deposits	$111,492	$111,492	$109,625	$109,625
Interest-bearing deposits	551,787	552,339	487,002	487,599
Subordinated debentures	10,310	10,310	10,310	10,310
FHLB and other borrowings	16,760	16,760	36,771	36,771

NOTE G — LOANS

Loans typically provide higher yields than the other types of earning assets, and, thus, one of the Company's goals is for loans to be the largest category of the Company's earning assets. At March 31, 2013 and December 31, 2012, loans accounted for 59.4% and 63.6% of earning assets, respectively. The Company controls and mitigates the inherent credit and liquidity risks through the composition of its loan portfolio.

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

Composition of Loan Portfolio

	March 31, 2013		December 31, 2012	
	Amount	Percent of Total	Amount	Percent of Total
	(Dollars in thousands)			
Mortgage loans held for sale	$3,677	.9 %	$ 5,586	1.4 %
Commercial, financial and agricultural	52,941	12.4	53,234	12.9
Real Estate:				
Mortgage-commercial	154,085	36.2	142,046	34.3
Mortgage-residential	144,345	34.0	140,703	34.0
Construction	56,293	13.2	57,529	13.9
Consumer and other	14,027	3.3	14,600	3.5
Total loans	425,368	100 %	413,698	100 %
Allowance for loan losses	(4,918)		(4,727)	
Net loans	$420,450		$ 408,971	

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

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

Activity in the allowance for loan losses for the period is as follows:

(In thousands)

	Three Months Ended March 31, 2013
Balance at beginning of period	$ 4,727
Loans charged-off:	
Real Estate	(30)
Installment and Other	(55)
Commercial, Financial and Agriculture	(66)
Total	(151)
Recoveries on loans previously charged-off:	
Real Estate	4
Installment and Other	21
Commercial, Financial and Agriculture	6
Total	31
Net Charge-offs	(120)
Provision for Loan Losses	311
Balance at end of period	$ 4,918

The following tables represent how the allowance for loan losses is allocated to a particular loan type, as well as the percentage of the category to total loans at March 31, 2013 and December 31, 2012.

Allocation of the Allowance for Loan Losses

	March 31, 2013 (Dollars in thousands)		
	Amount	% of loans in each category to total loans	
Commercial Non Real Estate	$ 406	12.5	%
Commercial Real Estate	3,382	64.4	
Consumer Real Estate	978	19.5	
Consumer	148	3.6	
Unallocated	4	-	
Total	$ 4,918	100	%

	December 31, 2012 (Dollars in thousands)		
	Amount	% of loans in each category to total loans	
Commercial Non Real Estate	$ 420	13.3	%
Commercial Real Estate	3,338	63.7	
Consumer Real Estate	810	19.0	
Consumer	151	4.0	
Unallocated	8	-	
Total	$ 4,727	100	%

The following table represents the Company's impaired loans at March 31, 2013, and December 31, 2012.

	March 31, 2013	December 31, 2012
	(In thousands)	
Impaired Loans:		
Impaired loans without a valuation allowance	$1,700	$ 1,445
Impaired loans with a valuation allowance	2,391	2,144

Total impaired loans	$4,091	$ 3,589
Allowance for loan losses on impaired loans at period end	992	936
Total nonaccrual loans	3,127	3,401
Past due 90 days or more and still accruing	161	158
Average investment in impaired loans	3,840	2,979

The following table is a summary of interest recognized and cash-basis interest earned on impaired loans:

	Three Months Ended March 31, 2013
Average of individually impaired loans during period	$ 3,840
Interest income recognized during impairment	-
Cash-basis interest income recognized	3

The gross interest income that would have been recorded in the period that ended if the nonaccrual loans had been current in accordance with their original terms and had been outstanding throughout the period or since origination, if held for part of the three ended March 31, 2013, was $66,000. The Company had no loan commitments to borrowers in non-accrual status at March 31, 2013 and 2012.

The following tables provide the ending balances in the Company's loans (excluding mortgage loans held for sale) and allowance for loan losses, broken down by portfolio segment as of March 31, 2013 and December 31, 2012. The tables also provide additional detail as to the amount of our loans and allowance that correspond to individual versus collective impairment evaluation. The impairment evaluation corresponds to the Company's systematic methodology for estimating its Allowance for Loan Losses.

<u>March 31, 2013</u>

	Real Estate	Installment and Other	Commercial, Financial and Agriculture	Total
	(In thousands)			
Loans				
Individually evaluated	$3,893	$ 50	$ 148	$4,091
Collectively evaluated	349,992	15,145	52,463	417,600
Total	$353,885	$ 15,195	$ 52,611	$421,691
Allowance for Loan Losses				
Individually evaluated	$895	$ 44	$ 53	$992
Collectively evaluated	3,465	108	353	3,926
Total	$4,360	$ 152	$ 406	$4,918

December 31, 2012

	Real Estate	Installment and Other	Commercial, Financial and Agriculture	Total
	(In thousands)			
Loans				
Individually evaluated	$4,111	$ 55	$ 221	$4,387
Collectively evaluated	333,299	16,401	54,025	403,725
Total	$337,410	$ 16,456	$ 54,246	$408,112
Allowance for Loan Losses				
Individually evaluated	$917	$ 110	$ 76	$1,103
Collectively evaluated	3,231	49	344	3,624
Total	$4,148	$ 159	$ 420	$4,727

The following tables provide additional detail of impaired loans broken out according to class as of March 31, 2013 and December 31, 2012. The recorded investment included in the following table represents customer balances net of any partial charge-offs recognized on the loans, net of any deferred fees and costs. As nearly all of our impaired loans at March 31, 2013, are on nonaccrual status, recorded investment excludes any insignificant amount of accrued interest receivable on loans 90-days or more past due and still accruing. The unpaid balance represents the recorded balance prior to any partial charge-offs.

March 31, 2013

	Recorded Investment	Unpaid Balance	Related Allowance	Average Recorded Investment YTD	Interest Income Recognized YTD
	(In thousands)				
Impaired loans with no related allowance:					
Commercial installment	$14	$14	$ -	$ 15	$ -
Commercial real estate	1,262	1,672	-	1,139	8
Consumer real estate	424	424	-	264	1
Consumer installment	-	-	-	155	-
Total	$1,700	$2,110	$ -	$ 1,573	$ 9
Impaired loans with a related allowance:					
Commercial installment	$134	$134	$ 53	$ 168	$ -
Commercial real estate	1,760	1,760	794	1,654	5
Consumer real estate	447	447	101	246	4

Consumer installment	50	50	44	199	1
Total	$ 2,391	$ 2,391	$ 992	$ 2,267	$ 10
Total Impaired Loans:					
Commercial installment	$ 148	$ 148	$ 53	$ 183	$ -
Commercial real estate	3,022	3,432	794	2,793	13
Consumer real estate	871	871	101	510	5
Consumer installment	50	50	44	354	1
Total Impaired Loans	$ 4,091	$ 4,501	$ 992	$ 3,840	$ 19

December 31, 2012

	Recorded Investment	Unpaid Balance	Related Allowance	Average Recorded Investment YTD	Interest Income Recognized YTD
	(In thousands)				
Impaired loans with no related allowance:					
Commercial installment	$15	$15	$ -	$ 46	$ -
Commercial real estate	1,013	1,529	-	1,004	39
Consumer real estate	106	969	-	168	8
Consumer installment	311	311	-	156	1
Total	$1,445	$2,824	$ -	$ 1,374	$ 48
Impaired loans with a related allowance:					
Commercial installment	$203	$203	$ 73	$ 173	$ 8
Commercial real estate	1,549	1,549	747	1,546	38
Consumer real estate	44	44	44	72	4
Consumer installment	348	348	72	197	2
Total	$2,144	$2,144	$ 936	$ 1,988	$ 52
Total Impaired Loans:					
Commercial installment	$218	$218	$ 73	$ 219	$ 8
Commercial real estate	2,562	3,078	747	2,550	77
Consumer real estate	150	1,013	44	240	12
Consumer installment	659	659	72	353	3
Total Impaired Loans	$3,589	$4,968	$ 936	$ 3,362	$ 100

The recorded investment in receivables for which the allowance for credit losses was previously measured under a general allowance for credit losses methodology and are now impaired under Section 310-10-35 was $177,000. The allowance for credit losses associated with those receivables on the basis of a current evaluation of loss was $29,000. All loans were performing as agreed with modified terms.

During the three month period ending March 31, 2013, there was one loan modified as TDR, and is considered non-performing.

The following tables summarize by class our loans classified as past due in excess of 30 days or more in addition to those loans classified as non-accrual:

	March 31, 2013 (In thousands)				
	Past Due 30 to 89 Days	Past Due 90 Days or More and Still Accruing	Non-Accrual	Total Past Due and Non-Accrual	Total Loans
Real Estate-construction	$419	$ -	$ 1,570	$ 1,989	$56,293
Real Estate-mortgage	2,817	66	886	3,769	143,507
Real Estate-non farm non residential	33	90	602	725	154,085
Commercial	114	-	64	178	52,611
Consumer	76	5	5	86	15,195
Total	$3,459	$ 161	$ 3,127	$ 6,747	$421,691

	December 31, 2012 (In thousands)				
	Past Due 30 to 89 Days	Past Due 90 Days or More and Still Accruing	Non-Accrual	Total Past Due and Non-Accrual	Total Loans
Real Estate-construction	$990	$ -	$ 1,667	$ 2,657	$57,529
Real Estate-mortgage	3,045	147	986	4,178	140,703

Real Estate-non farm non residential	389	-	608	997	142,046
Commercial	88	-	135	223	53,234
Consumer	132	11	5	148	14,600
Total	$4,644	$ 158	$3,401	$ 8,203	$408,112

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt, such as: current financial information, historical payment experience credit documentation, public information, and current economic trends, among other factors. The Company uses the following definitions for risk ratings, which are consistent with the definitions used in supervisory guidance:

Special Mention. Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the Company’s credit position at some future date.

Substandard. Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful. Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans.

As of March 31, 2013 and December 31, 2012, and based on the most recent analysis performed, the risk category of loans by class of loans (excluding mortgage loans held for sale) was as follows:

($ in thousands)

March 31, 2013

	Real Estate Commercial	Real Estate Mortgage	Installment and Other	Commercial, Financial and Agriculture	Total
Pass	$ 253,865	$ 80,605	$ 15,167	$ 52,322	$401,959
Special Mention	5,597	140	15	302	6,054
Substandard	12,651	1,361	13	-	