

FIRST BANCSHARES INC /MS/  
Form 10-Q  
August 14, 2012

U. S. SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15 (D)  
OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED: June 30, 2012

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

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(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  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

ON JUNE 30, 2012, 3,108,867 SHARES OF THE ISSUER'S COMMON STOCK, PAR VALUE \$1.00 PER SHARE, WERE ISSUED AND OUTSTANDING.

TRANSITIONAL DISCLOSURE FORMAT (CHECK ONE):

YES  NO

INDICATE BY CHECK MARK WHETHER THE REGISTRANT IS A SHELL COMPANY (AS DEFINED IN RULE 12B-2 OF THE EXCHANGE ACT):

YES  NO

PART I - FINANCIAL INFORMATION

ITEM NO. 1. FINANCIAL STATEMENTS

THE FIRST BANCSHARES, INC.

CONSOLIDATED BALANCE SHEETS

(\$ amounts in thousands)

	(Unaudited) June 30, 2012	December 31, 2011
<b>ASSETS</b>		
Cash and due from banks	\$ 11,871	\$ 10,152
Interest-bearing deposits with banks	10,495	12,788
Federal funds sold	764	241
Total cash and cash equivalents	23,130	23,181
Securities held-to-maturity, at amortized cost	8,484	6,002
Securities available-for-sale, at fair value	229,703	212,529
Other securities	3,090	2,645
Total securities	241,277	221,176
Loans held for sale	3,210	2,906
Loans	382,341	385,022
Allowance for loan losses	(4,468 )	(4,511 )
Loans, net	381,083	383,417

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Premises and equipment	22,592	22,991
Interest receivable	3,010	2,772
Cash surrender value of life insurance	6,358	6,270
Goodwill	9,362	9,362
Other assets	13,804	12,244
<b>TOTAL ASSETS</b>	<b>\$ 700,616</b>	<b>\$ 681,413</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>LIABILITIES:</b>		
Deposits:		
Noninterest-bearing	\$ 104,482	\$ 107,129
Interest-bearing	483,547	466,265
<b>TOTAL DEPOSITS</b>	<b>588,029</b>	<b>573,394</b>
Interest payable	259	308
Borrowed funds	28,291	27,032
Subordinated debentures	10,310	10,310
Other liabilities	10,427	9,944
<b>TOTAL LIABILITIES</b>	<b>637,316</b>	<b>620,988</b>
<b>STOCKHOLDERS' EQUITY:</b>		
Preferred stock, no par value, \$1,000 per share liquidation, 10,000,000 shares authorized; 17,123 issued and outstanding at June 30, 2012 and at December 31, 2011	16,980	16,939
Common stock, par value \$1 per share, 10,000,000 shares authorized; 3,135,361 and 3,092,566 shares issued at June 30, 2012 and at December 31, 2011	3,135	3,093
Additional paid-in capital	23,570	23,504
Retained earnings	18,356	16,791
Accumulated other comprehensive income	1,723	562
Treasury stock, at cost, 26,494 shares at June 30, 2012 and at December 31,	(464 )	(464 )

2011

TOTAL STOCKHOLDERS' EQUITY	63,300	60,425
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 700,616	\$ 681,413

## THE FIRST BANCSHARES, INC.

## CONSOLIDATED STATEMENTS OF INCOME

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

	(Unaudited)		Six Months Ended	
	Three Months Ended		June 30,	
	June 30,	2011	2012	2011
INTEREST INCOME:				
Interest and fees on loans	\$5,353	\$5,117	\$10,807	\$10,131
Interest and dividends on securities:				
Taxable interest and dividends	729	468	1,423	838
Tax exempt interest	507	333	1,014	663
Interest on federal funds sold	20	23	31	42
<b>TOTAL INTEREST INCOME</b>	<b>6,609</b>	<b>5,941</b>	<b>13,275</b>	<b>11,674</b>
INTEREST EXPENSE:				
Interest on deposits	834	1,127	1,726	2,308
Interest on borrowed funds	267	303	556	604
<b>TOTAL INTEREST EXPENSE</b>	<b>1,101</b>	<b>1,430</b>	<b>2,282</b>	<b>2,912</b>
<b>NET INTEREST INCOME</b>	<b>5,508</b>	<b>4,511</b>	<b>10,993</b>	<b>8,762</b>
<b>PROVISION FOR LOAN LOSSES</b>	<b>221</b>	<b>305</b>	<b>373</b>	<b>653</b>
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	<b>5,287</b>	<b>4,206</b>	<b>10,620</b>	<b>8,109</b>
OTHER INCOME:				
Service charges on deposit accounts	857	567	1,727	1,126
Other service charges and fees	653	461	1,258	817
Impairment loss on securities:				
Total other-than-temporary impairment (gain)loss	-	469	-	380
Portion of gain (loss) recognized in other comprehensive income	-	(473 )	-	(384 )
Net impairment loss recognized in earnings	-	(4 )	-	(4 )
<b>TOTAL OTHER INCOME</b>	<b>1,510</b>	<b>1,024</b>	<b>2,985</b>	<b>1,939</b>

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OTHER EXPENSES:				
Salaries and employee benefits	2,996	2,217	5,934	4,473
Occupancy and equipment	949	530	1,909	1,067
Other	1,469	1,546	3,093	3,277
<b>TOTAL OTHER EXPENSES</b>	<b>5,414</b>	<b>4,293</b>	<b>10,936</b>	<b>8,817</b>
<b>INCOME BEFORE INCOME TAXES</b>	<b>1,383</b>	<b>937</b>	<b>2,669</b>	<b>1,231</b>
<b>INCOME TAXES</b>	<b>346</b>	<b>267</b>	<b>661</b>	<b>60</b>
<b>NET INCOME</b>	<b>1,037</b>	<b>670</b>	<b>2,008</b>	<b>1,171</b>
<b>PREFERRED STOCK ACCRETION AND DIVIDENDS</b>	<b>106</b>	<b>85</b>	<b>212</b>	<b>171</b>
<b>NET INCOME APPLICABLE TO COMMON STOCKHOLDERS</b>	<b>\$931</b>	<b>\$585</b>	<b>\$1,796</b>	<b>\$1,000</b>
<b>NET INCOME APPLICABLE TO COMMON STOCKHOLDERS:</b>				
<b>BASIC</b>	<b>\$.30</b>	<b>\$.19</b>	<b>\$.58</b>	<b>\$.33</b>
<b>DILUTED</b>	<b>.30</b>	<b>.19</b>	<b>.58</b>	<b>.33</b>
<b>DIVIDENDS PER SHARE – COMMON</b>	<b>.0375</b>	<b>.0375</b>	<b>.075</b>	<b>.075</b>

THE FIRST BANCSHARES, Inc.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(\$ in thousands)	Three Months		Six Months	
	Ended June 30, 2012	2011	Ended June 30, 2012	2011
Net income per consolidated statements of income	\$1,037	\$670	\$2,008	\$1,171
Other comprehensive income, net of tax:				
Unrealized gains on available for sale securities:				
Unrealized holding gains arising during the period	770	954	1,137	1,138
Unrealized gain (loss) on derivative carried at fair value during the period	42	(18 )	24	(17 )
Comprehensive Income	\$1,849	\$1,606	\$3,169	\$2,292



## THE FIRST BANCSHARES, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(unaudited)

(\$ in thousands)

	Accumulated							
	Common	Preferred	Stock	Additional	Retained	Other	Treasury	Total
	Stock	Stock	Warrants	Paid-in	Earnings	Compre-	Stock	
				Capital		hensive		
						Income(Loss)		
Balance, January 1, 2011	\$ 3,059	\$ 16,939	\$ 284	\$ 23,135	\$ 14,723	\$ (577 )	\$ (464 )	\$ 57,099
Net income	-	-	-	-	1,171	-	-	1,171
Net change in unrealized gain(loss)on available- for-sale securities, net of tax	-	-	-	-	-	1,138	-	1,138
Net change in unrealized gain(loss)on derivative, net of tax	-	-	-	-	-	(17 )	-	(17 )
Dividends on preferred stock	-	-	-	-	(171 )	-	-	(171 )
Dividends on common stock, \$.075 per share	-	-	-	-	(232 )	-	-	(232 )
Restricted stock grant	34	-	-	(34 )	-	-	-	-
Compensation expense	-	-	-	56	-	-	-	56
Balance, June 30, 2011	\$ 3,093	\$ 16,939	\$ 284	\$ 23,157	\$ 15,491	\$ 544	\$ (464 )	\$ 59,044
Balance, January 1, 2012	\$ 3,093	\$ 16,939	\$ 284	\$ 23,220	\$ 16,791	\$ 562	\$ (464 )	\$ 60,425
Net income	-	-	-	-	2,008	-	-	2,008
Net change in unrealized gain(loss)on available- for-sale securities, net of tax	-	-	-	-	-	1,137	-	1,137
Net change in unrealized gain(loss)on derivative, net of tax	-	-	-	-	-	24	-	24
Accretion and dividends on preferred stock	-	41	-	-	(212 )	-	-	(171 )
Dividends on common stock, \$.075 per share	-	-	-	-	(231 )	-	-	(231 )
Restricted stock grant	42	-	-	(42 )	-	-	-	-
Compensation expense	-	-	-	108	-	-	-	108
Balance, June 30, 2012	\$ 3,135	\$ 16,980	\$ 284	\$ 23,286	\$ 18,356	\$ 1,723	\$ (464 )	\$ 63,300



THE FIRST BANCSHARES, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(\$ Amounts in Thousands)

	(Unaudited) Six Months Ended June 30,	
	2012	2011
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
NET INCOME	\$2,008	\$1,171
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and accretion	1,259	525
Impairment loss on securities	-	4
Provision for loan losses	373	653
Loss on sale/writedown of ORE	309	127
Restricted stock expense	108	56
Increase in cash value of life insurance	(88 )	(93 )
Federal Home Loan Bank stock dividends	(2 )	(2 )
Changes in:		
Interest receivable	(238 )	(125 )
Loans held for sale, net	(268 )	271
Interest payable	(49 )	(47 )
Other, net	1,891	(222 )
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>5,303</b>	<b>2,318</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Maturities and calls of securities available- for-sale	24,455	17,583
Purchases of securities available-for-sale and held-to-maturity	(42,876)	(43,225)
Purchases of other securities	(443 )	-
Net increase in loans	(1,725 )	(17,319)
Net additions in premises and equipment	(200 )	(838 )
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(20,789)</b>	<b>(43,799)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Increase in deposits	14,573	37,302
Net increase (decrease) in borrowed funds	1,259	(37 )
Dividends paid on common stock	(226 )	(226 )
Dividends paid on preferred stock	(171 )	(171 )
<b>NET CASH PROVIDED BY FINANCING ACTIVITIES</b>	<b>15,435</b>	<b>36,868</b>

NET DECREASE IN CASH	(51 )	(4,613 )
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	23,181	33,976
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$23,130	\$29,363
SUPPLEMENTAL DISCLOSURES:		
CASH PAYMENTS FOR INTEREST	\$2,331	\$2,959
CASH PAYMENTS FOR INCOME TAXES	768	648
LOANS TRANSFERRED TO OTHER REAL ESTATE	4,142	1,848
ISSUANCE OF RESTRICTED STOCK GRANTS	42	34

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 six months ended June 30, 2012, are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. 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, 2011.

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 June 30, 2012, the Company had approximately \$700.6 million in assets, \$385.6 million in loans, \$588.0 million in deposits, and \$63.3 million in stockholders' equity. For the six months ended June 30, 2012, the Company reported net income of \$2.0 million (\$1.8 million applicable to common stockholders).

In the first and second quarters of 2012, the Company declared and paid a dividend of \$.0375 per common share.

NOTE C – BUSINESS COMBINATION

On September 16, 2011 the Company completed the purchase of seven (7) branches located on the Mississippi Gulf Coast and one (1) branch located in Bogalusa, Louisiana from Whitney National Bank and Hancock Bank of Louisiana (the “Whitney branches”). As part of the agreement, the Company purchased loans of \$46.8 million and assumed deposit liabilities of \$179.3 million, and purchased the related fixed assets and cash of the branches. The Company operates the acquired bank branches under the name The First, A National Banking Association. The acquisition allowed the Company to expand its presence in South Mississippi as well as enter a new market in Louisiana. The Company’s condensed consolidated statements of income include the results of operations of the Whitney branches.

In connection with the acquisition, the Company recorded \$8.7 million of goodwill and \$2.4 million of core deposit intangible. The core deposit intangible of \$2.4 million will be expensed over 10 years. The recorded goodwill is deductible for tax purposes.

The Company acquired the \$46.8 million loan portfolio at a fair value discount of \$.7 million. The discount represents expected credit losses, adjustments to market interest rates and liquidity adjustments. The non credit quality portion of the discount was \$.1 million and the credit quality portion of the discount was \$.6 million.

The amounts of the acquired identifiable assets and liabilities as of the acquisition date were as follows (dollars in thousands):

Purchase price:	
Cash	\$9,100
Total purchase price	9,100
Identifiable assets:	
Cash	125,243
Loans and leases	46,118
Core deposit intangible	2,402
Personal and real property	7,481
Other assets	95
Total assets	181,339
Liabilities and equity:	
Deposits	179,196
Other liabilities	1,703
Total liabilities	180,899
Net assets acquired	440
Goodwill resulting from acquisition	\$8,660

The outstanding principal balance and the carrying amount of these loans included in the consolidated balance sheet at June 30, 2012 are as follows (dollars in thousands):

Outstanding principal balance	\$28,987
Carrying amount	28,543

All loans obtained in the acquisition of the Whitney branches reflect no specific evidence of credit deterioration and very low probability that the Company would be unable to collect all contractually required principal and interest payments.

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 non-voting Series A preferred shares issued, with a liquidation preference of \$1 thousand per share, will pay a cumulative cash dividend quarterly at 5% per annum during the first five years the preferred shares are outstanding, resetting to 9% thereafter if not redeemed. The CPP also includes certain restrictions on dividend payments of the Company’s lower ranking equity and the ability to purchase its outstanding common shares.



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) 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).

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  
June 30, 2012

	Net Income (Numerator)	Shares (Denominator)	Per Share Data
Basic per share	\$931,000	3,108,867	\$ .30
Effect of dilutive shares: Restricted stock grants		21,557	
Diluted per share	\$931,000	3,130,424	\$ .30

For the Six Months Ended  
June 30, 2012

	Net Income (Numerator)	Shares (Denominator)	Per Share Data
Basic per share	\$1,796,000	3,094,102	\$ .58
Effect of dilutive shares: Restricted stock grants		21,557	
Diluted per share	\$1,796,000	3,115,659	\$ .58

For the Three Months Ended  
June 30, 2011

	Net Income (Numerator)	Shares (Denominator)	Per Share Data
Basic per share	\$585,000	3,066,072	\$ .19
Effect of dilutive shares: Restricted stock grants		5,978	
Diluted per share	\$585,000	3,072,050	\$ .19

For the Six Months Ended  
June 30, 2011

	Net Income (Numerator)	Shares (Denominator)	Per Share Data
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Basic per share	\$ 1,000,000	3,060,430	\$ .33
Effect of dilutive shares:			
Restricted stock grants		5,978	
Diluted per share	\$ 1,000,000	3,066,408	\$ .33

The Company granted 42,795 shares of restricted stock in the first quarter of 2012 and 33,850 shares of restricted stock in the first quarter of 2011.

## NOTE F — COMPREHENSIVE INCOME

The following table discloses Comprehensive Income for the periods reported in the Consolidated Statements of Income:

(In thousands)

	Three Months Ended June 30,		Six Months Ended June 30	
	2012	2011	2012	2011
Unrealized holding gains on available-for-sale securities during the period, net of tax	\$770	\$954	\$1,137	\$1,138
Unrealized gain (loss) on derivative carried at fair value during the period, net of tax	42	(18 )	24	(17 )
Accumulated Other Comprehensive Income (Loss), beginning of period	911	(392)	562	(577 )
Accumulated Other Comprehensive Income, end of period	\$1,723	\$544	\$1,723	\$544

## NOTE G — 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 June 30, 2012 and December 31, 2011 (in thousands):

#### June 30, 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	\$ 47,709	\$ -	\$ 47,709	\$ -
Municipal securities	99,248	-	99,248	-
Mortgage-backed securities	61,281	-	61,281	-
Corporate obligations	20,491	-	18,201	2,290
Other	974	974	-	-
Total	\$ 229,703	\$ 974	\$ 226,439	\$ 2,290

December 31, 2011

		Fair Value Measurements Using		
		Quoted		
		Prices		
		in	Significant	Significant
		Active	Other	Unobservable
		Markets	Observable	Inputs
		For	Inputs	
		Identical		
		Assets		
	Fair Value	(Level	(Level 2)	(Level 3)
		1)		
Obligations of U. S. Government Agencies	\$ 43,673	\$ -	\$ 43,673	\$ -
Municipal securities	94,259	-	94,259	-
Mortgage-backed securities	59,330	-	59,330	-
Corporate obligations	14,293	-	12,041	2,252
Other	974	974	-	-
Total	\$ 212,529	\$ 974	\$ 209,303	\$ 2,252

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	
	2012	2011
Balance, January 1	\$2,252	\$2,619
Transfers into Level 3	-	-
Transfers out of Level 3	-	-
Other-than-temporary impairment loss included in earnings	-	(4 )
Unrealized gain (loss) included in comprehensive income	38	(363 )
Balance at June 30, 2012 and December 31, 2011	\$2,290	\$2,252

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 June 30, 2012, 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 June 30, 2012 and December 31, 2011.

(\$ in thousands)

June 30, 2012

	Fair Value	Fair Value Measurements Using		
		Quoted Prices in Significant Active Markets For Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans	\$2,303	\$-	\$ 2,303	\$ -
Other real estate owned	6,744	-	6,744	-

December 31, 2011

	Fair Value	Fair Value Measurements Using		
		Quoted Prices in Significant Active Markets For Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans	\$5,125	\$-	\$ 5,125	\$ -
Other real estate owned	4,353	-	4,353	-

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 June 30, 2012		As of December 31, 2011	
	Carrying	Estimated	Carrying	Estimated
	Amount	Fair Value	Amount	Fair Value
	(In thousands)			
Financial Instruments:				
Assets:				
Cash and cash equivalents	\$23,130	\$23,130	\$23,181	\$23,181
Securities available-for-sale	229,703	229,703	212,529	212,529
Securities held-to-maturity	8,484	8,850	6,002	6,002
Other securities	3,090	3,090	2,645	2,645
Loans, net	381,083	394,334	383,417	396,905
Liabilities:				
Noninterest-bearing deposits	\$104,482	\$104,482	\$107,129	\$107,129
Interest-bearing deposits	483,547	484,272	466,265	467,198
Subordinated debentures	10,310	10,310	10,310	10,310
FHLB and other borrowings	28,291	28,291	27,032	27,032

## NOTE H — 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 June 30, 2012 and December 31, 2011, respectively, loans accounted for 60.4% and 62.4% of earning assets. 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

	June 30, 2012			December 31, 2011		
	Amount	Percent of Total		Amount	Percent of Total	
	(Dollars in thousands)					
Mortgage loans held for sale	\$3,210	0.8	%	\$ 2,906	0.7	%
Commercial, financial and agricultural	50,306	13.0		48,385	12.5	
Real Estate:						
Mortgage-commercial	134,933	35.0		138,943	35.8	
Mortgage-residential	121,611	31.5		117,692	30.3	
Construction	60,939	15.8		63,357	16.3	
Consumer and other	14,552	3.9		16,645	4.4	
Total loans	385,551	100	%	387,928	100	%
Allowance for loan losses	(4,468 )			(4,511 )		
Net loans	\$381,083			\$ 383,417		

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)

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	Three Months Ended June 30, 2012	Six Months Ended June 30, 2012
Balance at beginning of period	\$ 4,372	\$ 4,511
Loans charged-off:		
Real Estate	(96 )	(364 )
Installment and Other	(65 )	(98 )
Commercial, Financial and Agriculture	(2 )	(26 )
Total	(163 )	(488 )
Recoveries on loans previously charged-off:		
Real Estate	13	14
Installment and Other	22	39
Commercial, Financial and Agriculture	3	19
Total	38	72
Net Charge-offs	(125 )	(416 )
Provision for Loan Losses	221	373
Balance at end of period	\$ 4,468	\$ 4,468

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 June 30, 2012 and December 31, 2011.

Allocation of the Allowance for Loan Losses

	June 30, 2012 (Dollars in thousands)		
	% of loans		
	Amount	in each category to total loans	
Commercial Non Real Estate	\$552	12.7	%
Commercial Real Estate	2,924	66.5	
Consumer Real Estate	710	16.4	
Consumer	133	4.3	
Unallocated	149	.1	
Total	\$4,468	100	%

	December 31, 2011 (Dollars in thousands)		
	% of loans		
	Amount	in each category to total loans	
Commercial Non Real Estate	\$ 397	16.3	%
Commercial Real Estate	3,356	63.8	
Consumer Real Estate	680	15.7	
Consumer	78	4.2	
Unallocated	-	-	
Total	\$ 4,511	100	%

The following table represents the Company's impaired loans at June 30, 2012 and December 31, 2011. This table excludes performing troubled debt restructurings.

	June 30, 2012	December 31, 2011
Impaired Loans:		(In thousands)



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Impaired loans without a valuation allowance	\$1,230	\$ 2,791
Impaired loans with a valuation allowance	1,073	2,334
Total impaired loans	\$2,303	\$ 5,125
Allowance for loan losses on impaired loans at period end	290	738
Total nonaccrual loans	2,303	5,125
Past due 90 days or more and still accruing	1,205	496
Average investment in impaired loans	3,439	4,185

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

	Three Months Ended June 30, 2012	Six Months Ended June 30, 2012
Average of individually impaired loans during period	\$ 2,596	\$ 3,439
Interest income recognized during impairment	-	-
Cash-basis interest income recognized	-	2

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 and six months ended June 30, 2012, was \$67,100 and \$69,400, respectively. The Company had no loan commitments to borrowers in non-accrual status at June 30, 2012 and 2011.

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 June 30, 2012 and December 31, 2011. 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.

June 30, 2012

	Real Estate  (In thousands)	Installment and Other	Commercial, Financial and Agriculture	Total
<b>Loans</b>				
Individually evaluated	\$2,016	\$ 27	\$ 260	\$2,303
Collectively evaluated	315,180	16,475	48,383	380,038
<b>Total</b>	<b>\$317,196</b>	<b>\$ 16,502</b>	<b>\$ 48,643</b>	<b>\$382,341</b>
<b>Allowance for Loan Losses</b>				
Individually evaluated	\$181	\$ 12	\$ 97	\$290
Collectively evaluated	3,453	270	455	4,178

Total	\$3,634	\$ 282	\$ 552	\$4,468
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December 31, 2011

	Real Estate (In thousands)	Installment and Other	Commercial, Financial and Agriculture	Total
<b>Loans</b>				
Individually evaluated	\$4,841	\$ 38	\$ 246	\$5,125
Collectively evaluated	301,271	16,107	62,519	379,897
<b>Total</b>	<b>\$306,112</b>	<b>\$ 16,145</b>	<b>\$ 62,765</b>	<b>\$385,022</b>
<b>Allowance for Loan Losses</b>				
Individually evaluated	\$662	\$ 13	\$ 63	\$738
Collectively evaluated	3,375	64	334	3,773
<b>Total</b>	<b>\$4,037</b>	<b>\$ 77</b>	<b>\$ 397</b>	<b>\$4,511</b>

The following tables provide additional detail of impaired loans broken out according to class as of June 30, 2012 and December 31, 2011. 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 June 30, 2012 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.

June 30, 2012

	Recorded Investment (In thousands)	Unpaid Balance	Related Allowance	Average Recorded Investment YTD	Interest Income Recognized YTD
Impaired loans with no related allowance:					
Commercial installment	\$77	\$77	\$ -	\$ 77	\$ -
Commercial real estate	920	920	-	904	2
Consumer real estate	231	231	-	274	-
Consumer installment	2	2	-	5	-
Total	\$1,230	\$1,230	\$ -	\$ 1,260	\$ 2
Impaired loans with a related allowance:					
Commercial installment	\$183	\$183	\$ 97	\$ 200	\$ -
Commercial real estate	613	613	157	810	-
Consumer real estate	252	252	24	298	-
Consumer installment	25	25	12	28	-
Total	\$1,073	\$1,073	\$ 290	\$ 1,336	\$ -
Total Impaired Loans:					
Commercial installment	\$260	\$260	\$ 97	\$ 277	\$ -
Commercial real estate	1,533	1,533	157	1,714	2
Consumer real estate	483	483	24	572	-
Consumer installment	27	27	12	33	-
Total Impaired Loans	\$2,303	\$2,303	\$ 290	\$ 2,596	\$ 2

December 31, 2011

	Recorded Investment (In thousands)	Unpaid Balance	Related Allowance	Average Recorded Investment YTD	Interest Income Recognized YTD
Impaired loans with no related allowance:					
Commercial installment	\$121	\$121	\$ -	\$ 69	\$ 5
Commercial real estate	2,420	2,420	-	1,457	85

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Consumer real estate	241	241	-	288	3
Consumer installment	9	9	-	11	-
Total	\$2,791	\$2,791	\$ -	\$ 1,825	\$ 93

Impaired loans with a related allowance:

Commercial installment	\$125	\$125	\$ 63	\$ 128	\$ -
Commercial real estate	1,533	1,533	571	1,463	23
Consumer real estate	647	647	91	740	12
Consumer installment	29	29	13	29	6
Total	\$2,334	\$2,334	\$ 738	\$ 2,360	\$ 41

Total Impaired Loans:

Commercial installment	\$246	\$246	\$ 63	\$ 197	\$ 5
Commercial real estate	3,953	3,953	571	2,920	108
Consumer real estate	888	888	91	1,028	15
Consumer installment	38	38	13	40	6
Total Impaired Loans	\$5,125	\$5,125	\$ 738	\$ 4,185	\$ 134

The following tables provide additional detail of troubled debt restructurings at June 30, 2012.

For the Three Months Ending June 30, 2012

	Outstanding Recorded Investment Pre-Modification (in thousands except number of loans)	Outstanding Recorded Investment Post - Modification	Number of Loans	Interest Income Recognized
Commercial installment	\$ -	\$ -	-	\$ -
Commercial real estate	-	-	-	-
Consumer real estate	63	63	1	1
Consumer installment	-	-	-	-
	\$ 63	\$ 63	1	\$ 1

For the Six Months Ending June 30, 2012

	Outstanding Recorded Investment Pre-Modification (in thousands except number of loans)	Outstanding Recorded Investment Post - Modification	Number of Loans	Interest Income Recognized
Commercial installment	\$ -	\$ -	-	\$ -
Commercial real estate	-	-	-	-
Consumer real estate	63	63	1	1
Consumer installment	-	-	-	-
	\$ 63	\$ 63	1	\$ 1

The balance of troubled debt restructurings at June 30, 2012 was \$104,000. There was no allocation in specific reserves established with respect to these loans as of June 30, 2012. As of June 30, 2012, the Company had no additional amount committed on any loan classified as troubled debt restructuring.

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 \$-0-. The

allowance for credit losses associated with those receivables on the basis of a current evaluation of loss was \$-0-. All loans were performing as agreed with modified terms.

During the three and six month period ending June 30, 2012, there was 1 loan modified as TDR.



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:

	June 30, 2012 (In thousands)			Total	
	Past Due	Past Due 90 Days or More and Still Accruing	Non- Accrual	Past Due and Non- Accrual	Total Loans
Real Estate-construction	\$ 1,108	\$ 33	\$ 712	\$ 1,853	\$60,939
Real Estate-mortgage	2,096	464	723	3,283	121,611
Real Estate-non farm non residential	68	685	581	1,334	134,933
Commercial	106	-	260	366	50,306
Consumer	158	23	27	208	14,552
Total	\$3,536	\$ 1,205	\$ 2,303	\$ 7,044	\$382,341

	December 31, 2011 (In thousands)			Total	
	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	\$70	\$ 22	\$ 945	\$ 1,037	\$63,357
Real Estate-mortgage	2,189	311	984	3,484	117,692
Real Estate-non farm non residential	1,662	144	2,877	4,683	138,943
Commercial	138	19	246	403	48,385
Consumer	214	-	73	287	16,645
Total	\$4,273	\$ 496	\$ 5,125	\$ 9,894	\$385,022

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 June 30, 2012 and December 31, 2011, 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)

June 30, 2012

	Real Estate Commercial	Real Estate Mortgage	Installment and Other	Commercial, Financial and Agriculture	Total
Pass	\$ 234,512	\$ 60,222	\$ 16,406	\$ 46,280	\$357,420
Special Mention	4,329	152	32	1,824	6,337
Substandard	15,731	2,408	64	475	18,678
Doubtful	-	-	-	68	68
Subtotal	254,572	62,782	16,502	48,647	382,503
Less:					
Unearned discount	98	60	-	4	162
Loans, net of unearned discount	\$ 254,474	\$ 62,722	\$ 16,502	\$ 48,643	\$382,341

December 31, 2011

	Real Estate Commercial	Real Estate Mortgage	Installment and Other	Commercial, Financial and Agriculture	Total
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Pass	\$ 223,692	\$ 57,835	\$ 16,004	\$ 60,741	\$358,272
Special Mention	5,169	71	45	3	5,288
Substandard	16,815	2,553	99	1,846	21,313
Doubtful	-	104	-	175	279
Subtotal	245,676	60,563	16,148	62,765	385,152
Less:					
Unearned discount	94	34	-	2	130
Loans, net of unearned discount	\$ 245,582	\$ 60,529	\$ 16,148	\$ 62,763	\$385,022

## NOTE I — SECURITIES

The following disclosure of the estimated fair value of financial instruments is made in accordance with authoritative guidance. The estimated fair value amounts have been determined using available market information and appropriate valuation methodologies. However, considerable judgment is necessarily required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts that could be realized in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

A summary of the amortized cost and estimated fair value of available-for-sale securities and held-to-maturity securities at June 30, 2012, follows:

(\$ in thousands)

	June 30, 2012			
	Amortized	Gross Unrealized	Gross Unrealized	Estimated
	Cost	Gains	Losses	Fair Value
<i>Available-for-sale securities:</i>				
Obligations of U.S. Government Agencies	\$47,544	\$ 170	\$ 5	\$47,709
Tax-exempt and taxable obligations of states and municipal subdivisions	95,843	3,435	30	99,248
Mortgage-backed securities	59,944	1,384	47	61,281
Corporate obligations	22,565	294	2,368	20,491
Other	1,255	-	281	974
Total	\$227,151	\$ 5,283	\$ 2,731	\$ 229,703
<i>Held-to-maturity securities:</i>				
Mortgage-backed securities	\$2,484	\$ 66	\$ -	\$2,550
Taxable obligations of states and municipal subdivisions	6,000	300	-	6,300
Total	\$8,484	\$ 366	\$ -	\$8,850

## NOTE J — ALLOWANCE FOR LOAN LOSSES

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

not be required.

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

The second part of the allowance is determined in accordance with authoritative guidance regarding loan impairment. Impaired loans are determined based upon a review by internal loan review and senior loan officers.

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

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

Impairment is measured on a loan by loan basis, and a specific allowance is assigned to each loan determined to be impaired. Impaired loans not deemed collateral dependent are analyzed according to the ultimate repayment source, whether that is cash flow from the borrower, guarantor or some other source of repayment. Impaired loans are deemed collateral dependent if in the Company's opinion the ultimate source of repayment will be generated from the liquidation of collateral.

The Company discontinues accrual of interest on loans when management believes, after considering economic and business conditions and collection efforts, that a borrower's financial condition is such that the collection of interest is doubtful. Generally, the Company will place a delinquent loan in nonaccrual status when the loan becomes 90 days or more past due. At the time a loan is placed in nonaccrual status, all interest which has been accrued on the loan but remains unpaid is reversed and deducted from earnings as a reduction of reported interest income. No additional interest is accrued on the loan balance until the collection of both principal and interest becomes reasonably certain.

#### NOTE K – SUBSEQUENT EVENTS

Subsequent events have been evaluated by management through the date the financial statements were issued.

#### NOTE L – RECLASSIFICATION

Certain amounts in the 2011 financial statements have been reclassified for comparative purposes to conform to the current period financial statement presentation.



ITEM NO. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS  
2 OF OPERATIONS

FINANCIAL CONDITION

The following discussion contains "forward-looking statements" relating to, without limitation, future economic performance, plans and objectives of management for future operations, and projections of revenues and other financial items that are based on the beliefs of the Company's management, as well as assumptions made by and information currently available to the Company's management. The words "expect," "estimate," "anticipate," and "believe," as well as similar expressions, are intended to identify forward-looking statements. The Company's actual results may differ materially from the results discussed in the forward-looking statements, and the Company's operating performance each quarter is subject to various risks and uncertainties that are discussed in detail in the Company's filings with the Securities and Exchange Commission, including the "Risk Factors" section in the Company's most recently filed Form 10-K.

The First represents the primary asset of the Company. The First reported total assets of \$699.3 million at June 30, 2012, compared to \$679.9 million at December 31, 2011. Loans decreased \$2.4 million, or .6%, during the first six months of 2012. Deposits at June 30, 2012, totaled \$588.0 million compared to \$573.4 million at December 31, 2011. For the six month period ended June 30, 2012, The First reported net income of \$2.2 million compared to \$1.6 million for the six months ended June 30, 2011.

NONPERFORMING ASSETS AND RISK ELEMENTS. Diversification within the loan portfolio is an important means of reducing inherent lending risks. At June 30, 2012, The First had no concentrations of ten percent or more of total loans in any single industry or any geographical area outside its immediate market areas.

At June 30, 2012, The First had loans past due as follows:

(\$ In Thousands)

Past due 30 through 89 days	\$ 3,536
Past due 90 days or more and still accruing	1,205

The accrual of interest is discontinued on loans which become ninety days past due (principal and/or interest), unless the loans are adequately secured and in the process of collection. Nonaccrual loans totaled \$2.3 million at June 30, 2012, a decrease of \$2.8 million from December 31, 2011. Any other real estate owned is carried at fair value, determined by an appraisal. Other real estate owned totaled \$6.7 million at June 30, 2012. A loan is classified as a

restructured loan when the following two conditions are present: First, the borrower is experiencing financial difficulty and second, the creditor grants a concession it would not otherwise consider but for the borrower's financial difficulties. At June 30, 2012, the Bank had \$104,000 in loans that were modified as troubled debt restructurings.

## LIQUIDITY AND CAPITAL RESOURCES

Liquidity is adequate with cash and cash equivalents of \$23.1 million as of June 30, 2012. In addition, loans and investment securities repricing or maturing within one year or less exceeded \$174.9 million at June 30, 2012. Approximately \$63.3 million in loan commitments could fund within the next six months and other commitments, primarily standby letters of credit, totaled \$.5 million at June 30, 2012.

There are no known trends or any known commitments or uncertainties that will result in The First's liquidity increasing or decreasing in a significant way.

Total consolidated equity capital at June 30, 2012, was \$63.3 million, or approximately 9.0% of total assets. The Company currently has adequate capital positions to meet the minimum capital requirements for all regulatory agencies. The Company's capital ratios as of June 30, 2012, were as follows:

Tier 1 leverage	8.49 %
Tier 1 risk-based	12.95 %
Total risk-based	13.92 %

On June 30, 2006, The Company issued \$4,124,000 of floating rate junior subordinated deferrable interest debentures to The First Bancshares Statutory Trust 2 in which the Company owns all of the common equity. The debentures are the sole asset of the Trust. The Trust issued \$4,000,000 of Trust Preferred Securities (TPSs) to investors. The Company's obligations under the debentures and related documents, taken together, constitute a full and unconditional guarantee by the Company of the Trust's obligations under the preferred securities. The preferred securities are redeemable by the Company at its option. The preferred securities must be redeemed upon maturity of the debentures in 2036. Interest on the preferred securities is the three month London Interbank Offer Rate (LIBOR) plus 1.65% and is payable quarterly. The terms of the subordinated debentures are identical to those of the preferred securities. On July 27, 2007, The Company issued \$6,186,000 of floating rate junior subordinated deferrable interest debentures to The First Bancshares Statutory Trust 3 in which the Company owns all of the common equity. The debentures are the sole asset of Trust 3. The Trust issued \$6,000,000 of Trust Preferred Securities (TPSs) to investors. The Company's obligations under the debentures and related documents, taken together, constitute a full and unconditional guarantee by the Company of the Trust's obligations under the preferred securities. The preferred securities are redeemable by the Company in 2012 or later, at its option. The preferred securities must be redeemed upon maturity of the debentures in 2037. Interest on the preferred securities is the three month LIBOR plus 1.40% and is payable quarterly. The terms of the subordinated debentures are identical to those of the preferred securities. In accordance with the authoritative guidance, the trusts are not included in the consolidated financial statements.

## RESULTS OF OPERATIONS – QUARTERLY

The Company had a consolidated net income of \$1,037,000 for the three months ended June 30, 2012, compared with consolidated net income of \$670,000 for the same period last year.

Net interest income increased to \$5,508,000 from \$4,511,000 for the three months ended June 30, 2012, or an increase of 22.1% as compared to the same period in 2011. Earning assets through June 30, 2012, increased \$136.0 million, or 27.1% and interest-bearing liabilities also increased \$98.1 million or 23.1% when compared to June 30, 2011.

Noninterest income for the three months ended June 30, 2012, was \$1,510,000 compared to \$1,024,000 for the same period in 2011, reflecting an increase of \$486,000 or 47.5%. Included in noninterest income is service charges on deposit accounts, which for the three months ended June 30 2012, totaled \$857,000 compared to \$567,000 for the same period in 2011.

The provision for loan losses was \$221,000 for the three months ended June 30, 2012, compared with \$305,000 for the same period in 2011. The allowance for loan losses of \$4.5 million at June 30, 2012 (approximately 1.16% of loans) is considered by management to be adequate to cover losses inherent in the loan portfolio. The level of this allowance is dependent upon a number of factors, including the total amount of past due loans, general economic conditions, and management's assessment of potential losses. This evaluation is inherently subjective as it requires estimates that are susceptible to significant change. Ultimately, losses may vary from current estimates and future additions to the allowance may be necessary.

Thus, there can be no assurance that charge-offs in future periods will not exceed the allowance for loan losses or that additional increases in the loan loss allowance will not be required. Management evaluates the adequacy of the allowance for loan losses quarterly and makes provisions for loan losses based on this evaluation.

Noninterest expense increased by \$1,121,000 or 26.1% for the three months ended June 30, 2012, when compared with the same period in 2011. This increase is primarily related to nonrecurring events including compromises of contingent claims and costs associated with the acquisition of the Whitney branches.

#### RESULTS OF OPERATIONS – YEAR TO DATE

The Company had a consolidated net income of \$2,008,000 for the six months ended June 30, 2012, compared with consolidated net income of \$1,171,000 for the same period last year.

Net interest income increased to \$11.0 million from \$8.8 million for the six months ended June 30, 2012, or an increase of 25.5% as compared to the same period in 2011. This increase was a result of increased loan volume and lower funding costs.

Noninterest income for the six months ended June 30, 2012, was \$2,985,000 compared to \$1,939,000 for the same period in 2011, reflecting an increase of \$1,046,000 or 53.9%. Included in noninterest income is service charges on deposit accounts, which for the six months ended June 30, 2012, totaled \$1,727,000 compared to \$1,126,000 for the same period in 2011. An increase in fee income associated with higher loan and deposit volumes attributed to this income as well as fee income generated from our mortgage division.

The provision for loan losses was \$373,000 for the six months ended June 30, 2012, compared with \$653,000 for the same period in 2011. The allowance for loan losses of \$4.5 million at June 30, 2012 (approximately 1.16% of total loans and 1.25% of loans excluding those booked at fair value due to business combination) is considered by

management to be adequate to cover losses inherent in the loan portfolio. The level of this allowance is dependent upon a number of factors, including the total amount of past due loans, general economic conditions, and management's assessment of potential losses. This evaluation is inherently subjective as it requires estimates that are susceptible to significant change. Ultimately, losses may vary from current estimates and future additions to the allowance may be necessary.

Thus, there can be no assurance that charge-offs in future periods will not exceed the allowance for loan losses or that additional increases in the loan loss allowance will not be required. Management evaluates the adequacy of the allowance for loan losses quarterly and makes provisions for loan losses based on this evaluation.

Noninterest expense increased by \$2.1 million or 24.0% for the six months ended June 30, 2012, when compared with the same period in 2011. This increase is primarily related to an increase in operating costs associated with the acquisition of the Whitney branches acquired in the fourth quarter of 2011, as more fully discussed at Note C.

### ITEM NO. 3. CONTROLS AND PROCEDURES

As of June 30, 2012, (the "Evaluation Date"), we carried out an evaluation, under the supervision of and with the participation of our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in SEC rules and forms.

There have been no changes, significant or otherwise, in our internal controls over financial reporting that occurred during the quarter ended June 30, 2012, that have materially affected, or are reasonably likely to affect, our internal control over financial reporting.

### ITEM NO. 4. RECENT ACCOUNTING PRONOUNCEMENTS

The Company has adopted ASU No. 2011-05, "Presentation of Comprehensive Income." This guidance (ASC Topic 220, *Comprehensive Income*) revises the manner in which entities present comprehensive income in their financial statements. It requires entities to report components in either a continuous statement of comprehensive income or in two separate but consecutive statements. The Company chose the latter presentation. The items that must be reported in other comprehensive income did not change. In December 2011, the FASB issued ASU No. 2011-12 to defer changes in ASU No. 2011-05 that relate to the presentation of reclassification adjustments until the FASB has time to reconsider the presentation of such adjustments.

In December 2011, the FASB issued ASU No. 2011-11, "Balance Sheet Disclosures about Offsetting Assets and Liabilities." The ASU amends ASC Topic 210 by requiring additional improved information to be disclosed regarding financial instruments and derivative instruments that are offset in accordance with the conditions under ASC 210-20-45 or ASC 815-10-45 or subject to an enforceable master netting arrangement or similar agreement. The amendment is effective for annual and interim reporting periods beginning on or after January 1, 2013. The disclosures required by the amendments should be applied retrospectively for all comparative periods presented. The Company does not believe the amendments will have a material impact on the financial statements.

## PART II -- OTHER INFORMATION

ITEM 1.

LEGAL PROCEEDINGS

None

ITEM 1A.

RISK FACTORS

There are no material changes in the Company's risk factors since December 31, 2011. Please refer to the Annual Report on Form 10-K of The First Bancshares, Inc., filed with the Securities and Exchange Commission on March 29, 2012.



ITEM 2. UNREGISTERED SALES OF EQUITY SECURITY AND USE OF PROCEEDS

Not Applicable

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not Applicable

ITEM 4. REMOVED AND RESERVED

ITEM 5. OTHER INFORMATION

Not Applicable

ITEM 6.

EXHIBITS

(a) Exhibits

Exhibit No.

- |      |  |
|------|--|
| 31.1 | Certification of principal executive officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 31.2 | Certification of principal financial officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 32.1 | Certification of principal executive officer pursuant to 18 U. S. C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification of principal financial officer pursuant to 18 U. S. C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

(b) The Company filed three reports on Form 8-K during the quarter ended June 30, 2012

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.

THE FIRST BANCSHARES, INC.  
(Registrant)

	/s/ M. RAY (HOPPY) COLE, JR.
August 14, 2012	M. Ray (Hoppy) Cole, Jr.
(Date)	Chief Executive Officer

	/s/ DEEDEE LOWERY
August 14, 2012	DeeDee Lowery, Executive
(Date)	Vice President and Chief Financial Officer