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NBC CAPITAL CORP
Form 10-Q
November 14, 2003

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

For the quarterly period ended September 30, 2003.

Commission File Number 1-15773

NBC CAPITAL CORPORATION

(Exact name of registrant as specified in its charter.)

Mississippi
(State of other jurisdiction of
incorporation or organization)

64-0694775
(I. R. S. Employer
Identification No.)

NBC Plaza, P. O. Box 1187, Starkville, Mississippi
(Address of principal executive offices)

39760
(Zip Code)

Registrant's telephone number, including area code: (662) 323-1341

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

YES NO

Indicate by check mark whether the registrant is an accelerated filer as defined in the Securities and Exchange Act of 1934 rule 12b-2.

YES NO

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date:

Common Stock, \$1 Par Value - 8,171,811 shares as of September 30, 2003.

PART I - FINANCIAL INFORMATION
NBC CAPITAL CORPORATION
CONSOLIDATED STATEMENTS OF INCOME FOR
NINE MONTHS ENDED SEPTEMBER 30, 2003 AND 2002

(Unaudited)

(Amounts in thousands, except per share data)

	2003	2002
INTEREST INCOME:	_____	_____

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Interest and Fees on Loans	\$25,663	\$30,596
Interest and Dividends on Investment Securities	13,046	15,001
Other Interest Income	227	146
	38,936	45,743
 INTEREST EXPENSE:		
Interest on Deposits	9,984	13,203
Interest on Borrowed Funds	3,875	4,288
	13,859	17,491
 Net Interest Income		
	25,077	28,252
Provision for Loan Losses	2,170	2,015
	22,907	26,237
 NON-INTEREST INCOME:		
Income from Fiduciary Activities	1,371	1,317
Service Charges on Deposit Accounts	5,697	5,143
Insurance Commission and Fee Income	3,438	3,046
Mortgage Loan Fee Income	1,838	990
Other Non-Interest Income	2,407	2,310
	14,751	12,806
Gains on Securities	1,362	279
 NON-INTEREST EXPENSE:		
Salaries and Employee Benefits	14,969	14,681
Expense of Premises and Fixed Assets	3,539	3,517
Other Non-Interest Expense	6,761	6,410
	25,269	24,608
 Income Before Income Taxes		
	13,751	14,714
Income Taxes	3,550	3,855
	\$10,201	\$10,859
 NET INCOME		
	=====	=====
 Net Earnings Per Share:		
Basic	\$ 1.25	\$ 1.32
	=====	=====
Diluted	\$ 1.25	\$ 1.32
	=====	=====
 Dividends Per Common Share		
	\$ 0.68	\$ 0.65
	=====	=====

Note 1: The 2002 statement has been restated to reflect the adoption of FASB No. 147, "Acquisition of Certain Financial Institutions".

NBC CAPITAL CORPORATION
CONSOLIDATED STATEMENTS OF INCOME FOR
QUARTER ENDED SEPTEMBER 30, 2003 AND 2002

(Unaudited)

(Amounts in thousands, except per share data)

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	2003	2002
	<u> </u>	<u> </u>
INTEREST INCOME:		
Interest and Fees on Loans	\$ 8,325	\$ 9,926
Interest and Dividends on Investment Securities	3,969	5,127
Other Interest Income	62	39
	<u> </u>	<u> </u>
Total Interest Income	12,356	15,092
INTEREST EXPENSE:		
Interest on Deposits	3,018	4,200
Interest on Borrowed Funds	1,252	1,469
	<u> </u>	<u> </u>
Total Interest Expense	4,270	5,669
	<u> </u>	<u> </u>
Net Interest Income	8,086	9,423
Provision for Loan Losses	680	755
	<u> </u>	<u> </u>
Net Interest Income after Provision for Loan Losses	7,406	8,668
	<u> </u>	<u> </u>
NON-INTEREST INCOME:		
Income from Fiduciary Activities	467	439
Service Charges on Deposit Accounts	2,014	1,812
Insurance Commission and Fee Income	1,182	1,081
Mortgage Loan Fee Income	679	349
Other Non-Interest Income	831	734
	<u> </u>	<u> </u>
Total Non-Interest Income	5,173	4,415
	<u> </u>	<u> </u>
Gain (Loss) on Securities	(6)	188
NON-INTEREST EXPENSE:		
Salaries and Employee Benefits	4,976	4,889
Expense of Premises and Fixed Assets	1,192	1,201
Other Non-Interest Expense	2,244	2,312
	<u> </u>	<u> </u>
Total Non-Interest Expense	8,412	8,402
	<u> </u>	<u> </u>
Income before Income Taxes	4,161	4,869
Income Taxes	1,046	1,253
	<u> </u>	<u> </u>
NET INCOME	\$ 3,115	\$ 3,616
	=====	=====
Net Earnings Per Share		
Basic	\$ 0.38	\$ 0.44
	=====	=====
Diluted	\$ 0.38	\$ 0.44
	=====	=====
Dividends Per Common Share	\$ 0.24	\$ 0.22
	=====	=====

Note 1: The 2002 statement has been restated to reflect the adoption of FASB No. 147, "Acquisition of Certain Financial Institutions".

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	Sept. 30, 2003	Dec. 31, 2002
	(Unaudited)	(Audited)
(Amounts in Thousands)		
ASSETS:		
Cash and Due From Banks:		
Noninterest-Bearing Balances	\$ 26,013	\$ 27,865
Interest-bearing Balances	822	567
	<hr/>	<hr/>
Total Cash and Due From Banks	26,835	28,432
Held-To-Maturity Securities (Market value of \$43,596 at September 30, 2003 and \$46,975 at December 31, 2002)	40,804	43,792
Available-For-Sale Securities	340,128	349,991
	<hr/>	<hr/>
Total Securities	380,932	393,783
Federal Funds Sold and Securities Purchased Under Agreements to Resell	420	28,486
Loans	584,884	576,325
Less: Reserve for Loan Losses	(6,238)	(6,029)
	<hr/>	<hr/>
Net Loans	578,646	570,296
Bank Premises and Equipment (Net)	14,750	14,816
Interest Receivable	5,995	7,605
Goodwill	2,853	2,853
Other Assets	29,349	31,185
	<hr/>	<hr/>
TOTAL ASSETS	\$1,039,780	\$1,077,456
	=====	=====
LIABILITIES AND SHAREHOLDERS' EQUITY:		
Deposits:		
Non-Interest Bearing Deposits	\$ 104,923	\$ 103,502
Interest-Bearing Deposits	681,502	713,945
	<hr/>	<hr/>
Total Deposits	786,425	817,447
Federal Funds Purchased and Securities Sold Under Agreements to Repurchase	22,184	25,599
Other Borrowed Funds	111,765	112,941
Interest Payable	1,254	1,626
Other Liabilities	8,461	8,736
	<hr/>	<hr/>
TOTAL LIABILITIES	930,089	966,349
Shareholders' Equity:		
Common Stock \$1 Par Value, Authorized 50,000,000 shares, Issued 9,615,806 shares	9,616	9,616
Surplus and Undivided Profits	129,340	124,710
Accumulated Other Comprehensive Income	(1,544)	4,122
Treasury Stock, at Cost	(27,721)	(27,341)
	<hr/>	<hr/>
TOTAL SHAREHOLDERS' EQUITY	109,691	111,107
	<hr/>	<hr/>
TOTAL LIABILITIES & SHAREHOLDERS' EQUITY	\$1,039,780	\$1,077,456
	=====	=====

Note 1: Certain 2002 amounts have been reclassified to conform to 2003 classifications.

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NBC CAPITAL CORPORATION CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2003 AND 2002

(Unaudited)

(Amounts in thousands)

	2003	2002
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income	\$ 10,201	\$ 10,806
Adjustments to Reconcile Net Income to Net Cash		
Depreciation and Amortization	1,460	1,593
Deferred Income Taxes (Credits)	5,908	(3,918)
Provision for Loan Losses	2,170	2,015
Loss (Gain) on Sale of Securities	(1,362)	(279)
(Increase) Decrease in Interest Receivable	1,610	760
(Increase) Decrease in Other Assets	(1,282)	(2,082)
Increase (Decrease) in Interest Payable	(372)	(435)
Increase (Decrease) in Other Liabilities	(275)	7,592
	18,058	16,052
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from Maturities of Securities	133,529	36,013
Proceeds from Sale of Securities	109,545	33,158
Purchase of Securities	(237,446)	(107,295)
(Increase) Decrease in Loans	(10,520)	27,493
(Additions) Disposal of Bank Premises and Equipment	(1,263)	(1,019)
	(6,155)	(11,650)
CASH FLOWS FROM FINANCING ACTIVITIES		
Increase (Decrease) in Deposits	(31,022)	(4,259)
Dividend Paid on Common Stock	(5,560)	(5,248)
Increase (Decrease) in Borrowed Funds	(4,591)	11,407
Purchase of Treasury Stock	(430)	(1,053)
Other Financing Activities	37	0
	(41,566)	847
Net Increase (Decrease) in Cash and Cash Equivalents	(29,663)	5,249
Cash and Cash Equivalents at Beginning of Year	56,918	43,525
	\$ 27,255	\$ 48,774
Cash paid during the period for:		
Interest	\$ 14,231	\$ 17,926
Income Taxes	\$ 3,823	\$ 3,889

Note 1: The 2002 statement has been restated to reflect the adoption of FASB No. 147, "Acquisition of Certain Financial Institutions".

Note 2: Certain 2002 amounts have been reclassified to conform to 2003 classifications.

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NBC CAPITAL CORPORATION NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The accompanying unaudited consolidated financial statements include the accounts of NBC Capital Corporation ("Corporation") and its subsidiaries, National Bank of Commerce and First National Finance Company. All significant intercompany accounts and transactions have been eliminated. In the normal decision making process, management makes certain estimates and assumptions that affect the reported amounts that appear in these statements. Although management believes that the estimates and assumptions are reasonable and are based on the best information available, actual results could differ.

In the opinion of management, all adjustments necessary for the fair presentation of the financial statements presented in this report have been made. Such adjustments were of a normal recurring nature.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with Generally Accepted Accounting Principles have been condensed or omitted.

Note 1. Accounting Pronouncements

The Corporation adopted Financial Accounting Standards Board "FASB" Statement No. 147, "Acquisition of Certain Financial Institutions", which became effective October 1, 2002. This Statement applies to unidentified intangible assets resulting from the acquisition of less-than-whole financial institutions. The Corporation had an unidentified intangible asset that resulted from such an acquisition. Management determined that the acquisition met the requirements of a business combination and, in accordance with FASB Statement No. 147, the related unidentified intangible asset was reclassified as goodwill and accounted for in accordance with FASB Statement No. 142. As a result, the Corporation reversed all related amortization expense recognized after FASB Statement No. 142 was applied. This reversal required the Corporation to restate each of the first three quarters of 2002. This reversal reduced the third quarter's other operating expense by \$28,000 and caused net income for that quarter to increase by approximately \$17,000. For the nine-month period ended September 30, 2002, this restatement reduced other operating expenses by \$85,000 and increased net income by \$53,000. This change did not cause the earnings per share to change.

At September 30, 2003, the Corporation had approximately \$2.8 million of goodwill on its balance sheet, including approximately \$800,000 of unidentified intangible assets reclassified as goodwill, which will remain at that level unless it becomes impaired under the definition of impairment in FASB Statement No. 142.

In December 2002, the FASB issued Statement No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure". This Statement amends FASB Statement No. 123, "Accounting for Stock-Based Compensation", to provide alternative methods of transition for voluntary change to the fair value based method of accounting for stock-based employee compensation. Since the Corporation accounts for its stock-based compensation under Accounting Principles Board "APB" No. 25, the Statement did not impact the Corporation's consolidated financial statements.

In April 2003, the FASB issued Statement No. 149, "Amendment of Statement

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133 on Derivative Instruments and Hedging Activities". This Statement amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under FASB Statement No. 133. Since the Corporation neither has derivative contracts nor engages in hedging activities, the Statement did not impact the Corporation's consolidated financial statements.

In May 2003, the FASB issued Statement No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity". This Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. Currently, the Corporation does not have financial instruments that fall within the scope of the Statement; therefore, this Statement currently has no impact on the Corporation's consolidated financial statements.

Note 2. Stock Options

The Corporation has a stock-based employee compensation plan which is accounted for under the recognition and measurement principles of APB Opinion No. 25, "Accounting for Stock Issued to Employees," and related Interpretations. No stock-based employee compensation cost is reflected in net income, as all stock options granted under these plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates what the effect on net income and earnings per share would have been if the Corporation had applied the fair value recognition provisions of FASB Statement No. 123, "Accounting for Stock-Based Compensation," to stock-based employee compensation.

(Amounts in thousands except for per share data)

	Quarter Ended September 30, 2003 2002 (In Thousands)	
Net income, as reported	\$3,115	\$3,616
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(28)	(65)
	\$3,087 \$3,551	
Pro forma net income		
Basic net earnings per share:		
As reported	\$.38	\$.44
Pro forma	.38	.44
Diluted net earnings per share:		
As reported	\$.38	\$.44
Pro forma	.38	.44
	Nine Months Ended September 30, 2003 2002	

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(In Thousands)

Net income, as reported	\$10,201	\$10,859
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(152)	(150)
Pro forma net income	\$10,049	\$10,709
Basic net earnings per share:		
As reported	\$ 1.25	\$ 1.32
Pro forma	1.23	1.30
Diluted net earnings per share:		
As reported	\$ 1.25	\$ 1.32
Pro forma	1.23	1.30

Note 3. Comprehensive Income

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

	Quarter Ended September 30, 2003 2002 (In thousands)	
Net Income	\$ 3,115	\$3,616
Other Comprehensive Income (Loss), net of tax:		
Reclassification adjustment for (gain) loss included in net income	4	(118)
Unrealized gains (losses) on securities	(4,066)	824
	(4,062)	706
Comprehensive Income (Loss)	\$ (947)	\$4,322
Accumulated Comprehensive Income (Loss)	\$(1,544)	\$5,350

	Nine Months Ended September 30, 2003 2002 (In thousands)	
Net Income	\$10,201	\$10,859
Other Comprehensive Income (Loss), net of tax:		
Reclassification adjustment for (gain) loss		

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included in net income	(851)	(174)
Unrealized gains (losses) on securities	(4,815)	3,874
	(5,666)	3,700
Comprehensive Income	\$ 4,535	\$14,559
	=====	=====
Accumulated Comprehensive Income	\$(1,544)	\$ 5,350
	=====	=====

PART I. ITEM 2

MANAGEMENT'S DISCUSSION AND ANALYSIS

SEPTEMBER 30, 2003

DISCLOSURE REGARDING FORWARD LOOKING INFORMATION

The following provides a narrative discussion and analysis of significant changes in the Corporation's results of operations and financial condition for the quarter and nine-month period ended September 30, 2003. Certain information included in this discussion contains forward-looking statements and information that are based on management's conclusions, drawn from certain assumptions and information currently available. The Private Securities Litigation Act of 1995 encourages the disclosure of forward-looking information by management by providing a safe harbor for such information. This discussion includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Although the Corporation believes that the expectations reflected in such forward-looking statements are reasonable, such forward-looking statements are based on numerous assumptions (some of which may prove to be incorrect) and are subject to risks and uncertainties which could cause the actual results to differ materially from the Corporation's expectations. The forward-looking statements made in this document are based on management's beliefs, as well as assumptions made by and information currently available to management. When used in the Corporation's documents, the words "anticipate," "estimate," "expect," "objective," "projection," "forecast," "goal" and similar expressions are intended to identify forward-looking statements. In addition to any assumptions and other factors referred to specifically in connection with forward-looking statements, factors that could cause the Corporation's actual results to differ materially from those contemplated in any forward-looking statements include, among others, increased competition, regulatory factors, economic conditions, changing interest rates, changing market conditions, availability or cost of capital, employee workforce factors, cost and other effects of legal and administrative proceedings, and changes in federal, state or local laws and regulations. The Corporation undertakes no obligation to update or revise any forward-looking statements, whether as a result of changes in actual results, changes in assumptions or other factors affecting such statements.

The two major trends that can have a material impact on the Corporation's financial condition and results of operations are the trend in interest rates and the overall trend in the economy. Currently, management expects, based on the available information, that interest rates will remain at their current levels and the overall economy in its market will remain relatively

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flat throughout the remainder of 2003. The Corporation's 2003 projections, budgets and goals are based on these expectations. If these trends move differently than expected in either direction and/or speed, they could have a material impact on the Corporation's financial condition and results of operations. It is also a risk if interest rates continue at current levels for an extended period of time. If this happens, as existing loans in the portfolio mature, they will be paying off at an older, higher interest rate. The new loans that will be replacing them will be made at much lower interest rates. Rates on deposits are at a level that will make it very difficult to offset this loss in yield with a reduced cost of deposits. There is also a risk that when rates begin to move up, new and existing borrowers will want to fix rates on loans at the lower end of this up cycle. During a rising rate environment, the rates on deposits will increase as time deposits mature. These situations, if they occur, will put additional pressure on the Corporation's net interest margin and net income. The areas of the Corporation's operations most directly impacted by all of the above described situations would be the net interest margin, loan and deposit growth and the provision for loan losses.

ACCOUNTING ISSUES

Note A of the Notes to Consolidated Financial Statements included in the Corporation's Form 10-K for the year ended December 31, 2002, contains a summary of the Corporation's accounting policies. Management is of the opinion that Note A, read in conjunction with all other information in the annual report, including management's letter to shareholders and management's discussion and analysis, is sufficient to provide the reader with the information needed to understand the Corporation's financial condition and results of operations. This information is also sufficient to enable the reader to identify the areas in which management is required to make the most difficult, subjective and /or complex judgments.

In the normal course of business, the Corporation's wholly-owned subsidiary, National Bank of Commerce, makes loans to related parties, including directors and executive officers of the Corporation and their relatives and affiliates. These loans are made in the ordinary course of business and on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other parties. Also, they are consistent with sound banking practices and within the applicable regulatory and lending limitations imposed by the national banking laws and regulations.

Under Section 402 of the Sarbanes-Oxley Act of 2002, loans to executive officers are generally prohibited. However, the rule does not apply to any loan made or maintained by an insured depository institution if the loans are subject to the insider lending restrictions of section 22(h) of the Federal Reserve Act. All loans to executive officers made by the Corporation's bank subsidiary are subject to the above referenced section of the Federal Reserve Act.

The Corporation does not have investments in any unconsolidated entities over which it exercises management or control. The Corporation does not have relationships with limited or special purpose entities that it relies on to provide financing, liquidity or market and credit risk support.

RESULTS OF OPERATIONS

First three quarters of 2003 compared to the first three quarters of 2002:

Earnings for the first three quarters of 2003 decreased by 6.1% to

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\$10.2 million, or \$1.25 per share. This compares to \$10.86 million, or \$1.32 per share, for the first three quarters of 2002. On an annualized basis, these 2003 totals equate to a 1.3% return on average assets and a 12.3% return on average equity. For this same period in 2002, return on average assets was 1.4% and return on average equity was 13.6%.

Net interest income for the first nine months of 2003 was \$25.08 million, compared to \$28.25 million for 2002. This represents a decrease of 11.2%. This decrease resulted from a forty-eight basis point decrease in the net interest margin. The primary reason for the decrease in margin was that the Corporation lost 100 basis points from the repricing of its earning assets from the first nine months of 2002 to the first nine months of 2003, while it was only able to decrease its cost of funds by 61 basis points. This decline was partially offset by a \$12.6 million or 1.3% increase in average earning assets. However, all of the growth in average earning assets came in the areas of the investment securities portfolio and federal funds sold, as loans continued to decline. Average loans declined from \$595.5 million during the first nine months of 2002 to \$566.5 million during the first nine months of 2003. During these same periods, the average balances of the investment securities portfolio increased from \$369.7 million to \$397.0 million, and average balances of federal funds sold increased from \$10.9 million to \$25.4 million. This change in the mix of average earning assets had a negative impact on margin because the yield on the loan portfolio for the first nine months of 2003 was 6.06%, while the yields on the investment portfolio and federal funds sold were only 4.39% and 1.20%, respectively. This change in mix occurred because of the Corporation's need to grow earning assets during a time of very soft loan demand and an overall slow economy in its market area. The Corporation continued to lose mortgage loans from its portfolio as the adjustable rate loans in the portfolio refinanced to fixed rate loans and were sold into the secondary market. In the area of consumer loans, there was continued competition from sources offering low or, in the case of automobiles, zero rate loans. All of these factors put pressure on the Corporation's ability to grow loans and to maintain or increase margins and net interest income. Management believes that if the Federal Reserve continues the current low rate environment for the remainder of the year, the Corporation's net interest income will continue to come under pressure. For additional information, see the table entitled "Analysis of Net Interest Earnings" at the end of this section.

The Corporation's Provision for Loan Losses is utilized to replenish the Reserve for Loan Losses on its balance sheet. The reserve is maintained at a level deemed adequate by the Board of Directors after its evaluation of the risk exposure contained in the Corporation's loan portfolio. The methodology used to make this determination is performed on a quarterly basis. An overall analysis of the portfolio is performed by the senior credit officers and the loan review staff. As a part of this evaluation, certain loans are individually reviewed to determine if there is an impairment of the Corporation's ability to collect the loan and the related interest. This determination is generally made based on collateral value. If it is determined that an impairment exists, a specific portion of the reserve is allocated to each affected loan. All other loans are grouped into homogeneous pools, and risk exposure is determined by considering the following list of factors (this list is not all inclusive and the factors reviewed may change as circumstances change): historical loss experiences; trends in delinquencies and non-accruals; and national, regional and local economic conditions. These economic conditions would include, but not be limited to, general real estate conditions, the current interest rate environment and trends, unemployment levels and other information, as deemed appropriate. Overall, loan quality remains good. Classified assets to capital were 12.5% at September 30, 2003, compared to 16.2% at September 30, 2002. The percentage of loans past due 30 days or more was 1.73% at September 30, 2003, compared to 2.26% at September 30, 2002. The Reserve for

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Loan Losses as a percentage of total loans increased from 1.03% of net loans at the end of 2002 to 1.07% at the end of the third quarter of 2003. During the first nine months of 2003, net charge-offs totaled \$1,961,000, compared to \$2,111,000 for the same period of 2002. At the end of the third quarter of 2003, the ratio of non-performing loans to total loans remained low at .49%, compared to .70% at December 31, 2002 and .68% at September 30, 2002. Also, at September 30, 2003, the coverage of the reserve for loan losses to non-performing loans was 218%, compared to 165% at September 30, 2002. Management is committed to not relaxing its underwriting standards. Based on these evaluations, the reserve amounts maintained at the end of the third quarter of 2003 and at the end of 2002 were deemed adequate to cover exposure within the Corporation's loan portfolio.

The Provision for Loan Losses increased from \$2,015,000 during the first nine months of 2002 to \$2,170,000 in the same period of 2003. The level of the provision for the first nine months of 2003 was increased due to a more conservative stance regarding the portion of the provision allocated to the consumer loan portfolio in light of the continuation of the soft economy and the heavy job losses in some of the Corporation's markets. In the opinion of management, the current level of the provision should be sufficient to reflect probable losses inherent in the loan portfolio.

Non-interest income grew 15.2%, resulting from a 10.8% increase in fee income from deposit accounts, a 12.9% increase in insurance commission and fee income, a 4.1% increase in income from fiduciary activities, an 85.7% increase in fees from mortgage-related activities and a 4.2% increase in other non-interest income. The solid increase in income from deposit accounts largely resulted from increased account activity, more uniform application of account-based fees, and selected fee increases. The increase in insurance commission and fee income resulted from an increased volume in all lines of the insurance business, an overall increase in premiums in the industry and improved profit sharing from carriers due to lower loss levels and increased underwriting volume. The increase in income from fiduciary activities resulted primarily from higher fees related to a general rise in value in the equity markets, which directly affected the value of assets under management. Mortgage fee income benefited from the continued demand for home loans in this low interest rate environment. The increase in other non-interest income resulted primarily from a 229.9% increase in retail investment income to \$254,000.

The Corporation recognized \$1,362,000 in securities gains during the first nine months of 2003, compared to gains of \$279,000 during the first nine months of 2002. During 2002 and 2003, the Corporation took advantage of a very unusual interest rate environment that allowed certain securities to be sold at a gain and replaced with similar securities with yields at or above the level of the securities sold. This opportunity resulted from the rapid prepayment of some mortgage-backed securities which reduced their yields and average lives and made them attractive at premium prices to short term investors. The Corporation took advantage of this opportunity to improve portfolio yields without extending maturities beyond acceptable levels, and at the same time, to recognize gains. Management believes the opportunities for similar gains during the fourth quarter of 2003 will depend on the level of long term interest rates during the quarter and their effect on the prepayment speeds of the mortgage-backed securities in the investment portfolio. The Corporation will take advantage of this situation, if it occurs.

Non-interest expenses for the first nine months of 2003 increased by 2.7% over the same period of 2002. This small increase resulted from a continued focus on managing these expenses. Salaries and employee benefits were up 2.0%, primarily due to higher pension costs and a 1.1% increase in salary expenses resulting from normal raises, offset by lower incentive pay and

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bonus accruals. Expenses associated with premises and fixed assets increased by \$22,000, or .6%, due to increases in property taxes and utilities. Other non-interest expenses increased by \$351,000, or 5.5%. This increase resulted from increases in several expense categories; however, the only category with a material change was marketing, which increased 48.6%, or \$145,000. The reason for the increase was the start of a new "Branding" campaign.

Changes in the Corporation's income tax expense have generally paralleled changes in income. The Corporation's effective tax rate decreased from 26.2% for the first nine months of 2002 to 25.8% for the first nine months of 2003. This decrease resulted primarily from the mix of income from tax-free investments and the percentage relationship of tax-free income to total pre-tax income. The Corporation's ability to reduce income tax expense by acquiring additional tax-free investments is limited by the alternative minimum tax provision, the market supply of acceptable municipal securities, the level of tax exempt yields and the Corporation's normal liquidity and balance sheet structure requirements.

Third quarter of 2003 compared to the third quarter of 2002:

Earnings for the third quarter of 2003 decreased by 13.9% to \$3.12 million, or \$.38 per share. This compares to \$3.62 million, or \$.44 per share, for the third quarter of 2002. On an annualized basis, the 2003 net income equates to a 1.2% return on average assets and a 11.2% return on average equity. For this same period in 2002, return on average assets was 1.4% and return on average equity was 13.2%.

Net interest income for the third quarter of 2003 was \$8.09 million, compared to \$9.42 million for 2002. This represents a decrease of 14.2%. This decrease resulted from a 49 basis point decrease in the net interest margin. The primary reason for the decrease in margin was that the Corporation lost 109 basis points from the repricing of its earning assets from the third quarter of 2002 to the third quarter of 2003, while it was only able to decrease its cost of funds by 68 basis points. This decline in margin was also affected by a \$2.8 million or .3% decrease in average earning assets, along with a change in the mix of these assets. Average investment securities, federal funds sold and other interest bearing accounts increased and average loans continued to decline. Average loans declined from \$590.1 million during the third quarter of 2002 to \$566.2 million during the third quarter of 2003. During these same periods, the average balances of the investment securities portfolio increased from \$384.6 million to \$390.2 million and federal funds sold and other interest bearing accounts increased from \$8.3 million to \$23.9 million. This change in the mix of average earning assets had a negative impact on margin because the yield on the loan portfolio for the third quarter of 2003 was 5.83%, while the yield on the investment portfolio was 4.04% and the yield on federal funds sold and other interest bearing accounts was 1.03%. This mix change occurred because of the Corporation's need to grow earning assets during a time of very soft loan demand and an overall slow economy in its market area. The Corporation continued to lose mortgage loans from its portfolio as the adjustable rate loans in the portfolio refinanced to fixed rate loans and were sold into the secondary market. In the area of consumer loans, there was continued competition from sources offering low or, in the case of automobiles, zero rate loans. All of these factors put pressure on the Corporation's ability to grow loans and to maintain margins and net interest income. Management believes that if the Federal Reserve continues the current low rate environment for the remainder of the year, the Corporation's net interest income will continue to come under pressure. For additional information, see the table

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entitled "Analysis of Net Interest Earnings" at the end of this section.

The Provision for Loan Losses decreased from \$755,000 during the third quarter of 2002 to \$680,000 in the same quarter of 2003. The level of the provision decreased due to the overall improvement in the credit quality of the Corporation's loan portfolio. As previously stated, classified assets as a percentage of capital improved from 16.2% at September 30, 2002 to 12.5% at September 30, 2003. The percentage of loans past due 30 days or more decreased from 2.26% to 1.73%. Also, the percentage of non-performing loans to total loans decreased from .68% to .49%. All of these factors were taken into consideration in making the decision to lower the provision for the quarter. In the opinion of management, the current level of the provision should be sufficient to protect the Corporation from any unforeseen deterioration in the quality of the loan portfolio.

Non-interest income grew 17.2%, resulting from a 11.1% increase in income from deposit accounts, a 6.4% increase in income from fiduciary activities, a 9.3% increase in insurance commission and fee income, a 94.6% increase in fees from mortgage-related activities and a 13.2% increase in other non-interest income. The solid increase in income from deposit accounts largely resulted from increased account activity from the introduction of a new free checking account, more uniform application of account-based fees, and selected fee increases. The increase in income from fiduciary activities resulted primarily from higher fees related to the impact of the equity markets on the value of assets under management. The increase in insurance commission and fee income resulted from a combination of increased business activity and overall higher premiums in the insurance industry. The increase in other non-interest income resulted primarily from an \$86,000 increase in retail investment income and a \$79,000 gain on the sale of student loans. Mortgage fee income benefited from the record demand for loans in this low interest rate environment. The month of August was the single largest month that the Corporation has experienced in all categories of mortgage lending (numbers of mortgage loans closed, total principal of loans closed and mortgage loan fees generated). During the month of September, the rate environment changed as the long end of the interest rate curve went up, causing mortgage rates to increase. This caused a drastic decline in mortgage loan activity. As a result, the pipeline for mortgage loans, both new home loans and refinancing of existing loans, declined 38.4% from June 30, 2003 to September 30, 2003. Even though rates have dropped back to the lower levels, activity has not increased. Management believes that the level of mortgage loan fee income for the fourth quarter of 2003 will be approximately half the average level for the first three quarters.

The Corporation recognized a securities loss of \$6,000 during the third quarter of 2003, compared to a gain of \$188,000 during the third quarter of 2002. In the third quarter of 2002, the Corporation took advantage of a very unusual interest rate environment that allowed certain securities to be sold at a gain and replaced with similar securities with yields at or above the level of the securities sold. This opportunity resulted from the rapid prepayment of some mortgage-backed securities which reduced their yields and average lives and made them attractive at premium prices to short term investors. The Corporation took advantage of this opportunity to improve portfolio yields without extending maturities beyond acceptable levels, and at the same time, to recognize gains. This opportunity was not available during the third quarter of 2003. The loss in 2003 resulted from securities that had been purchased at a premium being called at par.

Non-interest expenses for the third quarter of 2003 increased by only \$10,000 over the same period of 2002. This small increase resulted from a continued focus on managing these expenses. Salaries and employee benefits were up 1.8%, primarily due to higher pension expense. Expenses of premises and fixed

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assets and other non-interest expenses decreased by .8% and 2.9%, respectively. These decreases resulted from decreases in several expense categories, none of which were individually considered to be material.

Changes in the Corporation's income tax expense have generally paralleled changes in income. The Corporation's effective tax rate decreased from 25.7% in the third quarter of 2002 to 25.1% in the third quarter of 2003. The Corporation's ability to reduce income tax expense by acquiring additional tax-free investments is limited by the alternative minimum tax provision, the market supply of acceptable municipal securities, the level of tax exempt yields and the Corporation's normal liquidity and balance sheet structure requirements.

FINANCIAL CONDITION

The Corporation's balance sheet shows a slight decrease in total assets from \$1.08 billion to \$1.04 billion during the first nine months of 2003. During this period, loans increased by \$8.6 million, or 1.5%. Consumer loans and business loans continued to decline; however, increases in credit line loans and real estate loans offset the decline. Due to the lack of loan demand in its market area, the Corporation purchased approximately \$50 million of mortgage loans in the secondary market. Without these purchases, real estate loans would have declined due to the continued refinancing of variable rate mortgage loans to fixed rate loans (which the Corporation does not hold in its portfolio). The consumer loans continued to decline because of tighter underwriting standards and continued competition from low and zero rate loans, especially from the automobile industry. The decline in business loans from the end of the year was primarily due to the pay-off of a large loan that moved into its permanent financing phase with a government agency. Because of low loan demand and the large buildup in the investment portfolio, the Corporation decided not to aggressively price deposits, resulting in an \$31.0 million decline in deposits and an \$3.4 million decline in federal funds purchased and securities sold under agreements to repurchase. The Corporation also decreased its Federal Home Loan Bank borrowings by \$1.2 million. The funds to reduce these liabilities and to purchase the above mentioned loans came primarily from a \$12.9 million decrease in investment securities and a \$28.0 million decrease in federal funds sold. Changes in other categories of assets and liabilities were not considered material in nature and resulted from normal business activities.

Shareholders' equity decreased from \$111.1 million to \$109.7 million during the first nine months of 2003. During this period the accumulated other comprehensive income component of Shareholders' Equity decreased from an unrealized gain of \$4,122,000 at December 31, 2002 to an unrealized loss of \$1,544,000 at September 30, 2003. Part of the reason for the decline was that during the period, approximately \$1,362,000 of gross gains were actually realized. After adjusting for these realized gains, the market value of the remaining portfolio declined by approximately \$4,815,000, net of taxes. See Note 3 to the Consolidated Financial Statements in this document for additional information concerning the changes in comprehensive income. Also, during the first three quarters of 2003, the Corporation declared dividends of approximately \$5,558,000. Additionally, the Corporation repurchased 18,000 shares of its common stock in the open market under the announced stock repurchase plan for approximately \$430,000, or an average purchase price per share of \$23.86. These declines were partially offset by net earnings for the first three quarters of the year.

The Corporation's bank subsidiary is required to maintain a minimum amount of capital to total risk weighted assets as defined by the banking regulators. At September 30, 2003, the bank's Tier I, Tier II and Total

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Capital Ratios exceeded the well-capitalized standards developed under the applicable regulatory guidelines.

Dividends paid by the Corporation are provided from dividends received from the subsidiary bank. Under the regulations controlling national banks, the payment of dividends by the bank without prior approval from the Comptroller of the Currency is limited in amount to the current year's net profit and the retained net earnings of the two preceding years. To fund a 976,676 share repurchase transaction in March of 2001, the Corporation's subsidiary bank borrowed funds from the Federal Home Loan Bank and, with special permission from the Office of the Comptroller of the Currency, declared a special dividend to the Corporation to purchase this stock. As a result, the subsidiary bank is limited to its 2002 net retained earnings and the current year's net profits to pay dividends to the Corporation during 2003, without obtaining further approval from the Comptroller of the Currency. At September 30, 2003, without approval, the subsidiary bank's dividend paying ability was limited to approximately \$10.2 million.

Also, under regulations controlling national banks, the bank is limited in the amount it can lend to the Corporation, and such loans are required to be on a fully secured basis. At September 30, 2003, there were no borrowings between the Corporation and its subsidiary bank.

OFF-BALANCE SHEET ARRANGEMENTS

In the ordinary course of its business, the Corporation enters into agreements with customers to loan money. When a loan agreement is executed, the customer can either borrow the money immediately or draw against the loan over a predetermined time period. If an unfunded commitment is drawn against, the bank charges the customer the interest rate established in the original agreement for the amount of the draw for the time period outstanding. As of September 30, 2003, the amount of unfunded commitments outstanding was \$113,792,000.

Also, the Corporation provides commercial letters of credit to its customers. The Corporation charges the customer approximately one and one-half percent of the face amount of a letter of credit as a fee for issuance. This is a contingent obligation to make a loan to this customer for up to the amount of the letter of credit and at a predetermined rate of interest. As of September 30, 2003, the amount of outstanding letters of credit was \$5,372,000.

Both of these arrangements are subject to the same credit and underwriting standards as any other loan agreement.

At any point in time, the Corporation does not know when or if these commitments will be funded. Generally, if they are funded, they are funded at various times over the commitment period. As a result, the Corporation is able to fund them out of normal cash flow. If they were all funded at the same time, the Corporation has short-term borrowing lines in place to fund its cash needs.

From a profit standpoint, it would be in the best interest of the Corporation for all of these outstanding commitments to be funded.

ANALYSIS OF NET INTEREST EARNINGS

The table below shows, for the periods indicated, an analysis of net interest earnings, including the average amount of interest-earning assets and interest-bearing liabilities outstanding during the period, the interest

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earned or paid on such amounts, the average yields/rates paid and the net yield on interest-earning assets:

	(\$ In Thousands) Average Balance		
	Quarter ended 9/30/03	Nine Months ended 9/30/03	Year ended 12/31/02
EARNING ASSETS:			
Net loans	\$566,194	\$566,467	\$591,297
Federal funds sold and other interest-bearing assets	23,856	25,354	12,986
Securities			
Taxable	282,480	284,843	250,970
Nontaxable	107,739	112,133	123,380
	<hr/>	<hr/>	<hr/>
Totals	980,269	988,797	978,633
	<hr/>	<hr/>	<hr/>
INTEREST-BEARING LIABILITIES:			
Interest-bearing deposits	701,826	710,509	701,654
Borrowed funds, federal funds purchased and other	140,750	135,402	134,639
	<hr/>	<hr/>	<hr/>
Totals	842,576	845,911	836,293
	<hr/>	<hr/>	<hr/>
Net amounts	\$137,693	\$142,886	\$142,340
	=====	=====	=====

	(\$ In Thousands) Interest Income		
	Quarter ended 9/30/03	Nine Months ended 9/30/03	Year ended 12/31/02
EARNING ASSETS:			
Net loans	\$ 8,325	\$ 25,663	\$ 40,022
Federal funds sold and other interest-bearing assets	62	227	215
Securities:			
Taxable	2,669	8,945	13,675
Nontaxable	1,300	4,101	6,139
	<hr/>	<hr/>	<hr/>
Totals	\$ 12,356	\$ 38,936	\$ 60,051
	=====	=====	=====

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INTEREST-BEARING LIABILITIES:			
Interest-bearing deposits	\$ 3,018	\$ 9,984	\$ 17,171
Borrowed funds, federal funds purchased and other	1,252	3,875	5,705
	<hr/>	<hr/>	<hr/>
Totals	4,270	13,859	22,876
	<hr/>	<hr/>	<hr/>
Net interest income	\$ 8,086	\$ 25,077	\$ 37,175
	=====	=====	=====

Yields Earned
And Rates Paid (%)

	Quarter ended 9/30/03	Nine Months ended 9/30/03	Year ended 12/31/02
	<hr/>	<hr/>	<hr/>
EARNING ASSETS:			
Net loans	5.83%	6.06%	6.77%
Federal funds sold and other interest-bearing assets	1.03%	1.20%	1.66%
Securities:			
Taxable	3.75%	4.20%	5.45%
Nontaxable	4.79%	4.89%	4.98%
	<hr/>	<hr/>	<hr/>
Totals	5.00%	5.26%	6.14%
	<hr/>	<hr/>	<hr/>
INTEREST-BEARING LIABILITIES:			
Interest-bearing deposits	1.71%	1.88%	2.45%
Borrowed funds, federal funds purchased and other	3.53%	3.83%	4.24%
	<hr/>	<hr/>	<hr/>
Totals	2.01%	2.19%	2.74%
	<hr/>	<hr/>	<hr/>
Net yield on earning assets	3.31%	3.39%	3.80%
	<hr/>	<hr/>	<hr/>
Note: Yields on tax equivalent basis would be:			
Nontaxable securities	7.37%	7.52%	7.66%
	<hr/>	<hr/>	<hr/>
Total earning assets	5.28%	5.56%	6.47%
	<hr/>	<hr/>	<hr/>
Net yield on earning assets	3.56%	3.69%	4.14%
	<hr/>	<hr/>	<hr/>

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PART I. ITEM 3

Quantitative and Qualitative Disclosures about Market Risk

Not Applicable

PART I. ITEM 4

Controls and Procedures

September 30, 2003

It is the responsibility of the Chief Executive Officer and the Chief Financial Officer to establish and maintain disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for NBC Capital Corporation. These disclosure controls and procedures have been designed to ensure that material information relating to NBC Capital Corporation, including its consolidated subsidiaries, is made known to these officers by others within those entities, during the period covered by this filing and up to and including the filing date of this report.

In accordance with Item 307a of Regulation S-K, these disclosure controls and procedures were evaluated as of September 30, 2003. It is the conclusion of the Corporation's Chief Executive Officer and the Chief Financial Officer that, as of September 30, 2003, the disclosure controls and procedures of NBC Capital Corporation were functioning effectively to make known all material information that requires disclosure in this filing. There have been no significant changes in the Corporation's internal controls over financial reporting that occurred during the Corporation's most recent fiscal quarter that have materially affected, or would be reasonably likely to materially affect, the Corporation's internal control over financial reporting. Management believes that there were no significant deficiencies or material weaknesses in the Corporation's internal controls that required any corrective action.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

None

Item 2. Changes in Securities and Use of Proceeds

None

Item 3. Defaults Upon Senior Securities

None

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

None

Item 5. Other Information

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None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

- 11 Statement re computation of per-share earnings
- 31.1 Certificate pursuant to Rule 13a-14(a) or 15d-14(a) of Securities Exchange Act of 1934 as adopted pursuant to section 302 of Sarbanes-Oxley Act of 2002 - Chief Executive Officer
- 31.2 Certificate pursuant to Rule 13a-14(a) or 15d-14(a) of Securities Exchange Act of 1934 as adopted pursuant to section 302 of Sarbanes-Oxley Act of 2002 - Chief Financial Officer
- 32.1 Certificate pursuant to 18 U.S.C., Section 1350 as adopted pursuant to section 906 of Sarbanes-Oxley Act of 2002 - Chief Executive Officer
- 32.2 Certificate pursuant to 18 U.S.C., Section 1350 as adopted pursuant to section 906 of Sarbanes-Oxley Act of 2002 - Chief Financial Officer

(b) Form 8-K

A Form 8-K was filed to announce the release of a quarterly earnings release for the quarter ended September 30, 2003. The press release was made to the public after the market close on October 20, 2003 and included in a Current Report on Form 8-K filed on October 20, 2003.

The financial information furnished herein has not been audited by independent accountants; however, in the opinion of management, all adjustments necessary for a fair presentation on the results of operations for the three-month and the nine-month periods ended September 30, 2003, have been included.

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

NBC CAPITAL CORPORATION
Registrant

Date: November 11, 2003

/s/ Richard T. Haston

Richard T. Haston
Executive Vice President,
Chief Financial Officer and
Treasurer

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EXHIBIT INDEX:

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