

MIDSOUTH BANCORP INC  
Form 10-Q  
November 13, 2018

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, 2018

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

COMMISSION FILE NUMBER 1-11826  
MIDSOUTH BANCORP, INC.  
(Exact name of registrant as specified in its charter)

Louisiana 72-1020809  
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

102 Versailles Boulevard, Lafayette, Louisiana 70501  
(Address of principal executive offices, including zip code)  
(337) 237-8343  
(Registrant's telephone number, including area code)

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

YES  NO

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).

YES  NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer   Smaller reporting company  Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the

Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.)

YES      NO   

As of November 9, 2018, there were 16,641,105 shares of the registrant's Common Stock, par value \$0.10 per share, outstanding.

---

Part I – Financial Information	<u>3</u>
Item 1. <u>Financial Statements</u>	<u>3</u>
<u>Consolidated Balance Sheets</u>	<u>3</u>
<u>Consolidated Statements of Operations (unaudited)</u>	<u>4</u>
<u>Consolidated Statements of Comprehensive Loss (unaudited)</u>	<u>5</u>
<u>Consolidated Statement of Shareholders’ Equity (unaudited)</u>	<u>6</u>
<u>Consolidated Statements of Cash Flows (unaudited)</u>	<u>8</u>
<u>Notes to Interim Consolidated Financial Statements</u>	<u>9</u>
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operation.</u>	<u>31</u>
<u>Forward-Looking Statements</u>	<u>31</u>
<u>Critical Accounting Policies</u>	<u>32</u>
<u>Results of Operations</u>	<u>32</u>
<u>Balance Sheet Review</u>	<u>39</u>
<u>Liquidity and Capital</u>	<u>40</u>
<u>Asset Quality</u>	<u>41</u>
<u>Non-GAAP Financial Measures</u>	<u>43</u>
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk.</u>	<u>44</u>
Item 4. <u>Controls and Procedures.</u>	<u>44</u>
Part II – Other Information	<u>45</u>
Item 1. <u>Legal Proceedings.</u>	<u>45</u>
Item 1A. <u>Risk Factors.</u>	<u>45</u>
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds.</u>	<u>45</u>
Item 3. <u>Defaults Upon Senior Securities.</u>	<u>45</u>
Item 4. <u>Mine Safety Disclosures.</u>	<u>45</u>
Item 5. <u>Other Information.</u>	<u>45</u>
Item 6. <u>Exhibits.</u>	<u>46</u>

---

Table of Contents

## Part I – Financial Information

## Item 1. Financial Statements.

## MidSouth Bancorp, Inc. and Subsidiaries

## Consolidated Balance Sheets

(dollars in thousands, except per share amounts)

	September 30, 2018 (unaudited)	December 31, 2017 (audited)
<b>Assets</b>		
Cash and due from banks, including required reserves of \$13,843 and \$6,741, respectively	\$33,066	\$34,775
Interest-bearing deposits in other banks	261,985	114,839
Federal funds sold	7,837	3,350
Investment securities available-for-sale, at fair value	352,606	309,191
Investment securities held-to-maturity (fair value of \$63,581 and \$80,920, respectively)	64,893	81,052
Other investments	16,508	12,214
Loans held for sale	—	15,737
Loans	962,743	1,183,426
Allowance for loan losses	(24,450)	(26,888)
Loans, net	938,293	1,156,538
Bank premises and equipment, net	56,006	59,057
Accrued interest receivable	6,606	8,283
Goodwill	42,171	42,171
Intangibles	2,685	3,515
Cash surrender value of life insurance	15,071	14,896
Other real estate	1,022	2,001
Assets held for sale	1,372	3,995
Other assets	26,133	19,538
<b>Total assets</b>	<b>\$1,826,254</b>	<b>\$1,881,152</b>
<b>Liabilities and Shareholders' Equity</b>		
<b>Liabilities:</b>		
<b>Deposits:</b>		
Non-interest-bearing	\$425,696	\$416,547
Interest-bearing	1,083,433	1,063,142
<b>Total deposits</b>	<b>1,509,129</b>	<b>1,479,689</b>
Securities sold under agreements to repurchase	13,676	67,133
FHLB borrowings	27,506	50,021
Other borrowings	22,167	22,167
Other liabilities	12,325	8,127
<b>Total liabilities</b>	<b>1,584,803</b>	<b>1,627,137</b>
<b>Shareholders' equity:</b>		
Series B Preferred stock, no par value; 5,000,000 shares authorized, 32,000 shares issued and outstanding, respectively	32,000	32,000
Series C Preferred stock, no par value; 100,000 shares authorized, 89,725 and 89,875 shares issued and outstanding, respectively	8,972	8,987
Common stock, \$0.10 par value; 30,000,000 shares authorized, 16,641,105 and 16,548,829 shares issued and outstanding, respectively	1,664	1,655

Edgar Filing: MIDSOUTH BANCORP INC - Form 10-Q

Additional paid-in capital	169,070	168,412	
Unearned ESOP shares	(845	) (937	)
Accumulated other comprehensive loss	(6,972	) (1,828	)
Retained earnings	37,562	45,726	
Total shareholders' equity	241,451	254,015	
Total liabilities and shareholders' equity	\$1,826,254	\$1,881,152	

See notes to unaudited consolidated financial statements.

3

---

Table of Contents

MidSouth Bancorp, Inc. and Subsidiaries  
Consolidated Statements of Operations (unaudited)  
(dollars in thousands, except per share amounts)

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
Interest income:				
Loans, including fees	\$14,590	\$17,329	\$45,948	\$50,682
Securities and other investments:				
Taxable	2,156	2,276	6,296	7,019
Nontaxable	273	363	866	1,144
Interest bearing deposits in other banks	1,417	411	3,061	823
Total interest income	18,436	20,379	56,171	59,668
Interest expense:				
Deposits	1,602	1,094	4,249	3,002
Securities sold under agreements to repurchase	16	149	82	619
FHLB borrowings	81	111	330	290
Other borrowings	271	212	750	632
Total interest expense	1,970	1,566	5,411	4,543
Net interest income	16,466	18,813	50,760	55,125
Provision for loan losses	4,300	4,300	4,740	19,600
Net interest income after provision for loan losses	12,166	14,513	46,020	35,525
Non-interest income:				
Service charges on deposits	2,159	2,463	6,430	7,339
Gain on sale of securities, net	—	338	—	347
Loss on equity securities, other investments	(16 )	—	(66 )	—
ATM and debit card income	1,796	1,687	5,457	5,156
Other charges and fees	1,151	998	2,981	2,911
Total non-interest income	5,090	5,486	14,802	15,753
Non-interest expenses:				
Salaries and employee benefits	7,762	7,849	23,398	25,989
Occupancy expense	3,077	3,711	9,315	11,524
ATM and debit card expense	653	654	1,876	2,088
Data processing	730	640	2,061	1,928
FDIC insurance	360	448	1,296	1,275
Regulatory remediation expense	5,502	856	14,658	856
Legal and professional fees	2,543	548	5,425	2,127
Other	2,900	3,053	9,644	8,806
Total non-interest expenses	23,527	17,759	67,673	54,593
(Loss)Income before income tax benefit	(6,271 )	2,240	(6,851 )	(3,315 )
Income tax (benefit)expense	(1,373 )	574	(1,644 )	(2,058 )
Net (loss)income	(4,898 )	1,666	(5,207 )	(1,257 )
Dividends on preferred stock	810	810	2,430	2,432

Edgar Filing: MIDSOUTH BANCORP INC - Form 10-Q

Net (loss)income available to common shareholders	\$(5,708 )	\$856	\$(7,637 )	\$(3,689 )
Basic (loss)earnings per common share	\$(0.34 )	\$0.05	\$(0.46 )	\$(0.28 )
Diluted (loss)earnings per common share	\$(0.34 )	\$0.05	\$(0.46 )	\$(0.28 )
Weighted average number of shares outstanding:				
Basic	16,558	16,395	16,531	13,314
Diluted	16,558	16,396	16,531	13,314
Dividends declared per common share	\$0.01	\$0.01	\$0.03	\$0.19

See notes to unaudited consolidated financial statements.

Table of Contents

MidSouth Bancorp, Inc. and Subsidiaries  
 Consolidated Statements of Comprehensive Loss (unaudited)  
 (dollars in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net loss	\$(4,898)	\$1,666	\$(5,207 )	\$(1,257)
Other comprehensive (loss) income, net of tax:				
Net change in unrealized (loss) gains on securities available-for-sale	(2,025 )	(673 )	(6,946 )	2,877
Net change in unrealized gain on derivative instruments	35	(11 )	434	(134 )
Other comprehensive (loss) income, before tax	(1,990 )	(684 )	(6,512 )	2,743
Income tax effect related to items of other comprehensive (loss) income	418	240	1,368	(960 )
Total other comprehensive (loss) income, net of tax	(1,572 )	(444 )	(5,144 )	1,783
Total comprehensive loss	\$(6,470)	\$1,222	\$(10,351)	\$526
See notes to unaudited consolidated financial statements.				



Table of Contents

MidSouth Bancorp, Inc. and Subsidiaries  
 Consolidated Statement of Shareholders' Equity (unaudited)  
 (dollars in thousands, except per share amounts)

	Preferred Stock		Common Stock		Additional Paid-in Capital	Unearned ESOP Shares	Accumulated Other Comprehensive Loss	Retained Earnings	Total
	Shares	Amount	Shares	Amount					
Balance - December 31, 2016	123,098	\$41,110	11,362,716	\$ 1,136	\$ 111,166	\$(1,233)	\$(1,010)	\$63,207	\$214,376
Net earnings	—	—	—	—	—	—	—	(1,257)	(1,257)
Dividends on Series B and Series C preferred stock	—	—	—	—	—	—	—	(2,432)	(2,432)
Dividends on common stock, \$0.19 per share	—	—	—	—	—	—	—	(2,645)	(2,645)
Issuance of common stock	—	—	5,100,034	510	56,641	—	—	—	57,151
Restricted stock grant	—	—	58,090	6	(6)	—	—	—	—
Conversion of Series C preferred stock to common stock	(1,223)	(123)	6,791	1	122	—	—	—	—
ESOP shares released for allocation	—	—	—	—	50	266	—	—	316
Exercise of stock options	—	—	20,498	2	264	—	—	—	266
Vested restricted stock	—	—	700	—	—	—	—	—	—
Stock option and restricted stock compensation expense	—	—	—	—	85	—	—	—	85
Change in accumulated other comprehensive income	—	—	—	—	—	—	1,783	—	1,783
Balance - September 30, 2017	121,875	\$40,987	16,548,829	\$ 1,655	\$ 168,322	\$(967)	\$ 773	\$56,873	\$267,643

Table of Contents

MidSouth Bancorp, Inc. and Subsidiaries  
Consolidated Statement of Shareholders' Equity (unaudited)  
(dollars in thousands, except per share amounts)

	Preferred Stock		Common Stock		Additional Paid-in Capital	Unearned ESOP Shares	Accumulated Other Comprehensive Loss	Retained Earnings	Total
	Shares	Amount	Shares	Amount					
Balance, December 31, 2017	121,875	\$40,987	16,548,829	\$1,655	\$168,412	\$(937)	\$(1,828)	\$45,726	\$254,015
Adoption of ASU 2016-01	—	—	—	—	—	—	31	(31)	—
Net loss	—	—	—	—	—	—	—	(5,207)	(5,207)
Dividends on Series B and Series C preferred stock	—	—	—	—	—	—	—	(2,430)	(2,430)
Dividends on common stock, \$0.03 per share	—	—	—	—	—	—	—	(496)	(496)
Restricted stock grant	—	—	80,748	8	(8)	—	—	—	—
Restricted stock forfeitures	—	—	(38,837)	(4)	4	—	—	—	—
Conversion of Series C preferred stock to common stock	(150)	(15)	833	—	15	—	—	—	—
ESOP shares released for allocation	—	—	—	—	—	92	—	—	92
ESOP compensation expense	—	—	—	—	31	—	—	—	31
Exercise of stock options	—	—	49,532	5	637	—	—	—	642
Stock option and restricted stock compensation expense	—	—	—	—	(21)	—	—	—	(21)
Change in accumulated other comprehensive loss	—	—	—	—	—	—	(5,175)	—	(5,175)
Balance, September 30, 2018	121,725	\$40,972	16,641,105	\$1,664	\$169,070	\$(845)	\$(6,972)	\$37,562	\$241,451

See notes to unaudited consolidated financial statements.



Table of Contents

MidSouth Bancorp, Inc. and Subsidiaries  
 Consolidated Statements of Cash Flows (unaudited)  
 (dollars in thousands)

	For the Nine Months Ended September 30,	
	2018	2017
Cash flows from operating activities:		
Net loss	\$(5,207 )	\$(1,257 )
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation	3,484	4,345
Accretion of purchase accounting adjustments	569	(180 )
Provision for loan losses	4,740	19,600
Deferred tax expense (benefit)	(1,359 )	(704 )
Amortization of premiums on securities, net	2,224	2,128
Stock-based compensation expense	(21 )	85
Net excess tax benefit from stock-based compensation	163	379
ESOP compensation expense	31	50
Net gain on sale of investment securities	—	(347 )
Loss on mutual fund	66	—
Proceeds from sale of loans held for sale	15,623	—
Net loss on sale of other real estate owned	67	(15 )
Net write down of other real estate owned	154	83
Write down of assets held for sale	—	570
Loss on transfer of loans to held for sale	879	—
Net loss on sale/disposal of premises and equipment	(183 )	648
Change in accrued interest receivable	1,677	(121 )
Change in accrued interest payable	(11 )	(12 )
Change in other assets & other liabilities, net	3,069	(3,236 )
Net cash provided by operating activities	25,965	22,016
Cash flows from investing activities:		
Proceeds from maturities and calls of securities available-for-sale	38,015	42,585
Proceeds from maturities and calls of securities held-to-maturity	15,578	12,940
Proceeds from sale of securities available-for-sale	410	16,979
Proceeds from sale of security held-to-maturity	—	887
Purchases of securities available-for-sale	(92,529 )	(42,172 )
Proceeds from sale of other investments	—	57
Purchases of other investments	(2,300 )	(902 )
Net change in loans	213,002	28,649
Purchases of premises and equipment	(1,058 )	(2,940 )
Proceeds from sale of premises and equipment	808	249
Proceeds from sale of other real estate owned	834	1,728
Net cash provided by investing activities	172,760	58,060
Cash flows from financing activities:		
Change in deposits	29,440	(23,495 )
Change in securities sold under agreements to repurchase	(53,457 )	(39,586 )
Borrowings from FHLB	247,500	25,000
Repayments to FHLB	(270,000 )	(12,546 )

Edgar Filing: MIDSOUTH BANCORP INC - Form 10-Q

Repayments of notes payable	—	—
Proceeds from exercise of stock options	642	266
Proceeds from issuance of common stock	—	57,834
Stock offering expenses	—	(683 )
Payment of dividends on preferred stock	(2,430 )	(2,433 )
Payment of dividends on common stock	(496 )	(3,538 )
Net cash used by financing activities	(48,801 )	819
Net increase (decrease) in cash and cash equivalents	149,924	80,895
Cash and cash equivalents, beginning of period	152,964	82,228
Cash and cash equivalents, end of period	\$302,888	\$163,123
Supplemental cash flow information:		
Interest paid	\$5,422	\$4,555
Income taxes paid	—	2,500
Noncash investing and financing activities:		
Transfer of loans to other real estate	76	1,552
Transfer of loans to held for sale	221	—
Change in accrued common stock dividends	1	(859 )
Change in accrued preferred stock dividends	—	(1 )
Change in unrealized gains/losses on securities available-for-sale, net of tax	(5,518 )	—
Change in unrealized gains on derivative instruments, net of tax	343	—
Cumulative-effect adjustment to retained earnings due to ASU 2016-01, net of tax	31	—
Net change in loan to ESOP	92	266

See notes to unaudited consolidated financial statements.

Table of Contents

MidSouth Bancorp, Inc. and Subsidiaries  
Notes to Interim Consolidated Financial Statements  
September 30, 2018  
(Unaudited)

NOTE 1: BASIS OF PRESENTATION

Midsouth Bancorp (the "Company" or "we") is a bank holding company whose business is primarily conducted through its wholly-owned banking subsidiary, Midsouth Bank (the "Bank"). We operate a full-service banking business and offer a broad range of commercial and retail banking products to our customers.

The accompanying unaudited consolidated financial statements for the Company have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information. Accordingly, the financial statements do not include all of the information and footnotes required by GAAP for complete financial statement presentation. The interim consolidated financial statements included herein are unaudited, but reflect all adjustments, consisting of normal and recurring items, which, in the opinion of management, are necessary for fair presentation of the consolidated financial position and result of operations for the interim period presented. All significant intercompany accounts and transactions have been eliminated in consolidation. The results of operation for the period ended September 30, 2018 are not necessarily indicative of the results expected for the full year. These financial statements should be read in conjunction with the financial statements and notes thereto and the report of our independent registered public accounting firm included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

Certain amounts have been reclassified to conform with current period presentation. The reclassifications had no effect on net income or shareholders' equity as previously reported.

NOTE 2: ADOPTION OF NEW ACCOUNTING STANDARDS AND RECENT ACCOUNTING PRONOUNCEMENTS

Accounting Standards Adopted in 2018

— In May 2018, the FASB issued ASU 2018-06, Codification Improvements to Topic 942, Financial Services - Depository and Lending. ASU 2018-06 removes outdated guidance related to Circular 202 because that guidance has been rescinded by the Office of the Comptroller of the Currency. The amendments in this update are effective upon issuance. The adoption of this ASU did not have a material effect on the Company's financial position, result of operations or cash flows.

ASU 2018-03, Technical Corrections and Improvements to Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities was issued to clarify certain aspects of the guidance on recognizing and measuring financial assets and liabilities in ASU 2016-01:

- Clarification regarding the ability to discontinue application of the measurement alternative for equity securities without a readily determinable fair value
- Clarification of the measurement date for fair value adjustments to the carrying amount of equity securities without a readily determinable fair value for which the measurement alternative is elected
- Clarification of the unit of account for fair value adjustments to forward contracts and purchased options on equity securities without a readily determinable fair value for which the measurement alternative is expected to be elected
- Presentation requirements for certain hybrid financial liabilities for which the fair value option is elected
- Measurement of financial liabilities denominated in a foreign currency for which the fair value option is elected

¶Transition guidance for equity securities without a readily determinable fair value

The effective date of this Update is for fiscal years beginning on or after December 15, 2017 and for interim periods within those fiscal years beginning after June 15, 2018. Public business entities with fiscal years beginning between December 15, 2017 and June 15, 2018 are not required to adopt the amendments until interim periods beginning after June 15, 2018. Adoption of this Update is not expected to have a material effect on the Company's financial position, results of operations or its financial statement disclosures.

Table of Contents

Adoption of New Accounting Standards —ASU 2016-01, Financial Statements - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities was issued in January 2016 to address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. This standard impacts how the Company measures certain equity investments and discloses and presents certain financial instruments through the application of the “exit price” notion. The Company adopted the amendments beginning January 1, 2018. Under the new guidance, equity investments can no longer be classified as trading or available for sale (AFS), and related unrealized holding gains and losses can no longer be recognized in OCI. Per the ASU, such equity investments should be measured at fair value, with adjustments recognized in earnings at the end of each reporting period. As such, the Company reclassified its portfolio of equity investments previously classified as AFS investment securities to “other investments.” As these equity investments were previously measured at fair value, implementation of the ASU did not impact the Company’s valuation method. In accordance with the ASU, the cumulative-effect adjustment from AOCI to retained earnings for previously recorded fair value adjustments related to these equity investments at adoption was immaterial. The Company elected the practical expedient measurement alternative to prospectively account for other equity investments that do not have readily determinable fair values at cost less impairment plus or minus observable price changes in orderly transactions for an identical or similar investment of the same issuer. The investments are immaterial overall and are classified within “other investments” on the Company’s consolidated balance sheets rather than as available-for-sale securities.

In May 2014, the FASB issued ASU 2014-09 - Revenue from Contracts with Customers, which created a new principle-based framework to determine when and how an entity recognizes revenue from its customer contracts. FASB has established a core principle for recognizing revenue within the new rules, which states that revenue should only be recorded when services are provided or goods are transferred to customers at the agreed price. The majority of our revenue-generating transactions are not subject to ASC Topic 606, including revenue generated from financial instruments, such as our loans, letters of credit and investment securities, as these activities are subject to other GAAP discussed elsewhere within our disclosures. Description of our revenue-generating activities that are within the scope of ASC Topic 606, which are presented in our income statements as components of non-interest income are as follows:

Service charges on deposits - We collect service charges on most of our non-maturity deposits accounts on a monthly basis. Our fee earned is collected monthly when a particular cycle for a non-maturity deposit account closes. Each cycle is monthly and the fee earned is for our service for the month just closed. Our performance obligations are to process transactions, pay interest (on interest-bearing accounts), collect deposits, and allow access to on-line banking applications and other services ancillary to a banking relationship. Each month when our fee is charged, our obligation is complete. The contract-relationship is a month to month obligation - i.e. our obligation to perform these services would end if the customer closes their deposit account with MidSouth.

ATM and debit card income - ATM fees primarily consist of surcharges assessed to our customers for using a non-Bank ATM or a non-Bank customer using our ATM. Debit card income represents revenues earned from interchange fees, which are earned on debit card transactions conducted with payment networks. Such fees are generally recognized concurrently with the delivery of services on a daily basis.



Table of Contents

## NOTE 3: INVESTMENT SECURITIES

The amortized cost and estimated fair value of available-for-sale investment securities are as follows (dollars in thousands):

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
September 30, 2018				
Available for sale:				
State, county, and municipal securities	\$ 23,775	\$ 27	\$ 1,043	\$22,759
Mortgage-backed securities	313,605	468	10,028	304,045
Corporate debt securities	25,566	328	92	25,802
	\$ 362,946	\$ 823	\$ 11,163	\$352,606
December 31, 2017				
State, county, and municipal securities	\$ 23,042	\$ 209	\$ 442	\$22,809
Mortgage-backed securities	263,467	915	4,863	259,519
Mutual funds	2,100	—	39	2,061
Corporate debt securities	23,975	837	10	24,802
	\$ 312,584	\$ 1,961	\$ 5,354	\$309,191

The amortized cost and estimated fair value of held-to-maturity investment securities are as follows (dollars in thousands):

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
September 30, 2018				
Held-to-maturity:				
State, county, and municipal securities	\$ 27,148	\$ 83	\$ 149	\$27,082
Mortgage-backed securities	37,745	—	1,246	36,499
	\$ 64,893	\$ 83	\$ 1,395	\$63,581
December 31, 2017				
State, county, and municipal securities	\$ 35,908	\$ 265	\$ 22	\$36,151
Mortgage-backed securities	45,144	171	546	\$44,769
	\$ 81,052	\$ 436	\$ 568	\$80,920

Table of Contents

The amortized cost and estimated fair value of debt securities by contractual maturity are summarized in the tables below (dollars in thousands): Actual maturities will differ from contractual maturities because of rights to call or repay obligations with or without penalties and scheduled and unscheduled principal payments on mortgage-backed securities and collateralized mortgage obligations.

	Amortized Cost	Fair Value
September 30, 2018		
Available for sale:		
Due in one year or less	\$—	\$—
Due after one year through five years	8,140	8,150
Due after five years through ten years	22,640	22,805
Due after ten years	270,755	261,169
Mortgage-backed securities	61,411	60,482
	\$ 362,946	\$ 352,606
Held-to-maturity:		
Due in one year or less	\$ 768	\$ 767
Due after one year through five years	4,821	4,763
Due after five years through ten years	13,347	13,316
Due after ten years	15,963	15,563
Mortgage-backed securities	29,994	29,172
	\$ 64,893	\$ 63,581

The following tables detail the gross unrealized losses and estimated fair value of available for sale and held-to-maturity securities aggregated by category and duration of continuous unrealized loss position at September 30, 2018 and December 31, 2017 (dollars in thousands):

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
September 30, 2018						
Available for sale:						
State, county, and municipal securities	\$ 5,948	\$ 44	\$ 12,714	\$ 999	\$ 18,662	\$ 1,043
Mortgage-backed securities	96,704	1,193	179,082	8,835	275,786	10,028
Corporate debt securities	2,908	92	—	—	2,908	92
	\$ 105,560	\$ 1,329	\$ 191,796	\$ 9,834	\$ 297,356	\$ 11,163
December 31, 2017						
State, county, and municipal securities	\$ 596	\$ 5	\$ 12,716	\$ 437	\$ 13,312	\$ 442
Mortgage-backed securities	87,390	772	145,696	4,091	233,086	4,863
Mutual funds	2,061	39	—	—	2,061	39
Corporate debt securities	2,990	10	—	—	2,990	10
	\$ 93,037	\$ 826	\$ 158,412	\$ 4,528	\$ 251,449	\$ 5,354

Table of Contents

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
September 30, 2018						
Held-to-maturity:						
State, county, and municipal securities	\$12,645	\$ 149	\$—	\$ —	\$12,645	\$ 149
Mortgage-backed securities	15,922	226	20,578	1,020	36,500	1,246
	\$28,567	\$ 375	\$20,578	\$ 1,020	\$49,145	\$ 1,395
December 31, 2017						
State, county, and municipal securities	\$6,340	\$ 22	\$—	\$ —	\$6,340	\$ 22
Mortgage-backed securities	13,138	95	12,090	451	25,228	546
	\$19,478	\$ 117	\$12,090	\$ 451	\$31,568	\$ 568

Management evaluates each quarter whether unrealized losses on securities represent impairment that is other than temporary. For debt securities, the Company considers its intent to sell the securities or if it is more likely than not the Company will be required to sell the securities. If such impairment is identified, based upon the intent to sell or the more likely than not threshold, the carrying amount of the security is reduced to fair value with a charge to earnings. Upon the result of the aforementioned review, management then reviews for potential other than temporary impairment based upon other qualitative factors. In making this evaluation, management considers changes in market rates relative to those available when the security was acquired, changes in market expectations about the timing of cash flows from securities that can be prepaid, performance of the debt security, and changes in the market's perception of the issuer's financial health and the security's credit quality. If determined that a debt security has incurred other than temporary impairment, then the amount of the credit related impairment is determined. Effective January 1, 2018, equity securities with readily determinable fair values are measured at fair value with changes in the fair value recognized through net income.

As of September 30, 2018, 124 securities had unrealized losses totaling 3.50% of the individual securities' amortized cost basis and 2.94% of the Company's total amortized cost basis. Of the 124 securities, 60 had been in an unrealized loss position for over twelve months at September 30, 2018. These 60 securities had an amortized cost basis and unrealized loss of \$223.2 million and \$10.9 million, respectively. The unrealized losses on debt securities at September 30, 2018 resulted from changing market interest rates over the yields available at the time the underlying securities were purchased. Management identified no impairment related to credit quality. At September 30, 2018, management had the intent and ability to hold impaired securities and no impairment was evaluated as other than temporary. As a result, no other than temporary impairment losses were recognized during the three months ended September 30, 2018.

During the nine months ended September 30, 2018, the Company sold 1 security classified as available-for-sale for \$410,000 which resulted in neither a gain nor a loss. During the nine months ended September 30, 2017, the Company sold 16 securities classified as available-for-sale and 1 security classified as held-to-maturity. Of the available-for-sale securities, 13 securities were sold with gains totaling \$449,000 and 3 securities were sold at a loss of \$109,000 for a net gain of \$340,000. The decision to sell the 1 held-to-maturity security, which was sold at a gain of \$7,000, was based on the pre-refunding of the bond which would accelerate the maturity of the bond by 15 years with an anticipated call date within six months.

Securities with a carrying value of approximately \$189.4 million serve as collateral to secure public deposits, securities sold under agreements to repurchase and for other purposes required or permitted by law at September 30, 2018, compared with \$189.0 million at December 31, 2017.



Table of Contents

## NOTE 4: LOANS

The loan portfolio consisted of the following (in thousands):

	September 30, December 31,	
	2018	2017
Commercial, financial and agricultural	\$ 295,802	\$ 435,207
Real estate – construction	90,444	90,287
Real estate – commercial	394,416	454,051
Real estate – residential	136,151	146,751
Consumer and other	45,338	56,398
Lease financing receivable	592	732
Total loans	962,743	1,183,426
Allowance for loan and lease losses	(24,450 )	(26,888 )
Total loans, net	\$ 938,293	\$ 1,156,538

The Company monitors loan concentrations and evaluates individual customer and aggregate industry leverage, profitability, risk rating distributions, and liquidity for each major standard industry classification segment. At September 30, 2018, one industry segment concentration, the oil and gas industry, constituted more than 10% of the loan portfolio. The Company's exposure in the oil and gas industry, including related service and manufacturing industries, totaled approximately \$128.1 million, or 13.3% of total loans. Additionally, the Company's exposure to loans secured by commercial real estate is monitored. At September 30, 2018, loans secured by commercial real estate (including commercial construction, farmland and multifamily loans) totaled approximately \$484.9 million, or 45.5% of total loans, of which 52% are secured by owner-occupied commercial properties. Of the \$484.9 million in loans secured by commercial real estate, \$24.1 million, or 5.0%, were on nonaccrual status at September 30, 2018.

## Allowance for Loan Losses

The allowance for loan losses is a valuation account available to absorb probable losses on loans. All losses are charged to the allowance for loan losses when the loss actually occurs or when a determination is made that a loss is likely to occur. Recoveries are credited to the allowance for loan losses at the time of recovery. Quarterly, the probable level of losses in the existing portfolio is estimated through consideration of various factors. Based on these estimates, the allowance for loan losses is increased by charges to earnings and decreased by charge offs (net of recoveries).

The allowance is composed of general reserves and specific reserves. General reserves are determined by applying loss percentages to segments of the portfolio. The loss percentages are based on each segment's historical loss experience, generally over the past three to five years, and adjustment factors derived from conditions in the Company's internal and external environment. All loans considered to be impaired are evaluated on an individual basis to determine specific reserve allocations in accordance with GAAP. Loans for which specific reserves are provided are excluded from the calculation of general reserves.

The Company has an internal loan review department that is independent of the lending function to challenge and corroborate the loan grade assigned by the lender and to provide additional analysis in determining the adequacy of the allowance for loan losses. Additionally, the Company utilizes the services of a third party to supplement its loan review efforts.

Table of Contents

A rollforward of the activity within the allowance for loan losses by loan type and recorded investment in loans for the nine months ended September 30, 2018 and 2017 is as follows (in thousands):

	September 30, 2018						
	Real Estate						
	Coml, Fin, and Agric	Constructi	Commercial	Residential	Consumer and other	Lease financing receivable	Total
Allowance for loan losses:							
Beginning balance	\$20,577	\$596	\$3,893	\$837	\$982	\$ 3	\$26,888
Charge-offs	(6,782 )	(6 )	(1,034 )	(549 )	(606 )	—	(8,977 )
Recoveries	1,628	—	7	1	163	—	1,799
Provision	2,872	(240 )	687	1,094	327	—	4,740
Ending balance	\$18,295	\$350	\$3,553	\$1,383	\$866	\$ 3	\$24,450
Ending balance: individually evaluated for impairment	\$7,373	\$69	\$105	\$—	\$—	\$ —	\$7,547
Ending balance: collectively evaluated for impairment	\$10,922	\$281	\$3,448	\$1,383	\$866	\$ 3	\$16,903
Loans:							
Ending balance	\$295,802	\$90,444	\$394,416	\$136,151	\$45,338	\$ 592	\$962,743
Ending balance: individually evaluated for impairment	\$24,923	\$610	\$23,175	\$—	\$—	\$ —	\$48,708
Ending balance: collectively evaluated for impairment	\$270,879	\$89,834	\$371,241	\$136,151	\$45,338	\$ 592	\$914,035

Table of Contents

	September 30, 2017						
	Real Estate						
	Coml, Fin, and Agric	Constructi	Commercial	Residential	Consumer and other	Lease financing receivable	Total
Allowance for loan losses:							
Beginning balance	\$16,057	\$585	\$5,384	\$940	\$1,401	\$5	\$24,372
Charge-offs	(15,106)	(70)	(3,618)	(293)	(860)	—	(19,947)
Recoveries	537	—	158	97	235	—	1,027
Provision	17,413	28	2,024	(40)	177	(1)	19,601
Ending balance	\$18,901	\$543	\$3,948	\$704	\$953	\$4	\$25,053
Ending balance: individually evaluated for impairment	\$3,254	\$17	\$904	\$7	\$69	\$1	\$4,252
Ending balance: collectively evaluated for impairment	\$15,647	\$526	\$3,044	\$697	\$884	\$3	\$20,801
Loans:							
Ending balance	\$447,482	\$90,088	\$473,046	\$155,676	\$68,917	\$760	\$1,235,969
Ending balance: individually evaluated for impairment	\$30,892	\$2,416	\$18,132	\$1,031	\$338	\$34	\$52,843
Ending balance: collectively evaluated for impairment	\$416,590	\$87,672	\$454,488	\$154,582	\$68,579	\$726	\$1,182,637
Ending balance: loans acquired with deteriorated credit quality	\$—	\$—	\$426	\$63	\$—	\$—	\$489

## Non-Accrual and Past Due Loans

Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on non-accrual status when, in management's opinion, the probability of collection of interest is deemed insufficient to warrant further accrual. For loans placed on non-accrual status, the accrual of interest is discontinued and subsequent payments received are applied to the principal balance. Interest income is recorded after principal has been satisfied and as payments are received. Non-accrual loans may be returned to accrual status if all principal and interest amounts contractually owed are reasonably assured of repayment within a reasonable period and there is a period of at least six months to one year of repayment performance by the borrower depending on the contractual payment terms.

Table of Contents

An age analysis of past due loans (including both accruing and non-accruing loans) is as follows (in thousands):

	September 30, 2018						
	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Current	Total Loans	Loans >90 Days Past Due and Still Accruing
Commercial, financial, and agricultural	\$4,814	\$49	\$19,908	\$24,771	\$271,031	\$295,802	\$ 6
Real estate - construction	1,086	—	176	1,262	89,182	90,444	—
Real estate - commercial	1,200	521	20,009	21,730	372,686	394,416	—
Real estate - residential	1,234	237	1,507	2,978	133,173	136,151	—
Consumer and other	128	61	38	227	45,111	45,338	1
Lease financing receivable	—	—	—	—	592	592	—
	\$8,462	\$868	\$41,638	\$50,968	\$911,775	\$962,743	\$ 7

	December 31, 2017						
	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Current	Total Loans	Loans >90 Days Past Due and Still Accruing
Commercial, financial, and agricultural	\$1,195	\$1,893	\$14,847	\$17,935	\$417,272	\$435,207	\$ 545
Real estate - construction	616	—	190	806	89,481	90,287	125
Real estate - commercial	5,889	6,402	4,163	16,454	431,952	448,406	58
Real estate - residential	1,065	235	559	1,859	144,892	146,751	—
Installment loans to individuals	276	32	34	342	56,056	56,398	—
Lease financing receivable	—	—	—	—	732	732	—
Other loans	—	—	—	—	5,645	5,645	—
	\$9,041	\$8,562	\$19,793	\$37,396	\$1,146,030	\$1,183,426	\$ 728



Table of Contents

Non-accrual loans are as follows (in thousands):

	September 30, 2018	December 31, 2017
Commercial, financial, and agricultural	\$ 24,919	\$ 37,418
Real estate - construction	599	66
Real estate - commercial	23,468	11,128
Real estate - residential	2,450	618
Installment loans to individuals	40	48
	\$ 51,476	\$ 49,278

The amount of interest that would have been recorded on non-accrual loans, had the loans not been classified as non-accrual, totaled approximately \$5.0 million and \$2.6 million for the nine months ended September 30, 2018 and 2017, respectively. Interest received on non-accrual loans subsequent to their transfer to non-accrual status totaled \$253,000 and \$201,000 for the nine months ended September 30, 2018 and 2017, respectively.

Impaired Loans

Loans are considered impaired when, based upon current information, it is probable the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. All loans classified as special mention, substandard, or doubtful, based on credit risk rating factors, are reviewed to determine whether impairment testing is appropriate. All loan relationships with an outstanding commitment balance above a specified threshold are evaluated for potential impairment. All loan relationships with an outstanding commitment balance below the specified threshold are assigned an allowance allocation percentage that is determined by management and adjusted periodically based on certain factors. An allowance for each impaired loan is calculated based on the present value of expected future cash flows discounted at the loan's effective interest rate or at the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. All impaired loans are reviewed, at a minimum, on a quarterly basis. Existing valuations are reviewed to determine if additional discounts or new appraisals are required. After this review, when comparing the resulting collateral valuation to the outstanding loan balance, if the discounted collateral value exceeds the loan balance, no specific allocation is reserved.

The following table presents loans that are individually evaluated for impairment (in thousands). Interest income recognized represents interest on accruing loans modified in a troubled debt restructuring (TDR).

	September 30, 2018		Related	Average	Interest
	Recorded	Unpaid	Allowance	Recorded	Income
	Investment	Principal		Investment	Recognized
	Balance				
With no related allowance recorded:					
Commercial, financial, and agricultural	\$7,914	\$ 12,502	\$ —	\$ 19,153	\$ —
Real estate - construction	254	254	—	127	—
Real estate - commercial	22,382	23,606	—	11,874	—
Real estate - residential	—	—	—	151	—
Installment loans to individuals	—	—	—	—	—
Finance leases	—	—	—	—	—
Subtotal:	30,550	36,362	—	31,305	—
With an allowance recorded:					
Commercial, financial, and agricultural	17,009	18,928	7,373	15,469	—
Real estate - construction	356	356	69	178	—
Real estate - commercial	793	925	105	507	—

Edgar Filing: MIDSOUTH BANCORP INC - Form 10-Q

Real estate - residential	—	687	—	158	—
Installment loans to individuals	—	—	—	24	—
Finance leases	—	—	—	—	—
Subtotal:	18,158	20,896	7,547	16,336	—
Totals:					

18

---

Table of Contents

Commercial	48,098	55,961	7,478	47,003	—
Construction	610	610	69	305	—
Residential	—	687	—	309	—
Consumer	—	—	—	24	—
Grand total:	\$48,708	\$57,258	\$ 7,547	\$ 47,641	\$ —

## December 31, 2017

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial, financial, and agricultural	\$24,659	\$30,630	\$ —	\$ 19,880	\$ 90
Real estate - construction	—	—	—	5	—
Real estate - commercial	10,471	11,965	—	11,590	—
Real estate - residential	302	302	—	602	—
Installment loans to individuals	—	—	—	37	—
Subtotal:	35,432	42,897	—	32,114	90
With an allowance recorded:					
Commercial, financial, and agricultural	14,119	14,150	7,197	15,245	1
Real estate - construction	66	136	23	33	—
Real estate - commercial	657	657	131	8,318	—
Real estate - residential	316	316	5	620	—
Installment loans to individuals	48	50	14	258	—
Subtotal:	15,206	15,309	7,370	24,474	1
Totals:					
Commercial	49,906	57,402	7,328	55,033	91
Construction	66	136	23	38	—
Residential	618	618	5	1,222	—
Consumer	48	50	14	295	—
Grand total:	\$50,638	\$58,206	\$ 7,370	\$ 56,588	\$ 91

## Credit Quality

The Company manages credit risk by observing written underwriting standards and the lending policy established by the Board of Directors and management to govern all lending activities. The risk management program requires that each individual loan officer review his or her portfolio on a quarterly basis and assign recommended credit ratings on each loan. These efforts are supplemented by independent reviews performed by a loan review officer and other validations performed by the internal audit department. The results of the reviews are reported directly to the Audit Committee of the Board of Directors.

Loans are categorized into risk categories based on relevant information about the ability of borrowers to serve their debt, such as: current financial information, historical payment experience, credit documentation, public information, current economic trends, and other factors. Loans are analyzed individually and classified according to their credit risk. This analysis is performed on a continuous basis. The following definitions are used for risk ratings:

Special Mention: Weakness exists that could cause future impairment, including the deterioration of financial ratios, past due status, and questionable management capabilities. Collateral values generally afford adequate coverage but may not be immediately marketable.

Substandard: Specific and well-defined weaknesses exist that may include poor liquidity and deterioration of financial ratios. Currently the borrower maintains the capacity to service the debt. The loan may be past due and related deposit accounts experiencing overdrafts. Immediate corrective action is necessary.

Table of Contents

Doubtful: Specific weaknesses characterized as Substandard exist that are severe enough to make collection in full unlikely. There is no reliable secondary source of full repayment. Loans classified as Doubtful will usually be placed on non-accrual status. The probability of some loss is extremely high but because of certain important and reasonably specific factors, the amount of loss cannot be determined.

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

Table of Contents

The following tables present the classes of loans by risk rating (in thousands):

	Pass	Special Mention	Substandard	Doubtful	Total
September 30, 2018					
Commercial, Financial & Agricultural	\$236,572	\$18,808	\$40,422	\$	—\$295,802
Real Estate - Construction	89,671	57	716	—	90,444
Real Estate - Commercial	340,452	11,042	42,922	—	394,416
Real Estate - Residential	128,947	988	6,216	—	136,151
Consumer and other	45,241	7	90	—	45,338
Lease Financing Receivable	592	—	—	—	592
Total loans	\$841,475	\$30,902	\$90,366	\$	—\$962,743

December 31, 2017					
Commercial, Financial & Agricultural	\$358,373	\$9,687	\$67,147	\$	—\$435,207
Real Estate - Construction	89,323	600	364	—	90,287
Real Estate - Commercial	416,925	3,823	33,303	—	454,051
Real Estate - Residential	144,250	1,233	1,268	—	146,751
Consumer and other	56,041	—	357	—	56,398
Lease Financing Receivable	699	—	33	—	732
Total loans	\$1,065,611	\$15,343	\$102,472	\$	—\$1,183,426

Table of Contents

## Troubled Debt Restructurings

A TDR is a restructuring of a debt made by the Company to a debtor for economic or legal reasons related to the debtor's financial difficulties that it would not otherwise consider. The Company grants the concession in an attempt to protect as much of its investment as possible.

The following tables present information about TDRs that were modified during the periods presented by portfolio segment (in thousands):

	Three months ended	
	September 30, 2018	September 30, 2017
	Number of recorded loan investment	Number of recorded loan investment
Commercial, financial and agricultural	—	1
	\$	\$ 18

	Nine months ended	
	September 30, 2018	September 30, 2017
	Number of recorded loan investment	Number of recorded loan investment
Commercial, financial and agricultural	—	6
	\$	\$ 2,002

During the three month periods ending September 30, 2018 and 2017, there were no defaults on any loans that were modified as TDRs during the preceding twelve months. During the three months ended September 30, 2017, there was one loan relationship with a pre-modification balance of \$18,000 identified as a troubled debt restructuring as a result of a concession granting reduction in payments. During the nine months ended September 30, 2018 there were no loans modified and identified as a troubled debt restructuring. Comparatively, during the nine months ended, September 30, 2017, there were six loan relationships with a pre-modification balance of \$2.0 million identified as a TDR resulting from a concession for a reduction in payments. During the nine months ended September 30, 2018 and 2017, there were no defaults on any loans that were modified as TDRs during the preceding twelve months. The Company defines a payment default as any loan that is greater than 30 days past due or was past due greater than 30 days at any point during the reporting period, or since the date of modification, whichever is shorter.

For purposes of the determination of an allowance for loan losses on these TDRs, as an identified TDR, the Company considers a loss probable on the loan and, as a result is reviewed for specific impairment in accordance with the Company's allowance for loan loss methodology. If it is determined losses are probable on such TDRs, either because of delinquency or other credit quality indicator, the Company establishes specific reserves for these loans. As of September 30, 2018, there were no commitments to lend additional funds to debtors owing sums to the Company whose terms have been modified in TDRs.

## NOTE 5: DERIVATIVES

On July 6, 2016, the Company entered into two forward interest rate swap contracts on a reverse repurchase agreement and long-term FHLB advances. The interest rate swap contracts were designated as derivative instruments

in a cash flow hedge under ASC Topic 815, Derivatives and Hedging to convert forecasted variable interest payment to a fixed rate and the Company has concluded that the forecasted transactions are probable of occurring. For cash flow hedges, the effective portion of the gain or loss related to the derivative instrument is initially reported as a component of other comprehensive income and subsequently reclassified into earnings when the forecasted transaction affects earnings or when the hedge is terminated. The ineffective portion of the gain or loss is reported in earnings immediately.

No ineffectiveness related to the interest rate swaps designated as cash flow hedges was recognized in the consolidated statements of income for the nine months ended September 30, 2018. The accumulated net after-tax income related to the effective cash flow hedge included in accumulated other comprehensive income is reflected in Note 6 - Other Comprehensive (Loss) Income.

The following table discloses the notional amounts and fair value of derivative instruments in the Company's balance sheet as of September 30, 2018 and December 31, 2017 (in thousands):

22

---



Table of Contents

	Type of Hedge	Notional Amounts		Fair Value	
		September 30, 2018	December 31, 2017	September 30, 2018	December 31, 2017
Derivatives designated as hedging instruments:					
Interest rate swaps included in other assets	Cash Flow	\$27,500	\$ 27,500	\$1,513	\$ 1,078

The following tables present the pre-tax effect of hedging derivative instruments on the Company's consolidated statements of operations:

	Amount of Gain (Loss) Recognized in OCI on Derivative (Effective Portion)	Location of Gain Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain Reclassified from Accumulated OCI into Income (Effective Portion)	
			Three Months Ended September 30, 2018	Three Months Ended September 30, 2017
Interest rate swaps	35 (11 )	Interest Expense	74	4

	Amount of Gain (Loss) Recognized in OCI on Derivative (Effective Portion)	Location of Gain Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain Reclassified from Accumulated OCI into Income (Effective Portion)	
			Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
Interest rate swaps	434 (134 )	Interest Expense	176	4

**NOTE 6: OTHER COMPREHENSIVE (LOSS) INCOME**

The following is a summary of the tax effects allocated to each component of other comprehensive (loss) income (in thousands):

Edgar Filing: MIDSOUTH BANCORP INC - Form 10-Q

	Three Months Ended September 30,					
	2018			2017		
	Before Tax Amount	Tax Effect	Net of Tax Amount	Before Tax Amount	Tax Effect	Net of Tax Amount
Other comprehensive (loss) income:						
Securities available-for-sale:						
Change in unrealized gains/losses during period	\$ (2,025)	\$ 425	\$ (1,600)	\$ (335)	\$ 118	\$ (217 )
Reclassification adjustment for gains included in net income	—	—	—	(338 )	119	(219 )
Derivative instruments designated as cash flow hedges:						
Change in fair value of derivative instruments designated as cash flow hedges	109	(23 )	86	(7 )	2	(5 )
Reclassification adjustment for gains included in net income	(74 )	16	(58 )	(4 )	1	(3 )
Total other comprehensive (loss) income	\$ (1,990)	\$ 418	\$ (1,572)	\$ (684)	\$ 240	\$ (444 )

23

---

Table of Contents

	Nine Months Ended September 30,					
	2018			2017		
	Before Tax Amount	Tax Effect	Net of Tax Amount	Before Tax Amount	Tax Effect	Net of Tax Amount
Other comprehensive (loss) income:						
Securities available-for-sale:						
Change in unrealized gains/losses during period	\$(6,946)	\$1,459	\$(5,487)	\$3,224	\$(1,128)	\$2,096
Reclassification adjustment for gains included in net income	—	—	—	(347 )	121	(226 )
Derivative instruments designated as cash flow hedges:						
Change in fair value of derivative instruments designated as cash flow hedges	610	(128 )	482	(130 )	46	(84 )
Reclassification adjustment for gains included in net income	(176 )	37	(139 )	(4 )	1	(3 )
Total other comprehensive (loss) income	\$(6,512)	\$1,368	\$(5,144)	\$2,743	\$(960 )	\$1,783

Table of Contents

The reclassifications out of accumulated other comprehensive (loss) income into net income are presented below (in thousands):

	Three Months Ended September 30, 2018	2017
	Reclassifications Out of Accumulated Other Comprehensive (Loss) Income	Reclassifications Out of Accumulated Other Comprehensive (Loss) Income
Details about Accumulated Other Comprehensive (Loss) Income Components	Income Statement Line Item	Income Statement Line Item

Unrealized gains and losses on securities available-for-sale:

\$—	Gain on sale of securities, net	\$(338)	Gain on sale of securities, net
—	Tax expense	119	Tax expense
\$—	Net of tax	\$(219)	Net of tax

Gains on derivative instruments:

\$(74)	Interest expense	\$(4 )	Interest expense
14	Tax expense	1	Tax expense
\$(60)	Net of tax	\$(3 )	Net of tax

	Nine Months Ended September 30, 2018	2017
	Reclassifications Out of Accumulated Other Comprehensive (Loss) Income	Reclassifications Out of Accumulated Other Comprehensive (Loss) Income
Details about Accumulated Other Comprehensive (Loss) Income Components	Income Statement Line Item	Income Statement Line Item

Unrealized gains and losses on securities available-for-sale:

\$—	Gain on sale of securities, net	\$(347)	Gain on sale of securities, net
—	Tax expense	121	Tax expense
\$—	Net of tax	\$(226)	Net of tax

Gains on derivative instruments:

\$(176)	Interest expense	\$(4 )	Interest expense
37	Tax expense	1	Tax expense
\$(139)	Net of tax	\$(3 )	Net of tax



Table of Contents

## NOTE 7: EARNINGS PER COMMON SHARE

The following table is a summary of computation of earnings per common share based on the weighted average number of common shares outstanding (dollars in thousands, except per share amounts):

	Three Months		Nine Months	
	Ended		Ended September	
	September 30,		30,	
	2018	2017	2018	2017
Net (loss) income	\$(4,898)	\$1,666	\$(5,207)	\$(1,257)
Dividends on preferred stock	810	810	2,430	2,432
Adjusted net loss available to common shareholders	\$(5,708)	\$856	\$(7,637)	\$(3,689)
Weighted average number of common shares outstanding used in computation of basic loss per common share	16,558	16,395	16,531	13,314
Effect of dilutive securities:				
Stock options	—	1	—	—
Weighted average number of common shares outstanding plus effect of dilutive securities – used in computation of diluted loss per share	16,558	16,396	16,531	13,314
Net (loss)/income per common share:				
Basic	\$(0.34 )	\$0.05	\$(0.46 )	\$(0.28 )
Diluted	\$(0.34 )	\$0.05	\$(0.46 )	\$(0.28 )

The Company has reported a net loss for the three and nine months ended September 30, 2018 as well as the nine months ended September 30, 2017. As such, during those periods all potential common shares were excluded from the calculation of diluted earnings per share as they would have an anti-dilutive effect for the respective period.

## NOTE 8: FAIR VALUE MEASUREMENT

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

Level 1 – Valuation is based upon quoted prices for identical instruments traded in active markets.

Level 2 – Observable inputs other than Level 1 prices, such as quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

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.

The following methods and assumptions were used by the Company in estimating the fair value of its assets and liabilities recorded at fair value and for estimating the fair value of its financial instruments.

Cash and Due From Banks, Interest-Bearing Deposits in Banks and Federal Funds Sold—The carrying value of these short-term instruments approximates fair value.



Table of Contents

**Securities Available-for-Sale**—Fair value of securities available for sale is determined by various valuation methodologies. Where quoted market prices are available in active markets, securities are classified within Level 1 of the fair value hierarchy. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities within similar characteristics, or discounted cash flows. Level 2 securities include certain U.S. agency bonds, mortgage-backed securities and debt obligations, and municipal securities. The Level 2 fair value pricing is provided by an independent third party and is based upon similar securities in an active market. In certain cases where Level 1 or 2 inputs are not available, securities are classified within Level 3 of the hierarchy.

**Securities Held-to-Maturity**—The fair value of securities held-to-maturity is determined in the same manner as securities available-for-sale noted above.

**Other Investments**—FHLB and FRB stock are examples of other investments and do not have readily determinable fair values, as such these investments are carried at original cost basis. It is not practical to determine the fair values of these investments due to restrictions placed on transferability. These investments are periodically evaluated for impairment based on ultimate recovery of par value or cost basis. The cost basis approximates fair value for these investments.

**Loans**—The fair value for loans held for investment is estimated using an exit price methodology. An exit price methodology considers expected cash flows that take into account contractual loan terms, as applicable, prepayment expectations, probability of default, loss severity in the event of default, recovery lag and, in the case of variable rate loans, expectations for future interest rate movements. These cash flows are present valued at a risk adjusted discount rate, which considers the cost of funding, liquidity, servicing costs, and other factors. Because observable quoted prices seldom exist for identical or similar assets carried in loans held for investment, Level 3 inputs are primarily used to determine fair value exit pricing. The fair value of impaired loans is estimated based on discounted contractual cash flows or underlying collateral values, where applicable. A loan is determined to be impaired if the Company believes it is probable that all principal and interest amounts due according to the terms of the note will not be collected as scheduled. The fair value of impaired loans is determined in accordance with ASC 310-10, Accounting by Creditors for Impairment of a Loan, and generally results in a specific reserve established through a charge to the provision for loan losses. Losses on impaired loans are charged to the allowance when management believes the uncollectability of a loan is confirmed. Management has determined that the majority of impaired loans are Level 3 assets due to the extensive use of market appraisals.

**Cash Surrender Value of Life Insurance**—The carrying value of cash value of bank owned life insurance approximates fair value.

**Other Real Estate Owned**—The fair value of OREO is determined using certified appraisals and internal evaluations that value the property at its highest and best uses by applying traditional valuation methods common to the industry. The Company does not hold any OREO for profit purposes and all other real estate is actively marketed for sale. In most cases, management has determined that additional write-downs are required beyond what is calculable from the appraisal to carry the property at levels that would attract buyers. Because this additional write-down is not based on observable inputs, management has determined that OREO should be classified as Level 3.

**Assets Held For Sale**—The fair value of assets held for sale is determined in the same manner as OREO noted above.

**Derivative Financial Instruments**—The Company has entered into derivative financial instruments to manage interest rate risk. The valuation of these instruments is determined using widely accepted valuation techniques including discounted cash flow analysis on the expected cash flows of the derivatives. This analysis, performed by an independent third party, reflects the contractual terms of the derivative, including the period to maturity, and uses



observable market-based inputs, including interest rate curves and implied volatilities. The fair value of the derivatives is determined using the market standard methodology of netting the discounted future fixed cash receipts and the discounted expected variable cash payments. The variable cash payments are based on an expectation of future interest rates (forward curves derived from observable market interest rate curves).

Deposits—The carrying amount of demand deposits, savings deposits and variable-rate certificates of deposit approximates fair value. The fair value of fixed-rate certificates of deposit is estimated based on discounted contractual cash flows using interest rates currently being offered for certificates of similar maturities.

Securities Sold Under Agreements to Repurchase—The carrying amount of securities sold under agreements to repurchase approximates fair value and is classified as Level 1. The carrying amount of variable rate other borrowings approximates fair value and is classified as Level 1. The fair value of fixed rate other borrowings is estimated based on discounted contractual cash flows using the current incremental borrowing rates for similar borrowing arrangements and is classified as Level 2.

Table of Contents

Other borrowings—The fair value of the Company’s trust preferred securities is based on discounted cash flows using rates for securities with similar terms and remaining maturities and are classified as Level 2.

Off Balance Sheet-Instruments—Because commitments to extend credit and standby letters of credit are generally short-term and made using variable rates, the carrying value and estimated fair value associated with these instruments are immaterial.

The following table presents the fair value measurements of certain assets and liabilities measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall (dollars in thousands):

	Recurring Basis Fair Value Measurements			
	September 30, 2018			
	Fair Value	Level 1	Level 2	Level 3
Financial assets:				
State, county, and municipal securities	\$22,759	\$—	\$22,759	\$ —
Mortgage-backed securities	304,045	—	304,045	—
Mutual funds	1,994	1,994		
Corporate debt securities	25,802	—	25,802	—
Derivative assets	\$1,513	\$—	\$1,513	\$ —
Total recurring assets at fair value	\$356,113	\$1,994	\$354,119	\$ —
	Recurring Basis Fair Value Measurements			
	December 31, 2017			
	Fair Value	Level 1	Level 2	Level 3
Financial assets:				
State, county, and municipal securities	\$22,809	\$—	\$22,809	\$ —
Mortgage-backed securities	259,519	—	259,519	—
Mutual funds	2,061	2,061	—	—
Corporate debt securities	24,802	—	24,802	—
Derivative assets	\$1,078	\$—	\$1,078	\$ —
Total recurring assets at fair value	\$310,269	\$2,061	\$308,208	\$ —

Table of Contents

The following table presents the fair value measurements of certain assets and liabilities measured at fair value on a non-recurring basis and the level within the fair value hierarchy in which the fair value measurements fall (dollars in thousands):

	Nonrecurring Basis Fair Value Measurements		
	Fair Value	Level 1	Level 2 Level 3
September 30, 2018			
Financial assets:			
Impaired loans	\$10,611	\$ —	\$10,611
Other real estate	1,022	—	1,022
Assets held for sale	1,372	—	1,372 —
Total nonrecurring assets at fair value	\$13,005	\$ —	\$11,633

	Nonrecurring Basis Fair Value Measurements		
	Fair Value	Level 1	Level 2 Level 3
December 31, 2017			
Financial assets:			
Impaired loans	\$10,227	\$ —	\$10,227
Loans held for sale	15,737	—	15,737 —
Other real estate	2,001	—	2,001
Assets held for sale	3,572	—	3,572 —
Total nonrecurring assets at fair value	\$31,537	\$ —	\$12,228

The inputs used to determine estimated fair value of impaired loans include market conditions, loan terms, underlying collateral characteristics and discount rates. The inputs used to determine fair value of OREO include market conditions, estimated marketing period or holding period, underlying collateral characteristics and discount rates.

For the nine months ended September 30, 2018 and the year ended December 31, 2017, there was not a change in the methods and significant assumptions used to estimate fair value for assets carried at fair value.

The following table shows significant unobservable inputs used in the fair value measurement of Level 3 assets (dollars in thousands):

Description	Fair Value at	Technique	Unobservable Inputs
	September 30, 2018		
Impaired loans	\$ 10,611	Third party appraisals	Collateral discounts and estimated costs to sell
Other real estate	1,022	Third party appraisals	Collateral discounts and estimated costs to sell

Description	Fair Value at	Technique	Unobservable Inputs
	December 31, 2017		
Impaired loans	\$ 10,227	Third party appraisals	Collateral discounts and estimated costs to sell
Other real estate	2,001	Third party appraisals	Collateral discounts and estimated costs to sell



Table of Contents

The carrying amount and estimated fair value of the Company's financial instruments, not shown elsewhere in these financial statements, were as follows. The methods used to estimate the fair value of financial instruments at December 31, 2017 approximated an entry price. In accordance with the adoption of ASU 2016-01, the methods utilized to estimate the fair value of financial instruments at June 30, 2018 represent an approximation of exit price; however, an actual price derived in an active market may differ.

The carrying amounts and estimated fair values of the Company's financial instruments are as follows at September 30, 2018 and December 31, 2017 (dollars in thousands):

	Fair Value Measurements			
	September 30, 2018			
	Carrying Value	Level 1	Level 2	Level 3
Financial assets:				
Cash and due from banks, interest-bearing deposits in banks and federal funds sold	\$ 302,888	\$ 302,888	\$ —	—
Available-for-sale securities	352,606		352,606	
Securities held-to-maturity	64,893	—	63,581	—
Other investments	16,508	16,508	—	—
Loans, net	938,293	—	—	938,603
Cash surrender value of life insurance	15,071	—	15,071	—
Financial liabilities:				
Non-interest-bearing deposits	425,696	—	425,696	—
Interest-bearing deposits	1,083,433	—	981,921	—
Securities sold under agreements to repurchase	13,676	13,676	—	—
FHLB borrowings	27,506	—	27,506	—
Other borrowings	22,167	—	22,167	—

	Fair Value Measurements			
	December 31, 2017			
	Carrying Value	Level 1	Level 2	Level 3
Financial assets:				
Cash and due from banks, interest-bearing deposits in banks and federal funds sold	\$ 152,964	\$ 152,964	\$ —	—
Available-for-sale securities	309,191	2,061	307,130	
Securities held-to-maturity	81,052	—	80,920	—
Other investments	12,214	12,214	—	—
Loans, net	1,156,538	—	—	1,160,614
Cash surrender value of life insurance	14,896	—	14,896	—
Financial liabilities:				
Non-interest-bearing deposits	416,547	—	416,547	—
Interest-bearing deposits	1,063,142	—	881,139	179,910
Securities sold under agreements to repurchase	67,133	67,133	—	—
FHLB borrowings	50,021	—	50,021	—
Other borrowings	22,167	—	22,167	—



Table of Contents

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

MidSouth Bancorp, Inc. (the “Company”) is a bank holding company headquartered in Lafayette, Louisiana that conducts substantially all of its business through its wholly owned subsidiary bank, MidSouth Bank, N.A. (the “Bank”). We offer complete banking services to commercial and retail customers in Louisiana and south and central Texas with 42 locations and are connected to a worldwide ATM network that provides customers with access to more than 55,000 surcharge-free ATMs. We are community oriented and focus primarily on offering commercial and consumer loan and deposit services to individuals, small businesses, and middle market businesses.

The following discussion and analysis identifies significant factors that have affected our financial position and operating results during the periods included in the financial statements accompanying this report. We encourage you to read this discussion in conjunction with our consolidated financial statements and the notes thereto presented herein and with the financial statements, the notes thereto, and related Management’s Discussion and Analysis of Financial Condition and Results of Operation in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017.

Forward-Looking Statements

Certain statements included in this report are "forward-looking statements" within the meaning of, and subject to the protections of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Forward-looking statements include statements with respect to our beliefs, plans, objectives, goals, expectations, anticipations, assumptions, estimates, intentions and future performance and involve known and unknown risks, uncertainties and other factors, many of which may be beyond our control and which may cause the actual results, performance or achievements of the Company to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements.

The words “anticipate,” “believe,” “estimate,” “expect,” “intend,” “may,” “plan,” “will,” “would,” “could,” “should,” “guidance,” “continue,” “project,” “forecast,” “confident,” and similar expressions are typically used to identify forward-looking statements. These statements are based on assumptions and assessments made by management in light of their experience and their perception of historical trends, current conditions, expected future developments and other factors they believe to be appropriate. Any forward-looking statements are not guarantees of our future performance and are subject to risks and uncertainties and may be affected by various factors that may cause actual results, developments and business decisions to differ materially from those in the forward-looking statements. Some of the factors that may cause actual results, developments and business decisions to differ materially from those contemplated by such forward-looking statements include the factors discussed under the caption “Risk Factors” in this Report and in our 2017 Annual Report on form 10-K and under the caption “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in this Report and the following:

- changes in interest rates and market prices that could affect the net interest margin, asset valuation, and expense levels;
- changes in local economic and business conditions in the markets we serve, including, without limitation, changes related to the oil and gas industries that could adversely affect customers and their ability to repay borrowings under agreed upon terms, adversely affect the value of the underlying collateral related to their borrowings, and reduce demand for loans;
- increases in competitive pressure in the banking and financial services industries;
- increased competition for deposits and loans which could affect compositions, rates and terms;

changes in the levels of prepayments received on loans and investment securities that adversely affect the yield and value of the earning assets;

- our ability to successfully implement and manage our strategic initiatives;

costs and expenses associated with our strategic initiatives and regulatory remediation efforts and possible changes in the size and components of the expected costs and charges associated with our strategic initiatives and regulatory remediation efforts;

- our ability to realize the anticipated benefits and cost savings from our strategic initiatives within the anticipated time frame, if at all;
- the ability of the Company to comply with the terms of the formal agreement and Consent Order with the Office of the Comptroller of the Currency;
- risk of noncompliance with and further enforcement actions regarding the Bank Secrecy Act and other anti-money laundering statutes and regulations;

credit losses due to loan concentration, particularly our energy lending and commercial real estate portfolios;

- a deviation in actual experience from the underlying assumptions used to determine and establish our allowance for loan losses ("ALL"), which could result in greater than expected loan losses;
- the adequacy of the level of our ALL and the amount of loan loss provisions required in future periods including the impact of implementation of the new CECL (current expected credit loss) methodology;



Table of Contents

future examinations by our regulatory authorities, including the possibility that the regulatory authorities may, among other things, impose additional enforcement actions or conditions on our operations, require additional regulatory remediation efforts or require us to increase our allowance for loan losses or write-down assets;

changes in the availability of funds resulting from reduced liquidity or increased costs;

the timing and impact of future acquisitions or divestitures, the success or failure of integrating acquired operations, and the ability to capitalize on growth opportunities upon entering new markets;

the ability to acquire, operate, and maintain effective and efficient operating systems;

increased asset levels and changes in the composition of assets that would impact capital levels and regulatory capital ratios;

loss of critical personnel and the challenge of hiring qualified personnel at reasonable compensation levels;

legislative and regulatory changes, including the impact of regulations under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and other changes in banking, securities and tax laws and regulations and their application by our regulators, changes in the scope and cost of FDIC insurance and other coverage;

regulations and restrictions resulting from our participation in government-sponsored programs such as the U.S. Treasury's Small Business Lending Fund, including potential retroactive changes in such programs;

changes in accounting principles, policies, and guidelines applicable to financial holding companies and banking;

increases in cybersecurity risk, including potential business disruptions or financial losses;

acts of war, terrorism, cyber intrusion, weather, or other catastrophic events beyond our control; and

the ability to manage the risks involved in the foregoing

We can give no assurance that any of the events anticipated by the forward-looking statements will occur or, if any of them do, what impact they will have on our results of operations and financial condition. We disclaim any intent or obligation to publicly update or revise any forward-looking statements, regardless of whether new information becomes available, future developments occur or otherwise.

Critical Accounting Policies

There have been no significant changes to our critical accounting policies from those disclosed in our 2017 Annual Report on Form 10-K. The reader should refer to the notes to our consolidated financial statements in our 2017 Annual Report on Form 10-K for a full disclosure of all critical accounting policies.

Results of Operations

For the Three Months Ended September 30, 2018 and 2017

Net loss available to common shareholders totaled \$5.7 million, or \$0.34 per share, for the three months ended September 30, 2018, compared to net income available to common shareholders of \$856,000, or \$0.05 per share, for the three months ended September 30, 2017. Regulatory remediation costs, after tax, totaled \$4.3 million and \$556,000 for the three months ended September 30, 2018 and 2017, respectively. The remediation expenses increased substantially during 2018 as a result of having a full year of expenses which consisted primarily of \$5.0 million in consulting costs and \$400,000 in other outsourcing and legal costs. Comparatively, included in the three months ended September 30, 2017 were \$903,000 in branch closure expense. Excluding these non-operating expenses, diluted earnings for the third quarter of 2018 were a loss of \$1.4 million, or \$0.08 per diluted share, compared to income of \$2.0 million, of \$0.12 per diluted share for the third quarter of 2017.

Fully taxable-equivalent ("FTE") net interest income was \$16.5 million for the third quarter of 2018, a \$2.5 million decrease compared to \$19.0 million for the third quarter of 2017. Our annualized net interest margin, on a FTE basis, decreased 27 basis points in prior year quarterly comparison, from 4.20% for the third quarter of 2017 to 3.93% for the third quarter of 2018. Net interest income decreased \$2.3 million in quarterly comparison, resulting from a \$1.9

million decrease in interest income and a \$404,000 increase in interest expense.

Excluding non-operating expenses of \$5.5 million for the third quarter of 2018 and \$1.8 million for the third quarter of 2017, noninterest expenses increased \$2.0 million in quarterly comparison due to a \$2.0 million increase in legal and professional expenses. The provision for loan losses was unchanged in quarterly comparison. A \$1.4 million income tax benefit was reported for the third quarter of 2018, compared to a \$574,000 income tax expense reported in the third quarter of 2017.

Dividends on preferred stock totaled \$810,000 for the three months ended September 30, 2018 and 2017, respectively. Dividends on the Series B Preferred Stock were \$720,000 for the third quarters of 2018 and 2017, respectively. Dividends on the Series C Preferred Stock issued with the December 28, 2012 acquisition of PSB Financial Corporation (“PSB”) totaled \$90,000 for the three months ended September 30, 2018 and 2017, respectively.

Table of Contents

For the Nine Months Ended September 30, 2018 and 2017

We reported a net loss available to common shareholders of \$7.6 million, or \$0.46 per diluted share, for the nine months ended September 30, 2018, compared to net loss available to common shareholders of \$3.7 million, or \$0.28 per diluted share, for the nine months ended September 30, 2017. The first nine months of 2018 included non-operating expenses totaling \$15.8 million which consisted of \$14.7 million of regulatory remediation costs, a \$879,000 loss on the transfer of loans held for sale, \$100,000 on fees related to the bulk loan sale, and a \$145,000 one-time charge related to discontinued branch projects. Excluding these non-operating expenses, the operating earnings per share for the first nine months of 2018 was \$0.29.

FTE net interest income was \$51.0 million for the nine months ended September 30, 2018, a \$4.7 million decrease compared to \$55.7 million for the nine months ended September 30, 2017. Our annualized net interest margin, on a FTE basis, was 4.00% for the nine months ended September 30, 2018, compared to 4.19% for the same period in 2017. Net interest income decreased \$4.4 million in year-over-year comparison and consisted primarily of a \$3.5 million decrease in interest income and an \$868,000 increase in interest expense.

Excluding non-operating expenses of \$15.8 million for the nine months ended September 30, 2018 and \$4.1 million for the nine months ended September 30, 2017, noninterest expenses increased \$1.4 million in year-over-year comparison and consisted primarily of increases of \$3.3 million in legal and professional fees and \$0.8 million in other expenses, offset by \$2.2 million in occupancy expenses. The provision for loan losses decreased \$14.9 million in year-over-year comparison, from \$19.6 million for the nine months ended September 30, 2017 to \$4.7 million for the nine months ended September 30, 2018. A \$1.6 million income tax benefit was reported for the first nine months of 2018, compared to income tax benefit of \$2.1 million for the first nine months of 2017.

#### Net Interest Income

Our primary source of earnings is net interest income, which is the difference between interest earned on loans and investments and interest paid on deposits and other interest-bearing liabilities. Changes in the volume and mix of earning assets and interest-bearing liabilities combined with changes in market rates of interest greatly affect net interest income. Our net interest margin on a taxable equivalent basis, which is net interest income as a percentage of average earning assets, was 3.93% and 4.20% for the three months ended September 30, 2018 and 2017, respectively. Tables 1 and 2 below analyze the changes in net interest income in the three months ended September 30, 2018 and 2017.

FTE net interest income decreased \$2.5 million in prior year quarterly comparison. Interest income on loans decreased \$2.7 million due to a decrease in the average balance of loans of \$234.1 million in prior year quarterly comparison. The average yield on loans increased 24 basis points in prior year quarterly comparison, from 5.48% to 5.72%.

FTE interest income on investments decreased \$333,000 in prior year quarterly comparison. The average volume of investment securities decreased \$37.4 million during the three months ended September 30, 2018 compared to same period in 2017 and the average tax equivalent yield on investment securities decreased 9 basis points, from 2.65% to 2.56%.

The average yield on all earning assets decreased 15 basis points in prior year quarterly comparison, from 4.55% for the third quarter of 2017 to 4.40% for the third quarter of 2018.

Interest expense increased \$404,000 in quarterly comparison. The increase in interest is primarily a result of a \$508,000 increase in interest expense on deposits and a \$59,000 increase in interest expense on Trust Preferred Securities ("TruPs"), which were partially offset by a \$132,000 decrease in interest expense on repurchase agreements.

As a result of these changes in volume and yield on earning assets and interest-bearing liabilities, the FTE net interest margin decreased 27 basis points to 3.93% as of September 30, 2018 compared to the same period in 2017.

FTE net interest income for the nine months ended September 30, 2018 decreased \$4.8 million primarily due to a \$4.7 million decline in interest income on loans. Loans decreased \$165.0 million during the year, resulting in a yield increase of 29 basis points, from 5.30% to 5.59%. Interest income on investment securities decreased \$1.4 million. The average volume of investment securities decreased \$52.4 million in year-over-year comparison, and the average yield on investment securities decreased 12 basis points for the same period. Interest income from interest bearing deposits in other banks increased \$2.2 million with average volume of interest bearing deposits in other banks up \$132.1 million and an increase in average yields to 1.85% up 74 basis points in year-over-year comparison. The average yield on earning assets decreased 4 basis points in year-over-year comparison, from 4.47% at September 30, 2017 to 4.43% at September 30, 2018.

Interest expense increased \$0.9 million in year-over-year comparison. Increases in interest expense included a \$1.2 million increase in interest expense on deposits partially offset by an \$0.5 million decrease in interest expense on repurchase agreements. The average rate paid on interest-bearing liabilities was 0.62% for the nine months ended September 30, 2018, compared to 0.47% for the nine

Table of Contents

months ended September 30, 2017. The FTE net interest margin decreased 19 basis points, from 4.19% for the nine months ended September 30, 2017 to 4.00% for the nine months ended September 30, 2018.

Table 1  
Average Balances, Net Interest Income and Yields/Rates  
(dollars in thousands)

	Three Months Ended September 30,						
	2018		2017				
	Average Balance	Income/Expense	Yield/Rate	Average Balance	Income/Expense	Yield/Rate	
<b>Assets</b>							
Investment securities <sup>1</sup>							
Taxable	\$347,205	\$ 2,156	2.48 %	\$372,648	\$ 2,276	2.44 %	
Tax exempt <sup>2</sup>	43,151	345	3.20 %	55,129	558	4.05 %	
Total investment securities	390,356	2,501	2.56 %	427,777	2,834	2.65 %	
Federal funds sold	7,250	32	1.77 %	4,319	13	1.18 %	
Time and interest bearing deposits in other banks	250,349	1,279	2.04 %	94,675	305	1.26 %	
Other investments	15,640	106	2.72 %	12,098	93	3.07 %	
Total loans <sup>3</sup>	1,020,834	14,590	5.72 %	1,254,885	17,329	5.48 %	
Total earning assets	1,684,429	18,508	4.40 %	1,793,754	20,574	4.55 %	
Nonearning assets	146,405			160,589			
Total assets	\$1,830,834			\$1,954,343			
<b>Liabilities and shareholders' equity</b>							
Total interest bearing deposits	\$1,083,404	\$ 1,602	0.59 %	\$1,118,593	\$ 1,094	0.39 %	
Securities sold under repurchase agreements	14,641	16	0.45 %	75,654	149	0.78 %	
FHLB borrowings	29,139	81	1.11 %	31,677	111	1.37 %	
Other borrowings	22,167	271	4.88 %	22,167	212	3.74 %	
Total interest bearing liabilities	1,149,351	1,970	0.69 %	1,248,091	1,566	0.50 %	
Demand deposits	420,124			428,244			
Other liabilities	11,362			8,973			
Shareholders' equity	249,997			269,035			
Total liabilities and shareholders' equity	\$1,830,834			\$1,954,343			
Net interest income and net interest spread		\$ 16,538	3.71 %		\$ 19,008	4.05 %	
Net interest margin			3.93 %			4.20 %	

1. Securities classified as available-for-sale are included in average balances. Interest income figures reflect interest earned on such securities.

2. Reflects taxable-equivalent adjustments using the federal statutory rate of 21% and 35% as of September 30, 2018 and September 30, 2017, respectively, in adjusting interest on tax-exempt securities to a fully taxable basis. The taxable equivalent adjustments included above are \$70,000 for 2018 and \$190,000 for 2017 for the quarter ended.

3. Interest income includes loan fees of \$686,000 for 2018 and \$1.0 million for 2017. Nonaccrual loans are included in average balances and income on such loans is recognized on a cash basis.



Table of Contents

Table 2

## Average Balances, Net Interest Income and Yields/Rates

(dollars in thousands)

	Nine Months Ended September 30,							
	2018		2017		2018		2017	
	Average Balance	Income/Expense	Yield/Rate	Average Balance	Income/Expense	Yield/Rate		
<b>Assets</b>								
<b>Investment securities<sup>1</sup></b>								
Taxable	\$339,923	\$ 6,296	2.47 %	\$380,697	\$ 7,019	2.46 %		
Tax exempt <sup>2</sup>	45,826	1,096	3.19 %	57,436	1,760	4.09 %		
Total investment securities	385,749	7,392	2.55 %	438,133	8,779	2.67 %		
Federal funds sold	5,754	71	1.64 %	3,823	28	0.97 %		
Time and interest bearing deposits in other banks	195,286	2,706	1.85 %	64,124	540	1.11 %		
Other investments	15,118	285	2.51 %	11,651	255	2.92 %		
Total loans <sup>3</sup>	1,096,117	45,948	5.59 %	1,261,096	50,682	5.30 %		
Total earning assets	1,698,024	56,402	4.43 %	1,778,827	60,284	4.47 %		
Nonearning assets	152,472			158,103				
Total assets	\$1,850,496			\$1,936,930				
<b>Liabilities and shareholders' equity</b>								
Total interest bearing deposits	\$1,080,922	\$ 4,249	0.52 %	\$1,133,020	\$ 3,002	0.35 %		
Securities sold under repurchase agreements	26,902	82	0.41 %	86,282	619	0.95 %		
FHLB borrowings	35,096	330	1.26 %	27,459	290	4.13 %		
Other borrowings	22,167	750	4.51 %	22,167	632	3.76 %		
Total interest bearing liabilities	1,165,087	5,411	0.62 %	1,268,928	4,543	0.47 %		
Demand deposits	423,692			422,656				
Other liabilities	9,588			7,218				
Shareholders' equity	252,129			238,128				
Total liabilities and shareholders' equity	\$1,850,496			\$1,936,930				
Net interest income and net interest spread		\$ 50,991	3.81 %		\$ 55,741	4.00 %		
Net interest margin			4.00 %			4.19 %		

1. Securities classified as available-for-sale are included in average balances. Interest income figures reflect interest earned on such securities.

2. Reflects year-to-date taxable-equivalent adjustments using the federal statutory rate of 21% and 35% as of September 30, 2018 and September 30, 2017, respectively, in adjusting interest on tax-exempt securities to a fully taxable basis. The taxable equivalent adjustments included above are \$230,000 for 2018 and \$616,000 for 2017.

3. Interest income includes loan fees of \$2.8 million for 2018 and \$2.6 million for 2017. Nonaccrual loans are included in average balances and income on such loans is recognized on a cash basis.





Table of Contents

Table 3  
Rate/Volume Analysis on a Taxable Equivalent Basis  
(dollars in thousands)

	Three Months Ended			Nine Months Ended		
	September 30, 2018 vs. 2017			September 30, 2018 vs. 2017		
	Change Attributable to			Change Attributable to		
	Rate	Volume	Change(1)	Rate	Volume	Change(1)
<b>Interest Income:</b>						
Investment securities	\$(68 )	\$(265 )	\$(333 )	\$(314)	\$(1,073)	\$(1,387 )
Federal funds sold	4	15	19	25	18	43
Time and interest bearing deposits in other banks	419	555	974	522	1,644	2,166
Other investments	2	11	13	(39 )	69	30
Loans, including fees	(810 )	(1,929 )	(2,739 )	2,092	(6,826 )	(4,734 )
Total interest income	(453 )	(1,613 )	(2,066 )	2,286	(6,168 )	\$(3,882 )
<b>Interest Expense:</b>						
Deposits	911	(403 )	508	1,390	(143 )	1,247
Securities sold under repurchase agreements	(40 )	(93 )	(133 )	(246 )	(291 )	(537 )
FHLB advances	(58 )	28	(30 )	26	14	40
Other borrowings	105	(46 )	59	118	—	118
Total interest expense	918	(514 )	404	1,288	(420 )	868
Net interest income	\$(1,371)	\$(1,099)	\$(2,470 )	\$998	\$(5,748)	\$(4,750 )

(1) Amounts shown as increase (decrease) due to changes in either volume or rate includes an allocation of the amount that reflects the interaction of volume and rate changes. This allocation is based on the absolute dollar amounts of change due solely to changes in volume or rate.

Table of Contents

## Non-interest Income

Total non-interest income was \$5.1 million for the three months ended September 30, 2018, compared to \$5.5 million for the same period in 2017. For the nine months ended September 30, 2018, non-interest income was \$14.8 million, compared to \$15.8 million for the same period in 2017.

The following table presents the components of non-interest income for the three and nine-month periods ended September 30, 2018 and 2017 (dollars in thousands):

Table 4

## Non-Interest Income

(dollars in thousands)

	Three Months Ended September 30,		Nine Months Ended September	
	2018	2017	2018	2017
Service charges on deposit accounts	\$2,159	\$2,463	\$6,430	\$7,339
ATM and debit card income	1,796	1,687	5,457	5,156
Gain on sales of securities, net	—	338	—	347
Loss on equity securities, other investments	(16 )	—	(66 )	—
Other	1,151	998	2,981	2,911
Total non-interest income	\$5,090	\$5,486	\$14,802	\$15,753

Non-interest income decreased approximately \$400,000 in quarterly comparison, from \$5.5 million for the three months ended September 30, 2017 to \$5.1 million for the three months ended September 30, 2018. The decrease is primarily due to a decline in service charges on deposit accounts of approximately \$304,000.

Non-interest income decreased approximately \$900,000 in year-to-date comparison, from \$15.8 million for the nine months ended September 30, 2017 to \$14.8 million for the nine months ended September 30, 2018. The decline in non-interest income is a direct impact of the decline in service charges on deposit accounts during the year of \$904,000.

Table of Contents

## Non-interest Expense

Total non-interest expense was \$23.5 million and \$67.7 million for the three and nine months ended September 30, 2018, compared to \$17.8 million and \$54.6 million for the three and nine months ended September 30, 2017.

The following table presents the components of non-interest expense for the three and nine-month periods ended September 30, 2018 and 2017.

Table 5

Non-Interest Expense  
(dollars in thousands)

	Three Months		Nine Months	
	Ended September 30,		Ended September 30,	
	2018	2017	2018	2017
Salaries and employee benefits	\$7,762	\$7,849	\$23,398	\$25,989
Occupancy expense	3,077	3,711	9,315	11,524
ATM and debit card	653	654	1,876	2,088
Legal and professional fees	2,543	548	5,425	2,127
FDIC insurance	360	448	1,296	1,275
Data processing	730	640	2,061	1,928
Regulatory remediation costs (non-operating)	5,502	856	14,658	856
Other non-interest expense	2,900	3,053	9,644	8,806
Total non-interest expense	\$23,527	\$17,759	\$67,673	\$54,593

Regulatory remediation expense increased \$4.6 million and \$13.8 million for the three and nine months ended September 30, 2018, respectively, from the same periods in 2017. The increase is related to consulting and outsourcing costs for assistance with addressing and complying with the terms of the written regulatory order.

Legal and professional fees increased \$2.0 million and \$3.3 million for the three and nine months ended September 30, 2018, respectively, from the same periods in 2017. The increase is primarily related to an increase in services, both legal and professional, which are also a direct result of management's initiative to address and comply with the terms of the written regulatory order.

Salaries and employee benefits expense decreased \$87,000 and \$2.6 million for the three and nine months ended September 30, 2018, respectively, from the same periods in 2017. Salaries and employee benefits expense has continued to decline period over period due to efficiencies in the employee base and a reduction of employees due to branch closures and divestitures.

Occupancy expense decreased \$634,000 and \$2.2 million for the three and nine months ended September 30, 2018, respectively, from the same period in 2017. The decrease in occupancy expense is related to ongoing efficiency impacts related to prior period branch closures.

Table of Contents

## Balance Sheet Review

At September 30, 2018, we had total assets of approximately \$1.8 billion, consisting principally of \$0.9 billion in net loans, \$417.5 million in investment securities and \$302.9 million in cash and cash equivalents. Our liabilities at September 30, 2018 totaled \$1.6 billion, consisting primarily of \$1.5 billion in deposits. At September 30, 2018, our shareholders' equity was \$0.2 billion.

At December 31, 2017, we had total assets of approximately \$1.9 billion, consisting principally of \$1.2 billion in net loans, \$390.2 million in investment securities and \$153.0 million in cash and cash equivalents. Our liabilities at December 31, 2017 totaled \$1.6 billion, consisting primarily of \$1.5 billion in deposits. At December 31, 2017, our shareholders' equity was \$0.3 billion.

Investment securities totaled \$417.5 million, or 22.9% of total assets at September 30, 2018, versus \$390.2 million, or 20.7% of total assets at December 31, 2017. The investment portfolio had an effective duration of 3.59 years and a net unrealized loss of \$8.2 million at September 30, 2018.

## Table 6

## Composition of Loans

(dollars in thousands)

	September 30, 2018	December 31, 2017
Commercial, financial, and agricultural	\$ 295,802	\$ 435,207
Real estate – construction	90,444	90,287
Real estate – commercial	394,416	454,051
Real estate – residential	136,151	146,751
Installment loans to individuals	45,338	56,398
Lease financing receivable	592	732
Total loans	\$ 962,743	\$ 1,183,426
Less allowance for loan losses	(24,450 )	(26,888 )
Net loans	\$ 938,293	\$ 1,156,538

Our energy-related loan portfolio at September 30, 2018 totaled \$128.1 million, or 13.3% of total loans, down from \$179.7 million, or 15.2% of total loans at December 31, 2017. The majority of MidSouth's energy lending is focused on oil field service companies. Of the 265 total relationships in our energy-related loan portfolio, 35 relationships totaling \$37.6 million were classified, with \$24.3 million on nonaccrual status at September 30, 2018. At September 30, 2018, specific reserves for potential energy-related loan losses approximated 8.3% of energy loans.

Within the \$394.4 million commercial real estate portfolio, \$389.6 million is secured by commercial property, \$19.3 million is secured by multi-family property, and \$5.6 million is secured by farmland. Of the \$389.6 million secured by commercial property, \$251.2 million, or 64.5%, is owner-occupied. Of the \$136.2 million residential real estate portfolio, 77.3% represented loans secured by first liens.

Assets held for sale totaled \$1.4 million at September 30, 2018 compared to \$4.0 million at December 31, 2017. During the latter half of 2017 and the beginning of 2018 several former branch buildings were closed and subsequently sold during the second and third quarters of 2018 which was the driver for the decline in assets held for sale during the nine months ended September 30, 2018.

Total deposits at September 30, 2018 increased \$29.4 million to \$1.5 billion when compared to December 31, 2017. Our stable core deposit base, which excludes time deposits, totaled \$1.3 billion or 87.7% of total deposits at both

September 30, 2018 and December 31, 2017.

FHLB borrowings totaled \$27.5 million at September 30, 2018, compared to \$50.0 million at December 31, 2017. The decrease in total advances outstanding was the result of the FHLB terminating an advance and as well as overall strategy to reduce outstanding debt obligations.

#### Off-Balance Sheet Arrangements

In the normal course of operations, the Company engages in a variety of financial transactions that, in accordance with GAAP, are not recorded in the financial statements. These transactions involve, to varying degrees, elements of credit, interest rate, and liquidity risk. Such transactions are used primarily to manage customers' requests for funding and take the form of loan commitments, letters of credit

39

---

## Table of Contents

and lines of credit. For the period ended September 30, 2018, we did not engage in any off-balance sheet transactions reasonably likely to have a material impact on our financial condition, results of operations, or cash flows.

### Liquidity and Capital

#### Bank Liquidity

Liquidity is the availability of funds to meet maturing contractual obligations and to fund operations. The Bank's primary liquidity needs involve its ability to accommodate customers' demands for deposit withdrawals as well as customers' requests for credit. Liquidity is deemed adequate when sufficient cash to meet these needs can be promptly raised at a reasonable cost to the Bank.

Liquidity is available through four sources: a stable base of funding sources, an adequate level of assets that can be readily converted into cash, borrowing lines with correspondent banks and brokered deposits. Our core deposits are our most stable and important source of funding. Cash deposits at other banks, federal funds sold, and principal payments received on loans and mortgage-backed securities provide additional primary sources of liquidity. Approximately \$19.2 million in projected cash flows from securities repayments for the remainder of 2018 provides an additional source of liquidity.

The Bank also has significant borrowing capacity with the FRB-Atlanta and with the FHLB-Dallas. As of September 30, 2018, we had no borrowings with the FRB-Atlanta. FHLB advances totaled \$27.5 million at September 30, 2018 and consisted of two advances on existing swap contracts. Under existing agreements with the FHLB-Dallas, our borrowing capacity totaled \$289.9 million at September 30, 2018. The Bank has the ability to post additional collateral of approximately \$227.4 million if necessary to meet liquidity needs. Additionally, \$138.6 million in loan collateral is pledged under a Borrower-in-Custody line with the FRB-Atlanta. Unsecured borrowing lines totaling \$30.0 million are available through correspondent banks. We utilize these contingency funding alternatives to meet deposit volatility, which is more likely in the current environment, given unusual competitive offerings within our markets.

#### Company Liquidity

At the Company level, cash is needed primarily to meet interest payments on the junior subordinated debentures, dividends on our common stock and dividend payments on the Series B and Series C Preferred Stocks. The dividend rate on the \$32.0 million of Series B Preferred Stock issued to the U.S. Treasury for participation in the Small Business Lending Fund ("SBLF") was 9.0% for the three month period ended September 30, 2018.

On December 28, 2012, the Company issued 756,511 shares of common stock and 99,971 shares of Series C Preferred Stock in connection with the PSB acquisition. As of September 30, 2018, there were 89,725 shares of Series C Preferred Stock issued and outstanding. The Series C Preferred Stock is entitled to the payment of noncumulative dividends, if and when declared by the Company's Board of Directors, at the rate of 4.00% per annum, payable quarterly in arrears on January 15, April 15, July 15 and October 15 of each year. The Series C Preferred Stock paid dividends totaling \$90,000 for the three months ended September 30, 2018.

On June 13, 2017, the Company completed the sale of 4,583,334 shares of its common stock pursuant to an underwritten public offering, and on July 11, 2017, the Company completed the sale of an additional 516,700 shares of common stock, pursuant to the partial exercise of the option to purchase additional shares granted to the underwriter. After deducting the underwriting discount and costs associated with the capital raise, the offering resulted in net proceeds of \$57.2 million. The Company, subject to regulatory approval, intends to use \$32.0 million of the net proceeds to redeem all of the outstanding Series B Preferred Stock issued to the U.S. Treasury as a result of its

participation in the SBLF. The Company intends to use the remaining portion of the net proceeds to enhance its capital structure, to fund future organic growth, for working capital, and other general corporate purposes.

Due to the loss reported for year ended December 31, 2017, we currently do not have the ability to approve dividends from the Bank to the Company without prior approval from the OCC. As of September 30, 2018, the Company had \$46.5 million of cash to fund general corporate obligations. The Company also renewed a \$100.0 million Universal Shelf Registration during the third quarter of 2018.

## Table of Contents

### Capital

The Company and the Bank are required to maintain certain minimum capital levels. Risk-based capital requirements are intended to make regulatory capital more sensitive to the risk profile of an institution's assets. Effective January 1, 2015, the Company and the Bank adopted the Basel III rules which included new minimum risk-based and leverage ratios, and modified capital and asset definitions for purposes of calculating these ratios. These rules also created a new regulatory capital standard based on Tier 1 common equity and increased the minimum leverage and risk-based capital ratios applicable to all banking organizations.

In addition, the Basel III rules subject banking organizations to certain limitations on capital distributions and discretionary bonus payments to executive officers if the organization does not maintain a capital conservation buffer phased in by 2019 of 2.5% above the new regulatory minimum capital ratios. The effect of the capital conservation buffer once fully implemented in 2019 will be to increase the minimum common equity Tier 1 capital ratio to 7.0%, the minimum Tier 1 risk-based capital ratio to 8.5% and the minimum total risk-based capital ratio to 10.5% for banking organizations seeking to avoid the limitations on capital distributions and discretionary bonus payments to executive officers. The new minimum capital requirements were effective on January 1, 2015 for community banking organizations, such as MidSouth, whereas other requirements of the Basel III rules including the conservation buffer phase in over time.

At September 30, 2018, the Company and the Bank were in compliance with statutory minimum capital requirements and were classified as “well capitalized.” Minimum capital requirements include a total risk-based capital ratio (total risk-based capital to risk-weighted assets) of 8.0%, with Tier 1 capital not less than 6.0%, a Tier 1 leverage ratio (Tier 1 to total average adjusted assets) of 4.0% based upon the regulators latest composite rating of the institution, and a common equity Tier 1 capital to total risk-weighted assets of 4.5%. However, effective July 19, 2017, the OCC established higher individual minimum capital ratios for the Bank. Specifically, the Bank must maintain a Tier 1 leverage ratio of at least 8%, and a total risk-based capital ratio of at least 12%. The Bank had a Tier 1 leverage capital ratio of 9.94% and a total risk-based capital ratio of 16.40% at September 30, 2018. As of September 30, 2018, the Company’s Tier 1 leverage ratio was 12.53%, Tier 1 capital to risk-weighted assets was 19.09%, total capital to risk-weighted assets was 20.35% and common equity Tier 1 capital to risk-weighted assets was 13.78%.

### Asset Quality

#### Credit Risk Management

We manage credit risk primarily by observing written, board approved policies that govern all credit underwriting and approval activities. Our Chief Credit Officer (“CCO”) is responsible for credit underwriting as well as management of classified and criticized assets for the Bank. The role of the CCO includes on-going review and development of lending policies, commercial credit analysis, centralized consumer underwriting, and overall credit risk management procedures. The current risk management process requires that each individual loan officer review his or her portfolio on a quarterly basis and assign recommended credit ratings on each loan. These efforts are supplemented by independent reviews performed by the loan review officer and other validations performed by the internal audit department. The results of the reviews are reported directly to the Audit Committee of the Board of Directors.

Credit concentrations are monitored and reported quarterly whereby individual customer and aggregate industry leverage, profitability, risk rating distributions, and liquidity are evaluated for each major standard industry classification segment. At September 30, 2018, one industry segment concentration, the oil and gas industry, aggregated more than 10% of our loan portfolio. Our exposure in the oil and gas (energy-related) industry, including related service and manufacturing industries, totaled approximately \$128.1 million, or 13.3% of total loans. Of the 265 credit relationships in the energy-related loan portfolio, 35 relationships totaling \$37.6 million were classified



with \$24.3 million on nonaccrual status at September 30, 2018.

The federal banking agencies, including the OCC, have promulgated guidance governing financial institutions with concentrations in commercial real estate lending. The guidance provides that a bank has a concentration in commercial real estate lending if (1) total reported loans for construction, land development and other land represent 100% or more of total capital or (2) total reported loans secured by multifamily and non-farm residential properties and loans for construction, land development and other land represent 300% or more of total capital. Owner occupied loans are excluded from this second category. We monitor our exposure to each of these segments to ensure the concentration is consistent with our risk tolerance. At September 30, 2018, loans for construction, land development and other land totaled approximately \$90.4 million, or 46.9% of our bank's risk-based capital. Loans secured by multifamily and non-farm residential properties and loans for construction, land development and other land totaled approximately \$295.8 million at September 30, 2018, or 153% of our bank's risk-based capital. Additional information regarding credit quality by loan classification is provided in Note 4 – Credit Quality of Loans and Allowance for Loan Losses and Note 9 – Fair Value Measurement in the notes to the interim consolidated financial statements.

Table of Contents

## Nonperforming Assets and Allowance for Loan Loss

The following table sets forth the Company's nonperforming assets for the periods indicated:

Table 7

## Nonperforming Assets and Loans Past Due 90 Days or More and Still Accruing

(dollars in thousands)

	September 30, 2018	December 31, 2017	September 30, 2017		
Nonaccrual loans	\$51,476	\$49,278	\$51,289		
Loans past due 90 days and over and still accruing	7	728	402		
Total nonperforming loans	51,483	50,006	51,691		
Nonperforming loans held for sale	—	5,067	—		
Other real estate	1,022	2,001	1,931		
Other foreclosed assets	—	192	234		
Total nonperforming assets	\$52,505	\$57,266	\$53,856		
Troubled debt restructurings, accruing	\$896	\$1,360	\$1,557		
Nonperforming assets to total assets	2.88	% 3.04	% 2.77	%	
Nonperforming assets to total loans + ORE + other assets repossessed	5.45	% 4.83	% 4.35	%	
ALL to nonperforming loans	47.49	% 53.77	% 48.47	%	
ALL to total loans	2.54	% 2.27	% 2.03	%	
QTD charge-offs	\$4,339	\$8,931	\$4,381		
QTD recoveries	974	166	460		
QTD net charge-offs	\$3,365	\$8,765	\$3,921		
Annualized net charge-offs to total loans	1.40	% 2.94	% 1.26	%	

Nonperforming assets totaled \$52.5 million at September 30, 2018, a decrease of \$4.8 million and \$1.4 million from December 31, 2017 and September 30, 2017 reported amounts, respectively. The decrease since December 31, 2017 is primarily attributable to \$46.1 million of loans placed on non-accrual during the period. This increase was partially offset by the payoffs/paydowns of \$20.7 million of non-accrual loans and the decrease of \$4.3 million in nonperforming loans held for sale.

Allowance coverage for nonperforming loans was 47.49% at September 30, 2018 compared to 53.77% at December 31, 2017 and 48.47% at September 30, 2017. The ALL/total loans ratio was 2.54% at September 30, 2018, compared to 2.27% at year-end 2017 and 2.03% at September 30, 2017. The ratio of annualized net charge-offs to total loans was 1.40% for the three months ended September 30, 2018, compared to 2.94% for the three months ended December 31, 2017, and 1.26% for the three months ended September 30, 2017.

Total nonperforming assets to total loans plus ORE and other assets repossessed increased to 5.45% at September 30, 2018 from 4.83% at December 31, 2017 and 4.35% at September 30, 2017. Performing troubled debt restructurings ("TDRs") totaled \$0.9 billion at September 30, 2018, compared to \$1.4 million at December 31, 2017 and \$1.6 million at September 30, 2017. Classified assets, including ORE, were \$91.4 million at September 30, 2018 compared to \$118.2 million at December 31, 2017. Additional information regarding impaired loans is included in Note 3 – Credit Quality of Loans and Allowance for Loan Losses and Note 8 – Fair Value Measurement in the notes to the interim consolidated financial statements.

Quarterly evaluations of the allowance for loan losses are performed in accordance with GAAP and regulatory guidelines. The ALL is comprised of specific reserves assigned to each impaired loan for which a probable loss has been identified as well as general reserves to maintain the allowance at an acceptable level for other loans in the portfolio where historical loss experience is available that indicates certain probable losses may exist. Factors considered in determining provisions include estimated losses in significant credits; known deterioration in concentrations of credit; historical loss experience; trends in nonperforming assets; volume, maturity and composition of the loan portfolio; off-balance sheet credit risk; lending policies and control systems; national and local economic conditions; the experience, ability and depth of lending management; and the results of examinations of the loan portfolio by regulatory agencies and others. The processes by which we determine the appropriate level of the ALL, and the corresponding provision for probable credit

Table of Contents

losses, involves considerable judgment; therefore, no assurance can be given that future losses will not vary from current estimates. We believe the \$24.5 million in the ALL as of September 30, 2018 is sufficient to cover probable losses in the loan portfolio.

## Impact of Inflation and Changing Prices

The consolidated financial statements and notes thereto, presented herein, have been prepared in accordance with GAAP, which require the measurement of financial position and operating results in terms of historical dollars without considering the change in the relative purchasing power of money over time due to inflation. The impact of inflation is reflected in the increased cost of the Company's operations. Unlike most industrial companies, nearly all the assets and liabilities of the Company are financial. As a result, interest rates have a greater impact on the Company's performance than do the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services.

## Non-GAAP Financial Measures

Certain financial information included in the Management's Discussion and Analysis of Financial Condition and Results of Operations is determined by methods other than in accordance with GAAP. Table 8 below presents a reconciliation of these non-GAAP financial measures to the most comparable GAAP financial measures. These non-GAAP financial measures include "core net interest income", "core net interest margin", "diluted earnings per share, operating" and "operating earnings available to common shareholders". "Core net interest income" is defined as net interest income excluding net purchase accounting adjustments. "Core net interest margin" is defined as core net interest income expressed as a percentage of average earnings assets. "Diluted earnings per share, operating" is defined as net earnings available to common shareholders adjusted for specified one-time items divided by diluted weighted-average shares. "Operating earnings available to common shareholders" is defined as net earnings available to common shareholders adjusted for specified one-time items.

We use non-GAAP measures because we believe they are useful for evaluating our financial condition and performance over periods of time, as well as in managing and evaluating our business and in discussions about our performance. We also believe these non-GAAP financial measures provide users of our financial information with a meaningful measure for assessing our financial condition as well as comparison to financial results for prior periods. These results should not be viewed as a substitute for results determined in accordance with GAAP, and are not necessarily comparable to non-GAAP performance measures that other companies may use.

Table 8

Reconciliation of Non-GAAP Financial Measures  
(dollars in thousands except per share data)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Adjusted Net Income				
Net (loss)income available to common shareholders'	\$ (5,708)	\$ 856	\$ (7,637)	\$ (3,689 )
Adjustment items:				
Regulatory remediation costs	5,502	856	14,658	856
Loans held for sale expense	4	—	979	570
Severance and retention expenses	—	—	—	1,341
Branch closure expenses	—	903	145	1,368
Tax effect adjustments	(1,156 )	(616 )	(3,314 )	(1,447 )
Diluted earnings (loss) per share, operating	\$ (1,358)	\$ 1,999	\$ 4,831	\$ (1,001 )

Edgar Filing: MIDSOUTH BANCORP INC - Form 10-Q

Weighted average number of shares - diluted	16,557,791	16,395,740	16,530,851	13,314,469
Net income per diluted share	\$(0.34 )	\$ 0.05	\$(0.46 )	\$(0.28 )
Adjusted net income per diluted share	\$(0.08 )	\$ 0.12	\$0.29	\$(0.08 )

Table of Contents

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

There have been no significant changes to disclosures impacting market risk from those disclosed under the heading "Funding Sources-Interest Rate Sensitivity" in our 2017 Annual Report on Form 10-K. The reader should reference our 2017 Annual Report on Form 10-K for the full disclosure over quantitative and qualitative market risk.

Item 4. Controls and Procedures.

The Company's Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). As of the end of the period covered by this Quarterly Report on Form 10-Q, the Chief Executive Officer and Chief Financial Officer have concluded that such disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it submits under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission rules and forms.

During the third quarter of 2018, there was no change in the Company's internal controls over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Table of Contents

Part II – Other Information

Item 1. Legal Proceedings.

The Bank has been named as a defendant in various legal actions arising from normal business activities in which damages of various amounts are claimed. While the amount, if any, of ultimate liability with respect to such matters cannot be currently determined, management believes, after consulting with legal counsel, that any such liability will not have a material adverse effect on the Company's consolidated financial position, results of operations, or cash flows. However, in the event of unexpected future developments in these matters, if the ultimate resolution of any such matter is unfavorable, the result may be material to the Company's consolidated financial position, consolidated results of operations or consolidated cash flows.

Item 1A. Risk Factors.

The Office of the Comptroller of the Currency has issued a Consent Order with respect to our Bank Secrecy Act compliance. Failure to comply with the Consent Order could result in additional regulatory action.

The Bank Secrecy Act, the USA PATRIOT Act of 2001, and other laws and regulations require financial institutions, among other duties, to institute and maintain an effective anti-money laundering program ("BSA/AML Program") and file suspicious activity and currency transaction reports as appropriate. On October 25, 2018, MidSouth Bank, N.A. (the "Bank"), the wholly owned subsidiary of the Company, entered into a Stipulation to the Issuance of a Consent Order with the Office of the Comptroller of the Currency ("OCC"), consenting to the issuance of a consent order (the "Consent Order") relating to weaknesses in the Bank's BSA/AML Program. The Consent Order is expected to result in additional compliance expenses for the Bank. Issuance of the Consent Order does not preclude further enforcement actions with respect to the Bank's BSA/AML Program, including the possible imposition of fines, sanctions, and/or restrictions on the activities of the Bank. Failure to comply with the Consent Order could subject us to additional expense and result in these additional regulatory enforcement actions or enforcement of the Consent Order through court proceedings. Any of these results could have a material adverse effect on our business, financial condition and results of operations.

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

The Company did not sell any unregistered equity securities or repurchase any equity securities during the quarter ended September 30, 2018.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

None.

Item 5. Other Information.

None.





Table of Contents

Item 6. Exhibits.

Exhibit Number	Document Description
3.1	<u>Amended and Restated Articles of Incorporation of MidSouth Bancorp, Inc. (restated solely for purposes of Item 601(b)(3) of Regulation S-K) (filed as Exhibit 3.1 to MidSouth's Annual Report on Form 10-K filed on March 18, 2013 and incorporated herein by reference)</u>
3.2	<u>Amended and Restated By-laws of MidSouth Bancorp, Inc. effective as of September 26, 2012 (restated solely for purposes of Item 601(b)(3) of Regulation S-K (filed as Exhibit 3.3 to MidSouth's Quarterly Report on Form 10-Q for the quarter ended September 30, 2012 and incorporated herein by reference)</u>
31.1	<u>Certification pursuant to Exchange Act Rules 13(a) – 14(a)</u>
31.2	<u>Certification pursuant to Exchange Act Rules 13(a) – 14(a)</u>
32.1	<u>Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>
32.2	<u>Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>
101	The following financial information from the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2018, formatted in Extensible Business Reporting Language ("XBRL"): (i) Consolidated Statements of Operations, (ii) Consolidated Balance Sheets, (iii) Consolidated Statements of Cash Flows and (iv) Notes to Consolidated Financial Statements.*

Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not to be "filed" or part of a \*registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, or Section 18 of the Securities Act of 1934, as amended, and otherwise are not subject to liability under these sections.

Table of Contents

Signatures

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

MidSouth Bancorp, Inc.  
(Registrant)

Date: November 9, 2018

/s/ James R. McLemore  
James R. McLemore, President and CEO  
(Principal Executive Officer)

/s/ Lorraine D. Miller  
Lorraine D. Miller, CFO  
(Principal Financial Officer and Principal Accounting Officer)