MIDSOUTH BANCORP INC
Form 10-Q
May 08, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

xQUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2009
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 of 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 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
YES x NO ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a small reporting company.
Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨Small reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act.)
YES ¨ NO x
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted

pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
YES ¨ NO x

As of April 30, 2009, there were 6,788,885 shares of the registrant's Common Stock, par value $0.10 per share, outstanding.

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Part I – Financial Information

Item 1. Financial Statements.

MidSouth Bancorp, Inc. and Subsidiaries
Consolidated Statements of Condition
(dollars in thousands)

	March 31, 2009 (unaudited)	December 31, 2008 *
Assets		
Cash and due from banks	$ 23,464	$ 24,753
Interest-bearing deposits in other banks	10	33
Federal funds sold	13,507	-
Time deposits in other banks	9,023	9,023
Securities available-for-sale, at fair value (cost of $209,284 at March 31, 2009 and $223,372 at December 31, 2008)	212,515	225,944
Securities held-to-maturity (estimated fair value of $4,814 at March 31, 2009 and $6,648 at December 31, 2008)	4,677	6,490
Other investments	4,308	4,309
Loans	597,209	608,955
Allowance for loan losses	(7,801)	(7,586)
Loans, net of allowance	589,408	601,369
Bank premises and equipment, net	40,219	40,580
Accrued interest receivable	5,589	5,356
Goodwill and intangibles	9,572	9,605
Cash surrender value of life insurance	4,418	4,378
Other assets	6,381	4,975
Total assets	$ 923,091	$ 936,815
Liabilities and Stockholders' Equity		
Liabilities:		
Deposits:		
Non-interest bearing	$ 198,803	$ 199,899
Interest bearing	570,625	566,805
Total deposits	769,428	766,704
Borrowings	37,612	75,876
Accrued interest payable	768	1,227
Junior subordinated debentures	15,465	15,465
Other liabilities	6,107	4,499
Total liabilities	829,380	863,771
Stockholders' Equity:		
Series A Preferred stock, no par value; 5,000,000 shares authorized, 20,000 shares issued and outstanding at March 31, 2009 and none at December 31, 2008	19,063	-
Common stock, $0.10 par value- 10,000,000 shares authorized, 6,788,885 issued and 6,618,220 outstanding at March 31, 2009 and December 31, 2008	679	679
Additional paid-in capital	53,047	52,097
Unearned ESOP shares	(300)	(18)

Accumulated other comprehensive income	2,133	1,697
Treasury stock – 170,665 shares at March 31, 2009 and December 31, 2008, at cost	(3,544)	(3,544)
Retained earnings	22,633	22,133
Total stockholders' equity	93,711	73,044
Total liabilities and stockholders' equity	$ 923,091	$ 936,815

* Derived from audited financial statements.
See notes to unaudited consolidated financial statements.

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MidSouth Bancorp, Inc. and Subsidiaries
Consolidated Statements of Earnings (unaudited)
(in thousands, except per share data)

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2008
Interest income:		
Loans, including fees	$ 10,399	$ 12,006
Securities and other investments:		
Taxable	1,222	960
Nontaxable	1,140	1,041
Federal funds sold	33	305
Total interest income	12,794	14,312
Interest expense:		
Deposits	2,174	4,478
Borrowings	228	228
Junior subordinated debentures	266	332
Total interest expense	2,668	5,038
Net interest income	10,126	9,274
Provision for loan losses	1,000	1,200
Net interest income after provision for loan losses	9,126	8,074
Non-interest income:		
Service charges on deposits	2,387	2,370
ATM and debit card income	755	589
Other charges and fees	388	628
Total non-interest income	3,530	3,587
Non-interest expenses:		
Salaries and employee benefits	5,479	5,178
Occupancy expense	2,335	1,950
Other	3,452	3,165
Total non-interest expenses	11,266	10,293
Income before income taxes	1,390	1,368
Provision for income taxes	157	169
Net earnings	1,233	1,199
Dividends on preferred stock	277	-
Net earnings available to common shareholders	$ 956	$ 1,199
Earnings per share:		
Basic	$ 0.14	$ 0.18
Diluted	$ 0.14	$ 0.18

See notes to unaudited consolidated financial statements.

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MidSouth Bancorp, Inc. and Subsidiaries
Consolidated Statement of Stockholders' Equity (unaudited)
For the Three Months Ended March 31, 2009
(in thousands, except share and per share data)

	Preferred Stock		Common Stock							
	Shares	Amount	Shares	Amount	Additional Paid-in Capital	Unearned ESOP Shares	Accumulated Other Comprehensive Income	Treasury Stock	Retained Earnings	Total
Balance- January 1, 2009	-	-	6,788,885	$ 679	$ 52,097	$ (18)	$ 1,697	$ (3,544)	$ 22,133	$ 73,044
Net earnings	-	-	-	-	-	-	-	-	1,233	1,233
Net change in unrealized gains (losses) on securities available-for-sale, net of taxes	-	-	-	-	-	-	436	-	-	436
Comprehensive income	-	-	-	-	-	-	-	-	-	1,669
Issuance of Series A cumulative preferred stock and common stock warrants, net of issuance costs of $46,000	20,000	19,014	-	-	940	-	-	-	-	19,954
Accretion of discount associated with preferred stock	-	49	-	-	-	-	-	-	(49)	-
Dividends on preferred stock at 5%	-	-	-	-	-	-	-	-	(228)	(228)
Dividends on common stock, $0.07 per share	-	-	-	-	-	-	-	-	(456)	(456)
Tax benefit resulting from exercise of stock options	-	-	-	-	(4)	-	-	-	-	(4)
Increase in ESOP obligation, net of repayments	-	-	-	-	-	(282)	-	-	-	(282)
Stock option expense	-	-	-	-	14	-	-	-	-	14
	20,000	$ 19,063	6,788,885	$ 679	$ 53,047	$ (300)	$ 2,133	$ (3,544)	$ 22,633	$ 93,711

Balance- March
31, 2009

See notes to unaudited consolidated financial statements.

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MidSouth Bancorp, Inc. and Subsidiaries
Consolidated Statement of Stockholders' Equity (unaudited)
For the Three Months Ended March 31, 2008
(in thousands, except share and per share data)

	Common Stock							
	Shares	Amount	Additional Paid-in Capital	Unearned ESOP Shares	Accumulated Other Comprehensive Income	Treasury Stock	Retained Earnings	Total
Balance- January 1, 2008	6,722,993	$ 672	$ 51,327	$ (133)	$ 813	$ (3,040)	$ 18,830	$ 68,469
Cumulative-effect adjustment resulting from the adoption of EITF 06-04	-	-	-	-	-	-	(115)	(115)
Net earnings	-	-	-	-	-	-	1,199	1,199
Comprehensive income:								
Net change in unrealized gain on securities available-for-sale, net of taxes	-	-	-	-	1,081	-	-	1,081
Comprehensive income								2,281
Cash dividends on common stock, $0.07 per share	-	-	-	-	-	-	(457)	(457)
Exercise of stock options	39,539	4	302	-	-	-	-	306
Tax benefit resulting from exercise of stock options	-	-	77	-	-	-	-	77
Purchase of treasury stock	-	-	-	-	-	(287)	-	(287)
ESOP obligation, net of repayments	-	-	-	31	-	-	-	31
Excess of market value over book value of ESOP shares released, net adjustment	-	-	11	-	-	-	-	11
Stock option expense	-	-	17	-	-	-	-	17
Balance- March 31, 2008	6,762,532	$ 676	$ 51,734	$ (102)	$ 1,894	$ (3,327)	$ 19,457	$ 70,332

See notes to unaudited consolidated financial statements.

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

	For the Three Months Ended March 31, 2009	2008
Cash flows from operating activities:		
Net earnings	$ 1,233	$ 1,199
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	943	787
Provision for loan losses	1,000	1,200
Provision for deferred taxes	327	(363)
Amortization of premiums on securities, net	170	107
Stock option expense	14	17
Change in accrued interest receivable	(233)	503
Change in accrued interest payable	(459)	(170)
Change in other assets and other liabilities, net	268	1,384
Net cash provided by operating activities	3,263	4,664
Cash flows from investing activities:		
Proceeds from maturities and calls of securities available-for-sale	26,282	24,419
Proceeds from maturities and calls of securities held-to-maturity	1,815	1,000
Proceeds from other investments	-	1,159
Purchases of securities available-for-sale	(12,364)	(23,055)
Purchases of other investments	(1)	(691)
Loan originations, net of repayments	10,167	(890)
Purchase of premises and equipment	(551)	(1,493)
Proceeds from sale of premises and equipment	1	6
Net cash provided by investing activities	25,349	455
Cash flows from financing activities:		
Change in deposits	2,724	84,487
Change in repurchase agreements	12,636	201
Change in federal funds purchased	(14,900)	-
Repayments of Federal Reserve Bank discount window	(36,000)	-
Proceeds from FHLB advances	-	19,100
Repayments of FHLB advances	-	(23,500)
Net proceeds from the issuance of preferred stock	19,954	-
Purchase of treasury stock	-	(287)
Payment of dividends on preferred stock	(100)	-
Payment of dividends on common stock	(728)	(723)
Proceeds from exercise of stock options	-	305
Tax benefit due to exercise of stock options, net adjustment	(3)	77
Net cash (used in) provided by financing activities	(16,417)	79,660
Net increase in cash and cash equivalents	12,195	84,779

Cash and cash equivalents, beginning of period		24,786		30,872
Cash and cash equivalents, end of period	$	36,981	$	115,651
Supplemental information on investing and financing activities:				
Accrued preferred stock dividends	$	128	$	-

See notes to unaudited consolidated financial statements.

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MidSouth Bancorp, Inc. and Subsidiaries
Notes to Interim Consolidated Financial Statements
March 31, 2009
(Unaudited)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements and notes thereto contain all adjustments, consisting only of normal recurring adjustments, necessary to present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position of the Company and its subsidiaries as of March 31, 2009 and the results of their operations and their cash flows for the periods presented. The interim financial information should be read in conjunction with the annual consolidated financial statements and the notes thereto included in the Company's 2008 Annual Report and Form 10-K.

The results of operations for the three month period ended March 31, 2009 are not necessarily indicative of the results to be expected for the entire year.

Use of Estimates – The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

Summary of Significant Accounting Policies — The accounting and reporting policies of the Company conform with accounting principles generally accepted in the United States of America and general practices within the banking industry. There have been no material changes or developments in the application of accounting principles or in our evaluation of the accounting estimates and the underlying assumptions or methodologies that we believe to be Critical Accounting Policies and Estimates as disclosed in our Form 10-K for the year ended December 31, 2008.

Recent Accounting Pronouncements— The Financial Accounting Standards Board ("FASB") issued three FASB Staff Positions ("FSPs") in April 2009 that are effective for interim and annual reporting periods ending on or after June 15, 2009. FSP FAS 107-1 and APB 28-1 Interim Disclosures about Fair Value of Financial Instruments requires fair value disclosures about financial instruments in interim financial statements as well as disclosures about estimation methods and disclosure of changes in method from prior periods. FSP FAS 115-2 and FAS 124-2 Recognition and Presentation of Other-Than-Temporary Impairments ("OTTI FSP") create a new model for evaluating other-than-temporary impairments ("OTTI") in debt securities. The OTTI FSP requires an entity to record an OTTI if it intends to sell a debt instrument or if it cannot assert it is more likely than not that it will not have to sell the security before recovery. If the entity does not intend to sell the security but does not expect to recover the amortized cost basis, the amount of the impairment that is a result of credit related losses will be reported in earnings and the remaining impairment related to illiquidity will be reflected in other comprehensive income. FSP FAS 157-4 Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly requires companies, as they are estimating fair values for assets and liabilities that are subject to fair value measurement, to consider various factors to determine whether there has been a significant decrease in the volume and level of activity compared to normal market activity and to consider whether an observed transaction was not orderly based on the weight of available evidence. Implementation of the three FSPs is not expected to have a material impact on the Company's consolidated financial statements.

Reclassifications—Certain reclassifications have been made to the prior years' financial statements in order to conform to the classifications adopted for reporting in 2009. The reclassifications had no impact on stockholders equity or net income.

2. Allowance for Loan Losses

A summary of the activity in the allowance for loan losses is as follows (in thousands):

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	Three Months Ended March 31, 2009	2008
Balance, beginning of period	$ 7,586	$ 5,612
Provision for loan losses	1,000	1,200
Recoveries	71	9
Loans charged-off	(856)	(691)
Balance, end of period	$ 7,801	$ 6,130

3. Earnings Per Common Share

Following is a summary of the information used in the computation of earnings per common share:

	Three Months Ended March 31, 2009	2008
Net income available to common shareholders	$ 956	$ 1,199
Weighted average number of common shares outstanding used in computation of basic earnings per common share	6,617	6,586
Effect of dilutive securities:		
Stock options	10	36
Weighted average number of common shares outstanding plus effect of dilutive securities – used in computation of diluted earnings per share	6,627	6,622

4. Declaration of Dividends

On January 22, 2009, the Company declared a $0.07 per share quarterly dividend for holders of common stock of record on March 18, 2009. The Company's ability to declare and pay dividends on its common stock is subject to first having paid all accrued cumulative preferred dividends that are due. For three years following the issuance of Fixed Rate Cumulative Perpetual Preferred Stock, Series A ("Series A Preferred Stock") to the U. S. Department of the Treasury (the "Treasury") on January 9, 2009, the Company may not increase its per share common stock dividend rate above what was declared in 2008 without the Treasury's consent, unless the Treasury has transferred all the senior preferred shares to third parties.

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5. Fair Value Measurement

The Company groups its financial assets and financial liabilities measured 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. Effective January 1, 2009, the Company adopted FSP 157-2 for nonfinancial assets and liabilities. Upon adoption, the Company also groups its nonfinancial assets and liabilities carried at fair value on a recurring and nonrecurring basis into three levels of fair value.

These levels are:

Level 1 — Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange. Level 1 also includes securities that are traded by dealers or brokers in active markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 — Valuations for assets and liabilities traded in less active dealer or broker markets. For example, municipal securities valuations are based on markets that are currently offering similar financial products. Valuations are obtained from third party pricing services for identical or comparable assets or liabilities.

Level 3 — Valuations for assets and liabilities that are derived from other valuation methodologies, including option pricing models, discounted cash flow models and similar techniques, and not based on market exchange, dealer, or broker traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets or liabilities.

Below is a table that presents information about certain assets and liabilities measured at fair value on a recurring basis (in thousands):

Description	Total Carrying Amount in Statement of Condition at March 31, 2009	Assets / Liabilities Measured at Fair Value at March 31, 2009	Fair Value Measurements at March 31, 2009 using:		
			Level 1	Level 2	Level 3
Available-for-sale securities	$ 212,515	$ 212,515	$ 71	$ 212,444	$ -

Certain assets and liabilities are measured at fair value on a nonrecurring basis and therefore are not included in the table above. Impaired loans are level 2 assets measured using appraisals of the collateral from external parties less any prior liens. As of March 31, 2009, the fair value of impaired loans was approximately $18.1 million. Other real estate owned are also level 2 assets measured using appraisals from external parties, which had a fair value of approximately $843,000 as of March 31, 2009.

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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"). MidSouth Bank, N.A. offers complete banking services to commercial and retail customers in south Louisiana and southeast Texas with 35 locations and more than 170 ATMs. The Company is community oriented and focuses primarily on offering commercial and consumer loan and deposit services to individuals, small businesses, and middle market businesses.

Following is management's discussion of factors that management believes are among those necessary for an understanding of the Company's financial statements. The discussion should be read in conjunction with the Company's consolidated financial statements and the notes thereto presented herein and with the financial statements, the notes thereto, and related Management's Discussion and Analysis in the Company's 10-K for the year ended December 31, 2008.

Forward Looking Statements

The Private Securities Litigation Act of 1995 provides a safe harbor for disclosure of information about a company's anticipated future financial performance. This act protects a company from unwarranted litigation if actual results differ from management expectations. This management's discussion and analysis reflects management's current views and estimates of future economic circumstances, industry conditions, the Company's performance, and financial results based on reasonable assumptions. A number of factors and uncertainties could cause actual results to differ materially from the anticipated results and expectations expressed in the discussion. These factors and uncertainties include, but are not limited to:

- 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 that could adversely affect customers and their ability to repay borrowings under agreed upon terms and/or adversely affect the value of the underlying collateral related to the borrowings;
- increased competition for deposits and loans which could affect 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;
- a deviation in actual experience from the underlying assumptions used to determine and establish the Allowance for Loan Losses ("ALL");
- changes in the availability of funds resulting from reduced liquidity or increased costs;
- the timing and impact of future acquisitions, the success or failure of integrating 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;
- changes in government regulations and accounting principles, policies, and guidelines applicable to financial holding companies and banking; and
- acts of terrorism, weather, or other events beyond the Company's control.

Critical Accounting Policies

Certain critical accounting policies affect the more significant judgments and estimates used in the preparation of the consolidated financial statements. The Company's significant accounting policies are described in the notes to the consolidated financial statements included in Form 10-K for the year ended December 31, 2008. The accounting principles followed by the Company and the methods of applying these principles conform with accounting principles generally accepted in the United States of America ("GAAP") and general banking practices. The Company's most critical accounting policy relates to its allowance for loan losses, which reflects the estimated losses resulting from the inability of its borrowers to make loan payments. If the financial condition of its borrowers were to deteriorate, resulting in an impairment of their ability to make payments, the Company's estimates would be updated and additional provisions for loan losses may be required (see Asset Quality).

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Another of the Company's critical accounting policies relates to its goodwill and intangible assets. Goodwill represents the excess of the purchase price over the fair value of net assets acquired. In accordance with SFAS No. 142, Goodwill and Other Intangible Assets, goodwill is not amortized but evaluated for impairment annually. If the fair value of an asset exceeds the carrying amount of the asset, no charge to goodwill is made. If the carrying amount exceeds the fair value of the asset, goodwill will be adjusted through a charge to earnings. Given the current instability of the economic environment, the Company's common stock traded below its stated book value during the first quarter of 2009. Accordingly, the Company engaged a third party to assist management in assessing the current fair value of its common stock and performed a goodwill impairment analysis as of March 31, 2009. Upon review and analysis of the factors influencing value and utilizing the market value and investment value approaches, the Company determined the fair value of the common stock to be greater than stated and tangible book value, and therefore no impairment of the goodwill was recorded at the Company.

Compliance with accounting for stock-based compensation requires that management make assumptions including stock price volatility and employee turnover that are utilized to measure compensation expense. The fair value of the stock options granted is estimated at the date of grant using the Black-Scholes option-pricing model. This model requires the input of highly subjective assumptions. The Company recognized stock option expense of $14,065 for the grant-date fair value of stock options vested in the three months ended March 31, 2009. The Company did not grant any new stock options in the first quarter of 2009.

If the economic environment causes further instability in the market, it is reasonably possible that the methodology of the assessment of potential loan losses, goodwill impairment, and other fair value measurements could change in the near-term or could result in impairment going forward.

Results of Operations

Earnings Analysis

Net income available to common shareholders totaled $956,000 for the first quarter ended March 31, 2009, a decrease of 20.3% from net income of $1,199,000 reported for the first quarter of 2008 and 10.2% below net income of $1,064,000 reported for the fourth quarter of 2008. Diluted earnings per share for the first quarter of 2009 were $0.14 per share, a decrease of 22.2% from the $0.18 per share for the first quarter of 2008 and 12.5% below the $0.16 per share for the fourth quarter of 2008. In the first quarter of 2009, the Company recorded $277,000 in dividends on its Series A Preferred Stock issued to the Treasury on January 9, 2009 under the Capital Purchase Plan.

Net interest income for the first quarter of 2009 increased $852,000 in comparison to the first quarter of 2008 due to a $2.4 million decrease in interest expense which was partially offset by a $1.5 million decrease in interest income. The improvement in net interest income was offset by a $973,000 increase in non-interest expenses, primarily in occupancy expenses, group health insurance costs and increased FDIC deposit insurance premiums. Non-interest income decreased $57,000 in prior year quarterly comparison primarily due to a one-time payment of $131,000 received from VISA during the first quarter of 2008. The payment was related to VISA's redemption of a portion of its Class B shares outstanding in connection with its initial public offering. A $200,000 decrease in provision for loan losses in quarterly comparison, contributed to the $34,000 improvement to net earnings before dividends on preferred stock for the first quarter of 2009.

First quarter 2009 earnings were impacted by a $1.0 million provision for loan losses as a result of net charge-offs totaling $785,000 for the quarter, combined with credit downgrades and increased risk factors. During the first quarter of 2009, $6.4 million in loans were placed on nonaccrual status, $5.7 million of which is attributable to one shared national participation credit in the Company's Baton Rouge market. The $5.7 million credit was identified as a potential problem loan in the fourth quarter of 2008 and was a contributing factor in the $2.0 million recorded as provision expense in that quarter. Of the total $15.7 million in nonaccrual loans reported at March 31, 2009, $13.9 million, or 88.5%, are real estate credits in the Baton Rouge market and are continually monitored by the Company's risk management officers.

The Company's tax expense totaled $157,000 for the first quarter of 2009 and $169,000 for the first quarter of 2008 and approximated 11% and 12% of income before taxes, respectively. The lower effective tax rate for both periods was due to decreased earnings combined with sustained tax-exempt interest income on municipal securities within the investment portfolio.

The Company's total assets for the first quarter ended March 31, 2009 were $923.1 million, a $13.7 million, or 1.5%, decrease from the $936.8 million in total assets recorded at December 31, 2008. Deposits were $769.4 million as of March 31, 2009, an increase of $2.7 million, or .35%, from the $766.7 million as of December 31, 2008. Money market and NOW deposits increased $16.4 million during the first quarter of 2009, offsetting a $12.9 million decrease

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in certificates of deposit. Total loans were $597.2 million, a decrease of $11.7 million, or 1.92%, from $608.9 million as of December 31, 2008. Nonperforming assets to total assets were 1.96% as of March 31, 2009, compared to 1.17 % for the fourth quarter of 2008.

Net Interest Income

The primary source of earnings for the Company is the difference between interest earned on loans and investments (earning assets) and interest paid on deposits and other liabilities (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.

The Company's net interest margin on a taxable-equivalent basis, which is net interest income as a percentage of average earning assets, was 5.13% for the three months ended March 31, 2009, up 25 basis points from 4.88% for the three months ended March 31, 2008. Tables 1 and 2 following this discussion analyze the changes in taxable-equivalent net interest income for the three months ended March 31, 2009 and 2008.

Taxable-equivalent net interest income totaled $10,599,000 for the first quarter of 2009, an increase of 9.2%, or $892,000, from the $9,707,000 reported for the first quarter of 2008. The improvement in taxable-equivalent net interest income resulted primarily from a decrease of $2.4 million in interest expense which offset a decrease of $1.5 million in interest income. The impact to interest income of a $31.6 million increase in the average volume of loans, from $569.2 million at March 31, 2008 to $600.8 million at March 31, 2009, was offset by a 146 basis point reduction in the average yield on loans in quarterly comparison. The average yields on loans declined from 8.48% in the first quarter of 2008 to 7.02% in the first quarter of 2009 as New York Prime ("Prime") fell 200 basis points, from 5.25% to 3.25% during the same period. The average volume of investment securities, including federal funds sold and other interest earning assets, increased $5.8 million in quarterly comparison, while the taxable-equivalent yield increased 16 basis points, from 4.76% to 4.92%.

The decrease in interest expense in quarterly comparison resulted from a 148 basis point decrease in the average rate paid on interest-bearing liabilities, from 3.19% in the first quarter of 2008 to 1.71% in the first quarter of 2009. Additionally, a $3.9 million decline in the average volume of interest-bearing liabilities contributed to the decrease in interest expense in quarterly comparison. The decrease in the volume of interest-bearing liabilities was primarily in commercial platinum money market deposits and was partially offset by increases in the average volume of repurchase agreements, federal funds purchased and short term borrowings.

The average rate paid on the Company's junior subordinated debentures decreased 161 basis points from first quarter of 2008 to first quarter of 2009 on the $8.2 million of such debentures issued in the fourth quarter of 2004. The debentures carry a floating rate equal to the 3-month LIBOR plus 2.50%, adjustable and payable quarterly. The rate at March 31, 2009 was 3.78%. The debentures mature on September 20, 2034 and, under certain circumstances, are subject to repayment on September 20, 2009 or thereafter. In February 2001, the Company issued $7.2 million of junior subordinated debentures. The debentures carry a fixed interest rate of 10.20% and mature on February 22, 2031.

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Table 1
Consolidated Average Balances, Interest and Rates
(in thousands)

	Three Months Ended March 31,					
	2009			2008		
	Average Volume	Interest	Average Yield/Rate	Average Volume	Interest	Average Yield/Rate
Assets						
Investment securities1						
Taxable	$ 101,777	1,146	4.50%	$ 78,825	$ 958	4.86%
Tax exempt2	119,825	1,614	5.39%	108,933		