FIRST BANCSHARES INC /MS/
Form 10-Q
May 09, 2014

U. S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED: March 31, 2014

OR

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

COMMISSION FILE NUMBER: 33-94288

THE FIRST BANCSHARES, INC.

(EXACT NAME OF ISSUER AS SPECIFIED IN ITS CHARTER)

MISSISSIPPI (STATE OF INCORPORATION)	64-0862173 (I.R.S. EMPLOYER IDENTIFICATION NO.)
6480 U.S. HIGHWAY 98 WEST HATTIESBURG, MISSISSIPPI (ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)	39402 (ZIP CODE)

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

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

INDICATE BY CHECK MARK WHETHER THE ISSUER: (1) HAS FILED ALL REPORTS REQUIRED TO BE FILED BY SECTION 13 OR 15 (D) OF THE SECURITIES EXCHANGE ACT OF 1934 DURING THE PRECEDING 12 MONTHS (OR FOR SUCH SHORTER PERIOD THAT THE REGISTRANT WAS REQUIRED TO FILE SUCH REPORTS), AND (2) HAS BEEN SUBJECT TO SUCH FILING REQUIREMENTS FOR THE PAST 90 DAYS.

YES x NO ¨

INDIATE 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 (§232.405 OF THIS CHAPTER)

DURING THE PRECEDING 12 MONTHS (OR FOR SUCH SHORTER PERIOD THAT HE REGISTRANT WAS REQUIRED TO SUBMIT AND POST SUCH FILES).

YES x NO ¨

INDICATE BY CHECK MARK WHETHER THE REGISTRANT IS A LARGE ACCELERATED FILER, AN ACCELERATED FILER, A NON-ACCELERATED FILER, OR A SMALLER REPORTING COMPANY. SEE THE DEFINITIONS OF "LARGE ACCELERATED FILER," "ACCELERATED FILER," "NON-ACCELERATED FILER" AND "SMALLER REPORTING COMPANY" IN RULE 12B-2 OF THE EXCHANGE ACT.

LARGE ACCELERATED FILER	¨	ACCELERATED FILER	¨
NON-ACCELERATED FILER	x	SMALLER REPORTING COMPANY	¨

ON March 31, 2014, 5,149,280 SHARES OF THE ISSUER'S COMMON STOCK, PAR VALUE $1.00 PER SHARE WERE ISSUED AND OUTSTANDING.

TRANSITIONAL DISCLOSURE FORMAT (CHECK ONE):

YES ¨ NO x

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

YES ¨ NO x

PART I - FINANCIAL INFORMATION

ITEM NO. 1. FINANCIAL STATEMENTS

THE FIRST BANCSHARES, INC.

CONSOLIDATED BALANCE SHEETS

($ amounts in thousands)

	(Unaudited) March 31, 2014	December 31, 2013
ASSETS		
Cash and due from banks	$ 28,514	$ 24,080
Interest-bearing deposits with banks	31,203	14,205
Federal funds sold	22,261	967
Total cash and cash equivalents	81,978	39,252
Securities held-to-maturity, at amortized cost	8,429	8,438
Securities available-for-sale, at fair value	236,460	244,051
Other securities	6,148	5,534
Total securities	251,037	258,023
Loans held for sale	2,586	3,680
Loans	590,947	579,623
Allowance for loan losses	(5,811)	(5,728)
Loans, net	587,722	577,575
Premises and equipment	31,416	32,072
Interest receivable	3,431	3,292
Cash surrender value of life insurance	9,182	6,593
Goodwill	10,621	10,621
Other assets	7,959	8,992
Other real estate owned	5,221	4,470
TOTAL ASSETS	$ 988,567	$ 940,890
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES:		
Deposits:		
Noninterest-bearing	$ 179,334	$ 173,794
Interest-bearing	684,247	606,177
TOTAL DEPOSITS	863,581	779,971

Interest payable	351	400
Borrowed funds	15,000	52,000
Subordinated debentures	10,310	10,310
Other liabilities	11,829	13,101
TOTAL LIABILITIES	901,071	855,782
STOCKHOLDERS' EQUITY:		
Preferred stock, no par value, $1,000 per share liquidation, 10,000,000 shares authorized; 17,123 issued and outstanding at March 31, 2014 and December 31, 2013, respectively	17,123	17,103
Common stock, par value $1 per share, 10,000,000 shares authorized; 5,175,774 shares issued at March 31, 2014 and 5,122,941 at December 31, 2013, respectively	5,176	5,123
Additional paid-in capital	42,107	42,086
Retained earnings	23,637	22,509
Accumulated other comprehensive income (loss)	(83)	(1,249)
Treasury stock, at cost, 26,494 shares at March 31, 2014 and at December 31, 2013	(464)	(464)
TOTAL STOCKHOLDERS' EQUITY	87,496	85,108
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 988,567	$ 940,890

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THE FIRST BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF INCOME

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

	(Unaudited) Three Months Ended March 31,	
	2014	2013
INTEREST INCOME:		
Interest and fees on loans	$ 7,004	$ 5,231
Interest and dividends on securities:		
Taxable interest and dividends	903	903
Tax exempt interest	529	504
Interest on federal funds sold	11	12
TOTAL INTEREST INCOME	8,447	6,650
INTEREST EXPENSE:		
Interest on deposits	466	618
Interest on borrowed funds	157	141
TOTAL INTEREST EXPENSE	623	759
NET INTEREST INCOME	7,824	5,891
PROVISION FOR LOAN LOSSES	358	311
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	7,466	5,580
OTHER INCOME:		
Service charges on deposit accounts	984	844
Other service charges and fees	688	1,086
TOTAL OTHER INCOME	1,672	1,930
OTHER EXPENSES:		
Salaries and employee benefits	4,097	3,183
Occupancy and equipment	1,220	956
Other	1,910	1,840
TOTAL OTHER EXPENSES	7,227	5,979
INCOME BEFORE INCOME TAXES	1,911	1,531
INCOME TAXES	484	306

NET INCOME		1,427		1,225
PREFERRED STOCK ACCRETION AND DIVIDENDS		106		106
NET INCOME APPLICABLE TO COMMON STOCKHOLDERS	$	1,321	$	1,119
NET INCOME APPLICABLE TO COMMON STOCKHOLDERS:				
BASIC	$	..26	$	..36
DILUTED		..25		..35
DIVIDENDS PER SHARE COMMON		..0375		..0375

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THE FIRST BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

($ amounts in thousands)

	(Unaudited) Three Months Ended March 31, 2014	2013
Net income per consolidated statements of income	$ 1,427	$ 1,225
Other comprehensive income:		
Unrealized holding gains arising during the period on available-for-sale securities	1,749	105
Unrealized holding gains on loans held for sale	45	20
Income tax expense	(628)	(43)
Other Comprehensive Income	1,166	82
Comprehensive Income	$ 2,593	$ 1,307

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THE FIRST BANCSHARES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(unaudited)

($ in thousands)

	Common Stock	Preferred Stock	Stock Warrants	Additional Paid-in Capital	Retained Earnings	Accumulated Other Compre-hensive Income (Loss)	Treasury Stock	Total
Balance, January 1, 2013	$ 3,134	$ 17,021	$ 284	$ 23,427	$ 19,951	$ 2,533	$ (464)	$ 65,886
Net income	-	-	-	-	1,225	-	-	1,225
Other comprehensive income	-	-	-	-	-	82	-	82
Accretion and dividends on preferred Stock	-	20	-	-	(106)	-	-	(86)
Dividends on common stock, $0.0375 per Share	-	-	-	-	(116)	-	-	(116)
Issuance of 1,951,220 preferred Shares	-	20,000	-	-	-	-	-	20,000
Restricted stock grant	35	-	-	(35)	-	-	-	-
Compensation expense	-	-	-	77	-	-	-	77
Balance, March 31, 2013	$ 3,169	$ 37,041	$ 284	$ 23,469	$ 20,954	$ 2,615	$ (464)	$ 87,068
Balance, January 1, 2014	$ 5,123	$ 17,103	$ 284	$ 41,802	$ 22,509	$ (1,249)	$ (464)	$ 85,108
Net income	-	-	-	-	1,427	-	-	1,427
Other comprehensive income	-	-	-	-	-	1,166	-	1,166
Accretion and dividends on preferred Stock	-	20	-	-	(106)	-	-	(86)
Dividends on common stock, $0.0375 per share	-	-	-	-	(193)	-	-	(193)
Repurchase of restricted stock for payment of taxes	(4)	-	-	(60)	-	-	-	(64)
Restricted stock grant	57	-	-	(57)	-	-	-	-
	-	-	-	138	-	-	-	138

Compensation expense															
Balance, March 31, 2014	$	5,176	$	17,123	$	284	$	41,823	$	23,637	$	(83)	$	(464)	$	87,496

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THE FIRST BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

($ Amounts in Thousands)

	(Unaudited) Three Months Ended March 31, 2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
NET INCOME	$ 1,427	$ 1,225
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and accretion	523	421
Provision for loan losses	358	311
Loss on sale/writedown of ORE	149	10
Restricted stock expense	138	77
Increase in cash value of life insurance	(39)	(41)
Federal Home Loan Bank stock dividends	-	(1)
Changes in:		
Interest receivable	(139)	(49)
Loans held for sale, net	1,140	1,889
Interest payable	(49)	(14)
Other, net	(48)	1,805
NET CASH PROVIDED BY OPERATING ACTIVITIES	3,460	5,633
CASH FLOWS FROM INVESTING ACTIVITIES:		
Maturities and calls of securities available-for-sale	9,615	18,278
Purchases of securities available-for-sale and held-to-maturity	(1,008)	(16,135)
Net redemptions (purchases) of other securities	(614)	382
Net increase in loans	(12,898)	(13,719)
Purchase of bank owned life insurance	(2,550)	-
Net (increase) decrease in premises and equipment	279	(306)
NET CASH USED IN INVESTING ACTIVITIES	(7,176)	(11,500)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Increase in deposits	83,781	66,652
Net decrease in borrowed funds	(37,000)	(20,011)
Dividends paid on common stock	(189)	(113)
Dividends paid on preferred stock	(86)	(86)
Repurchase of restricted stock for payment of taxes	(64)	-
Issuance of 1,951,220 common shares, net	-	20,000
NET CASH PROVIDED BY FINANCING ACTIVITIES	46,442	66,442
NET INCREASE IN CASH	42,726	60,575
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	39,252	30,877
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 81,978	$ 91,452

SUPPLEMENTAL DISCLOSURES:

CASH PAYMENTS FOR INTEREST	672	773
CASH PAYMENTS FOR INCOME TAXES	275	189
LOANS TRANSFERRED TO OTHER REAL ESTATE	1,297	96
ISSUANCE OF RESTRICTED STOCK GRANTS	57	35

THE FIRST BANCSHARES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE A BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial statements and with the instructions to Form 10-Q of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. However, in the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the three months ended March 31, 2014, are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. For further information, please refer to the consolidated financial statements and footnotes thereto included in the Company's Form 10-K for the year ended December 31, 2013.

NOTE B SUMMARY OF ORGANIZATION

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

At March 31, 2014, the Company had approximately $988.6 million in assets, $587.7 million in net loans, $863.6 million in deposits, and $87.5 million in stockholders' equity. For the three months ended March 31, 2014, the Company reported net income of $1.4 million ($1.3 million applicable to common stockholders).

In the first quarter of 2014, the Company declared and paid a dividend of $.0375 per common share.

NOTE C BUSINESS COMBINATION

BCB Holding Company, Inc.

On March 3, 2014, the Company entered into an Agreement and Plan of Merger (the “Agreement”) with BCB Holding Company, Inc. an Alabama corporation (“BCB”) and parent of Bay Bank, Mobile, Alabama. The Agreement provides that, upon the terms and subject to the conditions set forth in the Agreement, BCB will merge with and into the Company (the “Merger”) and Bay Bank will merge with and into The First, A National Banking Association (“Bank Merger”). Subject to the terms and conditions of the Agreement, which has been approved by the Boards of Directors of the Company and BCB, each outstanding share of BCB common stock, other than shares held by the Company or BCB, or, shares with respect to which the holders thereof have perfected dissenters’ rights, will receive (i) for the BCB common stock that was outstanding prior to August 1, 2013, $3.60 per share which may be received in cash or the Company common stock provided that at least 30% of the aggregate consideration paid to such shareholders is in the Company common stock and one non-transferable contingent value right (“CVR”) of the CVR Consideration, and (ii) for the BCB common stock that was issued on August 1, 2013, $2.25 per share in cash. Each CVR is eligible to receive a cash payment equal to up to $0.40, with the exact amount based on the resolution of certain identified BCB loans over a three-year period following the closing of the transaction. Payout of the CVR will be overseen by a special committee of the Company’s Board of Directors. The Company will also either assume or redeem in full a note payable by BCB to Alostar Bank as well as the preferred stock issued under the U.S. Treasury’s Capital Purchase Program. The total consideration to be paid in connection with the acquisition will range between approximately $6.2 million and $6.6 million depending upon the payout of the CVR as well as the price of the Company common stock on the closing of the transaction, which is subject to a cap and a collar regarding its price.

The transaction is expected to close in the second quarter of 2014.

Concurrently, the Company and BCB will enter into an agreement and plan of merger pursuant to which BCB’s wholly-owned subsidiary, Bay Bank, will be merged with and into the Company’s wholly-owned subsidiary, the Bank.

First Baldwin Bancshares, Inc.

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

As of the closing on April 30, 2013, FNB became a wholly-owned subsidiary of the Company and subsequently was merged with and into the Bank.

In connection with the acquisition, the Company recorded $1.3 million of goodwill and $.7 million of core deposit intangible. The core deposit will be expensed over 10 years.

The Company acquired the $124.2 million loan portfolio at a fair value discount of $.5 million. The discount represents expected credit losses, adjustments to market interest rates and liquidity adjustments.

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

Purchase price:	
Cash	$ 3,300
Total purchase price	3,300
Identifiable assets:	
Cash and due from banks	46,450
Investments	2,508
Loans and leases	124,165
Other Real Estate	87
Core deposit intangible	680
Personal and real property	10,655
Deferred tax asset	2,969
Other assets	1,034
Total assets	188,548
Liabilities and equity:	
Deposits	185,771
Other liabilities	736
Total liabilities	186,507
Net assets acquired	2,041
Goodwill resulting from acquisition	$ 1,259

The outstanding principal balance and the carrying amount of these loans included in the consolidated balance sheet at March 31, 2014, are as follows (dollars in thousands):

Outstanding principal balance	$ 103,618
Carrying amount	$ 103,418

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

NOTE D PREFERRED STOCK AND WARRANT

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

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

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

The Letter Agreement, pursuant to which the Preferred Shares were exchanged, contains limitations on the payment of dividends on the common stock to no more than 100% of the aggregate per share dividend and distributions for the immediate prior fiscal year (dividends of $0.15 per share were declared and paid in 2011, 2012, and 2013) and on the Company's ability to repurchase its common stock, and continues to subject the Company to certain of the executive compensation limitations included in the Emergency Economic Stabilization Act of 2008 (EESA), as previously disclosed by the Company.

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

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

On March 22, 2013, the Company raised $20,000,005 in a private placement of 1,951,220 shares of newly authorized Series D Nonvoting Convertible Preferred Stock ("Convertible Preferred Stock") at a purchase price of $10.25 per share. The terms of the Convertible Preferred Stock provided for mandatory conversion into the Company's common stock upon approval, which occurred at the annual meeting, May 23, 2013. The Company paid $921,487.43 in fees to its financial advisors who acted as placement agents in the private placement.

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

Upon conversion of the Convertible Preferred Stock, the Company issued 1,951,220 shares of common stock. On March 31, 2014, the Company had 5,149,280 shares of common stock outstanding, excluding treasury shares.

NOTE E EARNINGS APPLICABLE TO COMMON STOCKHOLDERS

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

	For the Three Months Ended March 31, 2014		
	Net Income (Numerator)	Shares (Denominator)	Per Share Data
Basic per share	$ 1,321,000	5,140,500	$ ..26
Effect of dilutive shares:			
Restricted stock grants		49,429	
Diluted per share	$ 1,321,000	5,189,929	$ ..25

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

The Company granted 57,327 shares of restricted stock in the first quarter of 2014, 35,133 shares of restricted stock in the first quarter of 2013, and 15,500 shares of restricted stock in the third quarter of 2013.

NOTE F FAIR VALUE OF ASSETS AND LIABILITIES

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

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

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

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

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

Available-for-Sale Securities

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

The following table presents the Company’s assets that are measured at fair value on a recurring basis and the level within the hierarchy in which the fair value measurements fell as of March 31, 2014 and December 31, 2013 (in thousands):

March 31, 2014

(Dollars in thousands)		Fair Value Measurements Using		
	Fair Value	Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Obligations of U. S. Government Agencies	$ 25,381	$ -	$ 25,381	$ -
Municipal securities	106,228	-	106,228	-
Mortgage-backed securities	76,973	-	76,973	-

Corporate obligations	26,908	-	23,980	2,928
Other	970	970	-	-
Total	$ 236,460	$ 970	$ 232,562	$ 2,928

December 31, 2013

	Fair Value	Fair Value Measurements Using Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Obligations of U. S. Government Agencies	$ 29,962	$ -	$ 29,962	$ -
Municipal securities	108,078	-	108,078	-
Mortgage-backed securities	78,187	-	78,187	-
Corporate obligations	26,852	-	24,054	2,798
Other	972	972	-	-
Total	$ 244,051	$ 972	$ 240,281	$ 2,798

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

(Dollars in thousands)	Bank-Issued Trust Preferred Securities 2014	2013
Balance, January 1	$ 2,798	$ 2,668
Transfers into Level 3	-	-
Transfers out of Level 3	-	-
Other-than-temporary impairment loss included in earnings	-	-
Unrealized gain included in comprehensive income	130	130
Balance at March 31, 2014 and December 31, 2013	$ 2,928	$ 2,798

The following table presents quantitative information about recurring Level 3 fair value measurements (in thousands):

Trust Preferred Securities	Fair Value	Valuation Technique	Significant Unobservable Inputs	Range of Inputs		
March 31, 2014	$ 2,928	Discounted cash flow	Probability of default	0	100	%
December 31, 2013	2,798	Discounted cash flow	Probability of default	0	100	%

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

Impaired Loans

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

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

Other Real Estate Owned

Other real estate owned acquired through loan foreclosure is initially recorded at fair value less estimated costs to sell, establishing a new cost basis. The adjustment at the time of foreclosure is recorded through the allowance for loan losses. Due to the subjective nature of establishing the fair value, the actual fair value of the other real estate owned or foreclosed asset could differ from the original estimate. If it is determined the fair value declines subsequent to foreclosure, a valuation allowance is recorded through non-interest expense. Operating costs associated with the assets are also recorded as non-interest expense. Gains and losses on the disposition of other real estate owned and foreclosed assets are netted and posted to other non-interest expense. Other real estate owned measured at fair value on a non-recurring basis at March 31, 2014, amounted to $5.2 million. Other real estate owned is classified within Level 2 of the fair value hierarchy.

The following table presents the fair value measurement of assets measured at fair value on a nonrecurring basis and the level within the fair value hierarchy in which the fair value measurements fell at March 31, 2014 and December 31, 2013.

($ in thousands)

<u>March 31, 2014</u>

		Fair Value Measurements Using		
	Fair Value	Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans	$ 4,142	$ -	$ 4,142	$ -

Other real estate owned	5,221	-	5,221	-

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December 31, 2013

	Fair Value	Fair Value Measurements Using Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans	$ 4,830	$ -	$ 4,830	$ -
Other real estate owned	4,470	-	4,470	-

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

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

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

Loans The fair value of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

Bank-Owned Life Insurance The fair value of bank-owned life insurance approximates the carrying amount, because upon liquidation of these investments, the Company would receive the cash surrender value which equals the carrying amount.

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

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

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

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

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

As of March 31, 2014			Fair Value Measurements		
	Carrying Amount	Estimated Fair Value	Quoted Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Instruments:					
Assets:					
Cash and cash equivalents	$ 81,978	$ 81,978	$ 81,978	$ -	$ -
Securities available-for-sale	236,460	236,460	970	232,562	2,928
Securities held-to-maturity	8,429	9,774	-	9,774	-
Other securities	6,148	6,148	-	6,148	-
Loans, net	587,722	601,141	-	-	601,141
Bank-owned life insurance	9,182	9,182	-	9,182	-
Liabilities:					
Noninterest-bearing deposits	$ 179,394	$ 179,334	$ -	$ 179,334	$ -
Interest-bearing deposits	684,247	683,631	-	683,631	-
Subordinated debentures	10,310	10,310	-	-	10,310
FHLB and other borrowings	15,000	15,000	-	15,000	-

As of December 31, 2013			Fair Value Measurements		
	Carrying Amount	Estimated Fair Value	Quoted Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Instruments:					
Assets:					
Cash and cash equivalents	$ 39,252	$ 39,252	$ 39,252	$ -	$ -
Securities available-for-sale	244,051	244,051	972	240,281	2,798
Securities held-to-maturity	8,438	9,624	-	9,624	-
Other securities	5,534	5,534	-	5,534	-
Loans, net	577,575	590,866	-	-	590,866
Bank-owned life insurance	6,593	6,593	-	6,593	-
Liabilities:					
Noninterest-bearing deposits	$ 173,794	$ 173,794	$ -	$ 173,794	$ -
Interest-bearing deposits	606,177	605,737	-	605,737	-
Subordinated debentures	10,310	10,310	-	-	10,310
FHLB and other borrowings	52,000	52,000	-	52,000	-

NOTE G LOANS

Loans typically provide higher yields than the other types of earning assets, and, thus, one of the Company's goals is for loans to be the largest category of the Company's earning assets. At March 31, 2014 and December 31, 2013, average loans accounted for 67.7% and 67.1% of average earning assets, respectively. The Company controls and mitigates the inherent credit and liquidity risks through the composition of its loan portfolio.

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

Composition of Loan Portfolio

	March 31, 2014				December 31, 2013			
	Amount		Percent of Total		Amount		Percent of Total	
	(Dollars in thousands)							
Mortgage loans held for sale	$	2,586	0.4	%	$	3,680	0.6	%
Commercial, financial and agricultural		84,898	14.3			81,792	14.0	
Real Estate:								
Mortgage-commercial		198,984	33.5			202,343	34.7	
Mortgage-residential		218,901	36.9			212,388	36.4	
Construction		73,523	12.4			67,287	11.5	
Consumer and other		14,641	2.5			15,813	2.8	
Total loans		593,533	100	%		583,303	100	%
Allowance for loan losses		(5,811)				(5,728)		
Net loans	$	587,722			$	577,575		

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

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

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

(In thousands)

	Three Months Ended March 31, 2014	
Balance at beginning of period	$	5,728
Loans charged-off:		
Real Estate		300
Installment and Other		43
Commercial, Financial and Agriculture		-
Total		(343)
Recoveries on loans previously charged-off:		
Real Estate		43
Installment and Other		21
Commercial, Financial and Agriculture		4
Total		68

Net charge-offs		(275)
Provision for Loan Losses		358
Balance at end of period	$	5,811

The following tables represent how the allowance for loan losses is allocated to a particular loan type, as well as the percentage of the category to total loans at March 31, 2014 and December 31, 2013.

Allocation of the Allowance for Loan Losses

	March 31, 2014 (Dollars in thousands)		
	Amount		% of loans in each category to total loans
Commercial Non Real Estate	$	548	14.2 %
Commercial Real Estate		3,308	56.5
Consumer Real Estate		1,778	25.6
Consumer		175	3.7
Unallocated		2	-
Total	$	5,811	100 %

	December 31, 2013 (Dollars in thousands)		
	Amount		% of loans in each category to total loans
Commercial Non Real Estate	$	582	14.0 %
Commercial Real Estate		3,384	57.2
Consumer Real Estate		1,427	25.4
Consumer		173	3.4
Unallocated		162	-
Total	$	5,728	100 %

The following table represents the Company's impaired loans at March 31, 2014, and December 31, 2013.

	March 31, 2014 (In thousands)		December 31, 2013	
Impaired Loans:				
Impaired loans without a valuation allowance	$	605	$	759
Impaired loans with a valuation allowance		3,537		4,071
Total impaired loans	$	4,142	$	4,830
Allowance for loan losses on impaired loans at period end		1,025		849
Total nonaccrual loans		2,267		3,181
Past due 90 days or more and still accruing		443		159
Average investment in impaired loans		4,486		4,007

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

	Three Months Ended March 31, 2014

Average of individually impaired loans during period	$	4,486
Interest income recognized during impairment		-
Cash-basis interest income recognized		40

The gross interest income that would have been recorded in the period that ended if the nonaccrual loans had been current in accordance with their original terms and had been outstanding throughout the period or since origination, if held for part of the three months ended March 31, 2014, was $33,000. The Company had no loan commitments to borrowers in non-accrual status at March 31, 2014 and December 31,2013.

The following tables provide the ending balances in the Company's loans (excluding mortgage loans held for sale) and allowance for loan losses, broken down by portfolio segment as of March 31, 2014 and December 31, 2013. The tables also provide additional detail as to the amount of our loans and allowance that correspond to individual versus collective impairment evaluation. The impairment evaluation corresponds to the Company's systematic methodology for estimating its Allowance for Loan Losses.

March 31, 2014

	Real Estate (In thousands)	Installment and Other	Commercial, Financial and Agriculture	Total
Loans				
Individually evaluated	$ 3,778	$ 47	$ 317	$ 4,142
Collectively evaluated	481,203	21,830	83,772	586,805
Total	$ 484,981	$ 21,877	$ 84,089	$ 590,947
Allowance for Loan Losses				
Individually evaluated	$ 983	$ 33	$ 9	$ 1,025
Collectively evaluated	4,103	144	539	4,786
Total	$ 5,086	$ 177	$ 548	$ 5,811

December 31, 2013

	Real Estate (In thousands)	Installment and Other	Commercial, Financial and Agriculture	Total
Loans				
Individually evaluated	$ 4,709	$ 39	$ 82	$ 4,830
Collectively evaluated	473,832	19,725	81,236	574,793
Total	$ 478,541	$ 19,764	$ 81,318	$ 579,623
Allowance for Loan Losses				
Individually evaluated	$ 804	$ 35	$ 10	$ 849
Collectively evaluated	4,007	300	572	4,879
Total	$ 4,811	$ 335	$ 582	$ 5,728

The following tables provide additional detail of impaired loans broken out according to class as of March 31, 2014 and December 31, 2013. The recorded investment included in the following table represents customer balances net of any partial charge-offs recognized on the loans, net of any deferred fees and costs. As nearly all of our impaired loans at March 31, 2014, are on nonaccrual status, recorded investment excludes any insignificant amount of accrued interest receivable on loans 90-days or more past due and still accruing. The unpaid balance represents the recorded balance prior to any partial charge-offs.

March 31, 2014

	Recorded Investment	Unpaid Balance	Related Allowance	Average Recorded Investment YTD	Interest Income Recognized YTD
	(In thousands)				
Impaired loans with no related allowance:					
Commercial installment	$ 242	$ 242	$ -	$ 123	$ 5
Commercial real estate	312	370	-	332	1
Consumer real estate	41	41	-	220	4
Consumer installment	10	10	-	7	1
Total	$ 605	$ 663	$ -	$ 682	$ 11
Impaired loans with a related allowance:					
Commercial installment	$ 76	$ 76	$ 9	$ 77	$ 1
Commercial real estate	1,896	1,966	303	2,291	28
Consumer real estate	1,529	1,529	680	1,400	-
Consumer installment	36	36	33	36	-
Total	$ 3,537	$ 3,607	$ 1,025	$ 3,804	$ 29
Total Impaired Loans:					
Commercial installment	$ 318	$ 318	$ 9	$ 200	$ 6
Commercial real estate	2,208	2,336	303	2,623	29
Consumer real estate	1,570	1,570	680	1,620	4
Consumer installment	46	46	33	43	1
Total Impaired Loans	$ 4,142	$ 4,270	$ 1,025	$ 4,486	$ 40

December 31, 2013

	Recorded Investment (In thousands)	Unpaid Balance	Related Allowance	Average Recorded Investment YTD	Interest Income Recognized YTD
Impaired loans with no related allowance:					
Commercial installment	$ 3	$ 3	$ -	$ 45	$ -
Commercial real estate	353	353	-	1,035	8
Consumer real estate	341	399	-	262	9
Consumer installment	4	4	-	5	-
Total	$ 701	$ 759	$ -	$ 1,347	$ 17
Impaired loans with a related allowance:					
Commercial installment	$ 79	$ 79	$ 10	$ 42	$ 6
Commercial real estate	2,685	2,685	400	2,147	100
Consumer real estate	1,202	1,272	404	1,019	21
Consumer installment	35	35	35	36	4
Total	$ 4,001	$ 4,071	$ 849	$ 3,244	$ 131
Total Impaired Loans:					
Commercial installment	$ 82	$ 82	$ 10	$ 87	$ 6
Commercial real estate	3,038	3,038	400	3,182	108
Consumer real estate	1,543	1,671	404	1,281	30
Consumer installment	39	39	35	41	4
Total Impaired Loans	$ 4,702	$ 4,830	$ 849	$ 4,591	$ 148

The following tables provide additional detail of troubled debt restructurings at March 31, 2014.

For the Three Months Ending March 31, 2014

	Outstanding Recorded Investment Pre-Modification	Outstanding Recorded Investment Post-Modification	Number of Loans	Interest Income Recognized
Commercial installment	$ 239	$ 239	1	$ 5
Commercial real estate	-	-	-	-
Consumer real estate	-	-	-	-
Consumer installment	-	-	-	-
Total	$ 239	$ 239	1	$ 5

The recorded investment in receivables for which the allowance for credit losses was previously measured under a general allowance for credit losses methodology and are now impaired under Section 310-10-35 was $.2 million. The allowance for credit losses associated with those receivables on the basis of a current evaluation of loss was $0. All loans were performing as agreed with modified terms.

During the three month period ending March 31, 2014, there was 1 loan modified as TDR, and is considered non-performing.

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

	March 31, 2014 (In thousands)				
	Past Due 30 to 89 Days	Past Due 90 Days or More and Still Accruing	Non-Accrual	Total Past Due and Non-Accrual	Total Loans
Real Estate-construction	$ 684	$ 37	$ 19	$ 740	$ 73,523
Real Estate-mortgage	2,821	406	1,733	4,960	218,901
Real Estate-non farm non residential	851	-	497	1,348	198,984
Commercial	14	-	8	22	84,898
Consumer	48	-	10	58	14,641
Total	$ 4,418	$ 443	$ 2,267	$ 7,128	$ 590,947

	December 31, 2013 (In thousands)				
	Past Due 30 to 89 Days	Past Due 90 Days or More and Still Accruing	Non-Accrual	Total Past Due and Non-Accrual	Total Loans
Real Estate-construction	$ 478	$ -	$ 212	$ 690	$ 67,287
Real Estate-mortgage	4,696	143	2,453	7,292	202,343
Real Estate-non farm non residential	252	-	507	759	212,388
Commercial	12	-	9	21	81,792
Consumer	115	16	-	131	15,813
Total	$ 5,553	$ 159	$ 3,181	$ 8,893	$ 579,623

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

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

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

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

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

As of March 31, 2014 and December 31, 2013, and based on the most recent analysis performed, the risk category of loans by class of loans (excluding mortgage loans held for sale) was as follows:

($ in thousands)
March 31, 2014

	Real Estate Commercial	Real Estate Mortgage	Installment and Other	Commercial, Financial and Agriculture	Total
Pass	$ 322,113	$ 149,263	$ 21,809	$ 83,484	$ 576,669
Special Mention	1,358	31	-	411	1,800
Substandard	10,746	1,776	68	216	12,806
Doubtful	-	-	-	-	-
Subtotal	334,217	151,070	21,877	84,111	591,275
Less:					
Unearned discount	208	98	-	22	328
Loans, net of unearned discount	$ 334,009	$ 150,972	$ 21,877	$ 84,089	$ 590,947

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December 31, 2013

	Real Estate Commercial	Real Estate Mortgage	Installment and Other	Commercial, Financial and Agriculture	Total
Pass	$ 316,573	$ 145,787	$ 19,725	$ 80,087	$ 562,172
Special Mention	4,084	32	-	1,033	5,149
Substandard	10,972	1,426	39	225	12,662
Doubtful	-	-	-	-	-
Subtotal	331,629	147,245	19,764	81,345	579,983
Less:					
Unearned discount	236	97	-	27	360
Loans, net of unearned discount	$ 331,393	$ 147,148	$ 19,764	$ 81,318	$ 579,623

NOTE H SECURITIES

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

A summary of the amortized cost and estimated fair value of available-for-sale securities and held-to-maturity securities at March 31, 2014, follows:
($ in thousands)

	March 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale securities:				
Obligations of U.S. Government Agencies	$ 25,380	$ 97	$ 96	$ 25,381
Tax-exempt and taxable obligations of states and municipal subdivisions	104,882	2,312	966	106,228
Mortgage-backed securities	77,111	872	1,010	76,973
Corporate obligations	27,934	224	1,250	26,908
Other	1,255	-	285	970
Total	$ 236,562	$ 3,505	$ 3,607	$ 236,460
Held-to-maturity securities:				
Mortgage-backed securities	$ 2,429	$ -	$ 57	$ 2,372
Taxable obligations of states and municipal subdivisions	6,000	1,402	-	7,402
Total	$ 8,429	$ 1,402	$ 57	$ 9,774

NOTE I ALLOWANCE FOR LOAN LOSSES

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

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

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

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

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

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

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

NOTE J SUBSEQUENT EVENTS

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

NOTE K RECLASSIFICATION

Certain amounts in the 2013 financial statements have been reclassified for comparative purposes to conform to the current period financial statement presentation.

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

FINANCIAL CONDITION

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

The First represents the primary asset of the Company. The First reported total assets of $987.7 million at March 31, 2014, compared to $941.0 million at December 31, 2013. Loans increased $10.2 million, or 1.8%, during the first three months of 2014. Deposits at March 31, 2014, totaled $863.6 million compared to $780 million at December 31, 2013. For the three month period ended March 31, 2014, The First reported net income of $1.6 million compared to $1.6 million for the three months ended March 31, 2013.

NONPERFORMING ASSETS AND RISK ELEMENTS. Diversification within the loan portfolio is an important means of reducing inherent lending risks. At March 31, 2014, The First had no concentrations of ten percent or more of total loans in any single industry or any geographical area outside its immediate market areas.

At March 31, 2014, The First had loans past due as follows:

	($ In Thousands)
Past due 30 through 89 days	$ 4,418
Past due 90 days or more and still accruing	443

The accrual of interest is discontinued on loans which become ninety days past due (principal and/or interest), unless the loans are adequately secured and in the process of collection. Nonaccrual loans totaled $2.3 million at March 31, 2014, a decrease of $.9 million from December 31, 2013. Any other real estate owned is carried at fair value, determined by an appraisal, less estimated costs to sell. Other real estate owned totaled $5.2 million at March 31, 2014. A loan is classified as a restructured loan when the following two conditions are present: First, the borrower is experiencing financial difficulty and second, the creditor grants a concession it would not otherwise consider but for the borrower's financial difficulties. At March 31, 2014, the Bank had $2.4 million in loans that were modified as troubled debt restructurings, of which $1.7 million were performing as agreed with modified terms.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity is adequate with cash and cash equivalents of $82.0 million as of March 31,2014. In addition, loans and investment securities repricing or maturing within one year or less exceeded $209.6 million at March 31, 2014. Approximately $120.1 million in loan commitments could fund within the next six months and other commitments, primarily standby letters of credit, totaled .7 million at March 31, 2014.

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

Total consolidated equity capital at March 31, 2014, was $87.5 million, or approximately 8.9% of total assets. The Company currently has adequate capital positions to meet the minimum capital requirements for all regulatory agencies. The Company's capital ratios as of March 31, 2014, were as follows:

Tier 1 leverage	8.84	%
Tier 1 risk-based	12.57	%
Total risk-based	13.44	%

On June 30, 2006, The Company issued $4,124,000 of floating rate junior subordinated deferrable interest debentures to The First Bancshares Statutory Trust 2 in which the Company owns all of the common equity. The debentures are the sole asset of the Trust. The Trust issued $4,000,000 of Trust Preferred Securities (TPSs) to investors. The Company's obligations under the debentures and related documents, taken together, constitute a full and unconditional guarantee by the Company of the Trust's obligations under the preferred securities. The preferred securities are redeemable by the Company at its option. The preferred securities must be redeemed upon maturity of the debentures in 2036. Interest on the preferred securities is the three month London Interbank Offer Rate (LIBOR) plus 1.65% and is payable quarterly. The terms of the subordinated debentures are identical to those of the preferred securities. On July 27, 2007, The Company issued $6,186,000 of floating rate junior subordinated deferrable interest debentures to The First Bancshares Statutory Trust 3 in which the Company owns all of the common equity. The debentures are the sole asset of Trust 3. The Trust issued $6,000,000 of Trust Preferred Securities (TPSs) to investors. The Company's obligations under the debentures and related documents, taken together, constitute a full and unconditional guarantee by the Company of the Trust's obligations under the preferred securities. The preferred securities are redeemable by the Company in 2013 or later, at its option. The preferred securities must be redeemed upon maturity of the debentures in 2037. Interest on the preferred securities is the three month LIBOR plus 1.40% and is payable quarterly. The terms of the subordinated debentures are identical to those of the preferred securities. In accordance with the authoritative guidance, the trusts are not included in the consolidated financial statements.

RESULTS OF OPERATIONS

The Company had a consolidated net income of $1,427,000 for the three months ended March 31, 2014, compared with consolidated net income of $1,225,000 for the same period last year.

Net interest income increased to $7.8 million from $5.9 million for the three months ended March 31, 2014, or an increase of 32.8% as compared to the same period in 2013. Average earning assets through March 31, 2014, increased $208.3 million, or 31.5% and average interest-bearing liabilities also increased $143.4 million or 25.7% when compared to March 31, 2013.

Noninterest income for the three months ended March 31, 2014, was $1,672,000 compared to $1,930,000 for the same period in 2013, reflecting a decrease of $258,000 or 13.4%. The decrease for the quarter ended March 31, 2014, as compared to the first quarter of 2013 is attributed to an award in the amount of $415,000 granted to our Company in the first quarter of 2013 by the CDFI.

The provision for loan losses was $358,000 for the three months ended March 31, 2014, compared with $311,000 for the same period in 2013. The allowance for loan losses of $5.8 million at March 31, 2014 (approximately .98% of total loans and 1.20% of loans excluding those booked at fair value due to the business combination) is considered by management to be adequate to cover losses inherent in the loan portfolio. The level of this allowance is dependent upon a number of factors, including the total amount of past due loans, general economic conditions, and management’s assessment of potential losses. This evaluation is inherently subjective as it requires estimates that are susceptible to significant change. Ultimately, losses may vary from current estimates and future additions to the allowance may be necessary.

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

Noninterest expense increased by $1,248,000 or 20.9% for the three months ended March 31, 2014, when compared with the same period in 2013. This increase is primarily related to increases in operating costs as well as acquisition costs associated with the acquisition of First National Bank of Baldwin County. One-time acquisition costs, mainly related to Bay Bank, expensed during the first quarter of 2014 amounted to $91,000 and one-time acquisition costs, related to Baldwin County, expensed during the first quarter of 2013 amounted to $341,000.

Net non-interest expense related to non-recurring items amounted to $91,000 during the first quarter of 2014 compared to net non-interest income of $74,000 during the first quarter of 2013, reflecting a total difference of $165,000 between the first quarters.

ITEM NO. 3. CONTROLS AND PROCEDURES

As of March 31, 2014, (the “Evaluation Date”), we carried out an evaluation, under the supervision of and with the participation of our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in SEC rules and forms.

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There have been no changes, significant or otherwise, in our internal controls over financial reporting that occurred during the quarter ended March 31, 2014, that have materially affected, or are reasonably likely to affect, our internal control over financial reporting.

ITEM NO. 4. RECENT ACCOUNTING PRONOUNCEMENTS

In January 2014, the FASB issued ASU 2014-04, “Receivables Troubled Debt Restructurings by Creditors”, which will eliminate diversity in practice regarding the timing of derecognition for residential mortgage loans when a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan. Under ASU 2014-04, physical possession of residential real estate property is achieved when either the creditor obtains legal title to the residential real estate property upon completion of a foreclosure or the borrower conveys all interest in the residential real estate property through completion of a deed in lieu or foreclosure in order to satisfy the loan. Once physical possession has been achieved, the loan is derecognized and the property recorded within other assets at the lower of cost or fair value (less estimated costs to sell). In addition, the guidance requires both interim and annual disclosure of both the amount of foreclosed residential real estate property held by the creditor and the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure. The additional disclosure requirements are effective for annual reporting periods beginning on or after December 15, 2014, and interim periods within those annual periods with retrospective disclosure necessary for all comparative periods presented. The adoption of this standard will result in additional disclosures but is not expected to have any impact on the Company’s financial statements or results of operations.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None

ITEM 1A. RISK FACTORS

There are no material changes in the Company's risk factors since December 31, 2013. Please refer to the Annual Report on Form 10-K of The First Bancshares, Inc., filed with the Securities and Exchange Commission on March 31, 2014.

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

On March 20, 2013, The First Bancshares, Inc., a Mississippi corporation (the "Company") entered into Securities Purchase Agreements with a limited number of institutional and other accredited investors, including certain directors and executive officers of the Company (collectively, the "Purchasers') to sell a total of 1,951,220 shares of mandatorily convertible non-cumulative, non-voting, perpetual Preferred Stock, Series D, $1.00 par value (the "Series D Preferred Stock") at a price of $10.25 per share, for an aggregate gross purchase price of $20,000,005 (the "Private Placement"). The Private Placement closed on March 22, 2013, after the Company issued an aggregate of 1,951,220 shares of Series D Preferred Stock against receipt of $20,000,005 in cash from the Purchasers. The Private Placement was not registered under the Securities Act of 1933, as amended (the "Act"), in reliance on Section 4(2) of the Act and Rule 506 of Regulation D promulgated thereunder.

The Series D Preferred Stock automatically converted into a like number of shares of the Company's common stock after the Company received shareholder approval of such conversion at a meeting of shareholders held on May 23, 2013. Upon conversion of the Series D Preferred Stock, each share of Series D Preferred Stock was automatically converted into one share of the Company’s common stock par value of one U.S. dollar ($1.00) per share (“Common Stock”). The holders of record of Series D Preferred Stock were entitled to receive as, when, and if declared by the Company’s board of directors, dividends on each share of Series D Preferred Stock equal to the per share amount paid on a share of Common Stock (the “Preferred Dividend”), and no dividends were payable on the Common Stock or any other class or series of capital stock ranking with respect to dividends pari passu with the Common Stock unless a Preferred Dividend was payable at the same time on the Series D Preferred Stock; *provided, however,* in the event the shareholders of the Company did not approve the conversion of the Series D Preferred Stock to Common Stock within six (6) months of issuance, the holders of record of Series D Preferred Stock would have been entitled to receive as, when, and if declared by the board of directors of the Company, dividends on each share of Series D Preferred Stock equal to six (6) percent of liquidation value per annum or $0.62 per share (the “Fixed Preferred Dividend”) and no dividends would have been payable on the Common Stock or any other class or series of capital stock ranking with respect to dividends pari passu with the Common Stock unless a Preferred Dividend was payable at the time on the Series D Preferred Stock. Such Fixed Preferred Dividends would have been payable semi-annually in arrears on June 30 and December 31, beginning on December 31, 2013, until the shareholders of the Company approved the conversion of the Series D Preferred Shares into the Common Stock. The Series D Preferred Stock was not redeemable by the Company or by the holders. Complete details concerning the Series D Preferred Stock are contained in the Certificate of Designation filed with the Mississippi Secretary of State on March 20, 2013, a copy of which was attached as Exhibit 4.1 to the Form 8-K filed by the Company on March 25, 2013 and incorporated herein by reference.

In accordance with Section 4.11 of the Securities Purchase Agreement, the Company called a meeting of the Company shareholders to vote on proposals to approve the conversion of shares of Series D Preferred Stock into shares of Common Stock for purposes of compliance with NASDAQ Stock Market Rule 5635. The board of directors of the Company unanimously recommended shareholder approval of this proposal.

Also on March 20, 2013, pursuant to the Securities Purchase Agreements, the Company entered into a Registration Rights Agreement with each of the Purchasers. Pursuant to the Registration Rights Agreement, the Company filed a registration statement with the Securities and Exchange Commission to register for resale the Common Stock to be issued upon conversion of the Series D Preferred Stock, within 90 calendar days after the closing of the Private Placement, and to used commercially reasonable efforts to cause such registration statement to be declared effective upon the earlier of (i) the 120th calendar day following March 22, 2013 (or the 150th calendar day following March 22, 2013 in the event that such registration statement is subject to review by the Securities and Exchange Commission) and (ii) the 5th trading day (as defined in the Registration Rights Agreement) after the date the Company is notified (orally or in writing, whichever is earlier) by the Securities and Exchange Commission that such registration statement will not be “reviewed” or will not be subject to further review. Failure to meet these deadlines and certain other events could have resulted in the Company's payment of liquidated damages to the holders of the rights, monthly in the amount of 0.5% of the aggregate purchase price of each holder of the converted Common Stock.

Copies of the form of Securities Purchase Agreements and the form of Registration Rights Agreements were attached to the Company’s Form 8-K filed on March 25, 2013 as Exhibits 10.1 and 10.2, respectively, and are incorporated herein by reference. The foregoing descriptions of the Securities Purchase Agreements, the Registration Rights Agreements and the Certificate of Designation do not purport to be complete and are qualified in their entirety by reference to the full text of the Securities Purchase Agreements, the Registration Rights Agreements and the Certificate of Designation filed as exhibits to this report.

Pursuant to shareholder approval obtained at the Annual Meeting held on May 23, 2013, the Series D Nonvoting Convertible Preferred Stock has been converted to common stock.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not Applicable

ITEM 4. REMOVED AND RESERVED

ITEM 5. OTHER INFORMATION

Not Applicable

ITEM 6. EXHIBITS

(a) Exhibits

Exhibit No.

2.1 Agreement and Plan of merger, dated as of March 2, 2014, between The First Bancshares, Inc. and BCB Holding Company, Inc. (incorporated by reference to Exhibit 2.1 to the Company's Form 8-K filed on 3-7-2014)

2.1 Acquisition Agreement, dated as of January 31, 2013, between The First Bancshares, Inc. and First Baldwin Bancshares, Inc. (incorporated by reference to Exhibit 2.1 to the Company's Form 8-K filed on 2-1-13) and First Amendment to Acquisition Agreement, dated as of March 15, 2013, between First Bancshares, Inc. and First Baldwin Bancshares, Inc. (incorporated by reference to Exhibit 2.1 to the Company's Form 8-K filed on 3-20-13)

3.1 Articles of Amendment and Certificate of Designation, Preferences and Rights of Series D Nonvoting Convertible Preferred Stock dated as of March 18,2013(incorporated by reference to Exhibit 3.1 of the Company's Form 8-K filed on 3-21-13).

3.2 Restated Articles of Incorporation dated as of March 21, 2013 (incorporated by reference to Exhibit 3.2 of the Company's Form 8-K filed on 3-21-13).

4.1 Certificate of Designation of Series D Nonvoting Convertible Preferred Stock, as filed with the Mississippi Secretary of State on March 20, 2013 (incorporated by reference to Exhibit 4.1 to the Company's Form 8-K filed on March 25, 2013).

10.1	Form of Securities Purchase Agreement between the Company and each of the Purchasers, dated as of March 20, 2013 (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed on March 25, 2013)
10.2	Form of Registration Rights Agreement between the Company and each of the Purchasers, dated as of March 20, 2013 (incorporated by reference to Exhibit 10.2 to the Company's Form 8-K filed on March 25, 2013)
31.1	Certification of principal executive officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of principal financial officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of principal executive officer pursuant to 18 U. S. C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of principal financial officer pursuant to 18 U. S. C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS**	XBRL Instance Document
101.SCH**	XBRL Taxonomy Extension Schema
101.CAL**	XBRL Taxonomy Extension Calculation Linkbase
101.DEF**	XBRL Taxonomy Extension Definition Linkbase
101.LAB**	XBRL Taxonomy Extension Label Linkbase
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase

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

(b) The Company filed three reports on Form 8-K during the quarter ended March 31, 2014

SIGNATURES

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

THE FIRST BANCSHARES, INC.
(Registrant)

	/s/	M. RAY (HOPPY)COLE, JR.
May 9, 2014		M. Ray (Hoppy) Cole, Jr.
(Date)		Chief Executive Officer
	/s/	DEEDEE LOWERY
May 9, 2014		DeeDee Lowery, Executive
(Date)		Vice President and Chief Financial Officer

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