## BANCORPSOUTH INC

Form 10-Q
August 07, 2007

# UNITED STATES <br> SECURITIES AND EXCHANGE COMMISSION <br> Washington, D.C. 20549 

FORM 10-Q
(Mark One)

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

For the quarterly period ended June 30, 2007

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

For the transition period from $\qquad$ to

## Commission File Number: 001-12991 <br> BANCORPSOUTH, INC.

(Exact name of registrant as specified in its charter)

$$
\begin{array}{cc}
\text { Mississippi } & \mathbf{6 4 - 0 6 5 9 5 7 1} \\
\text { (State or other jurisdiction of incorporation or } \\
\text { organization) }
\end{array} \quad \text { (I.R.S. Employer Identification No.) }
$$

One Mississippi Plaza, 201 South Spring Street

Tupelo, Mississippi $\quad$| $\mathbf{3 8 8 0 4}$ |
| :---: |
| (Address of principal executive offices) |
| Registrant s telephone number, including area code: $(662) 680-2000$ |

NOT APPLICABLE
(Former name, former address, and former fiscal year, if changed since last report)
Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes p No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check One): Large Accelerated Filer p Accelerated Filer o Non-Accelerated Filer o
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No b
As of July 31, 2007, the registrant had outstanding $82,157,468$ shares of common stock, par value $\$ 2.50$ per share.

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## FORWARD-LOOKING STATEMENTS

Certain statements contained in this Report may not be based on historical facts and are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements may be identified by reference to a future $\operatorname{period}(s)$ or by the use of forward-looking terminology, such as anticipate, believe, estimate, expect, foresee, might, will, intend, could, would or plan, or future or conditional verb tenses, and variations or negatives of s terms. These forward-looking statements include, without limitation, those relating to the Company s net interest margin, payment of dividends, prepayment of Junior Subordinated Debt Securities, unrecognized tax benefits, effective tax rates, credit losses, valuation of mortgage servicing rights, operating results, key indicators of the Company s financial performance (such as return on average assets and return on average shareholders equity), capital resources, liquidity needs and strategies, future acquisitions to further the Company s business strategies, the effect of certain legal claims, the impact of federal and state regulatory requirements for capital, additional share repurchases under the Company s stock repurchase program, diversification of the Company s revenue stream, the impact of recent accounting pronouncements and the Company $s$ future growth and profitability. We caution you not to place undue reliance on the forward-looking statements contained in this report, in that actual results could differ materially from those indicated in such forward-looking statements as a result of a variety of factors. These factors include, but are not limited to, the ability of the Company to increase noninterest revenue and expand noninterest revenue business, the ability of the Company to fund growth with lower cost liabilities, the ability of the Company to maintain credit quality, the ability of the Company to provide and market competitive services and products, the ability of the Company to diversify revenue, the ability of the Company to attract, train and retain qualified personnel, the ability of
the Company to operate and integrate new technology, changes in consumer preferences, changes in the Company s operating or expansion strategy, changes in economic conditions and government fiscal and monetary policies, legislation and court decisions related to the amount of damages recoverable in legal proceedings, fluctuations in prevailing interest rates and the effectiveness of the Company s interest rate hedging strategies, the ability of the Company to balance interest rate, credit, liquidity and capital risks, the ability of the Company to collect amounts due under loan agreements and attract deposits, laws and regulations affecting financial institutions in general, the ability of the Company to identify and effectively integrate potential acquisitions, the ability of the Company to manage its growth and effectively serve an expanding customer and market base, geographic concentrations of the Company s assets and susceptibility to economic downturns in that area, availability of and costs associated with maintaining and/or obtaining adequate and timely sources of liquidity, the ability of the Company to compete with other financial services companies, the ability of the Company to repurchase its common stock on favorable terms, possible adverse rulings, judgments, settlements and other outcomes of pending or threatened litigation, other factors generally understood to affect the financial condition or results of financial services companies and other factors detailed from time to time in the Company s press releases and filings with the Securities and Exchange Commission. We undertake no obligation to update these forward-looking statements to reflect events or circumstances that occur after the date of this report.

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## PART I. <br> FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.
BANCORPSOUTH, INC. AND SUBSIDIARIES
Consolidated Balance Sheets


SHAREHOLDERS EQUITY

| Common stock, $\$ 2.50$ par value per share Authorized | $500,000,000$ |  |  |
| :--- | :---: | :---: | ---: |
| shares, Issued | $82,170,342$ and $79,109,573$ shares, respectively | 205,426 | 197,774 |
| Capital surplus | 100,043 | 113,721 |  |
| Accumulated other comprehensive loss | $(26,270)$ | $(24,742)$ |  |
| Retained earnings | 771,081 | 739,832 |  |
| TOTAL SHAREHOLDERS |  |  | $1,026,585$ |
| EQUITY | $1,140,280$ |  | $12,040,521$ |

(1) Derived from audited financial statements.
See accompanying notes to consolidated financial statements.

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INTEREST REVENUE:
Loans and leases
Deposits with other banks
Federal funds sold and securities purchased under agreement to resell
Held-to-maturity securities:
Taxable
Tax-exempt
Available-for-sale securities:
Taxable
Tax-exempt
Loans held for sale
Total interest revenue

INTEREST EXPENSE:
Deposits:

| Interest bearing demand | 21,992 | 14,613 | 41,879 | 28,402 |
| :--- | ---: | ---: | ---: | ---: |
| Savings | 2,481 | 2,044 | 4,864 | 3,738 |
| Other time | 55,459 | 40,773 | 107,444 | 78,423 |
| Federal funds purchased and securities sold under |  |  |  |  |
| agreement to repurchase | 9,283 | 6,549 | 17,107 | 12,451 |
| Other | 6,682 | 6,182 | 13,075 | 11,120 |
|  |  |  | 184,369 | 134,134 |
| Total interest expense | 95,897 | 70,161 |  | 193,150 |
|  |  |  | 205,326 | $(274)$ |
| Net interest revenue | 106,658 | 97,221 | 9,198 |  |
| Provision for credit losses | 7,843 | 3,586 |  | 193,424 |

NONINTEREST REVENUE:

| Mortgage lending | 5,484 | 3,720 | 7,263 | 6,896 |
| :--- | ---: | ---: | ---: | ---: |
| Credit card, debit card and merchant fees | 7,391 | 6,408 | 14,265 | 12,541 |
| Service charges | 17,677 | 16,323 | 33,073 | 30,615 |
| Trust income | 2,457 | 2,325 | 4,671 | 4,341 |
| Security gains, net | 10 | 10 | 17 | 27 |
| Insurance commissions | 17,665 | 14,841 | 37,459 | 31,162 |
| Other | 9,548 | 9,966 | 21,843 | 20,788 |


| Total noninterest revenue |  | 60,232 |  | 53,600 |  | 118,591 |  | 106,370 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| NONINTEREST EXPENSE: |  |  |  |  |  |  |  |  |
| Salaries and employee benefits |  | 63,851 |  | 58,376 |  | 127,479 |  | 115,949 |
| Occupancy, net of rental income |  | 8,709 |  | 7,759 |  | 17,172 |  | 15,201 |
| Equipment |  | 6,053 |  | 5,822 |  | 12,079 |  | 11,585 |
| Other |  | 27,315 |  | 26,387 |  | 54,808 |  | 51,617 |
| Total noninterest expense |  | 105,928 |  | 98,344 |  | 211,538 |  | 194,352 |
| Income before income taxes |  | 53,119 |  | 48,891 |  | 103,181 |  | 105,442 |
| Income tax expense |  | 17,238 |  | 13,392 |  | 33,723 |  | 32,198 |
| Net income | \$ | 35,881 | \$ | 35,499 | \$ | 69,458 | \$ | 73,244 |
| Earnings per share: Basic | \$ | 0.44 | \$ | 0.45 | \$ | 0.86 | \$ | 0.93 |
| Diluted | \$ | 0.43 | \$ | 0.45 | \$ | 0.86 | \$ | 0.92 |
| Dividends declared per common share | \$ | 0.21 | \$ | 0.20 | \$ | 0.41 | \$ | 0.39 |

See accompanying notes to consolidated financial statements.

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## BANCORPSOUTH, INC. AND SUBSIDIARIES <br> Consolidated Statements of Cash Flows <br> (Unaudited)

|  | Six months ended June 30, |  |
| :---: | :---: | :---: |
|  | 2007 | 2006 |
|  | (In thousands) |  |
| Operating Activities: |  |  |
| Net income | \$ 69,458 | \$ 73,244 |
| Adjustment to reconcile net income to net cash provided by operating activities: |  |  |
| Provision for credit losses | 9,198 | (274) |
| Depreciation and amortization | 13,745 | 12,282 |
| Deferred taxes | 1,173 | $(3,256)$ |
| Amortization of intangibles | 2,406 | 2,388 |
| Amortization of debt securities premium and discount, net | 3,670 | 7,005 |
| Security gains, net | (17) | (27) |
| Net deferred loan origination expense | $(4,093)$ | $(3,612)$ |
| Incremental tax benefit from exercise of stock options | (670) |  |
| Increase in interest receivable | $(2,393)$ | $(4,847)$ |
| Increase in interest payable | 5,599 | 4,233 |
| Realized gain on student loans sold | $(2,158)$ | $(2,477)$ |
| Proceeds from student loans sold | 80,593 | 92,561 |
| Origination of student loans held for sale | $(46,240)$ | $(54,956)$ |
| Realized gain on mortgages sold | $(5,162)$ | $(3,128)$ |
| Proceeds from mortgages sold | 407,978 | 260,648 |
| Origination of mortgages held for sale | $(421,911)$ | $(269,635)$ |
| Increase in bank-owned life insurance | $(3,406)$ | $(3,045)$ |
| Other, net | $(27,681)$ | $(14,899)$ |
| Net cash provided by operating activities | 80,089 | 92,205 |
| Investing activities: |  |  |
| Proceeds from calls and maturities of held-to-maturity securities | 79,043 | 241,024 |
| Proceeds from calls and maturties of available-for-sale securities | 302,399 | 177,541 |
| Proceeds from sales of available-for-sale and trading securities |  | 250 |
| Purchases of held-to-maturity securities | $(141,788)$ | $(521,339)$ |
| Purchases of available-for-sale securities | $(388,836)$ | $(103,476)$ |
| Net decrease in short-term investments | 125,871 | 305,350 |
| Net increase in loans and leases | $(322,640)$ | $(202,804)$ |
| Purchases of premises and equipment | $(15,030)$ | $(30,244)$ |
| Proceeds from sale of premises and equipment | 667 | 467 |
| Net cash paid for acquisitions | $(59,862)$ | $(3,688)$ |
| Other, net | $(1,243)$ | 2,268 |
| Net cash used in investing activities | $(421,419)$ | $(134,651)$ |
| Financing activities: |  |  |
| Net increase (decrease) in deposits | 123,927 | $(51,024)$ |


| Net increase in short-term debt and other liabilities | 129,386 | 100,106 |
| :--- | :---: | :---: |
| Repayment of long-term debt | $(9,561)$ | $(749)$ |
| Issuance of common stock | 4,339 | 4,009 |
| Purchase of common stock | $(10,846)$ | $(10,143)$ |
| Incremental tax benefit from exercise of stock options | $(32,994)$ | $(39,716)$ |
| Payment of cash dividends | 204,921 | 2,483 |
| Net cash provided by financing activities |  |  |
|  | $(136,409)$ | $(39,963)$ |
| Decrease in cash and cash equivalents | 451,451 | 468,468 |
| Cash and cash equivalents at beginning of period | $\$ 315,042$ | $\$ 428,505$ |

See accompanying notes to consolidated financial statements.

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## BANCORPSOUTH, INC. AND SUBSIDIARIES <br> Notes to Consolidated Financial Statements (Unaudited) <br> \section*{NOTE 1 BASIS OF FINANCIAL STATEMENT PRESENTATION AND PRINCIPLES OF CONSOLIDATION}

The accompanying unaudited interim consolidated financial statements of BancorpSouth, Inc. (the Company ) have been prepared in conformity with accounting principles generally accepted in the United States of America and follow general practices within the industries in which the Company operates. For further information, refer to the audited consolidated financial statements and footnotes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2006. In the opinion of management, all adjustments necessary for a fair presentation of the consolidated financial statements have been included and all such adjustments were of a normal recurring nature. The results of operations for the three-month and six-month periods ended June 30, 2007 are not necessarily indicative of the results to be expected for the full year. Certain 2006 amounts have been reclassified to conform with the 2007 presentation. Also, beginning March 1, 2007, the financial statements include the accounts of The Signature Bank. See Note 12, Business Combinations, for further information regarding The Signature Bank.
The consolidated financial statements include the accounts of the Company, its wholly-owned subsidiaries as of June 30, 2007, The Signature Bank (which merged with and into BancorpSouth Bank effective July 1, 2007), BancorpSouth Bank and Risk Advantage, Inc., and BancorpSouth Bank s wholly-owned subsidiaries, Century Credit Life Insurance Company, Personal Finance Corporation of Tennessee, BancorpSouth Insurance Services, Inc., BancorpSouth Investment Services, Inc. and BancorpSouth Municipal Development Corporation.

## NOTE 2 LOANS AND LEASES

The composition of the loan and lease portfolio by collateral type as of the dates indicated was as follows:

|  | 2007 |  | $\begin{gathered} 2006 \\ \text { (In } \\ \text { nousands) } \end{gathered}$ | $\begin{gathered} \text { December } \\ 31, \\ 2006 \end{gathered}$ |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Commercial and agricultural | \$ 1,250,113 | \$ | 946,720 | \$ | 968,915 |
| Consumer and installment | 391,075 |  | 392,225 |  | 388,212 |
| Real estate mortgage: |  |  |  |  |  |
| One-to-four family | 2,540,356 |  | 2,609,658 |  | 2,690,893 |
| Other | 4,275,168 |  | 3,302,585 |  | 3,514,598 |
| Lease financing | 292,752 |  | 322,643 |  | 312,313 |
| Other | 262,898 |  | 37,646 |  | 42,592 |
| Total | \$ 9,012,362 | \$ | 7,611,477 | \$ | 7,917,523 |

The following table presents information concerning non-performing loans as of the dates indicated:

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|  | 2007 | 3 | 006 <br> (In <br> sands) | $\begin{gathered} \text { December } \\ 31, \\ 2006 \end{gathered}$ |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Non-accrual loans | \$ 9,135 | \$ | 6,391 | \$ | 6,603 |
| Loans 90 days or more past due | 13,706 |  | 15,819 |  | 15,282 |
| Restructured loans | 1,066 |  | 2,181 |  | 1,571 |
| Total non-performing loans | \$ 23,907 | \$ | 24,391 | \$ | 23,456 |

## NOTE 3 ALLOWANCE FOR CREDIT LOSSES

The following table summarizes the changes in the allowance for credit losses for the periods indicated:

| Six months ended | Year ended <br> December |
| :---: | :---: |
| 2007 | June 30, |
| 2006 | 2006 |
| (In |  |
| thousands) |  |


| Balance at beginning of period | $\$ 98,834$ | $\$$ | 101,500 | $\$$ | 101,500 |
| :--- | :---: | :---: | :---: | :---: | ---: |
| Provision charged to expense | 9,198 |  | $(274)$ | 8,577 |  |
| Recoveries | 1,840 |  | 1,872 | 4,860 |  |
| Loans and leases charged off | $(6,682)$ |  | $(6,834)$ | $(16,103)$ |  |
| Acquisition | 6,138 |  |  |  |  |
|  |  |  |  |  |  |
| Balance at end of period | $\$ 109,328$ | $\$$ | 96,264 | $\$$ | 98,834 |

## NOTE 4 SECURITIES

The following table summarizes information pertaining to temporarily impaired held-to-maturity and available-for-sale securities with continuous unrealized loss positions at June 30, 2007:

| Continuous Unrealized Loss Position |  |  |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Less Than | 12 Months | 12 Months or Longer |  | Total |  |  |  |  |  |  |  |  |
| Fair | Unrealized | Fair | Unrealized | Fair | Unrealized |  |  |  |  |  |  |  |
| Value | Losses | Value | Losses | Value | Losses |  |  |  |  |  |  |  |
|  |  | (In thousands) |  |  |  |  |  |  |  |  |  |  |

## Held-to-maturity

 securities:| U.S. Treasury | $\$$ | $\$$ |  | $\$ 5,009$ | $\$$ | 2 | $\$$ | 5,009 | $\$$ |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| U.S. Government agencies | 561,518 |  | 5,102 | 886,228 |  | 17,661 | $1,447,746$ | 22,763 |  |
| Obligations of states and <br> political subdivisions | 68,358 |  | 1,060 | 64,165 |  | 1,252 | 132,523 |  | 2,312 |
| Total | $\$ 629,876$ | $\$$ | 6,162 | $\$ 955,402$ | $\$ 18,915$ | $\$ 1,585,278$ | $\$$ | 25,077 |  |


| Available-for-sale |  |  |  |  |  |  |  |  |  |  |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| securities: |  |  |  |  |  |  |  |  |  |  |
| U.S. Government agencies <br> Obligations of states and <br> political subdivisions | $\$ 318,363$ | $\$$ | 4,411 | $\$ 592,325$ | $\$$ | 15,698 | $\$$ | 910,688 | $\$$ | 20,109 |
| Other | 2,992 |  | 37 | 4,536 |  | 90 |  | 7,528 | 127 |  |
| Total | 7,920 |  | 80 |  |  |  |  | 7,920 | 80 |  |
|  | $\$ 329,275$ | $\$$ | 4,528 | $\$ 596,861$ | $\$$ | 15,788 | $\$$ | 926,136 | $\$$ | 20,316 |

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Based upon review of the credit quality of these securities, the ability and intent to hold these securities for a period of time sufficient for recovery of costs and the volatility of their market price, the impairments related to these securities were determined to be temporary.

## NOTE 5 PER SHARE DATA

The computation of basic earnings per share ( EPS ) is based on the weighted average number of shares of common stock outstanding. The computation of diluted earnings per share is based on the weighted average number of shares of common stock outstanding plus the shares resulting from the assumed exercise of all outstanding share-based awards using the treasury stock method.
The following tables provide a reconciliation of the numerators and denominators of the basic and diluted earnings per share computations for the periods shown:

|  | Three months ended June 30, |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  | 2007 | Per | 2006 | Per |
| Income | Shares | Share | Income | Shares |$c$| Share |
| :---: |
| (Numerator) | | (Denominator) | Amount |
| :---: | :---: |$\quad$ (Numerator) | (Denominator) | Amount |
| :---: | :---: |

## Basic EPS

Income available to common shareholder

Effect of dilutive sharebased awards

365 388

## Diluted EPS

Income available to common shareholders plus assumed exercise of all outstanding share-based awards \$ 35,88 82,170
\$ 0.44
\$ 35,499 79,147
\$ 0.45

| share-based awards | $\$ 35,881$ | 82,535 | $\$$ | 0.43 | $\$ 35,499$ | 79,535 | $\$$ | 0.45 |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |


| Six months ended June 30, |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
| 2007 |  | 2006 |  |  |  |
|  |  | Per |  |  | Per |
| Income | Shares | Share | Income | Shares | Share |
| (Numerator) | (Denominator) | Amount | (Numerator) | (Denominator) | Amount |
|  | (In th | ands, exc | t per share am | ounts) |  |

## Basic EPS

Income available to $\begin{array}{lllllllll}\text { common shareholders } & \$ 69,458 & 80,813 & \$ & 0.86 & \$ 73,244 & 79,179 & \$ & 0.93\end{array}$

Effect of dilutive stock
options

## Diluted EPS

$$
\begin{array}{llllllll}
\$ 69,458 & 81,214 & \$ & 0.86 & \$ 73,244 & 79,540 & \$ & 0.92
\end{array}
$$

Income available to
common shareholders
plus assumed exercise

## NOTE 6 COMPREHENSIVE INCOME

The following tables present the components of other comprehensive income and the related tax effects allocated to each component for the periods indicated:

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|  | Three months ended June 30, |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Before tax amount | 2007 <br> Tax (expense) benefit |  | Net of tax amount (In tho | $\begin{aligned} & \text { Before } \\ & \text { tax } \\ & \text { amount } \\ & \text { ands) } \end{aligned}$ | $\begin{gathered} 2006 \\ \text { Tax } \\ \text { (expense) } \\ \text { benefit } \end{gathered}$ |  | Net of tax amount |
| Unrealized gains on available-for- sale securities: |  |  |  |  |  |  |  |  |
| Less: Reclassification adjustment for net (gains) losses realized in net income | (10) |  | 4 | (6) | (3) |  | 1 | (2) |
| Minimum pension liability | 985 |  | (377) | 608 |  |  |  |  |
| Other comprehensive (loss) income | \$ $(5,103)$ | \$ | 1,953 | \$ $(3,150)$ | \$ $(6,238)$ | \$ | 2,388 | \$ $(3,850)$ |
| Net income |  |  |  | 35,881 |  |  |  | 35,499 |
| Comprehensive income |  |  |  | \$32,731 |  |  |  | \$ 31,649 |
|  | Six months ended June 30, |  |  |  |  |  |  |  |
|  | $\begin{aligned} & \text { Before } \\ & \text { tax } \\ & \text { amount } \end{aligned}$ |  | 2007 <br> Tax <br> pense) <br> nefit | Net of tax amount (In th | Before tax amount ands) |  | 2006 <br> Tax <br> xpense) <br> enefit | Net of $\operatorname{tax}$ amount |
| Unrealized gains on available-for- sale securities: |  |  |  |  |  |  |  |  |
| Unrealized (losses) gains arising during holding period | \$ $(3,452)$ | \$ | 1,322 | \$ $(2,130)$ | \$ $(7,315)$ | \$ | 2,801 | \$ $(4,514)$ |
| Less: Reclassification adjustment for net (gains) losses realized in net income | (10) |  | 4 | (6) | (11) |  | 4 | (7) |
| Minimum pension liability | 985 |  | (377) | 608 |  |  |  |  |
| Other comprehensive (loss) income | \$ $(2,477)$ | \$ | 949 | \$ $(1,528)$ | \$ $(7,326)$ | \$ | 2,805 | \$ $(4,521)$ |
| Net income |  |  |  | 69,458 |  |  |  | 73,244 |
| Comprehensive income |  |  |  | \$ 67,930 |  |  |  | \$ 68,723 |

NOTE 7 JUNIOR SUBORDINATED DEBT SECURITIES

In 2002, the Company issued $\$ 128,866,000$ in $8.15 \%$ Junior Subordinated Debt Securities to BancorpSouth Capital Trust I (the Trust ), a business trust. The Trust used the proceeds from the issuance of five million shares of 8.15\% trust preferred securities, $\$ 25$ face value per share, to acquire the Junior Subordinated Debt Securities. Both the Junior Subordinated Debt Securities and the trust preferred securities mature on January 28, 2032 and are callable at the option of the Company after January 28, 2007.
Pursuant to the merger with Business Holding Corporation on December 31, 2004, the Company assumed the liability for $\$ 6,186,000$ in Junior Subordinated Debt Securities issued to Business Holding Company Trust I, a statutory trust. Business Holding Company Trust I used the proceeds from the issuance of 6,000 shares of trust preferred securities to acquire the Junior Subordinated Debt Securities. Both the Junior Subordinated Debt Securities and the trust preferred securities mature on April 7, 2034, and are callable at the option of the Company, in whole or in part, on any January 7, April 7, July 7, or October 7 on or after April 7, 2009. The Junior Subordinated Debt Securities and the trust preferred securities pay a per annum rate of interest, reset quarterly, equal to the three-month London Interbank Offered Rate ( LIBOR ) plus 2.80\% from January 30, 2004 to April 7, 2009 and thereafter at LIBOR plus $2.85 \%$. Pursuant to the merger with Premier Bancorp, Inc. on December 31, 2004, the Company assumed the liability for $\$ 3,093,000$ in Junior Subordinated Debt Securities issued to Premier Bancorp Capital Trust I, a statutory trust. Premier Bancorp Capital Trust I used the proceeds from the issuance of 3,000 shares of trust preferred securities to acquire the Junior Subordinated Debt Securities. Both the Junior Subordinated Debt Securities and the trust preferred securities mature on November 7, 2032, and are callable at the option of the Company, in whole or in part,

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on any February 7, May 7, August 7 or November 7 on or after November 7, 2007. The Junior Subordinated Debt Securities and the trust preferred securities pay a per annum rate of interest, reset quarterly, equal to the three-month LIBOR plus $3.45 \%$.
Pursuant to the merger with American State Bank Corporation on December 1, 2005, the Company assumed the liability for $\$ 6,702,000$ in Junior Subordinated Debt Securities issued to American State Capital Trust I, a statutory trust. American State Capital Trust I used the proceeds from the issuance of 6,500 shares of trust preferred securities to acquire the Junior Subordinated Debt Securities. Both the Junior Subordinated Debt Securities and the trust preferred securities mature on April 7, 2034, and are callable at the option of the Company, in whole or in part, on any July 7, October 7, January 7 or April 7 on or after April 7, 2009. The Junior Subordinated Debt Securities and the trust preferred securities pay a per annum rate of interest, reset quarterly, equal to the three-month LIBOR plus $2.80 \%$. Pursuant to the merger with City Bancorp on March 1, 2007, the Company assumed the liability for $\$ 8,248,000$ in Junior Subordinated Debt Securities issued to Signature Bancshares Preferred Trust I, a statutory trust. Signature Bancshares Preferred Trust I used the proceeds from the issuance of 8,000 shares of trust preferred securities to acquire the Junior Subordinated Debt Securities. Both the Junior Subordinated Debt Securities and the trust preferred securities mature on October 8, 2033, and are callable at the option of the Company, in whole or in part, on any January 8, April 8, July 8 or October 8 on or after October 8, 2008. The Junior Subordinated Debt Securities and the trust preferred securities pay a per annum rate of interest, reset quarterly, equal to the three-month LIBOR plus $3.00 \%$. Pursuant to the merger with City Bancorp on March 1, 2007, the Company also assumed the liability for $\$ 10,310,000$ in Junior Subordinated Debt Securities issued to City Bancorp Preferred Trust I, a statutory trust. City Bancorp Preferred Trust I used the proceeds from the issuance of 10,000 shares of trust preferred securities to acquire the Junior Subordinated Debt Securities. Both the Junior Subordinated Debt Securities and the trust preferred securities mature on March 15, 2035, and are callable at the option of the Company, in whole or in part, on any March 15, June 15, September 15, or December 15 on or after March 15, 2010. The Junior Subordinated Debt Securities and the trust preferred securities pay a per annum rate of interest, reset quarterly, equal to the three-month LIBOR plus $2.2 \%$.
NOTE 8 GOODWILL AND OTHER INTANGIBLE ASSETS
The changes in the carrying amount of goodwill by operating segment for the six months ended June 30,2007 were as follows:

|  | Community Banking | General Corporate and Other (In thousands) | Total |
| :---: | :---: | :---: | :---: |
| Balance as of December 31, 2006 | \$ 105,083 | \$ 38,635 | \$ 143,718 |
| Goodwill acquired during the period | 105,708 |  | 105,708 |
| Balance as of June 30, 2007 | \$ 210,791 | \$ 38,635 | \$ 249,426 |

The following tables present information regarding the components of the Company s identifiable intangible assets for the dates and periods indicated:

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|  | $\begin{gathered} \text { As of } \\ \text { June } 30,2007 \end{gathered}$ |  |  | As of December 31, 2006 |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Gross Carrying Amount | $\begin{aligned} & \text { Acc } \\ & \text { Am } \end{aligned}$ | mulated <br> rtization <br> (In thousa | Gross <br> Carrying <br> Amount <br> ands) | Accumulated Amortization |  |
| Amortized intangible assets: |  |  |  |  |  |  |
| Core deposit intangibles | \$ 27,888 | \$ | 13,031 | \$ 20,699 | \$ | 11,706 |
| Customer relationship intangibles | 23,164 |  | 11,490 | 23,164 |  | 10,412 |
| Non-solicitation intangibles | 65 |  | 61 | 65 |  | 57 |
| Total | \$ 51,117 | \$ | 24,582 | \$ 43,928 | \$ | 22,175 |
| Unamortized intangible assets: |  |  |  |  |  |  |
| Trade names | \$ 688 | \$ |  | \$ 688 | \$ |  |
|  | Three months ended June 30, |  |  | Six months ended June 30, |  |  |
|  |  | 2007 | 2006 | 2007 |  | 2006 |
|  | (In thousands) |  |  |  |  |  |
| Aggregate amortization expense for: |  |  |  |  |  |  |
| Core deposit intangibles |  | 811 | \$ 557 | \$ 1,325 |  | \$ 1,139 |
| Customer relationship intangibles |  | 527 | 619 | 1,078 |  | 1,244 |
| Non-solicitation intangibles |  | 2 | 8 | 4 |  | 16 |
| Total | \$ 1,340 |  | \$ 1,184 | \$ 2,407 |  | \$ 2,399 |

The following table presents information regarding estimated amortization expense on the Company s amortizable identifiable intangible assets for the year ended December 31, 2007 and the succeeding four years:

| Core | Customer | Non- |  |
| :---: | :---: | :---: | ---: |
| Deposit <br> Intangibles | Relationship <br> Intangibles <br> (In thousands) | Solicitation <br> Intangibles | Total |
|  |  |  |  |
| $\$ 2,791$ | $\$ 2,048$ | $\$ 8$ | $\$ 4,847$ |
| 2,513 | 1,782 |  | 4,295 |
| 2,236 | 1,555 |  | 3,791 |
| 1,835 | 1,360 |  | 3,195 |
| 1,544 | 1,194 |  | 2,738 |

Estimated Amortization Expense:
For year ended December 31, 2007
For year ended December 31, 2008
For year ended December 31, 2009
For year ended December 31, 2010
For year ended December 31, 2011
NOTE 9 PENSION BENEFITS
The following table presents the components of net periodic benefit costs for the periods indicated:

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## NOTE 10 RECENT PRONOUNCEMENTS

In February 2006, Statement of Financial Accounting Standards ( SFAS ) No. 155, Accounting for Certain Hybrid Financial Instruments, an amendment of Financial Accounting Standards Board ( FASB ) Statements No. 133 and 140, was issued. SFAS No. 155 permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS No. 133, establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives and amends SFAS No. 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. SFAS No. 155 is effective for all financial instruments acquired or issued after the beginning of an entity s first fiscal year that begins after September 15, 2006. The adoption of SFAS No. 155 has had no material impact on the financial position or results of operations of the Company.
In September 2006, SFAS No. 157, Fair Value Measurements, was issued. SFAS No. 157 establishes a framework for measuring fair value in accordance with generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Company is currently evaluating the impact that the adoption of SFAS No. 157 will have on the financial position of the Company.
In September, 2006, the Emerging Issues Task Force reached a final consensus on Issue No. 06-4 ( EITF 06-4 ),
Accounting for the Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements. EITF $06-4$ requires employers to recognize a liability for future benefits provided through endorsement split-dollar life insurance arrangements that extend into postretirement periods in accordance with SFAS No. 106, Employers Accounting for Postretirement Benefits Other Than Pensions or APB Opinion No. 12, Omnibus Opinion 1967. EITF 06-4 is effective for fiscal years beginning after December 15, 2007. Entities should recognize the effects of applying this Issue through either (a) a change in accounting principle through a cumulative-effect adjustment to retained earnings or to other components of equity or net assets in the statement of financial position as of the beginning of the year of adoption or (b) a change in accounting principle through retrospective application to all prior periods. The Company is currently evaluating the impact that the adoption of EITF 06-4 will have on the financial position of the Company.
In February, 2007, SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, was issued. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact that the adoption of SFAS No. 159 will have on the financial position of the Company.

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## NOTE 11 ADOPTION OF FIN 48

The Company files income tax returns in the U.S. federal jurisdiction and various states jurisdictions. With a few exceptions, the Company is no longer subject to U.S. federal or state and local income tax examinations by tax authorities for years before 2003. However, taxing authorities have the ability to review prior tax years to the extent of tax attributes carrying forward to the open tax years.
The Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, ( FIN 48 ) on January 1, 2007. As a result of the implementation of FIN 48, the Company recognized an approximate $\$ 355,000$ increase in the liability for unrecognized tax benefits. The total balance of unrecognized tax benefits at January 1, 2007 was approximately $\$ 540,000$. The Company does not expect that unrecognized tax benefits will significantly increase or decrease within the next 12 months.
The Company recognizes accrued interest related to unrecognized tax benefits and penalties in other noninterest expense. The Company had recognized approximately $\$ 185,000$ for the payment of interest accrued and penalties at January 1, 2007. The adoption of FIN 48 had no impact on the Company s retained earnings.

## NOTE 12 BUSINESS COMBINATIONS

On March 1, 2007, City Bancorp, a bank holding company with approximately $\$ 850$ million in assets headquartered in Springfield, Missouri, merged with and into the Company. As a result of the merger, City Bancorp s subsidiary, The Signature Bank, became a subsidiary of the Company. Consideration paid to complete this transaction consisted of $3,279,484$ shares of the Company s common stock in addition to cash paid to City Bancorp s shareholders in the aggregate amount of approximately $\$ 82.5$ million. This transaction was accounted for as a purchase. This acquisition was not material to the financial position or results of operations of the Company. Effective July 1, 2007, The Signature Bank merged with and into BancorpSouth Bank.

## NOTE 13 SEGMENT REPORTING

The Company s principal activity is community banking, which includes providing a full range of deposit products, commercial loans and consumer loans. The general corporate and other operating segment includes leasing, mortgage lending, trust services, credit card activities, insurance services, investment services and other activities not allocated to community banking.
Results of operations and selected financial information by operating segment for the three-month and six-month periods ended June 30, 2007 and 2006 were as follows:

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|  | Community Banking |  | General Corporate and Other (In thousands) |  | Total |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Three months ended June 30, 2007: |  |  |  |  |  |  |
| Net interest revenue | \$ | 97,330 | \$ | 9,328 | \$ | 106,658 |
| Provision for credit losses |  | 7,850 |  | (7) |  | 7,843 |
| Net interest revenue after provision for credit losses |  | 89,480 |  | 9,335 |  | 98,815 |
| Noninterest revenue |  | 31,345 |  | 28,887 |  | 60,232 |
| Noninterest expense |  | 71,877 |  | 34,051 |  | 105,928 |
| Income before income taxes |  | 48,948 |  | 4,171 |  | 53,119 |
| Income taxes |  | 15,884 |  | 1,354 |  | 17,238 |
| Net income | \$ | 33,064 | \$ | 2,817 | \$ | 35,881 |
| Selected Financial Information |  |  |  |  |  |  |
| Total assets (at end of period) |  | 1,053,648 |  | 155,445 |  | 3,209,093 |
| Depreciation and amortization |  | 6,920 |  | 1,375 |  | 8,295 |
| Three months ended June 30, 2006: |  |  |  |  |  |  |
| Results of Operations |  |  |  |  |  |  |
| Net interest revenue | \$ | 88,274 | \$ | 8,947 | \$ | 97,221 |
| Provision for credit losses |  | 3,566 |  | 20 |  | 3,586 |
| Net interest revenue after provision for credit losses |  | 84,708 |  | 8,927 |  | 93,635 |
| Noninterest revenue |  | 28,505 |  | 25,095 |  | 53,600 |
| Noninterest expense |  | 66,485 |  | 31,859 |  | 98,344 |
| Income before income taxes |  | 46,728 |  | 2,163 |  | 48,891 |
| Income taxes |  | 12,800 |  | 592 |  | 13,392 |
| Net income | \$ | 33,928 | \$ | 1,571 | \$ | 35,499 |
| Selected Financial Information |  |  |  |  |  |  |
| Total assets (at end of period) | \$ | 9,847,381 |  | 984,864 |  | 1,832,245 |
| Depreciation and amortization |  | 5,990 |  | 1,314 |  | 7,304 |
|  |  |  |  |  |  |  |

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|  | Community Banking |  | General <br> Corporate and Other (In thousands) |  | Total |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Six months ended June 30, 2007: |  |  |  |  |  |  |
| Net interest revenue | \$ | 185,833 | \$ | 19,493 | \$ | 205,326 |
| Provision for credit losses |  | 9,193 |  | 5 |  | 9,198 |
| Net interest revenue after provision for credit losses |  | 176,640 |  | 19,488 |  | 196,128 |
| Noninterest revenue |  | 60,002 |  | 58,589 |  | 118,591 |
| Noninterest expense |  | 138,873 |  | 72,665 |  | 211,538 |
| Income before income taxes |  | 97,769 |  | 5,412 |  | 103,181 |
| Income taxes |  | 31,954 |  | 1,769 |  | 33,723 |
| Net income | \$ | 65,815 | \$ | 3,643 | \$ | 69,458 |
| Selected Financial Information |  |  |  |  |  |  |
| Total assets (at end of period) | \$ | 11,053,648 | \$ | 2,155,445 | \$ | 13,209,093 |
| Depreciation and amortization |  | 13,352 |  | 2,812 |  | 16,164 |
| Six months ended June 30, 2006: |  |  |  |  |  |  |
| Results of Operations |  |  |  |  |  |  |
| Net interest revenue | \$ | 175,215 | \$ | 17,935 | \$ | 193,150 |
| Provision for credit losses |  | (294) |  | 20 |  | (274) |
| Net interest revenue after provision for credit losses |  | 175,509 |  | 17,915 |  | 193,424 |
| Noninterest revenue |  | 53,144 |  | 53,226 |  | 106,370 |
| Noninterest expense |  | 127,583 |  | 66,769 |  | 194,352 |
| Income before income taxes |  | 101,070 |  | 4,372 |  | 105,442 |
| Income taxes |  | 30,863 |  | 1,335 |  | 32,198 |
| Net income | \$ | 70,207 | \$ | 3,037 | \$ | 73,244 |
| Selected Financial Information |  |  |  |  |  |  |
| Total assets (at end of period) | \$ | 9,847,381 | \$ | 1,984,864 | \$ | 11,832,245 |
| Depreciation and amortization |  | 12,082 |  | 2,636 |  | 14,718 |

## NOTE 14 MORTGAGE SERVICING RIGHTS

The Company recognizes mortgage servicing rights ( MSRs ) based on the fair value of the servicing right on the date the corresponding mortgage loan is sold. In determining the fair value of the MSRs, the Company utilizes the expertise of an independent third party. An estimate of the fair value of the Company s MSRs is determined by the independent third party utilizing assumptions about factors such as mortgage interest rates, discount rates, mortgage loan prepayment speeds, market trends and industry demand. This estimate and the assumptions used are reviewed by management. Because the valuation is determined by using discounted cash flow models, the primary risk inherent in valuing the MSRs is the impact of fluctuating interest rates on the estimated life of the servicing revenue stream. The use of different estimates or assumptions could also produce different fair values. The Company does not hedge the
change in fair value of MSRs and, therefore, the Company is susceptible to significant fluctuations in the fair value of its MSRs in changing interest rate environments.
The Company has one class of mortgage servicing asset comprised of closed end loans for one-to-four family residences, secured by first liens. The following table presents the activity in this class for the periods indicated:

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Fair value as of January 1
Additions:
Origination of servicing assets
Changes in fair value:
Due to change in valuation inputs or assumptions used in the valuation model
Other changes in fair value
Fair value as of June 30

$$
2007
$$

2006
(In thousands)
\$ 35,286 \$ 36,456
2,635
2,991
\$ 37,338
\$ 40,091

All of the changes to the fair value of the MSRs are recorded as part of mortgage lending noninterest revenue on the income statement. As part of mortgage lending noninterest revenue, the Company recorded contractual servicing fees of $\$ 2.02$ million and $\$ 2.02$ million and servicing fees and late and other ancillary fees of approximately $\$ 230,000$ and approximately $\$ 234,000$ for the second quarter ended June 30, 2007 and 2006, respectively. The Company recorded contractual servicing fees of $\$ 4.05$ million and $\$ 4.03$ million and servicing fees and ancillary fees of approximately $\$ 492,000$ and approximately $\$ 481,000$ for the six months ended June 30, 2007 and 2006, respectively.

## ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS. OVERVIEW

BancorpSouth, Inc. (the Company ) is a regional financial holding company with approximately $\$ 13.2$ billion in assets headquartered in Tupelo, Mississippi. As of June 30, 2007, BancorpSouth Bank, a wholly-owned banking subsidiary, had commercial banking operations in Mississippi, Tennessee, Alabama, Arkansas, Texas, Louisiana and Florida. During the first quarter of 2007, the Company entered the Missouri market through a merger with City Bancorp, a bank holding company headquartered in Springfield, Missouri. City Bancorp s subsidiary, The Signature Bank, operated as a subsidiary of the Company until July 1, 2007, at which time it merged with and into BancorpSouth Bank. BancorpSouth Bank and its consumer finance, credit insurance, insurance agency and brokerage subsidiaries provide commercial banking, leasing, mortgage origination and servicing, insurance, brokerage and trust services to corporate customers, local governments, individuals and other financial institutions through an extensive network of branches and offices. Until its merger with and into BancorpSouth Bank, The Signature Bank separately provided commercial banking, mortgage origination and brokerage services to corporate customers, local governments, individuals and other financial institutions through branches and offices in Springfield and the St. Louis market, which are now provided through BancorpSouth Bank.
Management s discussion and analysis provides a narrative discussion of the Company s financial condition and results of operations. For a complete understanding of the following discussion, you should refer to the unaudited consolidated financial statements for the three-month and six-month periods ended June 30, 2007 and 2006 and the notes to such financial statements found under Part I, Item 1. Financial Statements of this report. This discussion and analysis is based on reported financial information. The information that follows is provided to enhance comparability of financial information between periods and to provide a better understanding of the Company s operations. As a financial holding company, the financial condition and operating results of the Company are heavily influenced by economic trends nationally and in the specific markets in which the Company s subsidiaries provide financial services. Most of the revenue of the Company is derived from the operation of its banking subsidiaries. The financial condition and operating results of the banks are affected by the level and volatility of interest rates on loans, investment securities, deposits and other borrowed funds, and the impact of economic cycles on loan demand and creditworthiness of existing borrowers. The financial services industry is highly competitive and heavily

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regulated. The Company s success depends on its ability to compete aggressively within its markets while maintaining sufficient asset quality and cost controls to generate net income.
The tables below summarize the Company s net income, net income per share, return on average assets and return on average shareholders equity for the three months and six months ended June 30, 2007 and 2006. Management believes these amounts and ratios are key indicators of the Company sfinancial performance.
(Dollars in thousands, except per share amounts)
Net income
Net income per share: Basic
Diluted
Return on average assets (annualized)
Return on average shareholders equity (annualized)

| Three months ended |  |  |  |
| :---: | :---: | :---: | :---: |
| June 30, |  |  |  |
| 20007 | 2006 | \% Change |  |
| $\$ 35,881$ | $\$ 35,499$ | $1.08 \%$ |  |
| $\$$ | 0.44 | $\$$ |  |
| $\$$ | 0.45 | $(2.22)$ |  |
| 0.43 | $\$$ | 0.45 |  |
| $1.11 \%$ | $1.21 \%$ | $(4.44)$ |  |
| $12.82 \%$ | $14.32 \%$ | $(8.26)$ |  |
|  |  |  |  |

(Dollars in thousands, except per share amounts)
Net income
Net income per share: Basic
Diluted
Return on average assets (annualized)
Return on average shareholders equity (annualized)
Net income increased slightly for the three months ended June 30, 2007 2006 and decreased for the six months ended June 30, 2007 compared to the six months ended June 30, 2007. The Company s primary source of revenue, net interest revenue earned by its subsidiary banks, reflected continued positive trends for the three months and six months ended June 30, 2007 compared to the same periods in 2006. Net interest revenue is the difference between interest revenue earned on assets, such as loans, leases and securities, and interest expense paid on liabilities, such as deposits and borrowings. The Company s net interest revenue was positively impacted by increases in interest rates as well as the increased loan demand resulting from favorable economic activity throughout most of its banking subsidiaries markets and the Company s continued focus on funding this growth with maturing investment securities and lower-cost liabilities. These factors combined to increase the Company s net interest revenue to $\$ 106.66$ million for the second quarter of 2007 , a $\$ 9.44$ million, or $9.71 \%$, increase from $\$ 97.22$ million for the second quarter of 2006 , while net interest revenue increased to $\$ 205.33$ million for the first six months of 2007 , a $\$ 12.18$ million, or $6.3 \%$, increase from $\$ 193.15$ million for the first six months of 2006. While the increase in net interest revenue during the second quarter and first six months of 2007 compared to the second quarter and first six months of 2006 positively impacted net income, the provision for credit losses increased in the second quarter and first six months of 2007 compared to the same periods in 2006 , negatively impacting net income. The provision for credit losses was $\$ 7.84$ million for the second quarter of 2007 compared to $\$ 3.59$ million for the second quarter of 2006 and was $\$ 9.20$ million for the first six months of 2007 compared to a negative provision for credit losses of approximately $\$ 274,000$ for the first six months of 2006 . The increase in the provision for credit losses for the second quarter of 2007 was primarily a result of the loan growth experienced during the second quarter of 2007. The increase in the provision for credit losses for the six months ended June 30, 2007 as compared to the six months ended June 30, 2006 was primarily a result of the reduction in credit losses related to Hurricane Katrina in the first quarter of 2006. During the first quarter of 2006, the Company reduced its previous allowance for credit losses related to Hurricane Katrina by $\$ 4.77$ million, as the impact of the hurricane on the Company s customers had been less than originally estimated.
The Company has taken steps to diversify its revenue stream by increasing the amount of revenue received from mortgage lending operations, insurance agency activities, brokerage and securities activities and other activities that

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generate fee income. Management believes this diversification is important to reduce the impact of fluctuations in net interest revenue on the overall operating results of the Company. This diversification strategy resulted in an overall increase in noninterest revenue of $12.37 \%$ for the second quarter 2007, compared to the same period in 2006 and an overall increase of $11.49 \%$ for the first six months of 2007 compared to the first six months of 2006. One of the primary contributors to the increase in noninterest revenue was insurance commissions, which increased $19.03 \%$ for the second quarter of 2007 compared to the same period in 2006 and $20.21 \%$ for the first six months of 2007 compared to the first six months of 2006. The Company s mortgage lending revenue increased $47.42 \%$ during the second quarter of 2007 as compared to the second quarter of 2006 and $5.32 \%$ during the first six months in 2007 compared to the first six months in 2006. The increase in mortgage lending revenue for the second quarter and first six months of 2007 was primarily a result of a $\$ 1.23$ million net increase in the fair value of the Company s mortgage servicing asset during the second quarter of 2007 compared to an approximately $\$ 542,000$ net increase in the fair value of the Company s mortgage servicing asset during the second quarter of 2006.
Annualized net charge-offs decreased to $0.14 \%$ of average loans for the second quarter of 2007 from $0.18 \%$ of average loans for the second quarter of 2006 and to $0.11 \%$ of average loans for the first six months of 2007 compared to $0.13 \%$ of average loans for the first six months of 2006. Noninterest expense totaled $\$ 105.93$ million for the second quarter of 2007 compared to $\$ 98.34$ million for the second quarter of 2006 , an increase of $\$ 7.58$ million, or $7.71 \%$. For the first six months of 2007 and 2006, noninterest expense totaled $\$ 211.54$ million and $\$ 194.35$ million, respectively, representing an increase of $8.84 \%$. The increase in noninterest expense for the second quarter and first six months of 2007 resulted primarily from increased costs related to additional locations and facilities added since June 30, 2006, as well as costs related to the integration and operation of The Signature Bank, acquired by the Company on March 1, 2007. The major components of net income are discussed in more detail in the various sections that follow.

## CRITICAL ACCOUNTING POLICIES

During the three months ended June 30, 2007, there was no significant change in the Company s critical accounting policies and no significant change in the application of critical accounting policies as presented in the Company s annual report on Form 10-K for the year ended December 31, 2006.

## RESULTS OF OPERATIONS

## Net Interest Revenue

Net interest revenue is the difference between interest revenue earned on assets, such as loans, leases and securities, and interest expense paid on liabilities, such as deposits and borrowings, and continues to provide the Company with its principal source of revenue. Net interest revenue is affected by the general level of interest rates, changes in interest rates and changes in the amount and composition of interest earning assets and interest bearing liabilities. The Company s long-term objective is to manage interest earning assets and interest bearing liabilities to maximize net interest revenue, while balancing interest rate, credit, liquidity and capital risks. For purposes of the following discussion, revenue from tax-exempt loans and investment securities has been adjusted to a fully taxable equivalent basis, using an effective tax rate of $35 \%$.
Net interest revenue was $\$ 109.14$ million for the three months ended June 30, 2007, compared to $\$ 99.77$ million for the same period in 2006, representing an increase of $\$ 9.37$ million, or $9.39 \%$. For the first six months of 2007 and 2006, net interest revenue was $\$ 210.32$ million and $\$ 198.11$ million, respectively, representing an increase of $\$ 12.21$, million or $6.16 \%$. The increase in net interest revenue for the second quarter and first six months of 2007 is primarily a result of the acquisition of The Signature Bank during the first quarter of 2007.
Interest revenue increased $\$ 35.10$ million, or $20.66 \%$, to $\$ 205.04$ million for the three months ended June 30, 2007 from $\$ 169.94$ million for the three months ended June 30, 2006. The increase in interest revenue for the three months ended June 30, 2007 is attributable to a $\$ 1.18$ billion, or $11.04 \%$, increase in average interest earning assets to $\$ 11.85$ billion for the second quarter of 2007 from $\$ 10.67$ billion for the second quarter of 2006 and an increase in the yield of those assets of 55 basis points to $6.94 \%$ for the second quarter of 2007 from $6.39 \%$ for the second

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quarter of 2006. The acquisition of The Signature Bank during the first quarter of 2007 contributed $\$ 16.30$ million of the increase in interest revenue for the second quarter of 2007 and $\$ 842.81$ million of the increase in average interest earning assets for the second quarter of 2007 with those assets yielding $7.76 \%$. For the first six months of 2007 and 2006, interest revenue was $\$ 394.69$ million and $\$ 332.25$ million, respectively, representing an increase of $18.79 \%$ with the acquisition of The Signature Bank contributing $\$ 21.64$ million of that increase.
Interest expense increased $\$ 25.74$ million, or $36.68 \%$, to $\$ 95.90$ million for the three months ended June 30, 2007 from $\$ 70.16$ million for the three months ended June 30, 2006. This increase in interest expense is attributable to a larger amount of interest bearing liabilities and a higher average rate paid on those liabilities for the three months ended June 30, 2007 as compared to the three months ended June 30, 2006. Average interest bearing liabilities increased $\$ 1.08$ billion, or $12.17 \%$, to $\$ 9.96$ billion for the second quarter of 2007 from $\$ 8.88$ billion for the second quarter of 2006. The average rate paid on those liabilities also increased 69 basis points to $3.86 \%$ for the second quarter of 2007 from $3.17 \%$ for the second quarter of 2006. The acquisition of The Signature Bank during the first quarter of 2007 contributed $\$ 6.89$ million of the increase in interest expense and $\$ 724.86$ million of the increase in average interest bearing liabilities with the average rate paid on those liabilities totaling $3.81 \%$.
The relative performance of the Company s lending and deposit-raising functions is frequently measured by two calculations net interest margin and net interest rate spread. Net interest margin is determined by dividing fully taxable equivalent net interest revenue by average earning assets. Net interest rate spread is the difference between the average fully taxable equivalent yield earned on interest earning assets (earning asset yield) and the average rate paid on interest bearing liabilities. Net interest margin is generally greater than the net interest rate spread because of the additional income earned on those assets funded by noninterest bearing liabilities, or free funding, such as noninterest bearing demand deposits and shareholders equity.
Net interest margin for the second quarter of 2007 and 2006 was $3.69 \%$ and $3.75 \%$, respectively, representing a decrease of 6 basis points. Net interest margin for the six months ended June 30, 2007 and 2006 was $3.68 \%$ and $3.74 \%$, respectively, representing a decrease of 6 basis points. Net interest rate spread for the second quarter of 2007 was $3.08 \%$, a decrease of 14 basis points from $3.22 \%$ for the same period of 2006 . Net interest rate spread for the first six months of 2007 and 2006 was $3.06 \%$ and $3.23 \%$, respectively, representing a decrease of 17 basis points. The decrease in the net interest rate spread for the second quarter of 2007 as compared to the same period of 2006 was primarily a result of the larger increase in the average rate paid on interest bearing liabilities, from $3.17 \%$ for the second quarter of 2006 to $3.86 \%$ for the second quarter of 2007 , than the increase in the average rate earned on interest earning assets from $6.39 \%$ for the second quarter of 2006 to $6.94 \%$ for the second quarter of 2007 . The decrease in the net interest rate spread for the second quarter of 2007 was partially offset by the interest rate spread contributed by The Signature Bank which was $3.95 \%$. The decrease in the net interest rate spread for the first six months of 2007 as compared to the same period of 2006 was also primarily a result of the larger increase in the average rate paid on interest bearing liabilities, from $3.04 \%$ for the first six months of 2006 to $3.84 \%$ for the first six months of 2007, than the increase in the average rate earned on interest earning assets from $6.27 \%$ for the first six months of 2007 to $6.90 \%$ for the first six months of 2007. While the average rate paid on interest bearing liabilities increased at a larger rate than the average rate earned on interest earning assets, the earning asset yield increase for the second quarter of 2007 was a result of favorable economic activity throughout most of the Company s subsidiary banks markets, resulting in stronger loan demand. The Company has also invested funds from maturing securities in higher rate loans or new higher rate short- and intermediate-term investments. The acquisition of The Signature Bank during the first quarter of 2007 also partially offset the decrease in the net interest rate spread for the six months ended 2007 as compared to the six months ended 2006 as The Signature Bank s net interest rate spread since acquisition was $3.78 \%$.

## Interest Rate Sensitivity

The interest rate sensitivity gap is the difference between the maturity or repricing opportunities of interest sensitive assets and interest sensitive liabilities for a given period of time. A prime objective of the Company sasset/liability management is to maximize net interest margin while maintaining a reasonable mix of interest sensitive assets and liabilities. The following table presents the Company s interest rate sensitivity at June 30, 2007:

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|  | Interest Rate Sensitivity - Maturing or Repricing Opportunities |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | $\begin{gathered} 0 \text { to } 90 \\ \text { Days } \end{gathered}$ |  | 91 Days <br> to One Year (In th | F | Over One Year to Five Years ds) |  | Over Five Years |
| Interest earning assets: |  |  |  |  |  |  |  |  |
| Interest bearing deposits with banks | \$ | 13,143 | \$ |  | \$ |  | \$ |  |
| Federal funds sold and securities purchased under agreement to resell |  | 22,895 |  |  |  |  |  |  |
| Held-to-maturity securities |  | 61,658 |  | 196,058 |  | 1,136,193 |  | 391,559 |
| Available-for-sale and trading securities |  | 153,968 |  | 170,622 |  | 437,965 |  | 376,335 |
| Loans and leases, net of unearned income |  | 4,376,115 |  | 1,691,182 |  | 2,742,106 |  | 156,877 |
| Loans held for sale |  | 85,627 |  |  |  |  |  |  |
| Total interest earning assets |  | 4,713,406 |  | 2,057,862 |  | 4,316,264 |  | 924,771 |
| Interest bearing liabilities: |  |  |  |  |  |  |  |  |
| Interest bearing demand deposits and savings |  | 3,904,077 |  | 8,490 |  |  |  |  |
| Other time deposits |  | 1,383,994 |  | 2,378,205 |  | 1,004,547 |  | 955 |
| Federal funds purchased and securities sold under agreement to repurchase and other short-term FHLB borrowings |  | 1,146,182 |  |  |  |  |  |  |
| Long-term FHLB borrowings and junior subordinated debt securities |  | 324 |  | 52,566 |  | 12,255 |  | 243,406 |
| Other |  | 32 |  | 101 |  | 78 |  | 57 |
| Total interest bearing liabilities |  | 6,434,609 |  | 2,439,362 |  | 1,016,880 |  | 244,418 |
| Interest rate sensitivity gap | \$ | $(1,721,203)$ | \$ | $(381,500)$ |  | 3,299,384 | \$ | 680,353 |
| Cumulative interest sensitivity gap | \$ | $(1,721,203)$ | \$ | $(2,102,703)$ |  | 1,196,681 | \$ | 1,877,034 |

## Provision for Credit Losses and Allowance for Credit Losses

The provision for credit losses is the periodic cost of providing an allowance or reserve for estimated probable losses on loans and leases. The Company s subsidiary banks employ a systematic methodology for determining the allowance for credit losses that considers both qualitative and quantitative factors and requires that management make material estimates and assumptions that are particularly susceptible to significant change. Some of the quantitative factors considered by the banks include loan and lease growth, changes in nonperforming and past due loans and leases, historical loan and lease loss experience, delinquencies, management s assessment of loan and lease portfolio quality, the value of collateral and concentrations of loans and leases to specific borrowers or industries. Some of the qualitative factors that the banks consider include existing general economic conditions and the inherent risks of individual loans and leases.
The allowance for credit losses is based principally upon the banks loan and lease classification system, delinquencies and historic loss rates. The banks have a disciplined approach for assigning credit ratings and classifications to individual credits. Each credit is assigned a grade by the appropriate loan officer, which serves as a basis for the credit analysis of the entire portfolio. The assigned grade reflects the borrower s creditworthiness, collateral values, cash flows and other factors. An independent loan review department is responsible for reviewing the credit rating and
classification of individual credits and assessing trends in the portfolio, adherence to internal credit policies and procedures and other factors that may affect the overall adequacy of the allowance. The loss factors assigned to each classification are based upon the attributes of the loans and leases typically assigned to each grade (such as loan-to-collateral values and borrower creditworthiness). Management periodically reviews the loss factors assigned in light of the general economic environment and overall condition of the loan and lease portfolio and modifies the loss factors assigned to each classification as management deems appropriate. The overall allowance generally includes a component representing the results of other analyses intended to ensure that the

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allowance is adequate to cover other probable losses inherent in the portfolio. This component considers analyses of changes in credit risk resulting from the differing underwriting criteria in acquired loan and lease portfolios, industry concentrations, changes in the mix of loans and leases originated, overall credit criteria and other economic indicators. The Company s provision for credit losses, the allowance for credit losses as a percentage of loans and leases outstanding at June 30, 2007 and 2006, net charge-offs and net charge-offs as a percentage of average loans and leases for the three months and six months ended June 30, 2007 and 2006 are shown in the following table:

|  | Three months ended June 30, |  | \% Change |
| :---: | :---: | :---: | :---: |
|  | 2007 | $2006$ |  |
|  | (Dollars in thousands) |  |  |
| Provision for credit losses | \$7,843 | \$3,586 | 118.71\% |
| Net charge-offs | \$3,195 | \$3,339 | (4.31) |
| Net charge-offs as a percentage of average loans and leases (annualized) | 0.14\% | 0.18\% | (22.22) |
|  | Six months ended June 30, |  |  |
|  | 2007 | 2006 | \% Change |
|  |  | ars in thousands) |  |
| Provision for credit losses | \$9,198 | \$ (274) | NM \% |
| Net charge-offs | \$4,842 | \$4,962 | (2.42) |
| Net charge-offs as a percentage of average loans and leases (annualized) | 0.11\% | 0.13\% | (15.38) |
| Allowance for credit losses as a percentage of loans and leases outstanding at period end | 1.22\% | 1.27\% | (3.94) |

$\mathrm{NM}=$ not meaningful
The increase in the provision for credit losses for the first six months of 2007 compared to the same period of 2006 primarily reflects the $\$ 4.77$ million pre-tax reduction in the allowance for credit losses during the first quarter of 2006 related to Hurricane Katrina s impact on the Mississippi Gulf Coast region. Losses in the area impacted by the hurricane have been less than originally anticipated. The increase in the provision for credit losses for the second quarter of 2007 is a result of the loan growth experienced by the Company as well as some downward migration of loans within the Banks loan and lease credit ratings and classifications.
The breakdown of the allowance by loan and lease category is based, in part, on evaluations of specific loan and lease histories and on economic conditions within specific industries or geographical areas. Accordingly, because all of these conditions are subject to change, the allocation is not necessarily indicative of the breakdown of any future allowance or losses. The following table presents (a) the breakdown of the allowance for credit losses by loan and lease category and (b) the percentage of each category in the loan and lease portfolio to total loans and leases at the dates indicated:

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The following table provides an analysis of the allowance for credit losses for the periods indicated:

| Six months ended | Year ended <br> December |
| :---: | :---: |
| June 30, | 31, |
| 2007 | 2006 |
|  | (Dollars in thousands) |


| Balance, beginning of period | $\$$ | 98,834 | $\$$ | 101,500 |
| :--- | ---: | ---: | ---: | ---: |
| Loans and leases charged off: |  |  |  |  |
| Commercial and agricultural |  |  |  |  |
| Consumer and installment | $(1,564)$ | $(400)$ | $(1,479)$ |  |
| Real estate mortgage | $(3,013)$ | $(2,227)$ | $(5,305)$ |  |
| Lease financing | $(2,105)$ | $(4,026)$ | $(8,790)$ |  |
| Total loans charged off |  | $(181)$ | $(529)$ |  |
|  | $(6,682)$ | $(6,834)$ | $(16,103)$ |  |
| Recoveries: |  |  |  |  |
| Commercial and agricultural | 405 |  |  |  |
| Consumer and installment | 1,041 | 279 | 1,739 |  |
| Real estate mortgage | 367 | 1,324 | 2,401 |  |
| Lease financing | 27 | 263 | 658 |  |
| Total recoveries | 1,840 | 1,872 | 62 |  |
|  |  |  | 4,860 |  |
| Net charge-offs | $(4,842)$ | $(4,962)$ | $(11,243)$ |  |



## Noninterest Revenue

The components of noninterest revenue for the three months and six months ended June 30, 2007 and 2006 and the corresponding percentage changes are shown in the following table:

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|  | Three months ended June 30, |  |  |  | \% <br> Change |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  |  |  |  |
|  | 2007 |  | $2006$ <br> (Dollars in thousands) |  |  |
|  |  |  |  |  |  |
| Mortgage lending |  | \$ 5,484 |  | 3,720 | 47.42\% |
| Credit card, debit card and merchant fees |  | 7,391 |  | 6,408 | 15.34 |
| Service charges |  | 17,677 |  | 16,323 | 8.30 |
| Trust income |  | 2,457 |  | 2,325 | 5.68 |
| Securities gains, net |  | 10 |  | 17 | (41.18) |
| Insurance commissions |  | 17,665 |  | 14,841 | 19.03 |
| Other |  | 9,548 |  | 9,966 | (4.19) |
| Total noninterest revenue |  | \$ 60,232 | \$ | 53,600 | 12.37\% |
|  | Six months ended June 30, |  |  |  |  |
|  | 2007 |  |  |  | \% |
|  |  |  |  | 2006 | Change |
|  |  |  | ars | in thousa |  |
| Mortgage lending | \$ | 7,263 | \$ | 6,896 | 5.32\% |
| Credit card, debit card and merchant fees |  | 14,265 |  | 12,541 | 13.75 |
| Service charges |  | 33,073 |  | 30,615 | 8.03 |
| Trust income |  | 4,671 |  | 4,341 | 7.60 |
| Securities gains, net |  | 17 |  | 27 | (37.04) |
| Insurance commissions |  | 37,459 |  | 31,162 | 20.21 |
| Other |  | 21,843 |  | 20,788 | 5.08 |
| Total noninterest revenue | \$ | 118,591 | \$ | 106,370 | 11.49\% |

The Company s revenue from mortgage lending typically fluctuates as mortgage interest rates change and is primarily attributable to two activities origination and sale of new mortgage loans and servicing mortgage loans. The Company s normal practice is to generate mortgage loans to sell them in the secondary market and to either retain or release the associated MSRs with the loan sold.
Origination revenue, a component of mortgage lending, is comprised of gains or losses from the sale of the mortgage loans originated. Origination volume of $\$ 257.13$ million and $\$ 166.49$ million produced origination revenue of $\$ 2.00$ million and $\$ 928,000$ for the quarters ended June 30, 2007 and 2006, respectively. Origination volume of $\$ 440.06$ million and $\$ 288.80$ million produced origination revenue of $\$ 3.29$ million and $\$ 1.79$ million for the first six months ended June 30, 2007 and 2006, respectively. Increased origination volume for the three months and six months ended June 30, 2007 as compared to the same periods in 2006 resulted in higher origination revenue for the three months and six months ended June 30, 2007 as compared to the same period in 2006.
Revenue from the servicing process, the other component of mortgage lending revenue, includes fees from the actual servicing of loans and the recognition of changes in the valuation of the Company s MSRs. Revenue from the servicing of loans was $\$ 2.25$ million and $\$ 2.25$ million for the quarters ended June 30, 2007 and 2006, respectively. For the six months ended June 30, 2007 and 2006, revenue from the servicing of loans was $\$ 4.54$ million and 4.52 million, respectively. Changes in the fair value of the Company s MSRs are generally a result of changes in mortgage rates from the previous reporting date. The fair value is also impacted by principal payments, prepayments and payoffs on
loans in the servicing portfolio. An increase in mortgage rates typically results in an increase in the fair value of the MSRs while a decrease in mortgage rates typically results in a decrease in the fair value of MSRs. The Company does not hedge the change in fair value of its MSRs and is susceptible to significant fluctuations in their value in changing interest rate environments. Reflecting this sensitivity to interest rates, the fair

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value on MSRs increased $\$ 1.23$ million and approximately $\$ 542,000$ for the quarters ended June 30, 2007 and 2006, respectively. The fair value of MSRs declined approximately $\$ 570,000$ for the six months ended June 30, 2007, while the fair value of MSRs increased approximately $\$ 594,000$ for the six months ended June 30, 2006.
Credit card, debit card and merchant fees increased for the second quarter and six months ending June 30, 2007 when compared to the same periods in 2006 as a result of an increase in the numerical and monetary volume of items processed. Service charges on deposit accounts increased for the second quarter and six months ending June 30, 2007 as compared to the same periods in 2006 because of higher volumes of items processed and growth in the number of deposit accounts. Trust income increased for the comparable three-month and six-month periods as a result of increases in the value of assets custodied at or managed by the banks. The increase in insurance commissions is primarily a result of the increase in policies written since June 30 , 2006, including substantial new business generated in the Mississippi Gulf Coast region, coupled with higher policy premiums.
Contributing to the growth in other noninterest revenue for the first six months of 2007 compared to the first six months of 2006 were increases in corporate analysis charges, check printing fees, brokerage revenue and gains related to sales of fixed assets, with those increases somewhat offset by a gain of approximately $\$ 732,000$ recorded in the second quarter of 2006 related to the redemption of Class B shares of MasterCard common stock in connection with its initial public offering. As has been its practice of recent years, the Company sold the majority of its inventory of originated student loans in the first quarter of 2007. The Company recorded a gain from the sale of student loans of $\$ 2.16$ million in the first six months of 2007 compared to a gain of $\$ 2.48$ million in the first six months of 2006.

## Noninterest Expense

The components of noninterest expense for the three months and six months ended June 30, 2007 and 2006 and the corresponding percentage changes are shown in the following table:

|  | Three months ended June 30, |  |  |  | $\begin{gathered} \text { \% } \\ \text { Change } \end{gathered}$ |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  |  |  |  |
|  |  | 2007 |  | 2006 |  |
|  | (Dollars in thousands) |  |  |  |  |
| Salaries and employee benefits | \$ | 63,851 | \$ | 58,376 | 9.38\% |
| Occupancy, net of rental income |  | 8,709 |  | 7,759 | 12.24 |
| Equipment |  | 6,053 |  | 5,822 | 3.97 |
| Other |  | 27,315 |  | 26,387 | 3.52 |
| Total noninterest expense | \$ | 105,928 | \$ | 98,344 | 7.71\% |

Salaries and employee benefits
Occupancy, net of rental income
Equipment
Other
Total noninterest expense

Six months ended
June 30,

2007
2006
(Dollars in thousands)
\$ $\quad 127,479 \quad \$ \quad 115,949$
17,172 15,201
11,585

$$
12,079
$$

$$
54,808
$$

51,617
\$ 211,538 \$ 194,352
Change
9.38\%
12.24
3.97
3.52
7.71\%
\%
Change
9.94\%
12.97
4.26
6.18
8.84\%

Salaries and employee benefits expense for the three months and six months ended June 30, 2007 increased compared to the same period in 2006, primarily as a result of the hiring of employees to staff locations and facilities added since

June 30, 2006, as well as the addition of the salaries and employee benefits of employees of The Signature Bank during the first quarter of 2007. Occupancy expense also increased on a comparable three-month and six-month period basis primarily because of additional locations and facilities opened since June 30, 2006, including the addition of The Signature Bank facilities during the first quarter of 2007. Equipment expense

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increased for the comparable three-month and six-month periods because of increased depreciation related to equipment purchased since June 2006. The renovation and reconstruction of facilities, along with new equipment purchased as a result of the destruction caused by Hurricane Katrina, contributed to the increased facility and equipment depreciation expense in 2007. The increase in other noninterest expense primarily reflects normal increases and general inflation in the cost of services and supplies purchased by the Company during the second quarter and first six months of 2007 compared to the second quarter and first six months of 2006.

## Income Tax

Income tax expense was $\$ 17.24$ million for the second quarter of 2007, a $28.72 \%$ increase from $\$ 13.39$ million for the second quarter of 2006. For the six-month period ending June 30, 2007, income tax expense was $\$ 33.72$ million compared to $\$ 32.20$ million for the same period in 2006 , representing an increase of $4.74 \%$. The effective tax rates for the second quarters of 2007 and 2006 were $32.45 \%$ and $27.39 \%$, respectively, and the effective tax rates for the six-month periods ended June 30, 2007 and 2006 were $32.68 \%$ and $30.54 \%$, respectively. The increase in effective tax rates for the second quarter and first six months of 2007 compared to the same periods in 2006 was the result of the reversal of a previously recorded tax contingency of approximately $\$ 1.95$ million in the second quarter of 2006. The previously recorded tax contingency was related to the tax assessment resulting from an audit performed by the State Tax Commission of the State of Mississippi for tax years 1998 through 2001. The issues related to the audit were resolved in June 2006. With approximately $\$ 1.95$ million of the previously recorded contingency no longer deemed necessary, that amount was credited against the 2006 second quarter income tax expense. If the contingency had not been reversed in 2006, the effective tax rates would have remained relatively stable for the six months ended June 30, 2007 and 2006, at $32.68 \%$ and $32.39 \%$, respectively.

## FINANCIAL CONDITION

## Earning Assets

The percentage of earning assets to total assets measures the effectiveness of management $s$ efforts to invest available funds into the most efficient and profitable uses. Earning assets at June 30, 2007 were $\$ 12.01$ billion, or $90.94 \%$ of total assets, compared with $\$ 10.88$ billion, or $90.37 \%$ of total assets, at December 31, 2006.
The Company uses the subsidiary banks securities portfolios to make various term investments, to provide a source of liquidity and to serve as collateral to secure certain types of deposits. Held-to-maturity securities at June 30, 2007 were $\$ 1.79$ billion, compared with $\$ 1.72$ billion at December 31, 2006, a $3.60 \%$ increase. Available-for-sale securities were $\$ 1.14$ billion at June 30, 2007, compared to $\$ 1.04$ billion at December 31, 2006, a $9.30 \%$ increase.
The subsidiary banks loan and lease portfolios make up the single largest component of the Company s earning assets. The banks lending activities include both commercial and consumer loans and leases. Loan and lease originations are derived from a number of sources, including direct solicitation by the banks loan officers, real estate broker referrals, mortgage loan companies, current depositors and loan customers, builders, attorneys, walk-in customers and, in some instances, other lenders. The banks have established disciplined and systematic procedures for approving and monitoring loans and leases that vary depending on the size and nature of the loan or lease. Loans and leases, net of unearned income, totaled $\$ 8.97$ billion at June 30, 2007, which represented a $13.91 \%$ increase from $\$ 7.87$ billion at December 31, 2006. The acquisition of The Signature Bank in the first quarter of 2007 contributed $\$ 811.14$ million of the increase in loans and leases, net of unearned income at June 30, 2007.
At June 30, 2007, the Company did not have any concentrations of loans in excess of $10 \%$ of total loans outstanding. Loan concentrations are considered to exist if there are amounts loaned to a number of borrowers engaged in similar activities, which would cause them to be similarly impacted by economic or other conditions. However, the Company conducts a significant portion of its business in a geographically concentrated area, and the ability of the Company s borrowers to repay loans is somewhat dependent upon the economic conditions prevailing in the Company s market areas.

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In the normal course of business, management becomes aware of possible credit problems in which borrowers exhibit potential for the inability to comply with the contractual terms of their loans, but which do not currently meet the criteria for disclosure as non-performing loans. Historically, some of these loans are ultimately restructured or placed in non-accrual status. At June 30, 2007, no loans of material significance were known to be potential non-performing loans.
Collateral for some of the Company s loans is subject to fair value evaluations that fluctuate with market conditions and other external factors. In addition, while the Company has certain underwriting obligations related to such evaluations from a review standpoint, evaluations of some real property and other collateral are dependent upon third-party independent appraisers employed either by the Company s customers or as independent contractors of the Company.
The Company s policy provides that loans, other than installment loans, are generally placed in non-accrual status if, in management s opinion, payment in full of principal or interest is not expected or payment of principal or interest is more than 90 days past due, unless the loan is both well-secured and in the process of collection. Non-performing loans were $0.27 \%$ of loans and leases, net of unearned income, at June 30, 2007 and $0.30 \%$ of loans and leases, net of unearned income, at December 31, 2006.

## Deposits and Other Interest Bearing Liabilities

Deposits originating within the communities served by the subsidiary banks continue to be the Company s primary source of funding its earning assets. The Company has been able to compete effectively for deposits in its primary market areas, while continuing to manage the exposure to rising interest rates. Deposits totaled $\$ 10.44$ billion at June 30, 2007 as compared to $\$ 9.71$ billion at December 31, 2006, representing a $7.48 \%$ increase. Noninterest bearing demand deposits decreased by $\$ 60.57$ million, or $3.33 \%$, to $\$ 1.76$ billion at June 30,2007 from $\$ 1.82$ billion at December 31, 2006, and interest bearing demand, savings and time deposits increased $\$ 786.91$ million, or $9.97 \%$, to $\$ 8.68$ billion at June 30, 2007 from $\$ 7.89$ billion at December 31, 2006. The acquisition of The Signature Bank in the first quarter of 2007 contributed $\$ 510.98$ million of the increase in interest bearing demand, savings and time deposits at June 30, 2007.

## Liquidity and Capital Resources

One of the Company s goals is to provide adequate funds to meet increases in loan demand or any potential increase in the normal level of deposit withdrawals. The Company accomplishes this goal primarily by generating cash from the banks operating activities and maintaining sufficient short-term liquid assets. These sources, coupled with a stable deposit base and a strong reputation in the capital markets, allow the Company to fund earning assets and maintain the availability of funds. Management believes that the banks traditional sources of maturing loans and investment securities, sales of loans held for sale, cash from operating activities and a strong base of core deposits are adequate to meet the Company s liquidity needs for normal operations over both the short-term and the long-term. To provide additional liquidity, the Company utilizes short-term financing through the purchase of federal funds and securities lending arrangements. Further, the Company maintains a borrowing relationship with the Federal Home Loan Bank, which provides liquidity to fund term loans with borrowings of matched or longer maturities. If the Company straditional sources of liquidity were constrained, the Company would be forced to pursue avenues of funding not typically used by the Company and the Company s net interest margin could be impacted negatively. The Company utilizes, among other tools, maturity gap tables, interest rate shock scenarios and an active asset and liability management committee to analyze, manage and plan asset growth and to assist in managing the Company s net interest margin and overall level of liquidity. The Company s approach to providing adequate liquidity has been successful in the past and management does not anticipate any near- or long-term changes to its liquidity strategies.

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## Off-Balance Sheet Arrangements

In the ordinary course of business, the Company enters into various off-balance sheet commitments and other arrangements to extend credit that are not reflected in the consolidated balance sheets of the Company. The business purpose of these off-balance sheet commitments is the routine extension of credit. While most of the commitments to extend credit are made at variable rates, included in these commitments are forward commitments to fund individual fixed-rate mortgage loans. Fixed-rate lending commitments expose the Company to risks associated with increases in interest rates. As a method to manage these risks, the Company enters into forward commitments to sell individual fixed-rate mortgage loans. The Company also faces the risk of deteriorating credit quality of borrowers to whom a commitment to extend credit has been made; however, no significant credit losses are expected from these commitments and arrangements.

## Regulatory Requirements for Capital

The Company is required to comply with the risk-based capital guidelines established by the Board of Governors of the Federal Reserve System. These guidelines apply a variety of weighting factors that vary according to the level of risk associated with the assets. Capital is measured in two Tiers : Tier I consists of common shareholders equity and qualifying noncumulative perpetual preferred stock, less goodwill and certain other intangible assets; and Tier II consists of general allowance for losses on loans and leases, hybrid debt capital instruments and all or a portion of other subordinated capital debt, depending upon remaining term to maturity. Total capital is the sum of Tier I and Tier II capital. The Company s Tier I capital and total capital, as a percentage of total risk-adjusted assets, was $10.89 \%$ and $12.04 \%$, respectively, at June 30, 2007. Both ratios exceeded the required minimum levels for these ratios of $4 \%$ and $8 \%$, respectively, at June 30, 2007. In addition, the Company s Tier I leverage capital ratio (Tier I capital divided by total assets, less goodwill) was $8.23 \%$ at June 30,2007 , compared to the required minimum leverage capital ratio of $4 \%$.
The Federal Deposit Insurance Corporation s capital-based supervisory system for insured financial institutions categorizes the capital position for banks into five categories, ranging from well capitalized to critically undercapitalized. For a bank to classify as well capitalized, the Tier I capital, total capital and leverage capital ratios must be at least $6 \%, 10 \%$ and $5 \%$, respectively. BancorpSouth Bank met the criteria for the well capitalized category at June 30, 2007 as its Tier I capital, total capital and leverage capital ratios were $10.53 \%, 11.69 \%$ and $7.74 \%$, respectively. The Signature Bank met the criteria for the well capitalized category at June 30, 2007 as its Tier I capital, total capital and leverage capital ratios were $8.99 \%, 10.03 \%$ and $8.71 \%$, respectively.
There are various legal and regulatory limits on the extent to which the banks may pay dividends or otherwise supply funds to the Company. In addition, federal and state regulatory agencies have the authority to prevent a bank, bank holding company or financial holding company from paying a dividend or engaging in any other activity that, in the opinion of the agency, would constitute an unsafe or unsound practice. The Company does not expect these limitations to cause a material adverse effect with regard to its ability to meet its cash obligations.

## Uses of Capital

The Company may pursue acquisitions of depository institutions and businesses closely related to banking that further the Company s business strategies. The Company anticipates that consideration for any such transactions would be shares of the Company s common stock, cash or a combination thereof. For example, the merger with City Bancorp was completed on March 1, 2007 and the consideration in that transaction was a combination of shares of the Company s common stock and cash.
On April 27, 2005, the Company announced a stock repurchase program whereby the Company could acquire up to three million shares of its common stock. At the time of the expiration of this plan on April 30, 2007, the Company had repurchased $1,006,000$ shares of the three million shares authorized under this plan. On March 21, 2007, the Company announced a new stock repurchase program whereby the Company may acquire up to three million shares of its common stock in the open market at prevailing market prices or in privately negotiated transactions during the period from May 1, 2007 through April 30, 2009. The extent and timing of any repurchases will depend on market

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conditions and other corporate considerations. Repurchased shares will be held as authorized but unissued shares. These authorized but unissued shares will be available for use in connection with the Company stock option plans, other compensation programs, other transactions or for other corporate purposes as determined by the Company s Board of Directors. As of June 30, 2007, 175,000 shares had been repurchased under this program. The Company will continue to evaluate additional share repurchases under this repurchase program and will evaluate whether to adopt a new stock repurchase program before the current program expires. From January 1, 2001 through June 30, 2007, the Company repurchased approximately 11.7 million shares of its common stock under various repurchase plans authorized by the Company s Board of Directors. The Company conducts its stock repurchase program by using funds received in the ordinary course of business. The Company has not experienced, and does not expect to experience, a material adverse effect on its capital resources or liquidity in connection with its stock repurchase program during the term of the program. See Part II, Item 2. Unregistered Sales of Equity Securities and Use of Proceeds included herein for information about the Company s repurchases during the three months ended June 30, 2007.
In 2002, the Company issued $\$ 128.87$ million in $8.15 \%$ Junior Subordinated Debt Securities to BancorpSouth Capital Trust I (the Trust ), a business trust. The Trust used the proceeds from the issuance of five million shares of $8.15 \%$ trust preferred securities, $\$ 25$ face value per share, to acquire the Junior Subordinated Debt Securities. Both the Junior Subordinated Debt Securities and the trust preferred securities mature on January 28, 2032, and are callable at the option of the Company after January 28, 2007. The $\$ 125$ million in trust preferred securities issued by the Trust qualifies as Tier I capital under Federal Reserve Board guidelines. The Company may prepay the Junior Subordinated Debt Securities, and in turn the trust preferred securities, at a prepayment price of $100 \%$ of the principal amount of these securities within 90 days of a determination by the Federal Reserve Board that trust preferred securities will no longer qualify as Tier I capital.
The Company assumed $\$ 9.28$ million in Junior Subordinated Debt Securities and the related $\$ 9.00$ million in trust preferred securities pursuant to the mergers on December 31, 2004 with Premier Bancorp, Inc. and Business Holding Corporation. The Company also assumed $\$ 6.70$ million in Junior Subordinated Debt Securities and the related $\$ 6.50$ million in trust preferred securities pursuant to the merger on December 1, 2005 with American State Bank Corporation and $\$ 18.56$ million in Junior Subordinated Debt Securities and the related $\$ 18.00$ million in trust preferred securities pursuant to the merger on March 1, 2007 with City Bancorp. For more information, see Note 7 to the Company s Consolidated Financial Statements included elsewhere in this report. The Company s aggregate $\$ 33.50$ million in assumed trust preferred securities qualifies as Tier I capital under Federal Reserve Board guidelines. Certain Litigation Contingencies
The Company and its subsidiaries are engaged in lines of business that are heavily regulated and involve a large volume of financial transactions with numerous customers through offices in eight states. Although the Company and its subsidiaries have developed policies and procedures to minimize the impact of legal noncompliance and other disputes, litigation presents an ongoing risk.
The Company and its subsidiaries are defendants in various lawsuits arising out of the normal course of business, including claims against entities to which the Company is a successor as a result of business combinations. In the opinion of management, the ultimate resolution of such matters should not have a material adverse effect on the Company s consolidated financial position or results of operations. Litigation is, however, inherently uncertain, and the Company cannot make assurances that it will prevail in any of these actions, nor can it estimate with reasonable certainty the amount of damages that it might incur.

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

During the three months ended June 30, 2007, there were no significant changes to the quantitative and qualitative disclosures about market risks presented in the Company s Annual Report on Form 10-K for the year ended December 31, 2006.

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## ITEM 4. CONTROLS AND PROCEDURES.

The Company, with the participation of its management, including its Chief Executive Officer and Chief Financial Officer, carried out an evaluation of the effectiveness of the design and operation of its disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this report. Based upon that evaluation and as of the end of the period covered by this report, the Company s Chief Executive Officer and Chief Financial Officer concluded that the Company s disclosure controls and procedures are effective to allow timely decisions regarding disclosure in its reports that the Company files or submits to the Securities and Exchange Commission under the Securities Exchange Act of 1934. There have been no changes in the Company s internal control over financial reporting that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

## PART II <br> OTHER INFORMATION

## ITEM 1A. RISK FACTORS.

There have been no material changes from the risk factors previously disclosed in our annual report on Form 10-K for the year ended December 31, 2006.

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

The Company made the following purchases of its common stock during the quarter ended June 30, 2007:

|  | Total Number |  | Total Number of Shares | Maximum <br> Number of |
| :---: | :---: | :---: | :---: | :---: |
|  |  |  | Purchased as Part of Publicly | Shares that May Yet Be Purchased |
|  | of Shares | Average Price | Announced Plans | Under the Plans |
| Period | Purchased | Paid per Share | or Programs (1) | or Programs |
| April 1 - April 30 | 25,663(2) | \$ 24.79 | 20,000 | 3,000,000 |
| May 1 - May 31 | 105,000 | 25.03 | 105,000 | 2,895,000 |
| June 1 - June 30 | 70,000 | 24.74 | 70,000 | 2,825,000 |
| Total | 200,663 |  |  |  |

(1) During the three months ended June 30, 2007, the Company terminated no stock repurchase plans or programs prior to expiration. On April 30, 2007, the stock repurchase program
announced on
April 27, 2005
that authorized the repurchase of up to
3.0 million shares expired by its terms. On March 21, 2007, the Company announced a new stock
repurchase program that authorized the repurchase of up to 3.0 million shares of its common stock.
The March 21, 2007 stock repurchase program expires
on April 30,
2009. For more information, see Part I, Item 2.
Management s
Discussion and
Analysis of
Financial
Condition and
Results of
Operations
Financial
Condition Uses
of Capital.
(2) Of this amount,

5,663 shares
were redeemed
from an
employee upon the vesting of restricted stock
for tax
withholding
purposes.

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## ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The annual meeting of shareholders for the Company was held on April 25, 2007. At this meeting, the following matters were voted upon by the Company s shareholders:
(a) Election of Directors

Larry G. Kirk, Guy W. Mitchell, III, R. Madison Murphy and Aubrey B. Patterson were elected to serve as Class III directors of the Company until the annual meeting of shareholders in 2010 or until their respective successors are elected and qualified. The votes were cast as follows:

Name
Larry G. Kirk
Guy W. Mitchell, III
R. Madison Murphy

Aubrey B. Patterson

| Votes Cast | Votes Cast <br> Against or | Abstentions/ |
| :---: | :---: | :---: |
| in Favor | Withheld | Non-Votes |
| $62,177,912$ | 726,093 | 0 |
| $62,201,205$ | 702,800 | 0 |
| $62,244,773$ | 659,231 | 0 |
| $61,660,962$ | $1,243,043$ | 0 |

The following directors continued in office following the meeting and they will serve until the annual meeting of shareholders in the years indicated or until their respective successors are elected and qualified:

## Name

W. G. Holliman, Jr.

Term Expires
James V. Kelley 2008

Turner O. Lashlee 2008

Alan W. Perry 2008

Hassell H. Franklin 2008

Robert C. Nolan2009
W. Cal Partee, Jr. 2009

Travis E. Staub
2009
(b) Selection of Independent Auditors

The shareholders of the Company ratified the appointment of KPMG LLP as the Company s independent auditors for the fiscal year ending December 31, 2007 by the following vote:

Votes Cast In Favor 62,082,801

Votes Cast Against or
Withheld
645,348
Abstentions/ Non-Votes
175,856
(c) Amendment to Restated Articles of Incorporation

The shareholders of the Company approved the Amendment to the Restated Articles of Incorporation, which permits the Board of Directors to fill a vacancy on the Board if a vacancy arises for any reason by (i) appointing a director to fill the vacancy, (ii) leaving the position vacant until the election of directors at the next annual meeting or (iii) calling a special meeting for shareholders to vote on another nominee to fill the vacancy.

|  | Votes Cast Against or |  |
| :---: | :---: | :---: |
| Votes Cast In Favor | Withheld | Abstentions/ Non-Votes |
| $57,069,242$ | $5,405,553$ | 429,210 |

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## ITEM 6. EXHIBITS.

(3) (a) Articles of Incorporation, as amended and restated. *
(b) Bylaws, as amended and restated. (1)
(c) Amendment No. 1 to Amended and Restated Bylaws. (2)
(d) Amendment No. 2 to Amended and Restated Bylaws. (3)
(e) Amendment No. 3 to Amended and Restated Bylaws. (3)
(4) (a) Specimen Common Stock Certificate. (4)
(b) Rights Agreement, dated as of April 24, 1991, including as Exhibit A the forms of Rights Certificate and of Election to Purchase and as Exhibit B the summary of Rights to Purchase Common Shares. (5)
(c) First Amendment to Rights Agreement, dated as of March 28, 2001. (6)
(d) Amended and Restated Certificate of Trust of BancorpSouth Capital Trust I. (7)
(e) Second Amended and Restated Trust Agreement of BancorpSouth Capital Trust I, dated as of January 28, 2002, between BancorpSouth, Inc., The Bank of New York, The Bank of New York (Delaware) and the Administrative Trustees named therein. (8)
(f) Junior Subordinated Indenture, dated as of January 28, 2002, between BancorpSouth, Inc. and The Bank of New York. (8)
(g) Guarantee Agreement, dated as of January 28, 2002, between BancorpSouth, Inc. and The Bank of New York. (8)
(h) Junior Subordinated Debt Security Specimen. (8)
(i) Trust Preferred Security Certificate for BancorpSouth Capital Trust I. (6)
(j) Certain instruments defining the rights of certain holders of long-term debt securities of the Registrant are omitted pursuant to Item 601(b)(4)(iii)(A) of Regulation S-K. The Registrant hereby agrees to furnish copies of these instruments to the SEC upon request.
(10) (a) Form of Performance Share Award Agreement. (9)
(31.2) Certification of the Chief Financial Officer of BancorpSouth, Inc. pursuant to Rule 13a-14 or 15d-14 of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.* Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.* as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*
(1) Filed as an exhibit to the Company s Annual Report on Form 10-K for the year ended December 31, 1998 (file number 1-12991) and incorporated by reference thereto.
(2) Filed as an exhibit to the Company s Annual Report on Form 10-K for the year ended December 31, 2000 (file number 1-12991) and incorporated by reference thereto.
(3) Filed as exhibits
3.1 and 3.2 to
the Company s
Current Report on Form 8-K filed on January 26, 2007 (File number 1-12991) and incorporated by reference thereto.
(4) Filed as an exhibit to the
Company s
Annual Report on Form 10-K
for the year ended
December 31, 1994 (file number $0-10826$ ) and incorporated by reference thereto.
(5) Filed as exhibit
1 to the
Company s
registration
statement on
Form 8-A filed on April 24, 1991 (file number $0-10826$ ) and incorporated by reference thereto.
(6) Filed as exhibit
2 to the
Company s
amended
registration
statement on
Form 8-A/A
filed on
March 28, 2001
(file number 1-12991) and incorporated by reference thereto.
(7) Filed as exhibits
4.12 and 4.13 to the Company s registration statement on Form S-3 filed on November 2, 2001
(Registration

No. 33-72712)
and
incorporated by
reference
thereto.
(8) Filed as an exhibit to the Company s
Current Report on Form 8-K
filed on
January 28,
2002 (file
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## Table of Contents

(9) Filed as an exhibit to the Company s Current Report of Form 8-K filed on
March 7, 2007
(file number
1-12991) and incorporated by reference thereto.

* Filed herewith.


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## 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.

DATE: August 7, 2007
BancorpSouth, Inc.
(Registrant)
/s/ L. Nash Allen, Jr.
L. Nash Allen, Jr.

Treasurer and Chief Financial Officer
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## INDEX TO EXHIBITS

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