



***MIDSOUTH BANK  
TO OUR SHAREHOLDERS***

MidSouth Bank celebrated its fifth anniversary on January 20, 2009 and continues to be among the most desirable places to bank and work in Rutherford County. As we reflect on 2008 and look forward to 2009, both of these periods will be remembered for many positive achievements as well as many financial challenges. Arguably, 2008 will rank among the more economically challenging years in modern history, and its impact has been felt locally and nationally in the banking industry, as well as MidSouth Bank. We had just completed our first year of annual profit in 2007, and while 2008 started well, the second quarter began showing signs of economic weakness. The economic downturn, which was led by declining residential real estate values in an overbuilt market, had negative consequences on our community bank. We will share our story for 2008 in the following sections.

***Financial Results***

We operate in a very crowded financial environment, with 17 financial institutions serving Rutherford County, up from 11 just five years ago. We remain *Rutherford County's ONLY Hometown Bank*, and this distinction continues to be a major factor in our growth. During 2008, our loans grew by 13.4%, to \$216.7 million, and deposits grew by 7.5%, to \$222.9 million. In addition, total assets grew 9.6%, from \$247.0 million at year-end 2007, to \$270.8 million at year-end 2008. MidSouth Bank continues to be one of the fastest growing newly-chartered banks in America based on statistics compiled by the *American Bankers Association*. Our growth continues to be almost twice that of the top 25% of new banks chartered nationally during 2004. At June 30, 2008, we remained the sixth largest bank in deposits in Rutherford County out of 17 banks, with a 7.4% market share.

Unfortunately, we recorded approximately \$4.1 million in loan loss provisions in 2008, which was the driving factor in our recording a loss of \$3.7 million, compared to our profit of \$159,000 in 2007. At year-end 2008 we had a strong ratio of allowance for loan losses to total loans of 2.60%, compared to the minimum of 1.25% that was mandated during the Bank's first three years in existence. While we recorded a pre-loan loss provision profit of \$805,000, we could not overcome the rapidly declining Rutherford County real estate market. Residential real estate has been the primary economic growth engine in Rutherford County for many years, and our community bank assisted in funding this growth through many local builders. We have developed a strategic plan for 2009 that has identified over \$1.8 million in potential expense reductions and income enhancements which we believe will return us to profitability in 2009. Ultimately, our return to profitability will be determined by the leveling of residential values, the reduction in residential housing inventory, and the ability of our clients to maintain the liquidity and capital to ride out the current recession.

**Strong Capital Position**

We initially raised over \$29 million in capital, and since then we have raised an additional \$8.5 million in capital through the exercise of warrants and stock options. After our loss in 2008, we still have \$28.1 million in capital and continue to be a well capitalized bank with a total risk-based capital ratio of 12.1%. As a comparison, one of the regulatory guidelines for being a “well capitalized” bank requires maintaining at least a 10% total risk-based capital ratio. We believe that this solid capital position is the core strength that will carry us through this economic recession. While we are not pleased with this level of performance, losses were incurred by many Middle Tennessee community banks that were less than six years old. We are committed to implementing our strategic plan which focuses on managing our problem loans with a heavy emphasis on income enhancement and expense management.

**Great Place To Work**

For the fourth year in a row, MidSouth Bank was recognized in the list of “Best Employers in Tennessee” by *Business TN* magazine, ranking in the top 10 in the small and medium company (25 to 249 employees) category, based on an extensive survey of our team members. We are very honored by this designation since the survey covered all industries, not just the banking sector. We have achieved this recognition every year we were eligible since the bank’s inception. We continue to retain a family-friendly, team-oriented group of bankers who value our customer-focused philosophy. This success is further reflected by our retaining over 90% of our team members annually for our fourth consecutive year compared to industry averages of 60%. We value each of our team members and recognize that, ultimately, our team members are all that differentiate MidSouth Bank from the other 16 banks serving Rutherford County.

**Market Convenience**

We maintain six locations throughout Rutherford County to ensure convenient delivery to our valued clients, and we continue to offer free ATM usage on any ATM throughout the country. Currently, three of our offices are open on Saturdays to serve our customers. Our trust and investment team continues to thrive as one of only two such local departments in banks, with over \$100 million in assets under management.

Rutherford County remains the fastest growing county in Tennessee and among the fastest growth markets in the country. On the downside, our local unemployment rate of 9% exceeds the state average, and real estate inventory, while declining, remains excessive. Presently, we believe that continuing our focus exclusively on Rutherford County will enable us to achieve growth at a pace much greater than the market’s growth rate as economic conditions improve. Our bankers, who have 25+ years of experience servicing Rutherford County, continue to provide friendly, professional service with a focus on the client’s needs – not pushing products and services on the customer. We have commercial and personal bankers with the lending experience and authority to personally handle all of their client’s needs. This banking style has differentiated us from the much larger regional banks that have a presence in Rutherford County but make loan decisions elsewhere.

**MIDSOUTH BANK**  
**TO OUR SHAREHOLDERS**  
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As always, we appreciate your referrals and support as we seek to grow your investment. We welcome your comments and visits, for our shareholders have provided the financial resources for us to exist. Please know that we are centering our energies on behaviors that will produce the financial results that you deserve and we aspire to achieve! We invite you to join us on Thursday, May 28, at 4:30 p.m., for our annual shareholders' meeting. That is our opportunity to share our commitment to you!

Sincerely,

A handwritten signature in black ink, appearing to read "Lee Moss". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Lee M. Moss  
Chairman & Chief Executive Officer

A handwritten signature in black ink, appearing to read "J. Ben Weatherford". The signature is cursive and somewhat stylized, with a large initial "J" and a long, sweeping underline.

J. Ben Weatherford  
President & Chief Operating Officer

**MIDSOUTH BANK**

**2008 Annual Report**

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**MIDSOUTH BANK FINANCIAL HIGHLIGHTS (UNAUDITED)**

	For the Year Ended December 31, 2008	For the Year Ended December 31, 2007	For the Year Ended December 31, 2006	For the Year Ended December 31, 2005	For the Year Ended December 31, 2004
<b><u>BALANCE SHEETS:</u></b>					
End of period:					
Total assets	\$ 270,837	\$ 246,982	\$ 219,524	\$ 132,605	\$ 68,976
Loans, net	216,730	191,074	148,457	103,006	40,584
Securities	33,146	31,248	36,347	15,273	17,009
Deposits	222,930	207,448	192,516	107,445	43,871
Stockholders' equity	28,128	30,978	26,228	24,690	24,887
<b><u>STATEMENTS OF OPERATIONS:</u></b>					
Interest income	\$ 14,436	\$ 15,049	\$ 11,020	\$ 5,040	\$ 1,539
Interest expense	5,778	7,179	5,304	1,778	335
Net interest income (loss)	8,658	7,870	5,716	3,262	1,204
Provision for loan losses	4,514	400	611	803	514
Net interest income after provision for loan losses	4,144	7,470	5,105	2,459	690
Non-interest income	1,809	1,542	1,047	759	310
Non-interest expense	9,662	8,853	7,356	5,145	3,761
Earnings (loss) before income taxes	(3,709)	159	(1,204)	(1,927)	(2,761)
Income taxes	-	-	-	-	-
Net earnings (loss)	\$ (3,709)	\$ 159	\$ (1,204)	\$ (1,927)	\$ (2,761)
Comprehensive earnings (loss)	\$ (3,079)	\$ 526	\$ (751)	\$ (2,138)	\$ (2,970)
<b><u>PER SHARE DATA:</u></b>					
Basic earnings (loss) per common share	(0.99)	0.04	(0.38)	(0.65)	(0.95)
Diluted earnings (loss) per common share	(0.99)	0.04	(0.38)	(0.65)	(0.95)
Cash dividends per share	-	-	-	-	-
Book value per share, end of year	7.48	8.28	7.89	7.96	8.56
<b><u>RATIOS:</u></b>					
Return on average stockholders' equity	- %	0.53%	- %	- %	- %
Return on average assets	- %	0.07%	- %	- %	- %
Stockholders' equity to assets	10.39%	12.54%	11.95%	18.62 %	36.08 %
Dividends declared per share as percentage of basic earnings per share	- %	- %	- %	- %	- %

## **MIDSOUTH BANK**

### **Management's Discussion and Analysis of Financial Condition and Results of Operations**

#### **General**

MidSouth Bank ("Bank") is a relatively small community bank headquartered in Murfreesboro, Rutherford County, Tennessee, which is part of the Nashville-Davidson County-Murfreesboro MSA. The Bank is a state-chartered bank that began operations on January 20, 2004. The Bank currently operates from its main office and three branches in Murfreesboro, and two locations in Smyrna, all in Rutherford County, Tennessee. In addition, the Bank has a wholly-owned subsidiary, MSB Services, Inc., that provides credit life insurance services to the Bank. The Bank offers a wide range of banking services including checking, savings, money market accounts, treasury management, certificates of deposit and loans for consumer, commercial and real estate purposes. In addition to these traditional services, the Bank offers trust services and investment services through Raymond James to its customers.

The purpose of this discussion is to provide insight into the financial condition and results of operations of the Bank. This discussion should be read in conjunction with the Bank's annual consolidated financial statements filed in conjunction with the Bank's Annual Report on Form 10-K for its year ended December 31, 2008.

While MidSouth Bank continued to achieve significant growth, the year 2008 was a very difficult and chaotic time for banks in the United States and elsewhere, including MidSouth Bank in terms of profitability. The national economic downturn was strongly felt in the Bank's primary market areas. The Bank has made a number of loans to developers and builders, and a substantial portion of the Bank's loans are secured by real property. While Rutherford County did not see the dramatic decrease in real estate values that many parts of the country experienced, values have declined sharply due in part to the county's excessive real estate inventory. Real estate lending has become extremely difficult in all of its many facets: the number of quality real estate loan applications has declined, borrowers have had difficulty selling their real estate products, and many real estate projects have failed. As a result, primarily, of the severe real estate problems affecting Rutherford County and surrounding areas, the Bank has funded its allowance for loan losses as can be seen from the Bank's year-end 2008 balance sheet, recording loan loss provisions of over \$4.5 million for 2008, an increase in funding of the allowance of \$4.1 million as compared with 2007. Principally as a result of funding the allowance for loan losses, the Bank experienced a loss of more than \$3.7 million for 2008; however, the bank's pre-loan loss provision earnings increased from \$559,000 to \$805,000, reflecting an improvement in core earnings during 2008. Other factors contributing to the Bank's loss in 2008 included the drag on earnings related to the Bank's investment in its branch system and the ongoing costs of regulatory compliance. Fortunately, the loss was somewhat mitigated by the bank's very strong risk-based capital position of \$30,262,000, which is a total risk-based capital ratio of 12.1% compared to the minimum of 10% that is required to be considered well capitalized.

For more than a decade, if not longer, Rutherford County has relied heavily on residential growth as a primary economic driving force. In 2008, the county experienced a significant slowdown in residential expansion, especially in residential construction. When combined with the economic downturn that worsened as 2008 progressed, these two factors negatively affected our anticipated loan growth and earnings. Deposit growth also slowed during 2008 due primarily to competitive pressures, although business generated from our existing customers remained relatively strong.

The year 2009 may also be a difficult year for MidSouth Bank, as well as other banks. There can be no assurance that the local or national economies have either stopped declining or started a recovery. Real estate values may not have yet reached their lowest point, and because the Bank's historical lending strategy and its loan portfolio have been to a substantial extent dependent upon real estate values, the

## **MIDSOUTH BANK**

### **Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued**

#### **General (continued)**

Bank's profitability may continue to be affected adversely by the possible further decline in the real estate market. In addition, the rapid increase of unemployment during late-2008 and early-2009 has made it less likely that the economy will begin recovering during 2009. Competition with other financial services providers in our marketplace remains intense. When the bank opened in 2004, there were 11 financial competitors, and that has now grown to 17. The costs of deposit insurance can be expected to increase significantly in 2009 as the FDIC attempts to rebuild its reserves that have been depleted due to bank failures. The costs of regulatory compliance can also be expected to rise as governments attempt to respond to perceived problems in financial markets. The impact of federal stimulus programs may prove decisive in how rapidly the economy recovers, but neither the timing of any economic recovery nor the ultimate cost and impact of these stimulus programs can be predicted.

During 2008, management placed greater emphasis on managing the Bank's net interest margin. As interest rates declined, the interest that MidSouth Bank could effectively charge or expect to charge on loans also declined, but the Bank was able to lower the interest that it paid for deposits and interest-bearing liabilities to an even greater extent. Our interest income declined 4.0% to \$14.4 million, down from \$15.0 million, but that decrease was more than offset by the decline in total interest expense, which decreased 19.4% from \$7.2 million to \$5.8 million, due to our strategy of permitting higher-priced CD's to mature without renewal and by aggressively managing the Bank's cost of funds. Total non-interest income grew 20.0% from \$1.5 million to \$1.8 million while non-interest expense grew 9.0% from \$8.9 million to \$9.7 million.

Further, the Bank elected to forego "growth for growth's sake" or for the purpose of growing market share that could not be expected to result in higher net interest income. The Bank also expects to continue to aggressively manage expenses in 2009, pursuant to initiatives begun in the second half of 2008, as well as to continue its careful monitoring and management of its net interest margin; however, the Bank's ability to return to profitability remains greatly dependent on a general return of economic growth and prosperity. The Bank's branching strategy mandates quality asset growth and that growth is far more difficult to attain in current economic conditions.

Even with all of the problems that MidSouth Bank experienced in 2008, there were several positive developments and trends in the Bank's operations.

- MidSouth Bank grew its assets approximately 9.6% from \$247.0 million in 2007 to \$270.8 million at year-end 2008. Our asset growth places us in the top 10% in the nation in terms of growth for new banks opened during 2004.
- Total loans grew approximately 13.4% from \$191.1 million to \$216.7 million despite enhanced underwriting criteria.
- We have attracted what we believe to be increasingly stable and lower-priced deposits. Total deposits grew approximately 7.5% from \$207.4 million to \$222.9 million.
- MidSouth Bank remains a well-capitalized financial institution by banking standards.
- Our net interest margin has remained relatively steady and within our target range.
- Rutherford County continues to be rated as one of the fastest growing markets in Tennessee and in the United States.

## **MIDSOUTH BANK**

### **Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued**

#### **General (continued)**

- In 2008, we introduced a new service to larger deposit customers called "CDARS<sup>®</sup>", or Certificate of Deposit Account Registry Service, allowing us to ensure that customers' deposits in excess of \$250,000 were covered in full by FDIC insurance up to \$80 million. At year end, the deposits in that program had grown to nearly \$30 million in certificates of deposit.

The year 2008 was a difficult time for MidSouth Bank, and it is likely that 2009 will also be challenging. The Bank expects to aggressively manage its expenses and interest costs, as well as to carefully monitor and address weaknesses in the loan portfolio. We have adopted cost-reduction measures that we believe are proportional and responsive to the financial challenges that confront the Bank. Regaining profitability, however, will almost certainly depend more on a general and local economic recovery than on any cost-reduction programs that may be implemented.

#### **Forward-Looking Statements**

Management's discussion of the Bank and management's analysis of the Bank's operations and prospects, and other matters, may include forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and other provisions of federal and state securities laws. Although the Bank believes that the assumptions underlying such forward-looking statements contained in this Report are reasonable, any of the assumptions could be inaccurate and, accordingly, there can be no assurance that the forward-looking statements included herein will prove to be accurate. The use of such words as expect, anticipate, forecast, and comparable terms should be understood by the reader to indicate that the statement is "forward-looking" and thus subject to change in a manner that can be unpredictable. Factors that could cause actual results to differ from the results anticipated, but not guaranteed, in this Report, include (without limitation) economic and social conditions, competition for loans, mortgages, and other financial services and products, changes in interest rates, unforeseen changes in liquidity, results of operations, and financial conditions affecting the Bank's customers, as well as other risks that cannot be accurately quantified or completely identified. Many factors affecting the Bank's financial condition and profitability, including changes in economic conditions, the volatility of interest rates, political events and competition from other providers of financial services simply cannot be predicted. Because these factors are unpredictable and beyond the Bank's control, earnings may fluctuate from period to period. The purpose of this type of information is to provide readers with information relevant to understanding and assessing the financial condition and results of operations of the Bank, and not to predict the future or to guarantee results. The Bank is unable to predict the types of circumstances, conditions, and factors that can cause anticipated results to change. The Bank undertakes no obligation to publish revised forward-looking statements to reflect the occurrence of changes or unanticipated events, circumstances, or results.

#### **Critical Accounting Policies**

The accounting principles we follow and our methods of applying these principles conform with accounting principles generally accepted in the United States and with general practices within the banking industry. In connection with the application of those principles to the determination of our allowance for loan losses (ALL), we have made judgments and estimates which have significantly impacted our financial position and results of operations.

## **MIDSOUTH BANK**

### **Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued**

#### **Critical Accounting Policies, Continued**

Our management assesses the adequacy of the ALL on a regular basis. This assessment includes procedures to estimate the ALL and test the adequacy and appropriateness of the resulting balance. The ALL consists of two portions: (1) an allocated amount representative of specifically identified credit exposure and exposures readily predictable by historical or comparative experience; and (2) an unallocated amount representative of inherent loss which is not readily identifiable. Even though the ALL is composed of two components, the entire allowance is available to absorb any credit losses.

We establish the allocated amount separately for two different risk groups: (1) unique loans (commercial loans, including those loans considered impaired); and (2) homogenous loans (generally single family residential and consumer loans). We base the allocation for unique loans primarily on the projected collateral shortfall in relation to the recorded investment. We estimate losses on impaired loans based on estimated cash flows discounted at the loan's original effective interest rate or the underlying collateral value. We also assign estimated loss ratios to our consumer portfolio; however, we base the estimated loss ratios for these homogenous loans on the category of consumer credit (e.g., automobile, residential mortgage, home equity) and not on the results of individual loan reviews.

The unallocated amount is particularly subjective and does not lend itself to exact mathematical calculation. We use the unallocated amount to absorb inherent losses which may exist as of the balance sheet date for such matters as changes in the local or national economy, the depth or experience of the lending staff, any concentrations of credit in any particular industry group, and new banking laws or regulations. After we assess applicable factors, we evaluate the aggregate unallocated amount based on our management's experience.

We then test the resulting ALL balance by comparing the balance in the allowance account to historical trends and peer information. Our management then evaluates the result of the procedures performed, including the result of our testing, and concludes on the appropriateness of the balance of the ALL in its entirety. The provision resulting from the ALL assessment is presented to the board of directors prior to the public reporting of financial information.

#### **Results of Operations**

The Bank experienced a loss of \$3,709,000 for the year ended December 31, 2008 as compared to net earnings of \$159,000 for the year ended December 31, 2007. For the years ended December 31, 2008 and 2007, included in the earnings (loss) are provisions for loan losses of \$4,514,000 and \$400,000, respectively. For the years ended December 31, 2008 and 2007, on a per share basis, the net earnings (loss) was \$(0.99) and \$0.04, respectively, per common share.

Even though the Bank's core earnings have progressed over the last six months, they could not offset the impact of the loan loss provisions that the Bank incurred during the year, but especially the provisions recorded in the fourth quarter of 2008. The softening of the real estate market and the weakening economy played significant factors in the additional provisions that were taken. During the fourth quarter of 2008, the financial condition of several of the Bank's borrowers worsened, and it became apparent that those lending relationships had become, or were soon going to be, impaired. As a result of evaluating our ALL in conjunction with those loans, we determined that we needed to increase our loan loss reserve specifically for those loans.

As we enter 2009, many economists believe that the economy may continue to weaken. If so, it could potentially impact more of our customers' abilities to repay their loans. As a result, the Bank's earnings could continue to be adversely affected by increasing loan loss provisions. Additionally, FDIC

## **MIDSOUTH BANK**

### **Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued**

#### **Results of Operations, Continued**

insurance premiums are scheduled to increase during 2009 to rebuild the Deposit Insurance Fund, which has been reduced due to a number of bank failures that occurred during 2008.

#### **Net Interest Income**

Net interest income represents the amount by which interest earned on various earning assets exceeds interest paid on deposits and other interest-bearing liabilities and is the most significant component of the Bank's earnings. Total interest income for the years ended December 31, 2008 and 2007 was \$14,436,000 and \$15,049,000, respectively, a decrease of 4.1%, and total interest expense was \$5,778,000 and \$7,179,000, respectively, a decrease of 19.5%. Net interest income for 2008 and 2007 totaled \$8,658,000 and \$7,870,000, respectively, and interest rates are expected to remain flat in 2009. Management believes that a satisfactory level of loans and deposits can be booked during 2009 to provide for a stable, if not greater, net interest margin, depending on pricing in our local markets.

#### **Provision for Loan Losses**

The provision for loan losses represents a charge to earnings necessary to establish an allowance for loan losses that, in management's evaluation, is adequate to provide coverage for estimated losses on outstanding loans and to provide for uncertainties in the economy. The provision for loan losses was \$4,514,000 and \$400,000 for the years ended December 31, 2008 and 2007, respectively, an increase of 1,028.5%. The level of the allowance and the amount of the provision involve evaluation of uncertainties and matters of judgment. Management believes the allowance for loan losses at December 31, 2008 and 2007 to be adequate. The allowance for loan losses was 2.60% and 1.05% of loans at December 31, 2008 and 2007, respectively. Please refer to the discussion in the "Results of Operations" section on the prior page for more details related to the provision for loan losses.

#### **Non-Interest Income**

The Bank's non-interest income consists primarily of service charges on deposits, fees on mortgage originations, fees from brokerage operations and other fees and commissions. Total non-interest income for the year ended December 31, 2008 and 2007 was \$1,809,000 and \$1,542,000, respectively, an increase of \$267,000 or 17.3%. The increase in fees for 2008 are primarily related to growth in deposit fee income and investment department income, and these areas along with mortgage department income are expected to contribute significantly to non-interest income in 2009.

#### **Non-Interest Expense**

Non-interest expenses consist primarily of employee costs, occupancy expenses, furniture and equipment expenses, professional fees, advertising expense, data processing expense and other operating expenses. The non-interest expense for the years ended December 31, 2008 and 2007 was \$9,662,000 and \$8,853,000, respectively, an increase of \$809,000 or 9.1%. The increase in non-interest expense is primarily due to growth of the Bank including the payment of increased production-based commissions and volume-based data processing costs.

#### **Income Taxes**

Due to the Bank's cumulative loss, there was no income tax expense provision in 2008 or 2007.

**MIDSOUTH BANK**

**Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued**

**Financial Condition**

**Balance Sheet Summary.** The Bank's total assets were \$270,837,000 and \$246,982,000 at December 31, 2008 and 2007, respectively, an increase of 9.6%. Loans, net of allowance for loan losses, totaled \$216,730,000 and \$191,074,000 at December 31, 2008 and 2007, respectively, and investment securities totaled \$33,146,000 and \$31,248,000, respectively.

Total liabilities were \$242,709,000 and \$216,004,000 at December 31, 2008 and 2007, respectively, and stockholders' equity was \$28,128,000 and \$30,978,000, respectively. A more detailed discussion of assets, liabilities and capital follows.

**Loans**

Loan categories are as follows:

	December 31, 2008		December 31, 2007	
	<u>Amount</u>	<u>Percentage</u>	<u>Amount</u>	<u>Percentage</u>
	<i>(In Thousands, except percentages)</i>		<i>(In Thousands, except percentages)</i>	
Commercial, financial and agricultural	\$ 130,342	58.6%	\$ 106,564	55.2%
Consumer	3,644	1.6	3,480	1.8
Real estate - mortgage	46,124	20.7	27,611	14.3
Real estate - construction	42,404	19.1	55,451	28.7
Total	\$ 222,514	100.0%	\$ 193,106	100.0%

Loans are a large component of the Bank's assets and are a primary source of income. The loan portfolio is composed of four primary loan categories: commercial, financial and agricultural; consumer; real estate - mortgage; and real estate - construction. The table above sets forth the loan categories and the percentage of such loans in the portfolio at December 31, 2008 and 2007.

As represented in the table, primary loan growth was commercial loans and real estate mortgage. Management intends to make loans in an orderly fashion and to monitor loans once made to maintain maximum possible asset quality.

The Bank follows the provisions of Statement of Financial Accounting Standards ("SFAS") No. 114, "Accounting by Creditors for Impairment of a Loan" and SFAS No. 118, "Accounting by Creditors for Impairment of a Loan - Income Recognition and Disclosures". These pronouncements apply to impaired loans except for large groups of smaller-balance homogeneous loans that are collectively evaluated for impairment including residential mortgage and consumer installment loans.

A loan is impaired when it is probable that the Bank will be unable to collect the scheduled payments of principal and interest due under the contractual terms of the loan agreement. Impaired loans are measured at the present value of expected future cash flows discounted at the loan's effective interest rate, at the loan's observable market price, or the fair value of the collateral if the loan is collateral dependent. If the measure of the impaired loan is less than the recorded investment in the loan, the Bank recognizes an impairment by creating a valuation allowance with a corresponding charge to the provision for loan losses or by adjusting an existing valuation allowance for the impaired loan with a corresponding charge or credit to the provision for loan losses.

## **MIDSOUTH BANK**

### **Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued**

#### **Financial Condition, Continued**

The Bank's single family residential mortgage and consumer loans, which total approximately \$46,718,000 and \$3,644,000, respectively at December 31, 2008, are divided into various groups of smaller-balance homogeneous loans that are collectively evaluated for impairment and thus are not subject to the provisions of SFAS Nos. 114 and 118. Substantially all other loans of the Bank are evaluated for impairment under the provisions of SFAS Nos. 114 and 118.

The Bank considers all loans subject to the provisions of SFAS Nos. 114 and 118 that are on nonaccrual status to be impaired. Loans are placed on nonaccrual status when doubt as to timely collection of principal or interest exists, or when principal or interest is past due 90 days or more unless such loans are well-secured and in the process of collection. Delays or shortfalls in loan payments are evaluated with various other factors to determine if a loan is impaired. Generally, delinquencies under 90 days are considered insignificant unless certain other factors are present which indicate impairment is probable. The decision to place a loan on nonaccrual status is also based on an evaluation of the borrower's financial condition, collateral, liquidation value, and other factors that affect the borrower's ability to pay.

Generally, at the time a loan is placed on nonaccrual status, all interest accrued on the loan in the current fiscal year is reversed from income, and all interest accrued and uncollected from the prior year is charged off against the allowance for loan losses. Thereafter, interest on nonaccrual loans is recognized as interest income only to the extent that cash is received and future collection of principal is not in doubt. If the collectibility of outstanding principal is doubtful, such interest received is applied as a reduction of principal. A nonaccrual loan may be restored to accruing status when principal and interest are no longer past due and unpaid and future collection of principal and interest on a timely basis is not in doubt. There were five nonaccrual loans totaling \$2,338,000 as of December 31, 2008, and there were no nonaccrual loans as of December 31, 2007.

Other loans may be classified as impaired when the current net worth and financial capacity of the borrower or of the collateral pledged, if any, is viewed as inadequate. In those cases, such loans have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt, and if such deficiencies are not corrected, there is a probability that the Bank will sustain some loss. In such cases, interest income continues to accrue as long as the loan does not meet the Bank's criteria for nonaccrual status.

Generally the Bank also classifies as impaired any loans the terms of which have been modified in a troubled debt restructuring. Interest is accrued on such loans that continue to meet the modified terms of their loan agreements. At December 31, 2008 and 2007, the Bank had no loans that have had terms modified in a troubled debt restructuring.

The Bank's charge-off policy for impaired loans is similar to its charge-off policy for all loans in that loans are charged-off in the month when they are considered uncollectible.

At December 31, 2008 and 2007, the Bank had \$9,862,000 and \$4,970,000, respectively, in impaired loans outstanding and no loans past due 90 days that were still accruing interest.

At December 31, 2008 and 2007, there were \$24,082,000 and \$16,088,000, respectively, in loans included in the Bank's internal classified loan list. Loans are listed as classified when information obtained about possible credit problems of the borrower has prompted management to question the ability of the borrower to comply with the agreed repayment terms of the loan agreement. The loan

## **MIDSOUTH BANK**

### **Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued**

#### **Financial Condition, Continued**

classifications do not represent or result from trends or uncertainties which management expects will materially impact future operating results, liquidity or capital resources.

The allowance for loan losses is discussed under "Provision for Loan Losses". The Bank maintains its allowance for loan losses at an amount considered by management to be adequate to provide for the possibility of loan losses in the loan portfolio. As required by the Bank's regulators, management maintained a minimum of 1.25% of loans in the allowance for loan losses for the first three years of operations. This required minimum expired January 20, 2007. The Bank does not originate, make or service "subprime" loans.

Essentially all of the Bank's loans originate from Rutherford and adjacent counties in Tennessee. The Bank seeks to exercise prudent risk management in lending, including diversification by loan category and industry segment, as well as by identification of credit risks.

The Bank's management believes there is a significant opportunity to continue to increase the loan portfolio in the Bank's primary market area. The Bank has targeted commercial business lending, commercial and residential real estate lending and consumer lending. The Bank seeks to build a loan portfolio which is capable of adjusting to swings in the interest rate market, and it is the Bank's policy to maintain a diverse loan portfolio not dependent on any particular market or industrial segment. Management has set a goal for loans to approximate 100% of deposits.

#### **Securities**

Securities totaled \$33,146,000 and \$31,248,000 at December 31, 2008 and 2007, respectively, and were a significant component of the Bank's earning assets. The Bank follows the provisions of SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities". Under the provisions of the Statement, securities are classified in three categories and accounted for as follows:

- Debt securities that the Bank has the positive intent and ability to hold to maturity are classified as held-to-maturity securities and reported at amortized cost.
- Debt and equity securities that are bought and held principally for the purpose of selling them in the near term are classified as trading securities and reported at fair value, with unrealized gains and losses included in earnings.
- Debt and equity securities not classified as either held-to-maturity securities or trading securities are classified as available-for-sale securities and reported at fair value, with unrealized gains and losses excluded from earnings and reported in a separate component of stockholders' equity.

## MIDSOUTH BANK

### Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued

#### Securities, Continued

The Bank's classification of securities as of December 31, 2008 is as follows:

	Available-for-Sale	
	Amortized Cost	Estimated Market Value
	<i>(In Thousands)</i>	
U.S. Treasury and other U.S.		
Government agencies and corporations	\$ 4,500	\$ 4,539
Mortgage-backed securities	27,214	28,198
Corporate	402	409
	<u>\$ 32,116</u>	<u>\$ 33,146</u>

The Bank's classification of securities as of December 31, 2007 is as follows:

	Available-for-Sale	
	Amortized Cost	Estimated Market Value
	<i>(In Thousands)</i>	
U.S. Treasury and other U.S.		
Government agencies and corporations	\$ 8,386	\$ 8,466
Mortgage-backed securities	22,060	22,376
Corporate	402	406
	<u>\$ 30,848</u>	<u>\$ 31,248</u>

No securities have been classified as trading or held-to-maturity.

#### Deposits

Total deposits, which are the principal source of funds for the Bank, totaled \$222,930,000 and \$207,448,000 at December 31, 2008 and 2007, respectively, which is an increase of \$15,482,000, or 7.5%. The Bank has targeted local consumers, professionals, local governments and commercial businesses as its central client base; therefore, deposit instruments in the form of demand deposits, savings accounts, money market demand accounts, certificates of deposit and individual retirement accounts are offered to customers.

Management believes Rutherford County and the surrounding area is a growing economic market offering growth opportunities for the Bank; however, the Bank competes with several of the larger bank holding companies that have bank offices in this area, as well as other community banks; and therefore, no assurances of market growth can be given. Even though the Bank is in a very competitive market, management currently believes that its market share will be expanded. Management firmly believes that its position as a locally owned financial institution that offers personalized service will contribute significantly to quality loans and deposit growth and profitability.

**MIDSOUTH BANK**

**Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued**

**Liquidity and Asset Management**

The Bank's management seeks to maximize net interest income by managing the Bank's assets and liabilities within appropriate constraints on capital, liquidity and interest rate risk. Liquidity is the ability to maintain sufficient cash levels necessary to fund operations, meet the requirements of depositors and borrowers and fund attractive investment opportunities. The Bank's primary source of liquidity is expected to be a stable core deposit base. In addition, short-term investments, loan payments, investment security maturities and short-term borrowing lines at the Federal Home Loan Bank and correspondent banks provide secondary sources of liquidity. At the present time, there are no known trends or any known commitments, demands, events or uncertainties that will result in or that are reasonably likely to result in the Bank's liquidity changing in any material way.

Interest rate risk (sensitivity) management focuses on the earnings risk associated with changing interest rates. Management seeks to maintain profitability in both immediate and long term earnings through funds management/interest rate risk management. The Bank's rate sensitivity position has an important impact on earnings. Senior management of the Bank meets frequently to analyze the rate sensitivity position. These meetings focus on the spread between the cost of funds and interest yields generated primarily through loans and investments.

The following table shows the rate sensitivity gaps for different time period as of December 31, 2008:

<b>Interest Rate Sensitivity Gaps</b>					
December 31, 2008	<i>1-90</i>	<i>3 months to</i>	<i>1 to 5</i>	<i>Over</i>	
<u>(In Thousands)</u>	<u>Days</u>	<u>12 months</u>	<u>Years</u>	<u>5</u>	<u>Total</u>
Interest-earning assets	\$ 101,417	18,913	97,902	37,397	255,629
Interest-bearing liabilities	<u>136,091</u>	<u>56,257</u>	<u>18,771</u>	<u>1,942</u>	<u>213,331</u>
Interest-rate sensitivity gap	<u>\$ (34,674)</u>	<u>(37,614)</u>	<u>79,131</u>	<u>35,455</u>	<u>42,298</u>
Cumulative gap	<u>\$ (34,674)</u>	<u>(72,288)</u>	<u>6,843</u>	<u>42,298</u>	

**Capital Position and Dividends**

At December 31, 2008 and 2007, total stockholders' equity was \$28,128,000 and \$30,978,000, respectively, or 10.39% and 12.54%, respectively, of total assets. The change in stockholders' equity resulted from a net loss of \$3,709,000, an increase in unrealized gains on available-for-sale securities of \$630,000, net proceeds from the issuance of common stock totaling \$205,000 and stock-based compensation expense of \$24,000.

As part of the original offering, any shares purchased received non-detachable warrants which provide the stockholder the ability to purchase one additional share of common stock for every two shares of common stock purchased. The purchase price for the additional shares is equal to the greater of \$10 or 110% of the book value of the stock at the date of exercise. For each recipient, one half of the warrants received were to have been exercised within three years from January 20, 2004 (the date of issuance) and the other half within five years of the date of issuance. As of December 31, 2008, 814,470 warrants had been exercised.

## **MIDSOUTH BANK**

### **Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued**

#### **Capital Position and Dividends, Continued**

The Bank's principal regulators have established minimum risk-based capital requirements and leverage capital requirements for the Bank. These guidelines classify capital into two categories of Tier I and Total risk-based capital. Total risk-based capital consists of Tier I (or core) capital (essentially common equity less intangible assets) and Tier II capital (essentially qualifying long-term debt, of which the Bank has none, and a part of the allowance for loan losses). In determining risk-based capital requirements, assets are assigned risk-weights of 0% to 100%, depending on regulatory assigned levels of credit risk associated with such assets. The risk-based capital guidelines require the Bank to have a total risk-based capital ratio of 8.0% and a Tier I risk-based capital ratio of 4.0%. At December 31, 2008 and 2007, the Bank's total risk-based capital ratios were 12.1% and 14.3%, respectively, and its Tier I risk-based capital ratios was 10.8% and 13.4%, respectively. The required Tier I leverage capital ratio (Tier I capital to average assets for the most recent quarter) for the Bank is 4.0%. At December 31, 2008 and 2007, the Bank had a leverage ratio of 10.2% and 13.0%, respectively. The declines in these ratios are attributed to the Bank's sizable loss for 2008. These ratios are expected to decrease as the Bank continues to grow in assets and liabilities, depending upon the rate at which the Bank grows.

There is no established trading market for the Bank's stock. From time to time the Bank may, subject to regulatory approval, acquire shares of its stock to provide some liquidity in the shares. During the year ended December 31, 2008, the Bank issued 17,032 shares at \$10 per share, of its voting common stock in connection with the warrants and 3,500 shares of \$10 per share in connection with the exercise of options. No shares of the Bank's common voting stock were redeemed for the years ending December 31, 2008 and 2007. Privately negotiated trades may involve the Bank's directors and officers, and their interests and, accordingly, may not be reliable indicators of value.

In October, 2004, the Shareholders of the Bank approved the MidSouth Bank's 2004 Stock Option Arrangement (the "Arrangement"). The Arrangement provides for the granting of stock options, and authorizes the issuance of common stock upon the exercise of such options, for up to 380,000 shares of common stock, to employees and organizers of the Bank and up to 143,080 shares of common stock for future use as decided by the Directors of the Bank.

Under the Stock Option Arrangement, stock option awards may be granted in the form of incentive stock options or nonstatutory stock options, and generally vest over a five year period with a ten year option to purchase. Exercise prices of incentive stock options must be equal to or greater than 100% of the fair market value of the common stock on the grant date.

At December 31, 2008 and 2007, 470,000 and 465,000, respectively, shares of the options had been granted. All of the options granted prior to 2008 were granted at \$10 per share, and the 5,000 options granted during 2008 were granted at \$12.80 per share. Of the options granted, 422,000 and 420,500 were outstanding at December 31, 2008 and 2007, respectively. At December 31, 2008 and 2007, 353,836 and 337,078 shares were exercisable.

**FDICIA.** Under the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"), the federal banking regulators have assigned each insured institution to one of five categories ("well capitalized," "adequately capitalized" or one of three undercapitalized categories) based upon the three measures of capital adequacy discussed above. Institutions which have a Tier I leverage capital ratio of 5%, a Tier I risk based capital ratio of 6% and a total risk based capital ratio of 10% are defined as "well capitalized". All institutions, regardless of their capital levels, are restricted from making any capital distribution or paying any management fees that would cause the institution to fail to satisfy the minimum levels for any of its capital requirements for "adequately capitalized" status. The Bank currently meets the requirements for "well capitalized" status.

## **MIDSOUTH BANK**

### **Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued**

#### **Capital Position and Dividends, Continued**

An institution that fails to meet the minimum level for any relevant capital measure (an "undercapitalized institution") may be: (i) subject to increased monitoring by the appropriate federal banking regulator; (ii) required to submit an acceptable capital restoration plan within 45 days (which must be guaranteed by the institution's holding company); (iii) subject to asset growth limits; and (iv) required to obtain prior regulatory approval for acquisitions, branching and new lines of businesses. The bank regulatory agencies have discretionary authority to reclassify a well capitalized institution as adequately capitalized or to impose on an adequately capitalized institution requirements or actions specified for undercapitalized institutions if the agency determines that the institution is in an unsafe or unsound condition or is engaging in an unsafe or unsound practice.

A "significantly undercapitalized" institution may be subject to a number of additional requirements and restrictions, including orders to sell sufficient voting stock to become "adequately capitalized," requirements to reduce total assets and cessation of receipt of deposits from correspondent banks. "Critically undercapitalized" institutions are subject to the appointment of a receiver or conservator.

Under FDICIA, bank regulatory agencies have prescribed safety and soundness guidelines for all insured depository institutions relating to internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, asset quality, earnings and compensation.

The Bank is assessed annually at the rate of 0.0687% of insured deposits for deposit insurance. The assessments are paid quarterly.

The Federal Deposit Insurance Corporation ("FDIC") has announced that the rates paid by banks will be increased significantly in 2009 to replenish the Deposit Insurance Fund that has been diminished by a number of bank failures during 2008. Management expects the increase in the assessment rate to increase the Bank's FDIC insurance expense greatly. Depending on the amounts of any special assessments that may be levied in 2009, the Bank's FDIC insurance expense could exceed \$600,000, as compared with \$168,000 for 2008.

## MIDSOUTH BANK

### Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued

#### Capital Position and Dividends, Continued

**Monetary Policy.** The Bank is affected by commercial bank credit policies of regulatory authorities, including the Federal Reserve Board (the "Board"). An important function of the Board is to regulate the national supply of bank credit in order to attempt to combat recessionary and curb inflationary pressures. Among the instruments of monetary policy used by the Board to implement these objectives are: open market operations in U.S. Government securities, changes in discount rates on member borrowings, changes in reserve requirements against bank deposits and limitations on interest rates which member banks may pay on time and savings deposits. These means are used in varying combinations to influence overall growth of bank loans, investments and deposits, and may also affect interest rates charged on loans or paid on deposits. The monetary policies of the Board have had a significant effect on the operating results of commercial banks, including nonmembers as well as members, in the past and are expected to continue to do so in the future.

#### Contractual Obligations

The Bank has the following contractual obligations as of December 31, 2008:

<i>(In Thousands)</i>	Less Than <u>1 Year</u>	1 - 3 <u>Years</u>	3 - 5 <u>Years</u>	More Than <u>5 Years</u>	<u>Total</u>
Long-term FHLB debt	\$ 77	166	182	1,942	2,367
Federal funds purchased	4,693	-	-	-	4,693
Securities sold under agreement to repurchase	836	-	-	-	836
Advances from Federal Home Loan Bank	11,100	-	-	-	11,100
Capital leases	-	-	-	-	-
Operating leases	120	160	144	783	1,207
Purchases	-	-	-	-	-
Other long-term liabilities	-	-	-	-	-
Total	<u>\$ 16,826</u>	<u>326</u>	<u>326</u>	<u>2,725</u>	<u>20,203</u>

#### Off Balance Sheet Arrangements

At December 31, 2008, the Bank had unfunded loan commitments outstanding of \$54.4 million and outstanding standby letters of credit of \$1.9 million. Because these commitments generally have fixed expiration dates and many will expire without being drawn upon, the total commitment level does not necessarily represent future cash requirements. If needed to fund these outstanding commitments, the Bank has the ability to liquidate securities available-for-sale or on a short-term basis to borrow and purchase Federal funds from correspondent banks or from the Federal Home Loan Bank. Additionally, the Bank could sell participations in these or other loans to correspondent banks. As mentioned above, the Bank has been able to fund its ongoing liquidity needs through its stable core deposit base, loan payments, its investment security maturities and short-term borrowings.

## **MIDSOUTH BANK**

### **Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued**

#### **Impact of Inflation**

Although interest rates are significantly affected by inflation, the inflation rate is immaterial when reviewing the Bank's results of operations.

#### **Quantitative and Qualitative Disclosures About Market Risk**

The Bank's primary component of market risk is interest rate volatility. Fluctuations in interest rates will ultimately impact both the level of income and expense recorded on a large portion of the Bank's assets and liabilities, and the market value of all interest-earning assets and interest-bearing liabilities, other than those which possess a short term to maturity. Based upon the nature of the Bank's operations, the Bank is not subject to foreign currency exchange or commodity price risk.

Interest rate risk (sensitivity) management focuses on the earnings risk associated with changing interest rates. Management seeks to maintain profitability in both immediate and long-term earnings through funds management/interest rate risk management. The Bank's rate sensitivity position has an important impact on earnings. Senior management monitors the Bank's rate sensitivity position throughout each month, and then quarterly the Asset Liability Committee (ALCO) of the Bank meets to analyze the rate sensitivity position and other aspects of asset/liability management. These meetings cover the spread between the cost of funds (primarily time deposits) and interest yields generated primarily through loans and investments, rate shock analyses, liquidity and dependency positions, and other areas necessary for proper balance sheet management.



**Murfreesboro, Tennessee**

**Management Report on Internal Control Over Financial Reporting**

The management of MidSouth Bank (the Bank) is responsible for establishing and maintaining adequate internal control over financial reporting. The Bank’s internal control system was designed to provide reasonable assurance to MidSouth Bank’s management and board of directors regarding the preparation and fair presentation of published financial statements. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

MidSouth Bank’s management assessed the effectiveness of the Bank’s internal control over financial reporting as of December 31, 2008. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in “Internal Control-- Integrated Framework.” Based on our assessment we believe that, as of December 31, 2008, the Bank’s internal control over financial reporting is effective based on those criteria.

The Bank’s independent registered public accounting firm is not presently required to issue, and has not issued, any audit report on management’s assessment of the Bank’s internal control over financial reporting.

Lee M. Moss  
Chairman & Chief Executive Officer

Kevin D. Busbey  
Chief Financial Officer  
(Principal financial and  
principal accounting officer)

**MIDSOUTH BANK**

*Consolidated Financial Statements*

**December 31, 2008, 2007 and 2006**

**(With Independent Auditor's Report Thereon)**

**MAGGART & ASSOCIATES, P.C.**

*Certified Public Accountants*

150 FOURTH AVENUE, NORTH  
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NASHVILLE, TENNESSEE 37219-2417

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*Independent Auditor's Report*

**The Board of Directors  
MidSouth Bank**

We have audited the accompanying consolidated balance sheets of MidSouth Bank and subsidiary as of December 31, 2008 and 2007, and the related consolidated statements of operations, comprehensive earnings (losses), changes in stockholders' equity and cash flows for each of the three years in the period ended December 31, 2008. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board in the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of MidSouth Bank and subsidiary as of December 31, 2008 and 2007, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America.

*Maggart & Associates, P.C.*

Nashville, Tennessee  
March 5, 2009

## MIDSOUTH BANK

*Consolidated Balance Sheets*  
December 31, 2008 and 2007

<i>(In Thousands, Except Share Amounts)</i>	<b>2008</b>	2007
<b>ASSETS</b>		
Loans, less allowance for loan losses of \$5,784,000 and \$2,032,000, respectively	\$ 216,730	\$ 191,074
Securities available-for-sale, at market (amortized cost of \$32,116,000 and \$30,848,000, respectively) .....	33,146	31,248
Loans held for sale .....	594	987
Restricted equity securities .....	1,581	1,439
Interest-bearing accounts at other financial institutions .....	132	20
<i>Total earning assets</i> .....	<b>252,183</b>	224,768
Cash and due from banks .....	5,694	8,838
Bank premises and equipment, net .....	10,099	10,752
Accrued interest receivable .....	969	1,054
Foreclosed assets, net of allowance for losses of \$63,000 and \$50,000, respectively .....	1,487	1,309
Other assets .....	405	261
<i>Total assets</i> .....	<b>\$ 270,837</b>	\$ 246,982
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Deposits .....	\$ 222,930	\$ 207,448
Advances from Federal Home Loan Bank .....	13,467	7,346
Federal funds purchased .....	4,693	226
Securities sold under agreement to repurchase .....	836	-
Accrued interest payable .....	349	631
Accounts payable and other liabilities .....	434	353
<i>Total liabilities</i> .....	<b>242,709</b>	216,004
Stockholders' equity:		
Preferred stock, no par, authorized 20,000,000 shares, no shares issued .....	-	-
Common stock, par value \$1 per share, authorized 20,000,000 shares, 3,762,161 and 3,741,629 shares issued and outstanding, respectively .....	3,762	3,742
Additional paid-in capital .....	33,983	33,774
Deficit .....	(10,647)	(6,938)
Net unrealized gains on available-for-sale securities .....	1,030	400
<i>Total stockholders' equity</i> .....	<b>28,128</b>	30,978
<b>COMMITMENTS AND CONTINGENCIES</b>		
<i>Total liabilities and stockholders' equity</i> .....	<b>\$ 270,837</b>	\$ 246,982

See accompanying notes to consolidated financial statements.

*Consolidated Statements of Operations*  
**For the Three Years Ended December 31, 2008**

<i>(In Thousands, Except Per Share Amounts)</i>	<b>2008</b>	2007	2006
Interest income:			
Interest and fees on loans .....	<b>\$ 12,699</b>	\$ 12,895	\$ 9,442
Interest and dividends on taxable securities ..	<b>1,641</b>	1,882	1,010
Interest on Federal funds sold .....	<b>8</b>	195	518
Interest and dividends on restricted equity securities .....	<b>87</b>	77	50
Interest on interest-bearing balances at other financial institutions .....	<b>1</b>	-	-
<i>Total interest income</i> .....	<b>14,436</b>	15,049	11,020
Interest expense:			
Interest on negotiable order of withdrawal accounts .....	<b>130</b>	330	223
Interest on money market and other savings accounts .....	<b>745</b>	944	908
Interest on certificates of deposit.....	<b>4,598</b>	5,799	4,161
Interest on Fed funds purchased and securities sold under agreement to repurchase .....	<b>53</b>	23	12
Interest on advances from Federal Home Loan Bank.....	<b>252</b>	83	-
<i>Total interest expense</i> .....	<b>5,778</b>	7,179	5,304
Net interest income before provision for loan losses .....	<b>8,658</b>	7,870	5,716
Provision for loan losses.....	<b>4,514</b>	400	611
Net interest income after provision for loan losses .....	<b>4,144</b>	7,470	5,105
Non-interest income .....	<b>1,809</b>	1,542	1,047
Non-interest expense .....	<b>9,662</b>	8,853	7,356
<i>Earnings (loss) before income taxes</i> ...	<b>(3,709)</b>	159	(1,204)
Income taxes .....	-	-	-
<i>Earnings (loss)</i> .....	<b>\$ (3,709)</b>	\$ 159	\$ (1,204)
Basic earnings (loss) per common share .....	<b>\$ (.99)</b>	\$ .04	\$ (.38)
Diluted earnings (loss) per common share .....	<b>\$ (.99)</b>	\$ .04	\$ (.38)

See accompanying notes to consolidated financial statements.

*Consolidated Statements of Comprehensive Earnings (Losses)*  
**For the Three Years Ended December 31, 2008**

<i>(In Thousands)</i>	<b>2008</b>	2007	2006
Earnings (loss).....	\$ (3,709)	\$ 159	\$ (1,204)
Other comprehensive earnings:			
Net unrealized gains on available-for-sale securities arising during period.....	<b>630</b>	367	453
Comprehensive earnings (losses)....	<b>\$ (3,079)</b>	\$ 526	\$ (751)

*See accompanying notes to consolidated financial statements.*

*Consolidated Statements of Changes in Stockholders' Equity*  
**For the Three Years Ended December 31, 2008**

<i>(In Thousands)</i>	<i>Common Stock</i>	<i>Additional Paid-In Capital</i>	<i>Deficit</i>	<i>Net Unrealized Gains (Losses) on Available- For-Sale Securities</i>	<i>Total</i>
Balance December 31, 2005 .....	\$ 3,100	\$ 27,903	\$ (5,893)	\$ (420)	\$ 24,690
Issuance of 222,866 shares related to exercise of warrants and stock options .....	223	2,006	-	-	2,229
Stock-based compensation expense .....	-	60	-	-	60
Net change in unrealized gains (losses) on available-for- sale securities during the year .....	-	-	-	453	453
Loss for the period .....	-	-	(1,204)	-	(1,204)
Balance December 31, 2006 .....	3,323	29,969	(7,097)	33	26,228
Issuance of 418,467 shares related to exercise of warrants and stock options .....	419	3,767	-	-	4,186
Stock-based compensation expense .....	-	38	-	-	38
Net change in unrealized gains on available-for-sale securities during the year .....	-	-	-	367	367
Earnings for the period .....	-	-	159	-	159
Balance December 31, 2007 .....	3,742	33,774	(6,938)	400	30,978
Issuance of 20,532 shares related to exercise of warrants and stock options .....	20	185	-	-	205
Stock-based compensation expense .....	-	24	-	-	24
Net change in unrealized gains on available-for-sale securities during the year .....	-	-	-	630	630
Loss for the period .....	-	-	(3,709)	-	(3,709)
<b>Balance December 31, 2008 .....</b>	<b>\$ 3,762</b>	<b>\$ 33,983</b>	<b>\$ (10,647)</b>	<b>\$ 1,030</b>	<b>\$ 28,128</b>

See accompanying notes to consolidated financial statements.

*Consolidated Statements of Cash Flows*  
**For the Three Years Ended December 31, 2008**

<i>(In Thousands)</i>	<b>2008</b>	2007	2006
<b>Cash flows from operating activities:</b>			
Interest received.....	\$ 14,361	\$ 14,900	\$ 10,522
Fees received .....	1,355	1,103	1,274
Proceeds from sale of loans .....	35,750	31,173	20,043
Origination of loans held for sale .....	(34,907)	(30,010)	(21,603)
Interest paid .....	(6,060)	(7,065)	(4,999)
Cash paid to suppliers and employees .....	(8,936)	(8,050)	(6,870)
<i>Net cash provided by (used in) operating activities .....</i>	<b>1,563</b>	2,051	(1,633)
<b>Cash flows from investing activities:</b>			
Purchase of available-for-sale securities.....	(12,945)	(6,397)	(25,606)
Repayments of mortgage-backed securities..	3,793	3,522	1,882
Purchase of restricted equity securities.....	(172)	(493)	(351)
Proceeds from sale of restricted equity securities.....	30	160	9
Maturities of available-for-sale securities.....	8,044	8,410	3,125
Loans made to customers, net of repayments .....	(31,342)	(44,376)	(46,105)
Purchase of premises and equipment.....	(74)	(308)	(2,598)
Capitalized cost of foreclosed assets.....	(64)	-	-
Proceeds from sales of foreclosed assets .....	1,024	-	-
<i>Net cash used in investing activities...</i>	<b>(31,706)</b>	(39,482)	(69,644)
<b>Cash flows from financing activities:</b>			
Net (decrease) increase in non-interest bearing savings and NOW deposit accounts .....	(1,468)	10,455	31,046
Net increase in time deposits .....	16,950	4,477	54,019
Proceeds from advances from the Federal Home Loan Bank.....	101,055	25,996	-
Repayments of advances from the Federal Home Loan Bank.....	(94,934)	(18,650)	-
Proceeds from Fed funds purchased .....	4,467	226	-
Increase in securities sold under agreement to repurchase .....	836	-	-
Proceeds from sale of common stock .....	205	4,186	2,229
<i>Net cash provided by financing activities.....</i>	<b>27,111</b>	26,690	87,294
Net increase (decrease) in cash and cash equivalents .....	<b>(3,032)</b>	(10,741)	16,017
Cash and cash equivalents at beginning of year .....	<b>8,858</b>	19,599	3,582
Cash and cash equivalents at end of year.....	<b>\$ 5,826</b>	\$ 8,858	\$ 19,599

*See accompanying notes to consolidated financial statements.*

*Consolidated Statements of Cash Flows, Continued*  
**For the Three Years Ended December 31, 2008**

<i>(In Thousands)</i>	<b>2008</b>	2007	2006
Reconciliation of earnings (loss) to net cash provided by (used in) operating activities:			
Earnings (loss).....	\$ (3,709)	\$ 159	\$ (1,204)
Adjustments to reconcile earnings (loss) to net cash provided by (used in) operating activities:			
Depreciation.....	709	625	628
Gain on sale of restricted equity securities.....	-	(14)	-
Gain on sale of foreclosed assets ..	(4)	-	-
Provision for loan losses.....	4,514	400	611
Amortization and accretion, net....	(160)	(69)	(22)
Stock-based compensation expense.....	24	38	60
Valuation adjustment on foreclosed assets.....	38	50	-
Decrease (increase) in loans held for sale.....	393	752	(1,560)
Decrease (increase) in accrued interest receivable.....	85	(80)	(411)
Increase in other assets .....	(126)	(14)	(51)
Increase (decrease) in accrued interest payable.....	(282)	114	305
Increase in accounts payable and other liabilities.....	81	90	11
<i>Total adjustments .....</i>	<b>5,272</b>	1,892	(429)
<i>Net cash provided by (used in) operating activities .....</i>	<b>\$ 1,563</b>	\$ 2,051	\$ (1,633)
Supplemental Schedule of Non-Cash Activities:			
Unrealized gain in value of securities available-for-sale .....	\$ 630	\$ 367	\$ 453
Transfer of loans to foreclosed assets.....	\$ 1,172	\$ 1,359	\$ -
Reclassification of construction in process	\$ 18	\$ -	\$ -

See accompanying notes to consolidated financial statements.

*Notes to Consolidated Financial Statements*  
December 31, 2008, 2007 and 2006

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(1) **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The accounting and reporting policies of MidSouth Bank and subsidiary (“the Bank”) are in accordance with accounting principles generally accepted in the United States of America and conform to general practices within the banking industry. The following is a brief summary of the more significant policies.

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(a) *Principles of Consolidation*

The consolidated financial statements include the accounts of MidSouth Bank and its wholly-owned subsidiary, MSB Services, Inc. All significant intercompany accounts and transactions have been eliminated in consolidation.

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(b) *Nature of Operations*

MidSouth Bank operates under a state bank charter and provides full banking services. As a state bank, the Bank is subject to regulations of the Tennessee Department of Financial Institutions and the Board of Governors of the Federal Reserve System. The area served by MidSouth Bank is Rutherford County and adjacent counties of Middle Tennessee. Services are provided at the main office and three branch offices located in Murfreesboro, Tennessee and two branch offices located in Smyrna, Tennessee.

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(c) *Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to determination of the allowance for loan losses, valuation of debt and equity securities and the related deferred taxes and foreclosed assets.

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(d) *Loans*

Loans are stated at the principal amount outstanding. The allowance for loan losses is shown as reductions of loans. Loan origination and commitment fees and certain loan-related costs are being deferred and the net amount amortized as an adjustment of the related loan’s yield over the contractual life of the loan. Interest income on loans is accrued based on the principal amount outstanding.

The Bank follows the provisions of Statement of Financial Accounting Standards (SFAS) No. 114, “Accounting by Creditors for Impairment of a Loan” and SFAS No. 118, “Accounting by Creditors for Impairment of a Loan - Income Recognition and Disclosures”. These pronouncements apply to impaired loans except for large groups of smaller-balance homogeneous loans that are collectively evaluated for impairment including residential mortgage and installment loans.

*Notes to Consolidated Financial Statements*  
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A loan is impaired when it is probable that the Bank will be unable to collect the scheduled payments of principal and interest due under the contractual terms of the loan agreement. Impaired loans are measured at the present value of expected future cash flows discounted at the loan's effective interest rate, at the loan's observable market price, or the fair value of the collateral if the loan is collateral dependent. If the measure of the impaired loan is less than the recorded investment in the loan, the Bank recognizes an impairment by creating a valuation allowance with a corresponding charge to the provision for loan losses or by adjusting an existing valuation allowance for the impaired loan with a corresponding charge or credit to the provision for loan losses.

The Bank's installment and residential mortgage loans which total \$3,644,000 and \$46,718,000 (including \$594,000 of loans held for sale), respectively, at December 31, 2008, are divided into various groups of smaller-balance homogeneous loans that are collectively evaluated for impairment and, thus, are not subject to the provisions of SFAS Nos. 114 and 118. Substantially all other loans of the Bank are evaluated for impairment under the provisions of SFAS Nos. 114 and 118.

The Bank considers all loans subject to the provisions of SFAS Nos. 114 and 118 that are on a nonaccrual status to be impaired. Loans are placed on nonaccrual status when doubt as to timely collection of principal or interest exists, or when principal or interest is past due 90 days or more unless such loans are well-secured and in the process of collection. Past due status of loans is based on the contractual terms of the loan. Delays or shortfalls in loan payments are evaluated along with various other factors to determine if a loan is impaired. Generally, delinquencies under 90 days are considered insignificant unless certain other factors are present which indicate impairment is probable. The decision to place a loan on nonaccrual status is also based on an evaluation of the borrower's financial condition, collateral, liquidation value, and other factors that affect the borrower's ability to pay.

Generally, at the time a loan is placed on nonaccrual status, all interest accrued and uncollected on the loan in the current fiscal year is reversed from income, and all interest accrued and uncollected from the prior year is charged off against the allowance for loan losses. Thereafter, interest on nonaccrual loans is recognized as interest income only to the extent that cash is received and future collection of principal is not in doubt. If the collectibility of outstanding principal is doubtful, such cash received is applied as a reduction of principal. A nonaccrual loan may be restored to an accruing status when principal and interest are no longer past due and unpaid and future collection of principal and interest on a timely basis is not in doubt.

Loans not on nonaccrual status are classified as impaired in certain cases when there is inadequate protection by the current net worth and financial capacity of the borrower or of the collateral pledged, if any. In those cases, such loans have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt, and if such deficiencies are not corrected, there is a probability that the Bank will sustain some loss. In such cases, interest income continues to accrue as long as the loan does not meet the Bank's criteria for nonaccrual status.

Generally, the Bank also classifies as impaired any loans the terms of which have been modified in a troubled debt restructuring. Interest is generally accrued on such loans that continue to meet the modified terms of their loan agreements.

The Bank's charge-off policy for impaired loans is similar to its charge-off policy for all loans in that loans are charged off in the month when they are considered uncollectible.

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(e) *Allowance for Loan Losses*

The provision for loan losses represents a charge to earnings necessary, after loan charge-offs and recoveries, to maintain the allowance for loan losses at an appropriate level which is adequate to absorb estimated losses inherent in the loan portfolio. Such estimated losses arise primarily from the loan portfolio but may also be derived from other sources, including commitments to extend credit and letters of credit. The level of the allowance is determined on a monthly basis using procedures which include: (1) categorizing commercial and commercial real estate loans into risk categories to estimate loss probabilities based primarily on the historical loss experience of those risk categories and current economic conditions; (2) analyzing significant commercial

*Notes to Consolidated Financial Statements*  
December 31, 2008, 2007 and 2006

and commercial real estate credits and calculating specific reserves as necessary; (3) assessing various homogeneous consumer loan categories to estimate loss probabilities based primarily on historical loss experience; and (4) considering various other factors, such as changes in credit concentrations, loan mix, and economic conditions which may not be specifically quantified in the loan analysis process.

The allowance for loan losses consists of an allocated portion and an unallocated, or general, portion. The allocated portion is maintained to cover estimated losses applicable to specific segments of the loan portfolio. The unallocated portion is maintained to absorb losses which probably exist as of the evaluation date but are not identified by the more objective processes used for the allocated portion of the allowance due to risk of errors or imprecision. While the total allowance consists of an allocated portion and an unallocated portion, these terms are primarily used to describe a process. Both portions of the allowance are available to provide for inherent loss in the entire portfolio.

The allowance for loan losses is increased by provisions for loan losses charged to expense and is reduced by loans charged off net of recoveries on loans previously charged off. The provision is based on management's determination of the amount of the allowance necessary to provide for estimated loan losses based on its evaluation of the loan portfolio. Determining the appropriate level of the allowance and the amount of the provision involves uncertainties and matters of judgment and therefore cannot be determined with precision.

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(f) *Securities*

The Bank accounts for securities under the provisions of SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities". Under the provisions of the Statement, securities are classified in three categories and accounted for as follows:

- *Securities Held-to-Maturity*

Debt securities that the Bank has the positive intent and ability to hold to maturity are classified as held-to-maturity securities and reported at amortized cost. Amortization of premiums and accretion of discounts are recognized by the interest method. No securities have been classified as held-to-maturity.

- *Trading Securities*

Debt and equity securities that are bought and held principally for the purpose of selling them in the near term are classified as trading securities and reported at fair value, with unrealized gains and losses included in earnings. No securities have been classified as trading securities.

- *Securities Available-for-Sale*

Debt and equity securities not classified as either held-to-maturity securities or trading securities are classified as available-for-sale securities and reported at estimated fair value, with unrealized gains and losses excluded from earnings and reported in a separate component of stockholders' equity. Premiums and discounts are recognized by the interest method.

The Bank has classified all its securities as available-for-sale.

If a decline in the fair value of a security below its amortized cost is judged by management to be an other-than-temporary loss, the cost basis of the security is written down to fair value, and the amount of the write-down is included in the statement of operations. In estimating other-than-temporary losses, management considers the following: the length of time and extent to which fair value has been less than cost, the financial condition and near-term prospects of the issue and the Bank's ability and intent to hold the security for a period sufficient to allow for any anticipated recovery in fair value.

*Notes to Consolidated Financial Statements*  
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Realized gains or losses from the sale of securities are recognized based upon the specific identification method.

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**(g) *Loans Held for Sale***

Mortgage loans held for sale are reported at the lower of cost or market value determined by outstanding commitments from investors at the balance sheet date. These loans are valued on an aggregate basis.

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**(h) *Bank Premises and Equipment***

Premises and equipment are stated at cost. Depreciation is computed by the straight-line method over the estimated useful lives of the related assets. Gain or loss on items retired and otherwise disposed of is credited or charged to operations, and cost and related accumulated depreciation are removed from the asset and accumulated depreciation accounts.

Expenditures for major renewals and improvements of bank premises and equipment are capitalized and those for maintenance and repairs are charged to earnings as incurred.

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**(i) *Foreclosed Assets***

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at the lower of cost or fair value less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management, and the assets are carried at the lower of carrying amount or fair value less estimated retention and disposition costs. Revenue and expenses from operations and changes in the valuation allowance are included in non-interest expenses.

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**(j) *Cash and Cash Equivalents***

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, Federal funds sold and interest-bearing deposits at other financial institutions. Generally, Federal funds sold are purchased and sold for one-day periods. The Bank maintains deposits in excess of the Federal insurance amounts with other financial institutions. Management makes deposits only with financial institutions it considers to be financially sound.

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**(k) *Interest-Bearing Accounts at Other Financial Institutions***

Interest-bearing accounts at other financial institutions mature within one year and are carried at cost.

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**(l) *Long-Term Assets***

Premises and equipment and other long-term assets are reviewed for impairment when events indicate their carrying amount may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at the lower of cost or fair value.

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*Notes to Consolidated Financial Statements*  
December 31, 2008, 2007 and 2006

**(m) Stock Options**

The Bank accounts for the MidSouth Bank 2004 Stock Option Arrangement (the "Arrangement") using the provisions of SFAS No. 123R, "Share-Based Payment (Revised 2004)." The Bank recognizes stock compensation cost for services received in a share-based payment transaction over the required write-down period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award. The compensation cost of employee and director services received in exchange for stock awards is based on the grant date fair value of the award (as determined by using a Black-Scholes option valuation model). Stock compensation expense recognized reflects estimated forfeitures, adjusted as necessary for actual forfeitures.

The fair value of each option award is estimated on the date of grant using a Black-Scholes option valuation model that uses the following assumptions. Expected volatility is based on implied volatility from comparable publicly traded banks. The Bank uses historical data to estimate option exercise and employee termination within the valuation model; separate groups of employees that have similar historical exercise behavior are considered separately for valuation purposes. The expected term of options granted is derived from the average of: 1) the weighted average vesting term and 2) original contractual term as permitted under the Securities and Exchange Commission ("SEC") Staff Accounting Bulletin No. 107. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant and the weighted average expected life of the grant.

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**(n) Income Taxes**

Provisions for income taxes are based on taxes payable or refundable for the current year (after exclusion of non-taxable income such as interest on state and municipal securities) and deferred taxes on temporary differences between the amount of taxable and pretax financial income and between the tax bases of assets and liabilities and their reported amounts in the consolidated financial statements. Deferred tax assets and liabilities are included in the consolidated financial statements at currently enacted income tax rates applicable to the period in which the deferred tax asset and liabilities are expected to be realized or settled as prescribed in SFAS No. 109, "Accounting for Income Taxes." As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the consolidated financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying consolidated balance sheets along with any associated interest and penalties that would be payable to the taxing authorities upon examination. Interest and penalties associated with unrecognized tax benefits are classified as additional income taxes in the consolidated statement of operations.

The Bank is currently open to audit under the statute of limitations by the Internal Revenue Service for the years ended December 31, 2004 through 2008 and the State of Tennessee for the years ended December 31, 2003 through 2008.

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**(o) Advertising Costs**

Advertising costs are expensed when incurred by the Bank.

*Notes to Consolidated Financial Statements*  
December 31, 2008, 2007 and 2006

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**(p) *Off-Balance-Sheet Financial Instruments***

In the ordinary course of business the Bank has entered into off-balance-sheet financial instruments consisting of commitments to extend credit, commercial letters of credit and standby letters of credit. Such financial instruments are recorded in the consolidated financial statements when they are funded or related fees are incurred or received.

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**(q) *Derivative Financial Instruments***

Derivative financial instruments are recognized as assets and liabilities in the consolidated financial statements and measured at fair value.

*Derivative Loan Commitments*

Mortgage loan commitments are referred to as derivative loan commitments if the loan that will result from exercise of the commitment will be held for sale upon funding. Loan commitments that are derivatives are recognized at fair value in the consolidated balance sheet with changes in their fair values recorded in fees on mortgage originations.

The Bank records a zero value for the loan commitment at inception (at the time the commitment is issued to a borrower (“the time of rate lock”), consistent with Emerging Issues Task Force (“EITF”) 02-3, “Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities”, and SEC Staff Accounting Bulletin (“SAB”) No. 109, “Written Loan Commitments Recorded at Fair Value through Earnings”, and accordingly, does not recognize the value of the expected normal servicing rights until the underlying loan is sold. Subsequent to inception, changes in fair values of the loan commitments are recognized based on changes in the fair values of the underlying mortgage loans due to interest rate changes, changes in the probability the derivative loan commitments will be exercised, and the passage of time. In estimating fair value, the Bank assigns a probability to a loan commitment based on an expectation that it will be exercised and the loan will be funded.

*Forward Loan Sale Commitments*

The Bank carefully evaluates each loan sales agreement to determine whether it meets the definition of a derivative under SFAS No. 133 as facts and circumstances may differ significantly for each agreement. If agreements qualify, to protect against the price risk inherent in derivative loan commitments, the Bank utilizes “best efforts” forward loan sales commitments to mitigate the risk of potential decreases in the values of loans that would result from the exercise of the derivative loan commitments. Generally, the Bank’s best efforts contracts meet the definition of derivative instruments. Accordingly, forward loan sale commitments that economically hedge derivative loan commitments are recognized at fair value in the consolidated balance sheet with changes in their fair values recorded in fees on mortgage originations.

The Bank estimates the fair value of its forward loan sales commitments using a methodology similar to that used for derivative loan commitments.

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**(r) *Impact of New Accounting Standards***

In September 2006, the Financial Accounting Standards Board (“FASB”) issued SFAS No. 157, “Fair Value Measurements”. This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This Statement establishes a fair value hierarchy about the assumptions used to measure fair value and clarifies assumptions about risk and the effect of a restriction on

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the sale or use of an asset. The standard is effective for fiscal years beginning after November 15, 2007. The impact of adoption in 2008 did not have a material impact on the Bank's consolidated financial position or results of operations. In February 2008, the FASB issued Staff Position ("FSP") 157-2, "Effective Date of FASB Statement No. 157". This FSP delays the effective date of SFAS No. 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. The impact of adoption was not material. In October 2008, the FASB issued FSP 157-3, "Determining the Fair Value of a Financial Asset when the Market for That Asset Is Not Active". This FSP clarifies the application of SFAS No. 157 in a market that is not active. The impact of adoption was not material.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities". The standard provides companies with an option to report selected financial assets and liabilities at fair value and establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. The new standard became effective for the Bank on January 1, 2008. The Bank did not elect the fair value option for any financial assets or financial liabilities as of January 1, 2008.

On November 5, 2007, the SEC issued SAB No. 109, "Written Loan Commitments Recorded at Fair Value through Earnings". Previously, SAB No. 105, "Application of Accounting Principles to Loan Commitments", stated that in measuring the fair value of a derivative loan commitment, a company should not incorporate the expected net future cash flows related to the associated servicing of the loan. SAB No. 109 supersedes SAB No. 105 and indicates that the expected net future cash flows related to the associated servicing of the loan should be included in measuring fair value for all written loan commitments that are accounted for at fair value through earnings. SAB No. 105 also indicated that internally-developed intangible assets should not be recorded as part of the fair value of a derivative loan commitment, and SAB No. 109 retains that view. SAB No. 109 is effective for derivative loan commitments issued or modified in fiscal quarters beginning after December 15, 2007. The impact of adoption in 2008 did not have a material impact on the Bank's consolidated financial position or results of operations.

On September 12, 2008, the FASB issued FSP No. 133-1 and FASB Interpretation ("FIN") 45-4, "Disclosures and Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FIN No. 45; and Clarification of the Effective Date of FASB Statement No. 161" (FSP No. 133-1). FSP No. 133-1 requires expanded disclosures about credit derivatives and guarantees. The expanded disclosure requirements for FSP No. 133-1 are effective for the Bank's consolidated financial statements for the year ending December 31, 2008 and earlier adoption is not permitted. The adoption of FSP No. 133-1 did not have a material impact on the Bank's consolidated financial position, results of operations or cash flows.

On December 11, 2008, the FASB issued FSP No. 140-4 and FIN 46(R)-8, "Disclosures by Public Entities about Transfers of Financial Assets and Interests in Variable Interest Entities". The FSP requires additional disclosure regarding Transfers of Financial Assets and Variable Interest Entities. The FSP became effective for the first interim or annual reporting period ending after December 15, 2008. As the Bank does not have any variable interests in Variable Interest Entities, and does not securitize its loans or other financial assets the FSP did not have an impact on the Bank's consolidated financial position, results of operations or cash flows, or our footnote disclosures.

In December 2007, the FASB issued SFAS No. 141R, (revised 2007) "Business Combinations". SFAS No. 141R replaces the current standard on business combinations and has significantly changed the accounting for and reporting of business combinations in consolidated financial statements. This statement requires an entity to measure the business acquired at fair value and to recognize goodwill attributable to any non-controlling interests (previously referred to as minority interests) rather than just the portion attributable to the acquirer. The statement will also result in fewer exceptions to the principle of measuring assets acquired and liabilities assumed in a business combination at fair value. In addition, the statement requires payments to third parties for consulting, legal, audit, and similar services associated with an acquisition to be recognized as expenses when incurred rather than capitalized as part of the business combination. SFAS No. 141R is effective for fiscal years beginning on or after December 15, 2008. The adoption of SFAS No. 141R could have a material impact to the consolidated financial statements if any business combinations are entered into after the effective date.

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In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities an Amendment of FASB Statement No. 133". SFAS No. 161 amends SFAS No. 133 by requiring expanded disclosures about an entity's derivative instruments and hedging activities, but does not change SFAS No. 133's scope or accounting. This statement requires increased qualitative, quantitative, and credit-risk disclosures. SFAS No. 161 also amends SFAS No. 107 to clarify that derivative instruments are subject to SFAS No. 107's concentration-of-credit-risk disclosures. SFAS No. 161 is effective for fiscal years beginning on or after November 15, 2008. The adoption of SFAS No. 161 in 2009 is not expected to have a material impact on the Bank's consolidated financial position, results of operations or cash flows.

In June 2008, the FASB issued FSP No. EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities". The FSP addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing EPS under the two-class method. The FSP affects entities that accrue cash dividends on share-based payment awards during the awards' service period when the dividends do not need to be returned if the employees forfeit the awards. FSP No. EITF 03-6-1 is effective for fiscal years beginning after December 15, 2008. The Bank does not accrue cash dividends, therefore, the adoption of FSP No. EITF 03-6-1 in 2009 will not have a material impact on the Bank's consolidated financial position, results of operations or cash flows.

(s) **Reclassifications**

Certain reclassifications have been made to the 2007 and 2006 figures to conform to the presentation for 2008.

(2) **LOANS AND ALLOWANCE FOR LOAN LOSSES**

The classification of loans at December 31, 2008 and 2007 is as follows:

<i>(In Thousands)</i>	<b>2008</b>	2007
Commercial, financial and agricultural.....	\$ 130,342	\$ 106,564
Real estate - construction.....	42,404	55,451
Real estate - mortgage.....	46,124	27,611
Consumer.....	3,644	3,480
	<b>222,514</b>	193,106
Allowance for loan losses.....	<b>(5,784)</b>	(2,032)
Net loans.....	<b>\$ 216,730</b>	\$ 191,074

The principal maturities on loans at December 31, 2008 are as follows:

<i>(In Thousands)</i>	<i>Commercial, Financial and Agricultural</i>	<i>Real Estate - Construction</i>	<i>Real Estate - Mortgage</i>	<i>Consumer</i>	<i>Total</i>
3 months or less .....	\$ 16,061	\$ 18,483	\$ 1,196	\$ 278	\$ 36,018
3 to 12 months.....	29,741	22,802	6,287	1,670	60,500
1 to 5 years.....	74,141	994	21,672	1,642	98,449
Over 5 Years .....	10,399	125	16,969	54	27,547
	<b>\$ 130,342</b>	<b>\$ 42,404</b>	<b>\$ 46,124</b>	<b>\$ 3,644</b>	<b>\$ 222,514</b>

*Notes to Consolidated Financial Statements*  
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At December 31, 2008, variable rate and fixed rate loans totaled \$90,836,000 and \$131,678,000, respectively. At December 31, 2007, variable rate and fixed rate loans totaled \$93,302,000 and \$99,804,000, respectively.

In the normal course of business, the Bank has made loans at prevailing interest rates and terms to its executive officers, directors and their affiliates aggregating \$16,702,000 and \$11,791,000 at December 31, 2008 and 2007, respectively. During 2008 and 2007, \$9,065,000 and \$9,185,000, respectively, in loan advances were made, and \$4,154,000 and \$5,617,000, respectively, in repayments were made. As of December 31, 2008 and 2007 none of these loans were restructured, nor were any related party loans charged off during the past three years, nor did they involve more than the normal risk of collectibility or present other unfavorable features.

Transactions in the allowance for loan losses of the Bank for the year ended December 31, 2008, 2007 and 2006 are summarized as follows:

<i>(In Thousands)</i>	<b>2008</b>	2007	2006
Balance - beginning of year .....	\$ 2,032	\$ 1,922	\$ 1,317
Provision charged to operating expense .....	4,514	400	611
Loans charged off .....	(767)	(350)	(7)
Recoveries .....	5	70	1
Reclassification of allowance for off-balance sheet items.....	-	(10)	-
Balance - end of year .....	<b>\$ 5,784</b>	<b>\$ 2,032</b>	<b>\$ 1,922</b>

The Bank's principal customers are generally in the Middle Tennessee area with a concentration in Rutherford and adjacent counties. Credit is extended to businesses and individuals and is evidenced by promissory notes. The terms and conditions of the loans, including collateral, vary depending upon the purpose of each credit and each borrower's financial condition.

In 2008, 2007 and 2006, the Bank originated loans for sale in the secondary market of \$34,907,000, \$30,010,000 and \$21,603,000, respectively. The Bank's recourse related to its sold loans is limited since only one of the three entities to whom the Bank sold its loan during the fourth quarter of 2008 has recourse related to loans it purchases. The recourse period for that entity is 90 days from the purchase date for each loan and is effective only if a borrower defaults on an individual loan within that 90-day period. At December 31, 2008, the Bank had loans sold with recourse totaling \$1,189,000. At December 31, 2008, the Bank had been required to repurchase only one of the loans originated and sold in the secondary market for \$65,000. The fees on mortgage loan originations totaled \$450,000, \$411,000 and \$283,000 in 2008, 2007 and 2006, respectively.

Impaired loans and related allowance for loan loss allocation amounts at December 31, 2008 and 2007 were as follows:

<i>(In Thousands)</i>	<b>2008</b>	2007
Recorded investment .....	\$ 7,879	\$ 4,970
Loan loss allocation .....	\$ 3,603	\$ 465

Impaired loans without allowance for loan loss allocation amounts at December 31, 2008 and 2007 were as follows:

<i>(In Thousands)</i>	<b>2008</b>	2007
Recorded investment .....	\$ 1,983	\$ -

The average recorded investment in impaired loans for the year ended December 31, 2008 was \$6,308,000. The related total amount of interest income recognized on the accrual basis for the period that such loans were impaired was \$384,000 for 2008. The average recorded investment in impaired loans for the year ended December 31, 2007 was \$2,670,000. The related total amount of interest income recognized on the accrual basis for the period that such loans were impaired was \$195,000 for 2007.

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There were no loans that were past due 90 days or more and still accruing interest at December 31, 2008 and 2007. Non-accrual loans totaled \$2,338,000 at December 31, 2008, and there were no non-accrual loans at December 31, 2007.

**(3) DEBT AND EQUITY SECURITIES**

Debt and equity securities have been classified in the consolidated balance sheets according to management's intent. The Bank's classification of securities at December 31, 2008 and 2007 is as follows:

<b>2008</b>				
<i>Securities Available-for-Sale</i>				
<i>(In Thousands)</i>	<i>Amortized Cost</i>	<i>Gross Unrealized Gains</i>	<i>Gross Unrealized Losses</i>	<i>Estimated Market Value</i>
U.S. Treasury and other U.S. Government agencies and corporations .....	\$ 4,500	\$ 39	\$ -	\$ 4,539
Mortgage-backed securities .....	27,214	991	7	28,198
Corporate .....	402	7	-	409
	<b>\$ 32,116</b>	<b>\$ 1,037</b>	<b>\$ 7</b>	<b>\$ 33,146</b>

<b>2007</b>				
<i>Securities Available-for-Sale</i>				
<i>(In Thousands)</i>	<i>Amortized Cost</i>	<i>Gross Unrealized Gains</i>	<i>Gross Unrealized Losses</i>	<i>Estimated Market Value</i>
U.S. Treasury and other U.S. Government agencies and corporations .....	\$ 8,386	\$ 82	\$ 2	\$ 8,466
Mortgage-backed securities .....	22,060	345	29	22,376
Corporate .....	402	4	-	406
	<b>\$ 30,848</b>	<b>\$ 431</b>	<b>\$ 31</b>	<b>\$ 31,248</b>

The amortized cost and estimated market value of debt and equity securities at December 31, 2008, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

<i>(In Thousands)</i>	<i>Amortized Cost</i>	<i>Estimated Market Value</i>
<i>Securities Available-for-Sale</i>		
Due in one year or less .....	\$ 2,383	\$ 2,386
Due after one year through five years.....	6,033	6,246
Due after five years through ten years.....	17,551	18,098
Over ten years.....	6,149	6,416
	<b>\$ 32,116</b>	<b>\$ 33,146</b>

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There were no sales of available-for-sale securities during 2008, 2007 or 2006.

Securities carried in the consolidated balance sheets of approximately \$6,197,000 (approximate book value of \$5,952,000) and \$5,136,000 (approximate book value of \$5,084,000) at December 31, 2008 and 2007, respectively, were pledged to secure public deposits and for other purposes as required or permitted by law.

Securities that have rates that adjust prior to maturity totaled \$1,021,000 (approximate market value of \$1,043,000) and \$1,389,000 (approximate market value of \$1,409,000) at December 31, 2008 and 2007, respectively.

The following table shows the Bank's investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in continuous unrealized loss position, at December 31, 2008:

<i>In Thousands, Except Number of Securities</i>								
Less than 12 Months			12 Months or More			Total		
Fair Value	Unrealized Losses	Number of Securities Included	Fair Value	Unrealized Losses	Number of Securities Included	Fair Value	Unrealized Losses	
Mortgage-backed securities.....	\$ 346	\$ 7	2	\$ -	\$ -	-	\$ 346	\$ 7
Total temporarily impaired securities.....	\$ 346	\$ 7	2	\$ -	\$ -	-	\$ 346	\$ 7

These securities are considered high quality investments in line with normal industry investing practices. The unrealized losses are primarily the result of changes in the interest rate and sector environments. Consistent with the original classification as available-for-sale securities, the Bank intends and has the ability and intent to hold the above securities until the value is realized.

The Bank may sell the above or other securities in the ordinary course of business in response to unexpected and significant changes in liquidity needs, unexpected and significant increases in interest rates and/or sector spreads that significantly extend the security's holding period, or conducting a small volume of security transactions.

#### (4) RESTRICTED EQUITY SECURITIES

Restricted equity securities consist of stock of the Federal Reserve Bank and the Federal Home Loan Bank of Cincinnati amounting to \$909,000 and \$672,000, respectively, at December 31, 2008. At December 31, 2007, restricted equity securities consisted of stock of the Federal Reserve Bank of Atlanta and the Federal Home Loan Bank of Cincinnati amounting to \$897,000 and \$542,000, respectively. The stock can be sold back only at par or a value as determined by the issuing institution and only to the respective financial institution or to another member institution. These securities are recorded at cost.

During the year ended December 31, 2008, the Bank sold a portion of its restricted stock of the Federal Reserve Bank of Atlanta for proceeds of \$30,000, with no gain or loss being realized. During the year ended December 31, 2007, the Bank sold its restricted stock of the Bankers Bank for proceeds of \$141,000 resulting in a realized gain of \$14,000. The Bank also sold a portion of its restricted stock of the Federal Reserve Bank of Atlanta for proceeds of \$19,000, with no gain or loss being realized. During the year ended December 31, 2006, the Bank sold a portion of its restricted stock of the Federal Reserve Bank for proceeds of \$9,000, with no gain or loss being realized.

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**(5) BANK PREMISES AND EQUIPMENT**

The classification of premises and equipment at December 31, 2008 and 2007 are as follows:

<i>(In Thousands)</i>	<b>2008</b>	2007
Land.....	\$ 3,911	\$ 3,911
Buildings.....	5,494	5,492
Leasehold improvements.....	129	129
Furniture and equipment.....	2,783	2,694
Automobiles.....	61	61
Construction in process.....	382	398
	<b>12,760</b>	12,685
Less accumulated depreciation.....	<b>(2,661)</b>	(1,933)
	<b>\$ 10,099</b>	\$ 10,752

Depreciation expense was \$709,000, \$625,000 and \$628,000 for the years ended December 31, 2008, 2007 and 2006, respectively.

The Bank anticipates opening additional branches but the timing and cost is not yet determinable. In addition, the Bank anticipates renovating and expanding the main office facilities but the timing and cost has not yet been determined.

**(6) DEPOSITS**

Deposits at December 31, 2008 and 2007 are summarized as follows:

<i>(In Thousands)</i>	<b>2008</b>	2007
Demand deposits.....	\$ 28,595	\$ 25,987
Savings deposits.....	1,747	1,162
Negotiable order of withdrawal accounts.....	22,703	30,599
Money market demand accounts.....	39,330	36,095
Certificates of deposit \$100,000 or greater.....	53,332	68,182
Other certificates of deposit.....	71,736	40,101
Individual retirement accounts \$100,000 or greater.....	2,523	2,137
Other individual retirement accounts.....	2,964	3,185
	<b>\$ 222,930</b>	\$ 207,448

Principal maturities of certificates of deposit and individual retirement accounts at December 31, 2008 are as follows:

<i>(In Thousands)</i>	<b>Total</b>
2009.....	\$ 112,064
2010.....	13,385
2011.....	1,704
2012.....	1,678
2013.....	1,724
	<b>\$ 130,555</b>

At December 31, 2008 and 2007, certificates of deposit and individual retirement accounts in denominations of \$100,000 or more amounted to \$55,855,000 and \$70,319,000, respectively. Included in time deposits in denominations of \$100,000 or more at December 31, 2008, are approximately \$42,129,000 of time deposits in denominations of more

*Notes to Consolidated Financial Statements*  
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than \$100,000 but less than \$250,000 with maturities prior to December 31, 2009, as those qualify for expanded FDIC insurance coverage.

The aggregate amount of overdrafts reclassified as loans receivable was \$31,000 and \$11,000 at December 31, 2008 and 2007, respectively.

The Bank is required to maintain cash balances or balances with the Federal Reserve Bank or other correspondent banks based on certain percentages of deposit types. The average required amounts for the years ended December 31, 2008 and 2007 were approximately \$1,216,000 and \$1,106,000, respectively.

**(7) SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE**

The following is a summary of information pertaining to securities sold under agreement to repurchase at December 31, 2008:

<i>(In Thousands)</i>	<b>2008</b>
Ending balance.....	<b>\$ 836</b>
Weighted average interest rate at year-end ....	<b>1.00%</b>

Securities sold under agreements to repurchase, which are classified as secured borrowings, generally mature within one to four days from the transaction date. Securities sold under agreements to repurchase are reflected at the amount of cash received in connection with the transaction. The Bank may be required to provide additional collateral based on the fair value of the underlying security. The securities sold under agreements to repurchase are collateralized by government agency and mortgage-backed securities held by the Bank.

Information concerning securities sold under agreements to repurchase is summarized below for the year ended December 31, 2008:

<i>(In Thousands)</i>	<b>2008</b>
Average daily balance during the year.....	<b>\$ 920</b>
Maximum month-end balance during the year ...	<b>\$ 1,653</b>
Average interest rate during the year .....	<b>1.66%</b>

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**(8) BORROWINGS**

A summary of the Bank's borrowings is as follows:

<i>(Dollars In Thousands)</i>	Principal	Interest rate	Maturity date	Total committed
<i>December 31, 2008</i>				
Short-term borrowings:				
FHLB cash management advance line.....	\$ 11,100	0.47%		\$ 12,665
Total short-term borrowings .....	11,100			12,665
Long-term borrowings:				
FHLB term note (fixed rate).....	2,367	4.61%	5/1/2015	
Total long-term borrowings.....	2,367			
Total borrowings.....	\$ 13,467			\$ 12,665
<hr/>				
<i>(Dollars In Thousands)</i>	Principal	Interest rate	Maturity date	Total committed
<i>December 31, 2007</i>				
Short-term borrowings:				
FHLB cash management advance line.....	\$ 7,346	4.28%		\$ 20,000
Total short-term borrowings.....	7,346			20,000
Total borrowings.....	\$ 7,346			\$ 20,000

Each advance with the Federal Home Loan Bank ("FHLB") is payable at its maturity date, with a prepayment penalty if paid prior to maturity. The weighted average rate on the FHLB term note is 4.61% at December 31, 2008. The note is amortized over 20 years and has a balloon payment due at maturity.

The maturity schedule of the FHLB term note at December 31, 2008 is as follows:

<i>(In Thousands)</i>	
2009.....	\$ 77
2010.....	81
2011.....	85
2012.....	89
2013.....	93
Thereafter .....	1,942
	\$ 2,367

The Bank has executed a blanket pledge and security agreement with the FHLB in the amount of \$12,665,000 and \$20,000,000 at December 31, 2008 and 2007, respectively, which encompasses certain types of loans as collateral for these borrowings. The maximum borrowing capacity for future borrowings, including term loans and the line of credit, was \$1,605,000 and \$3,300,000 at December 31, 2008 and 2007, respectively.

*Notes to Consolidated Financial Statements*  
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**(9) NON-INTEREST INCOME AND NON-INTEREST EXPENSE**

The significant components of non-interest income and non-interest expense for the years ended December 31 are presented below:

<i>(In Thousands)</i>	<b>2008</b>	2007	2006
Non-interest income:			
Service charges on deposit accounts .....	\$ 450	\$ 305	\$ 181
Fees on mortgage originations.....	450	411	283
Fees from brokerage operations .....	529	472	380
Other fees and commissions .....	376	340	203
Gain on sale of foreclosed assets, net .....	4	-	-
Gain on sale of restricted equity securities .....	-	14	-
<i>Total non-interest income</i> .....	<b>\$ 1,809</b>	<b>\$ 1,542</b>	<b>\$ 1,047</b>
Non-interest expense:			
Employee salaries and benefits.....	\$ 5,056	\$ 4,619	\$ 3,758
Occupancy expenses.....	878	794	708
Furniture and equipment expense.....	475	442	437
Professional fees .....	438	339	315
Advertising expense .....	396	354	455
Data processing expense.....	583	544	401
Computer network expense .....	105	153	93
Computer software amortization .....	28	27	64
Directors fees.....	124	114	109
Other operating expenses .....	1,411	1,307	1,001
FDIC insurance.....	168	160	15
<i>Total non-interest expense</i> .....	<b>\$ 9,662</b>	<b>\$ 8,853</b>	<b>\$ 7,356</b>

**(10) INCOME TAXES**

The components of the net deferred income tax asset at December 31, 2008 and 2007 were as follows:

<i>(In Thousands)</i>	<b>2008</b>	2007
Deferred tax asset:		
Federal .....	\$ 3,499	\$ 2,314
State .....	715	473
	<b>4,214</b>	<b>2,787</b>
Deferred tax liability:		
Federal .....	527	299
State .....	108	61
	<b>635</b>	<b>360</b>
Total net deferred assets .....	<b>3,579</b>	2,427
Less valuation allowance .....	<b>(3,579)</b>	(2,427)
Net deferred assets.....	<b>\$ -</b>	<b>\$ -</b>

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The tax effects of each type of significant item that gave rise to deferred tax assets (liabilities) at December 31, 2008 and 2007 are:

<i>(In Thousands)</i>	2008	2007
Financial statement allowance for loan losses in excess of the tax allowance .....	\$ 2,020	\$ 585
Net operating loss carryforward .....	1,969	2,069
Pre-opening costs amortized over a five-year period for tax purposes, expensed for financial statements in initial year .....	-	88
Stock compensation expense recognized for financial statement purposes and deferred for tax purposes.....	47	38
Unrealized contributions carryovers .....	7	7
Stock dividends on Federal Home Loan Bank stock recognized for financial statement purposes and deferred for tax purposes .	(9)	-
Interest on non-accrual loans deferred for financial statement purposes and recognized for tax purposes.....	113	-
Capital loss carryover .....	34	-
Allowance for foreclosed assets recognized for financial statement purposes and deferred for tax purposes.....	24	-
Excess of depreciation deducted for tax purposes over the amounts deducted for financial statements.....	(194)	(184)
Loan fees recognized for tax purposes deferred for financial statements .....	(28)	(21)
Discount accretion for securities recognized for financial statement purposes and deferred for tax purposes.....	(10)	(2)
Excess of estimated market value over amortized cost related to available-for-sale securities .....	(394)	(153)
	<b>3,579</b>	2,427
Valuation allowance .....	<b>(3,579)</b>	(2,427)
	<b>\$ -</b>	<b>\$ -</b>

Management reviews the Bank's deferred tax assets for realization based upon historical taxable income, prudent and feasible tax planning strategies, the expected timing of the reversals of existing temporary differences and expected future taxable income. The Bank records a valuation allowance to reduce our deferred tax assets to the amount that management believes will more likely than not be realized.

The components of income tax expense (benefit) are summarized as follows:

<i>(In Thousands)</i>	2008	2007	2006
Current:			
Federal .....	\$ -	\$ -	\$ -
State .....	-	-	-
	-	-	-
Deferred:			
Federal .....	(1,157)	69	(366)
State .....	(236)	14	(74)
	<b>(1,393)</b>	83	(440)
Less valuation allowance related to realization of deferred tax assets .....	<b>1,393</b>	(83)	440
Actual tax expense .....	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>

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A reconciliation of actual income tax expense (benefit) in the consolidated financial statements to the “expected” tax benefit (computed by applying the statutory Federal income tax rate of 34% to loss before income taxes) is as follows:

<i>(In Thousands)</i>	<b>2008</b>	2007	2006
Computed “expected” tax benefit .....	\$ (1,261)	\$ 54	\$ (409)
State income taxes, net of effect of Federal income taxes .....	(156)	9	(49)
Disallowed deductions .....	24	20	18
Benefit of book net operating losses not recognized .....	1,393	-	440
Reversal of valuation allowance related to deferred tax assets, net .....	-	(83)	-
Actual tax expense .....	\$ -	\$ -	\$ -

At December 31, 2008, the Bank has a net operating loss carry-forward for tax purposes of approximately \$5,142,000 which are available to reduce Federal income taxes. Unused carryforwards begin to expire in 2025.

As of December 31, 2008 and December 31, 2007, the Bank did not have any unrecognized tax benefits. The Bank does not expect the total amount of unrecognized tax benefits to significantly increase or decrease in the next twelve months. The Bank recognizes interest related to income tax matters as interest expense and penalties related to income tax matters as other noninterest expense and did not have any accrued interest and/or penalties at December 31, 2008 or 2007. No interest or penalties related to tax matters was incurred during 2008 or 2007. The Bank and its subsidiary are subject to U.S. federal income tax as well as income tax of the state of Tennessee.

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**(11) COMMITMENTS AND CONTINGENCIES**

During November, 2004, the Bank entered into a ground lease for their new branch location located on Memorial Boulevard in Murfreesboro, Tennessee. The agreement provides for lease payments of \$6,024 per month through November 2009. Thereafter, the lease payment will be adjusted every five years based on the change in the Consumer Price Index for the prior five-year lease term as provided by the Bureau of Labor Statistics of the United States Department of Labor. The ground lease expires in November 2024.

During 2005, the Bank entered into an operating lease agreement for the facility related to the operation of a branch office in Smyrna, Tennessee. The agreement provides for lease payments of \$4,000 per month through April 2010. Thereafter, this lease will be month-to-month.

The Bank has entered into a lease related to a temporary teller facility at its main office location. The lease is on a month-to-month basis with monthly payments of \$850.

Future minimum payments under these operating leases as of December 31, 2008 are as follows:

<i>(In Thousands)</i>	
<u>Year Ending December 31,</u>	
2009 .....	\$ 120
2010 .....	88
2011 .....	72
2012 .....	72
2013 .....	72
Thereafter .....	783
	\$ 1,207

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Rental payments under all leases totaled \$131,000, \$131,000 and \$133,000 for the years ended December 31, 2008, 2007 and 2006, respectively.

The Bank has lines of credit with other financial institutions, including the Federal Home Loan Bank, totaling \$41,065,000. At December 31, 2008, there was \$15,793,000 outstanding under these lines of credit.

**(12) FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK**

The Bank is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments consist primarily of commitments to extend credit. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated balance sheets. The contract or notional amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual notional amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

<i>(In Thousands)</i>	<b>Contract or Notional Amount</b>	
	<b>2008</b>	<b>2007</b>
Financial instruments whose contract amount represent credit risk:		
Unused commitments to extend credit .....	\$ 54,414	\$ 51,485
Standby letters of credit .....	1,898	1,734
<b>Total</b> .....	<b>\$ 56,312</b>	<b>\$ 53,219</b>

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to be drawn upon, the total commitment amounts generally represent future cash requirements. The Bank evaluates each customer's credit-worthiness on a case-by-case basis. The amount of collateral, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral normally consists of real property.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements, including commercial paper, bond financing, and similar transactions. Most guarantees extend from one to two years. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The fair value of standby letters of credit is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements, the likelihood of the counter parties drawing on such financial instruments and the present creditworthiness of such counter parties. Such commitments have been made on terms which are competitive in the markets in which the Bank operates, thus, the fair value of standby letters of credit equals the carrying value for the purposes of this disclosure. The maximum potential amount of future payments that the Bank could be required to make under the guarantees totaled \$1,898,000 and \$1,734,000 at December 31, 2008 and 2007, respectively.

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**(13) ON-BALANCE SHEET DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES**

*Derivative Loan Commitments*

Mortgage loan commitments are referred to as derivative loan commitments if the loans that will result from the exercise of the commitments will be held for sale upon funding. The Bank enters into commitments to fund residential mortgage loans at specified times in the future, with the intention that these loans will subsequently be sold in the secondary market. A mortgage loan commitment binds the Bank to lend funds to a potential borrower at a specified interest rate and within a specified period of time, generally up to 60 days after inception of the rate lock.

Outstanding derivative loan commitments expose the Bank to the risk that the price of the loans arising from exercise of the loan commitments might decline from inception of the rate locks to funding of the loans due to increases in mortgage interest rates. If interest rates increase, the values of these loan commitments decrease. Conversely, if interest rates decrease, the values of these loan commitments increases. The notional amount of undesignated mortgage loan commitments was \$1,785,000 and \$1,159,000 at December 31, 2008 and 2007, respectively. The total fair value of such commitments was immaterial as of December 31, 2008 and 2007.

*Forward Loan Sale Commitments*

To protect against the price risk inherent in derivative loan commitments, the Bank utilizes “best efforts” forward loan sale commitments to mitigate the risk of potential decreases in the values of loans that would result from the exercise of the derivative loan commitments.

With a “best efforts” contract, the Bank commits to deliver an individual mortgage loan of a specified principal amount and quality to an investor if the loan to the underlying borrower closes. Generally, the price the investor will pay the seller for an individual loan is specified prior to the loans being funded (e.g., on the same day the lender commits to lend funds to a potential borrower).

The Bank expects that these forward loan sales commitments will experience changes in fair values opposite to the change in fair values of derivative loan commitments. The notional amount of undesignated forward loan sale commitments was \$2,379,000 and \$2,146,000 at December 31, 2008 and 2007, respectively. The total fair value of such commitments was immaterial as of December 31, 2008 and 2007.

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**(14) CONCENTRATION OF CREDIT RISK**

Practically all of the Bank’s loans, commitments, and commercial and standby letters of credit have been granted to customers in the Bank’s market area. Practically all such customers are depositors of the Bank. The concentrations of credit by type of loan are set forth in note 2 to the consolidated financial statements.

At December 31, 2008 and 2007, the Bank’s cash and due from banks included commercial bank deposits aggregating \$4,094,000 and \$7,408,000, respectively, in excess of the Federal Deposit Insurance Corporation limits of \$250,000 and \$100,000, respectively, per institution.

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**(15) REGULATORY MATTERS AND RESTRICTIONS ON DIVIDENDS**

The Bank is subject to regulatory capital requirements administered by the Board of Governors of the Federal Reserve System and the Tennessee Department of Financial Institutions. In addition, the Bank has entered into an agreement with the Bank’s regulatory agencies that provides for periodic reporting of the Bank’s earnings, projections, annual budgets, strategic plans, capital plans and plans for the reduction of classified assets. The agreement also provides for additions of, or enhancements to, certain policies related to the Bank’s lending and audit functions and for limitations on extensions of credit for certain classified borrower relationships.

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Failure to meet capital requirements can initiate certain mandatory -- and possibly additional discretionary -- actions by regulators that could, in that event, have a direct material effect on the institution's consolidated financial statements. The relevant regulations require the Bank to meet specific capital adequacy guidelines that involve quantitative measures of the Bank's assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting principles. The Bank's capital classifications are also subject to qualitative judgments by the Regulators about components, risk weightings and other factors. Those qualitative judgments could also affect the Bank's capital status and the amount of dividends the Bank may distribute.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined) and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2008 and 2007, that the Bank meets all capital adequacy requirements to which they are subject.

As of December 31, 2008, the most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios set forth in the following tables. There are no conditions or events since the notification that management believes have changed the Bank's category.

The Bank's actual capital amounts and ratios as of December 31, 2008 and 2007 are also presented in the following table:

<i>(Dollars In Thousands)</i>	Actual		Minimum Capital Requirement		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>December 31, 2008:</b>						
Total capital to risk weighted assets.....	\$ 30,262	12.1%	\$ 20,042	8.0%	\$ 25,053	10.0%
Tier 1 capital to risk weighted assets.....	\$ 27,098	10.8%	\$ 10,021	4.0%	\$ 15,032	6.0%
Tier 1 capital to average assets.....	\$ 27,098	10.2%	\$ 10,622	4.0%	\$ 13,278	5.0%

<i>(Dollars In Thousands)</i>	Actual		Minimum Capital Requirement		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>December 31, 2007:</b>						
Total capital to risk weighted assets.....	\$ 32,620	14.3%	\$ 18,249	8.0%	\$ 22,811	10.0%
Tier 1 capital to risk weighted assets.....	\$ 30,578	13.4%	\$ 9,125	4.0%	\$ 13,687	6.0%
Tier 1 capital to average assets.....	\$ 30,578	13.0%	\$ 9,439	4.0%	\$ 11,799	5.0%

Under the terms of an agreement with the Bank's regulatory agency, the Bank was restricted from paying dividends for a period of three years from the date the Bank began operations (January 20, 2004). The restriction was lifted in January, 2007. The Bank is also restricted from seeking approval for the payment of dividends by Tennessee State law that requires a bank to be profitable for two consecutive years before paying dividends.

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**(16) STOCK OPTION ARRANGEMENT**

In October, 2004, the stockholders of the Bank approved the MidSouth Bank 2004 Stock Option Arrangement (the "Arrangement"). The Arrangement provides for the granting of stock options, and authorizes the issuance of common stock upon the exercise of such options, for up to 380,000 shares of common stock to employees and organizers of the Bank and up to 143,080 shares of common stock for future use as decided by the Board of Directors.

Under the Arrangement, stock option awards may be granted in the form of incentive stock options or nonstatutory stock options, and are generally exercisable for up to ten years following the date such option awards are granted. Exercise prices of incentive stock options must be equal to or greater than 100% of the fair market value of the common stock on the grant date and generally vest at the end of four years. Certain option awards provide for accelerated vesting if there is a change in control (as defined in the Arrangement).

The fair value of each option award is estimated on the date of grant using the Black-Scholes option pricing model that uses the assumptions noted in the following table. Expected volatility is based on the historical volatility of the Bank's common stock and other factors. The Bank uses historical data to estimate option exercise and employee termination with the valuation model. The expected term of options granted represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. No options were granted during the year ended December 31, 2006. A total of 5,000 and 14,000 options were granted during the years ended December 31, 2008 and 2007, respectively.

	2008	2007
Volatility.....	15.00%	15.00%
Dividend yield.....	- %	- %
Expected term (in years).....	7.5	5 - 7.5
Risk-free rate.....	3.57%	4.92%

A summary of option activity under the Arrangement is presented below:

<i>Options</i>	<i>Shares</i>	<i>Weighted Average Exercise Price</i>	<i>Weighted Average Remaining Contractual Maturity</i>	<i>Aggregate Intrinsic Value</i>
Outstanding at December 31, 2005.....	451,000	\$ 10.00		
Granted .....	-			
Exercised.....	(20,000)	\$ 10.00		
Forfeited.....	(5,500)	\$ 10.00		
Outstanding at December 31, 2006.....	425,500	\$ 10.00		
Granted .....	14,000	\$ 10.00		
Exercised.....	(18,000)	\$ 10.00		
Forfeited.....	(1,000)	\$ 10.00		
Outstanding at December 31, 2007.....	420,500	\$ 10.00		
Granted .....	5,000	\$ 12.80		
Exercised.....	(3,500)	\$ 10.00		
Forfeited.....	-			
Outstanding at December 31, 2008.....	<b>422,000</b>	<b>\$ 10.03</b>	<b>5.8</b>	<b>\$ 620,000</b>
Exercisable at December 31, 2008 .....	<b>353,836</b>	<b>\$ 10.00</b>	<b>5.7</b>	<b>\$ 531,000</b>

*Notes to Consolidated Financial Statements*  
**December 31, 2008, 2007 and 2006**

The total intrinsic value of options exercised during the year ended December 31, 2008 and 2007 was \$10,000 and \$69,000, respectively. The weighted average grant-date fair value of options granted during the years ended December 31, 2008 and 2007 was \$3.71 and \$3.30, respectively. There were no options granted in 2006.

As of December 31, 2008, there was \$51,000 of total unrecognized compensation cost related to nonvested share-based compensation granted under the Arrangement. The cost is expected to be recognized over a weighted-average period of 2.1 years. The total fair value of shares vested during the years ended December 31, 2008 and 2007 was \$28,000 and \$48,000, respectively. Compensation cost recognized for the years ended December 31, 2008 and 2007 totaled \$24,000 and \$38,000, respectively.

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**(17) STOCK WARRANTS**

As part of the original offering of common stock during its organizational phase, any shares purchased received non-detachable warrants which provide the stockholder the ability to purchase one additional share of common stock for every two shares of common stock purchased. The purchase price for the additional shares is equal to the greater of \$10 or 110% of the book value of the stock at the date of exercise. For each recipient, one half of the warrants received were required to be exercised within three years from January 20, 2004 (the date of issuance) and the other half within five years of the date of issuance. The “three-year warrants” have expired (if unexercised), and the “five-year warrants” expire on January 20, 2009. There were 17,032, 400,467 and 202,866 warrants exercised in 2008, 2007 and 2006, respectively. No warrants were forfeited in 2008, and 128,690 warrants were forfeited in 2007. Total warrants outstanding as of December 31, 2008 and 2007 totaled 509,931 and 526,963, respectively. Of the warrants outstanding as of December 31, 2008, 79,574 were exercised, and 430,357 were forfeited during January 2009.

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**(18) ADDITIONAL RELATED PARTY TRANSACTIONS**

In the normal course of business, the Bank utilizes legal and landscaping services which are provided by companies with board member relationships. During 2008, 2007 and 2006, the fees paid to these companies were not significant.

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**(19) RETIREMENT PLAN**

The Bank has in effect a 401(k) profit sharing plan that covers eligible employees. To participate in the plan an employee must have reached the age of 18. The provisions of the plan provide for both employee and employer contributions. For the years ended December 31, 2008, 2007 and 2006, the Bank contributed \$133,000, \$128,000 and \$107,000, respectively, to this plan.

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**(20) EARNINGS PER COMMON SHARE**

SFAS No. 128 “Earnings Per Share” establishes uniform standards for computing and presenting earnings per share. The computation of basic earnings per share is based on the weighted average number of common shares outstanding during the period. For the Bank the computation of diluted earnings per share begins with the basic earnings per share plus the effect of common shares contingently issuable from stock options and warrants.

*Notes to Consolidated Financial Statements*  
**December 31, 2008, 2007 and 2006**

The following is a summary of the components comprising basic and diluted earnings (loss) per common share (EPS):

<i>(In Thousands, Except Share and Per Share Amounts)</i>	<b>2008</b>	2007	2006
<b>Basic EPS Computation:</b>			
Numerator - Earnings (loss) for the year .....	\$ (3,709)	\$ 159	\$ (1,204)
Denominator - Weighted average number of common shares outstanding .....	<b>3,745,423</b>	3,703,040	3,182,339
Basic earnings (loss) per common share .....	<b>\$ (.99)</b>	\$ .04	\$ (.38)
<b>Diluted EPS Computation:</b>			
Numerator - Earnings (loss) for the year .....	\$ (3,709)	\$ 159	\$ (1,204)
Denominator:			
Weighted average number of common shares outstanding .....	<b>3,745,423</b>	3,703,040	3,182,339
Dilutive effect of stock options .....	-	111,196	-
Dilutive effect of warrants.....	-	175,965	-
	<b>3,745,423</b>	3,990,201	3,182,339
Diluted earnings (loss) per common share.....	<b>\$ (.99)</b>	\$ .04	\$ (.38)

The effect of stock options and warrants was excluded from the 2008 and 2006 computations since the Bank had a loss from continuing operations and the exercise of options and warrants would have been antidilutive.

## (21) FAIR VALUE

Effective January 1, 2008, the Bank adopted SFAS No. 157, "Fair Value Measurements". SFAS No. 157 clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. Under SFAS No. 157, fair value measurements are not adjusted for transaction costs. SFAS No. 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy under SFAS No. 157 are described below:

### Basis of Fair Value Measurement:

Level 1—Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets.

Level 2—Significant other observable inputs other than Level 1 prices such as quoted prices in markets that are not active, quoted prices for similar assets, or other inputs that are observable, either directly or indirectly, for substantially the full term of the asset.

Level 3—Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

A financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

The fair values of securities available for sale are generally determined by matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs).

*Notes to Consolidated Financial Statements*  
**December 31, 2008, 2007 and 2006**

The fair value of loans held for sale is based upon binding contracts and quotes from third party investors (Level 2 inputs).

Impaired loans are evaluated and valued at the time the loan is identified as impaired, at the lower of cost or fair value. Fair value is measured based on the value of the collateral securing these loans and is classified at a level 3 in the fair value hierarchy. Collateral may be real estate and/or business assets including equipment, inventory and/or accounts receivable and is determined based on appraisals performed by qualified licensed appraisers hired by the Bank. Appraised and reported values may be discounted based on management's historical knowledge, changes in market conditions from the time of valuation, and/or management's expertise and knowledge of the client and client's business. Such discounts are typically significant and result in a Level 3 classification of the inputs for determining fair value. Impaired loans are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly, based on the same factors identified above.

Level 3 is for positions that are not traded in active markets or are subject to transfer restrictions, and/or where valuations are adjusted to reflect illiquidity and/or non-transferability. Such adjustments are generally based on available market evidence. In the absence of such evidence, management's best estimate is used.

***Assets and Liabilities Measured on a Recurring Basis***

Assets and liabilities measured at fair value on a recurring basis are summarized below:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of December 31, 2008
	(In thousands)			
Assets at December 31, 2008				
Securities available-for-sale...	\$ -	\$ 33,146	\$ -	\$ 33,146

The table below presents a reconciliation and income statement classification of gains and losses for all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the year ended December 31, 2008:

***Fair Value Measurements Using Significant Unobservable Inputs (Level 3)***

	(In Thousands)
Balance, December 31, 2007.....	\$ -
Total unrealized gains (losses) included in:	
Net Income.....	-
Other Comprehensive Income.....	-
Purchases, sales, issuances and settlements, net...	-
Transfers in and (out) of level three.....	-
Balance, December 31, 2008.....	\$ -

*Notes to Consolidated Financial Statements*  
December 31, 2008, 2007 and 2006

**Assets and Liabilities Measured on a Non-Recurring Basis**

The following represent assets and liabilities measured at fair value on a non-recurring basis as of December 31, 2008. The valuation methodology used to measure the fair value of these loans is described earlier in the Note.

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of December 31, 2008
(In thousands)				
Assets at December 31, 2008				
Impaired loans.....	\$ -	\$ -	\$ 9,862	\$ 9,862
Loans held for sale.....	\$ -	\$ 594	\$ -	\$ 594

Loans held for sale, which are carried at the lower of cost or fair value, did not have an impairment charge for 2008.

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a carrying amount of \$9,862,000 with a valuation allowance of \$3,603,000.

SFAS No. 107, "Disclosures about Fair Value of Financial Instruments," requires that the Bank disclose estimated fair values for its financial instruments. Fair value estimates, methods, and assumptions are set forth below for the Bank's financial instruments.

***Cash and short-term investments***

For those short-term instruments, the carrying amount is a reasonable estimate of fair value.

***Securities***

The carrying amounts for short-term securities approximate fair value because they mature in 90 days or less and do not present unanticipated credit concerns. The fair value of longer-term securities and mortgage-backed securities, except certain state and municipal securities, is estimated based on bid prices published in financial newspapers or bid quotations received from securities dealers. The fair value of certain state and municipal securities is not readily available through market sources other than dealer quotations, so fair value estimates are based on quoted market prices of similar instruments, adjusted for differences between the quoted instruments and the instruments being valued.

SFAS No. 107 specifies that fair values should be calculated based on the value of one unit without regard to any premium or discount that may result from concentrations of ownership of a financial instrument, possible tax ramifications, or estimated transaction costs. Accordingly, these considerations have not been incorporated into the fair value estimates.

***Loans***

Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type such as commercial, mortgage and other consumer. Each loan category is further segmented into fixed and adjustable rate interest terms.

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

The estimated maturity for mortgages is modified from the contractual terms to give consideration to management's experience with prepayments. Management has made estimates of fair value discount rates

*Notes to Consolidated Financial Statements*  
**December 31, 2008, 2007 and 2006**

that it believes to be reasonable. However, because there is no market for many of these financial instruments, management has no basis to determine whether the fair value presented below would be indicative of the value negotiated in an actual sale.

The value of the loan portfolio is also discounted in consideration of the credit quality of the loan portfolio as would be the case between willing buyers and sellers. Particular emphasis has been given to loans on the Bank's internal watch list. Valuation of these loans is based upon borrower performance, collateral values (including external appraisals), etc.

***Loans Held for Sale***

These instruments are carried in the consolidated balance sheet at the lower of cost or market value. The fair values of these instruments are based on subsequent liquidation values of the instruments which did not result in any significant gains or losses.

***Deposit Liabilities***

The fair value of demand deposits, savings accounts and certain money market deposits is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is estimated using the rates currently offered for deposits of similar remaining maturities. Under the provision of SFAS No. 107 the fair value estimates for deposits does not include the benefit that results from the low cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market.

***Federal Funds Purchased and Sold***

The carrying amounts approximate fair values as Federal funds are overnight borrowings or investments.

***Advances from Federal Home Loan Bank***

*Short-Term Advances*

The carrying amounts of short-term advances approximate fair value as they mature within 90 days.

*Long-Term Advances*

The fair values of the Bank's long-term advances are estimated using discounted cash flow analyses based on the Bank's current incremental borrowing rates for similar types of borrowing arrangements.

***Commitments to Extend Credit, Standby Letters of Credit and Financial Guarantees Written***

Loan commitments are made to customers generally for a period not to exceed one year and at the prevailing interest rates in effect at the time the loan is closed. Commitments to extend credit related to construction loans are made for a period not to exceed one year with interest rates at the current market rate at the date of closing. In addition, standby letters of credit are issued for periods extending from one to two years with rates to be determined at the date the letter of credit is funded. Fees are only charged for the construction loans and the standby letters of credit and the amounts unearned at December 31, 2008, are insignificant. Accordingly, these commitments have no carrying value and management estimates the commitments to have no significant fair value.

*Notes to Consolidated Financial Statements*  
**December 31, 2008, 2007 and 2006**

The carrying values and estimated fair values of the Bank's financial instruments at December 31, 2008 and 2007 are as follows:

<i>(In Thousands)</i>	2008		2007	
	<i>Carrying Amount</i>	<i>Fair Value</i>	<i>Carrying Amount</i>	<i>Fair Value</i>
<b>Financial assets:</b>				
Cash and short-term investments .....	\$ 5,826	\$ 5,826	\$ 8,858	\$ 8,858
Securities .....	33,146	33,146	31,248	31,248
Restricted equity securities .....	1,581	1,581	1,439	1,439
Loans held for sale .....	594	594	987	987
Loans .....	222,514		193,106	
Less: allowance for loan losses .....	(5,784)		(2,032)	
Loans, net of allowance .....	<b>216,730</b>	<b>210,039</b>	191,074	189,449
<b>Financial liabilities:</b>				
Deposits .....	222,930	221,914	207,448	207,531
Advances from Federal Home Loan Bank .....	13,467	13,640	7,346	7,346
Federal funds purchased .....	4,693	4,693	226	226
Securities sold under agreement to repurchase .....	836	836	-	-
<b>Unrecognized financial instruments:</b>				
Commitments to extend credit .....	-	-	-	-
Standby letters of credit .....	-	-	-	-

***Limitations***

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instruments. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Bank's entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Bank's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on estimating on-and-off-balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Other significant assets and liabilities that are not considered financial assets or liabilities include deferred tax assets and liabilities and property, plant and equipment. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in the estimates.

*Notes to Consolidated Financial Statements*  
**December 31, 2008, 2007 and 2006**

**(22) QUARTERLY FINANCIAL DATA (UNAUDITED)**

Selected quarterly results of operations for the four quarters ended December 31, 2008 and 2007 are as follows:

*(In Thousands, except per share data)*

	2008				2007			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Interest income .....	\$ 3,591	\$ 3,615	\$ 3,548	\$ 3,682	\$ 3,918	\$ 3,887	\$ 3,720	\$ 3,524
Net interest income .....	2,333	2,263	2,089	1,973	2,144	2,078	1,895	1,753
Provision for loan losses .....	3,520	365	380	249	160	122	61	57
Earnings (loss) before income taxes .....	(3,048)	(93)	(340)	(228)	(81)	169	45	26
Net earnings (loss) .....	(3,048)	(93)	(340)	(228)	(81)	169	45	26
Basic earnings (loss) per common share .....	(.81)	(.02)	(.09)	(.06)	(.02)	.05	.01	.01
Diluted earnings (loss) per common share .....	(.81)	(.02)	(.09)	(.06)	(.02)	.04	.01	.01

The fourth quarter 2008 results included provisions for loan losses of \$3,520,000 resulting from the changes in certain specific lending relationships in the Bank's loan portfolio.

## MIDSOUTH BANK

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### Board of Directors

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**ALLEN, JIMMY E.**

*President*

*Venture Express, Inc. (Trucking)*

**ALEXANDER, DONALD W.**

*President*

*Alexander Ford-Lincoln-Mercury &  
Alexander Chevrolet-Buick-Pontiac-GMC-Cadillac*

**BARTON, ROSEANN H.**

*Principal*

*John Pittard Elementary School*

**CAUDLE, DALLAS G., JR.**

*Secretary to the Board*

*Executive Vice President*

*MidSouth Bank*

**COGGIN, D. GERALD, SR.**

*Senior Vice President*

*National HealthCare Corporation*

**DECKER, DANIEL B.**

*Co-Owner/Partner*

*Decker and Belt Company (Construction)*

**DEMPSEY, PERCY E., III, CPA**

*Member in Charge of Consulting Services*

*Dempsey Vantrease & Follis, PLLC*

*(Accounting and Consulting)*

**FLOYD, JOHN D.**

*Owner & President*

*Ole South Properties, Inc.*

*(Real Estate and Construction)*

**GINTZIG, DONALD R.**

*Rear Admiral United States Navy*

*Assistant Chief - Health Care Operations*

**JOHNS, A. FRANK, JR.**

*Owner*

*Frank Johns Realty Company*

**MOSS, LEE M.**

*Chairman & CEO*

*MidSouth Bank*

**MURFREE, MATT B., III**

*Senior Partner*

*Murfree & Murfree, PLLC (Attorney)*

**O'BRIEN, BETH S.**

*Managing Broker*

*Coldwell Banker Snow and Wall*

*(Real Estate Sales)*

**PARKS, ROBERT A.**

*Owner*

*The Parks Group (Real Estate Sales)*

**SMITH, DR. GEORGE W.**

*Physician/Partner*

*Family Health Associates*

**WALDRON, GREGORY E.**

*Partner/Managing Member*

*Waldron Enterprises (Construction)*

**WEATHERFORD, J. BEN**

*President & COO*

*MidSouth Bank*

**WEATHERFORD, JACK O., SR.**

*Senior Chairman*

*MidSouth Bank*

## MIDSOUTH BANK

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### MidSouth Bank Officers

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**BEACH, JAMES**

Assistant Vice President – Community Banker

**BOWMAN, JANET**

Assistant Vice President – Old Fort Parkway Office Leader

**BUSBY, KEVIN D.**

Senior Vice President & Chief Financial Officer

**CAUDLE, DALLAS G., JR.**

Executive Vice President – Lending,  
Asset/Liability Management

**DAWSON, ERIKA**

Credit Officer – Credit Administration

**FOLKMANN, TYLER**

Banking Officer – Lowry Street Office Leader

**GIPSON, ANDREA**

Assistant Vice President – Accounting

**HAMBLIN, BEVERLEY**

Assistant Vice President – Sam Ridley Office Leader

**HICKS, TONY**

Vice President – Branch Administrator,  
Main Office Leader

**HILL, ANDREA**

Banking Officer – Main Office Assistant Leader

**JERNIGAN, D. EDWIN, JR.**

Senior Vice President – Investments

**JONES, LEATH ANN**

Vice President – Business Banking

**KING, GINA A.**

Vice President & Trust Officer

**MARSTEINER, DEBBIE**

Vice President – Loan Operations Team Leader

**MARTIN, FELECIA**

Assistant Vice President –  
South Church Street Office Leader

**MARTIN, RONNIE**

Vice President – Real Estate Lending

**McGREW, JENNIFER**

Assistant Vice President – Memorial Office Leader

**MEDLEN, REGINA**

Vice President – Community Banker – Smyrna

**MILLER, AL**

Vice President – Real Estate Lending

**MOORE, ABBY**

Information Technology Officer &  
Information Security Officer

**MOSS, LEE**

Chairman & Chief Executive Officer –  
Marketing, Community Banking Administration

**PARKS, LYNDELL**

Vice President – Deposit Operations Team Leader

**SAALFELD, MARSHA**

Assistant Vice President –  
Mortgage Loan Originator

**STONE, RICHARD**

Vice President – Commercial Banking

**TAYLOR, LISA A.**

Senior Vice President – Private Banking

**WADDEY, PAM**

Assistant Vice President – Loan Operations

**WALKER, TERRY**

Assistant Vice President – Community Banker

**WEATHERFORD, BEN**

President & Chief Operating Officer

**WEATHERFORD, JACK O.**

Senior Chairman

**WELBORN, KARREN**

Assistant Vice President –  
Mortgage Team Leader

**WHITE, KIM**

Assistant Vice President –  
Mortgage Loan Originator

## MIDSOUTH BANK

### *Market and Dividend Information*

There is no established public trading market for the Bank's common stock, and trading, if any, is very thin and privately negotiated. The Bank has no "trading symbol," and it is not listed on any established public securities exchange. Management believes that Middle Tennessee, especially Rutherford County, is the principal market area for the common stock. The following table sets forth the estimated high and low sales prices per share of the common stock for each quarter of fiscal 2008 and 2007. Such information may not include all transactions in the Bank's common stock for the respective periods shown, and it is possible that transaction occurred during the periods reflected or discussed at prices higher or lower than the prices set forth in the table. Certain of the transactions involved, or may have involved, persons affiliated with the Bank. The information concerning transactions in the Bank's common stock is believed to be accurate, but it is based on information reported to the Bank but that has not been verified. The Bank first began conducting its full-service banking business on January 20, 2004.

	2008		2007	
	<i>High</i>	<i>Low</i>	<i>High</i>	<i>Low</i>
First Quarter	\$ 15.00	\$ 12.50	\$ 17.00	\$ 11.00
Second Quarter	\$ 15.00	\$ 12.00	\$ 15.50	\$ 10.00
Third Quarter	\$ 12.00	\$ 12.00	\$ 15.00	\$ 10.00
Fourth Quarter	\$ 13.00	\$ 10.00	\$ 16.00	\$ 10.00

The Bank paid no dividends in 2008 and cannot pay dividends under Tennessee law until the Bank has achieved two consecutive years of profitable earnings. The Bank has opted to reinvest its earnings to support its growth and to finance its operations. Assuming continued growth consistent with historical experience, it is currently expected that the Bank would continue its reinvestment strategy indefinitely (and thus not pay cash dividends for the foreseeable future); however, the Bank could in the future elect to pay permissible stock and/or cash dividends in 2010 or in later years if so determined by its board of directors based on factors such as regulatory requirements and working capital needs, asset growth, results of operations, and the exercise of prudence by the board of directors.

### *Federal Deposit Insurance Corporation Statement*

This statement has not been reviewed, or confirmed for accuracy or relevance, by the Federal Deposit Insurance Corporation.

### *Availability of Form 10-K*

**Upon the written request of any record holder or beneficial owner of the shares of our Common Stock entitled to vote at the 2009 Annual Meeting, we will provide, without charge, a copy of our Annual Report on Form 10-K for the fiscal year ended December 31, 2008, together with financial statements and schedules, as filed with the Federal Reserve Board.** Requests should be mailed to Dallas G. Caudle, Jr., at the Bank's Corporate Office. The Bank will provide copies of any exhibit requested in writing from the Investor Relations Department for a reasonable copying charge that will not exceed \$1.00 per page. (A list of Exhibits can be found in the Annual Report on Form 10-K under the caption "Exhibit Index.") Each request must contain a good faith representation that the requesting party, as of the record date for this year's annual meeting of the Bank's stockholders, is or was a beneficial owner of Bank securities entitled to vote.

## ***MIDSOUTH BANK***

### ***Corporate Office***

One East College Street, Murfreesboro, TN 37130

### ***2009 Annual Meeting***

The 2009 annual meeting of stockholders will be held May 28, 2009 at 4:30 p.m. at MidSouth Bank, One East College Street, Murfreesboro, Tennessee.

### ***Investor Services and Transfer Agent***

The Bank has appointed Dallas G. Caudle, Jr., Executive Vice President, as its principal Investor Services spokesperson. He may be reached at (615) 278-7100, by mail at P.O. Box 7100, Murfreesboro, Tennessee 37133, and by e-mail at [info@midsouthbanking.com](mailto:info@midsouthbanking.com). The Bank acts as its own transfer agent. The transfer agent can be contacted at the address of the Bank's Corporate Office and at the above telephone number; ask for Debbie Marsteiner or Dallas Caudle. The Bank's Internet Web Site address is [www.midsouthbanking.com](http://www.midsouthbanking.com). A copy of the Bank's 2008 Annual Report to Shareholders can be obtained by shareholders on written request to the Bank at its Corporate Office, Attention: Investor Services.

### ***Lines of Business***

MidSouth Bank is a full-service commercial bank. The Bank offers demand deposit accounts (checking and money market), savings accounts, certificates of deposit and retirement accounts. These deposit accounts are available to individuals and to businesses. The Bank also offers a variety of loans to help meet personal credit needs, business needs and is engaged in a spectrum of real estate loans to individuals, contractors and developers. A mortgage loan department exists to assist home owners with long-term fixed rate loans as well as adjustable rate mortgages. Ancillary services are provided including safe deposit boxes, issuance of cashier's checks, notary services, night depository services, automated teller machines (ATMs), wire transfers, debit cards, credit cards and internet banking capabilities.

### ***Business Philosophy***

MidSouth Bank believes that it is important to help customers accumulate and manage wealth and then to assist in the planning of transferring wealth to heirs. As a result, the Bank provides investment and trust services (wealth management and estate planning) to our customers. Though the products offered in these areas are non-FDIC insured, assets are managed in a fashion that is consistent with our client's objectives and suitability.

**MIDSOUTH BANK**

***Code of Ethics***

The Bank has adopted a Code of Ethics that is applicable to all employees of the Bank, including the principal executive officer, the principal financial officer and the principal accounting officer. The Code of Ethics is available for inspection at the corporate office at One East College Street, Murfreesboro, Tennessee 37130. The Bank intends to give notices of amendments to, or waivers from, its Code of Ethics (to the extent applicable to the Bank's directors, chief executive officer, principal financial officer or principal accounting officer) by appropriate filings on Form 8-K.

Independent Registered Public  
Accounting Firm:

Maggart & Associates, P.C.  
Suite 2150, 150 Fourth Avenue, North  
Nashville, Tennessee 37219

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***MidSouth Bank Offices***

Main Office of the Bank	One East College Street Murfreesboro, TN 37130
Lowry Street Office	403 South Lowry Street Smyrna, TN 37167
Sam Ridley Parkway Office	724 President Place Smyrna, TN 37167
Memorial Boulevard Office	2415 Memorial Boulevard Murfreesboro, TN 37129
South Church Street Office	2782 South Church Street Murfreesboro, TN 37128
Old Fort Parkway Office	2610 Old Fort Parkway Murfreesboro, TN 37128

**FOR MORE INFORMATION:**

**MidSouth Bank  
One East College Street  
Murfreesboro, Tennessee 37130  
Attention: Investor Services**

**(615) 278-7100**