# Edgar Filing: SOUTHSIDE BANCSHARES CORP - Form 10-Q 

SOUTHSIDE BANCSHARES CORP

## Form 10-Q

May 15, 2001

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SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549

FORM 10-Q
(MARK ONE)
[ X ] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2001

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

For the transition period from to

Commission file number 0-10849

SOUTHSIDE BANCSHARES CORP.


Yes | X |
| :---: |
| _------_ |

At MAY 15, 2001 , the number of shares outstanding of the registrant's common stock was $8,417,528$.

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SOUTHSIDE BANCSHARES CORP.

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Condensed Consolidated Balance Sheets<br>March 31, 2001 and December 31, 2000<br>(dollars in thousands except per share data) (unaudited)

```
MARCH
ASSETS
Cash and due from banks
Interest-bearing deposits in banks
Cash and cash equivalents
Federal funds sold
Investments in debt and equity securities:
    Available for sale, at fair value
    Held to maturity, at amortized cost (fair value of $32,814
        in 2001, and $36,660 in 2000)
            Total investments in debt and equity securities
Loans, net of unearned discount
    Less allowance for loan losses
Loans, net
Premises and equipment
Other assets
Total assets
LIABILITIES AND SHAREHOLDERS' EQUITY
Deposits:
    Noninterest-bearing demand
    Interest-bearing demand and savings
$ 73,0
    Time deposits
    309,
```

Federal funds purchased
Securities sold under agreements to repurchase
FHLB borrowings
Other borrowings
Debt of Employee Stock Ownership Plan
Other liabilities
Total liabilities
Commitments and contingent liabilities
Shareholders' equity:
Cumulative preferred stock, no par value, 1,000,000 shares authorized and
unissued
Common stock, \$1 par value, 15,000,000 shares authorized, 8,985,378 shares
issued in 2001 and 2000
Surplus
Retained earnings
Unearned Employee Stock Ownership Plan shares
Treasury stock, at cost, 569,850 shares in 2001 and 591,850 shares in 2000
Accumulated other comprehensive income (loss)
Total shareholders' equity
Total liabilities and shareholders' equity
See accompanying notes to condensed consolidated financial statements.
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```

\author{
SOUTHSIDE BANCSHARES CORP. AND SUBSIDIARIES \\ Condensed Consolidated Statements of Income
}
``` Three months ended March 31, 2001 and March 31, 2000
(dollars in thousands except per share data) (unaudited)
```

Interest income:
Interest and fees on loans
Interest on investments in debt and equity
securities:
Taxable
Exempt from Federal income taxes
Interest on short-term investments

Total interest income

Interest expense:
Interest on interest-bearing demand and savings
deposits

Interest on time deposits 4,423
Interest on Federal funds purchased 52
Interest on securities sold under agreements to repurchase

78
Interest on FHLB borrowings 958
Interest on other borrowings 39
Interest on debt of Employee Stock Ownership Plan

Total interest expense

Net interest income

Provision for loan losses
159

5,675
Net interest income after provision for loan losses $\qquad$

Noninterest income:
Trust fees
287
Service charges on deposit accounts 398
Gains on the sales of loans
Other 401

Total noninterest income

Noninterest expenses:
Salaries and employee benefits
Net occupancy and equipment expense
Data processing
Other

2,492
683
211
1,289

288
378
2
374

1,042

2,275
679
190
1,362

Net income

```
Share data:
    Earnings per common share - basic
    Earnings per common share - diluted
    Dividends paid per common share
    Average common shares outstanding
    Average common shares outstanding, including
    potentially dilutive shares
```

See accompanying notes to condensed consolidated financial statements.

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SOUTHSIDE BANCSHARES CORP. AND SUBSIDIARIES

Condensed Consolidated Statements of Shareholders' Equity and Comprehensive Income

Three months ended March 31, 2001 and year ended December 31, 2000
(dollars in thousands except per share data)
(unaudited)


| Purchase of 200,100 common shares for treasury |  | -- | -- | -- | -- | $(2,059)$ |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Balance at December 31, 2000 |  | 8,985 | 5,516 | 62,592 | (791) | $(6,394)$ |
| Comprehensive income: |  |  |  |  |  |  |
| Net income |  | -- | -- | 1,553 | -- | -- |
| Change in net unrealized gain (loss) on available for sale securities, net of tax effect |  | -- | -- | -_- | -- | -- |
| Total comprehensive income |  | -- | -- | 1,553 | -- | -- |
| Cash dividends paid (\$.08 per share) |  | -- | -- | (661) | -- | -- |
| Allocation of 9,265 shares to ESOP participants |  | -- | 51 | -_ | 50 | -- |
| Exercise of 22,000 stock options |  | -- | (99) | -- | -- | 238 |
| Balance at March 31, 2001 | \$ | 8,985 | 5,468 | 63,484 | (741) | $(6,156)$ |

See accompanying notes to condensed consolidated financial statements.

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> SOUTHSIDE BANCSHARES CORP. AND SUBSIDIARIES
> Condensed Consolidated Statements of Cash Flows
> Three months ended March 31, 2001 and March 31, 2000
> (dollars in thousands)
> (unaudited)

| Cash flows from operating activities: |  |
| :--- | :---: |
| Net income | 1,553 |
| Adjustments to reconcile net income to net cash provided by operating activities: |  |
| Depreciation and amortization | 432 |
| Provision for loan losses | 159 |
| Gains on sale of loans | $(76)$ |
| Other operating activities, net | 1,096 |
| Originations of loans for sale | $(6,460)$ |
| Proceeds from sale of loans | 5,529 |

Net cash provided by operating activities ..... 2,233
Cash flows from investing activities:
Net increase in Federal funds sold ..... $(21,211)$
Proceeds from maturities of and principal payments on debt securities ..... 20,569
Net increase in loans ..... $(25,007)$
Recoveries of loans previously charged off ..... 34
Purchases of premises and equipment ..... (78)
property
Net cash used in investing activities ..... $(35,664)$
Cash flows from financing activities:
Net increase in demand and savings deposits ..... 13,463
Net increase (decrease) in time deposits ..... 26,430
Net decrease in securities sold under agreements to repurchase ..... $(1,916)$
Repayments of FHLB borrowings ..... (41)
Repayment of ESOP debt
Stock options exercised ..... (197)
Cash dividends paid ..... (661)
Net cash provided by financing activities ..... 31,467
Net decrease in cash and cash equivalents ..... $(1,964)$
Cash and cash equivalents, beginning of period ..... 17,998
Cash and cash equivalents, end of period ..... \$ 16,034
$=======$
Supplemental disclosures of cash flow information: Cash paid during the period for: Interest on deposits and borrowings ..... $\$ 7,084$
200
Noncash transactions -
Transfers to other real estate owned in settlement of loans

See accompanying notes to condensed consolidated financial statements.

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SOUTHSIDE BANCSHARES CORP. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2001 AND 2000
(unaudited)

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BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation $S-X$. They do not include all information and footnotes required by accounting principles generally accepted in the United States of America for complete consolidated financial statements. In the opinion of management, all adjustments, consisting of normal recurring accruals, considered necessary for a fair presentation have been included. For further information, refer to Southside Bancshares Corp.'s (the Company or Southside) Annual Report on Form 10-K for the year ended December 31, 2000. Operating results for the three months ended March 31, 2001 are not necessarily indicative of the results that may be expected for the year ending December 31, 2001.

SEGMENT INFORMATION

The responsibility for management of the subsidiary banks remains with the officers and directors of the respective banks. The financial performance of the Company is measured internally by subsidiary bank results and key performance measures. The following tables show the financial information of the Company's subsidiary banks, South Side National Bank in St. Louis (SSNB), State Bank of Jefferson County (SBJC), Bank of Ste. Genevieve County (BSG), and The Bank of St. Charles County (BSCC) for the three months ended March 31, 2001 and 2000. The "Other" column includes the Parent Company and all intercompany elimination entries.

THREE MONTHS ENDED MARC


THREE MONTHS ENDED MARCH

|  | SSNB |  | SBJC |  | BSG |  | BS |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  | (dollars in thousa |  |  |  |  |
| Results of Operations: |  |  |  |  |  |  |  |
| Net interest income | \$ | 3,743 | \$ | 636 | \$ | 946 | \$ |
| Provision for loan losses |  | 75 |  | -- |  | -- |  |
| Noninterest income |  | 669 |  | 88 |  | 119 |  |
| Noninterest expense |  | 2,782 |  | 464 |  | 444 |  |
| Income tax expense (benefit) |  | 432 |  | 79 |  | 198 |  |
| Net income |  | 1,123 |  | 181 |  | 423 |  |
| Average Balances: |  |  |  |  |  |  |  |
| Loans |  | 8,278 | \$ | 48,309 | \$ | 56,522 | \$ |
| Assets |  | 2,741 |  | 68,142 |  | 93,338 |  |
| Deposits |  | 1,691 |  | 58,812 |  | 81,288 |  |
| Financial Ratios: |  |  |  |  |  |  |  |
| Return on assets |  | $0.99 \%$ |  | $1.06 \%$ |  | $1.81 \%$ |  |
| Return on equity |  | 11.18 |  | 11.89 |  | 17.65 |  |
| Net interest margin |  | 3.78 |  | 4.20 |  | 4.46 |  |

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ITEM 2.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

GENERAI

This discussion is presented to provide an understanding of Southside Bancshares Corp. and subsidiaries (the "Company" or "Registrant") consolidated financial condition and the results of operations for the three months ended March 31, 2001 and 2000.

The Company's net income is derived primarily from the net interest income of its subsidiary banks. Net interest income is the difference (or spread) between the interest income the subsidiary banks receive from their loan and investment portfolios and their cost of funds, consisting primarily of the interest paid on deposits and borrowings. Net income is also affected by the levels of provisions for loan losses, noninterest income, and noninterest expense.

Statements contained in this Report and in future filings by the Company with the Securities and Exchange Commission, in the Company's press releases and in oral statements made with the approval of an authorized executive officer which are not historical or current facts are "forward-looking statements" made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 (Section 27A of the Securities Act of 1993, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended). Such statements are based on management's beliefs, and assumptions made by and information currently available to management, and are subject to certain risks and uncertainties that could cause actual results to differ materially from historical earnings and those currently anticipated or projected. When used in

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the Company's documents or oral presentations, the words "anticipates,"
"believes," "estimates," "expects," "intends," "forecasts," "plan," "projects,"
and similar expressions are intended to identify such forward-looking
statements. There can be no assurance that such forward-looking statements will
in fact transpire. The following important factors, risks and uncertainties,
among others, could cause actual results to differ materially from such
forward-looking statements: (1) credit risk, (2) interest rate risk, (3)
competition, (4) changes in the regulatory environment and (5) changes in
general business and economic trends. The foregoing list should not be construed
as exhaustive and the Company disclaims any obligation to subsequently update or
revise any forward-looking statements after the date of this Report.
```

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    Item 2. (continued)
FINANCIAL HIGHLIGHTS
COMPARISON OF SELECTED FINANCIAL DATA
(dollars in thousands except per share data)


TWELVE DECEMBE
Earnings:
Total interest income \$ 13,081
Total interest expenseren ene
Net interest income 5,834
Provision for loan losses 159
\$ $\quad 5,675$
\$ $\quad 1,553$
$=========$
$===$

```
Financial Position:
    Total assets $ 772,658
    Total deposits 614,087
    Total loans, net of unearned discount 474,330
    Allowance for loan losses 5,318
    Short-term borrowings 6,036
    FHLB borrowings 70,906
        Other borrowings 1,900
    Debt of Employee Stock Ownership Plan 791
    Total shareholders' equity 72,122
```

SELECTED RATIOS

The table below summarizes various selected ratios as of the end and for the periods indicated.

```
Loan-to-deposit ratio
Allowance for loan losses to total loans
Dividend payout ratio
Return on average assets
Return on average shareholders' equity
Net interest margin on average interest-earning assets
Average shareholders' equity to average total assets
Tier I leverage capital to adjusted total consolidated assets
less intangibles
Tier I capital to risk-weighted assets
Total capital to risk-weighted assets
```

THREE MONTHS
ENDED
MARCH 31, 2001(2)

| $77.24 \%$ | 80.71 |
| ---: | ---: |
| 1.12 | 1.12 |
| 42.11 | 41.03 |
| .83 | .92 |
| 8.81 | 9.76 |
| 3.51 | 3.76 |
| 9.39 | 9.37 |
| 9.05 | 9.15 |
| 12.98 | 13.66 |
| 14.00 | 14.72 |

(1) Shares outstanding at March 31, 2001, December 31, 2000 and March 31, 2000 include 138,982, 148,248, 176,044 shares, respectively, held by the ESOP which have not been allocated to participants' accounts and thus are not considered outstanding for purposes of computing book value and tangible book value per share. These unallocated shares are also excluded from the average shares outstanding used to compute earnings per common share.
(2) Statistical information is annualized where applicable.

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Item 2. (continued)

FINANCIAL POSITION

Total consolidated assets of the Company have increased $\$ 35,231,000$ during the first quarter of 2001 to $\$ 772,658,000$ at March 31,2001 compared to

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$\$ 737,427,000$ at December 31, 2000. In addition, total assets of the Company have increased $\$ 82,631,000$, or $12 \%$, over the past twelve months. The Company's strategic business plan includes growth as one of the Company's priorities, and over the past several quarters, the Company has experienced significant growth in loans, deposits and total assets.

LOAN PORTFOLIO

The Company's loan portfolio consists of business loans to small and medium size companies, commercial, construction and residential real estate loans, and consumer loans. Traditionally, the majority of the loan portfolio has focused on real estate as an integral component of a credit's underlying source of collateral. The following table is a breakdown of the Company's loan portfolio as of the end of the periods indicated.

MARCH 31, 2001
DECEMBER 31, 2000
----------------
(in thousands)

```
Commercial, financial and agricultural
Real estate-commercial
Real estate-construction
Real estate-residential
Consumer
Other loans
```

| $\$ 80,325$ | 78,586 |
| ---: | ---: |
| 170,818 | 157,771 |
| 28,091 | 28,808 |
| 158,241 | 161,252 |
| 26,642 | 27,189 |
| 10,213 | 9,800 |
| ------- |  |
| $\$ 474,330$ | 463,406 |
| $========$ | $========$ |

The Company's loan portfolio totaled $\$ 474,330,000$ at March 31, 2001, which represents an increase of $\$ 10,924,000$ or $2.36 \%$, since December 31,2000 , and an increase of $\$ 69,009,000$ or $17.03 \%$, over the past twelve months. These increases in the loan portfolio were the result of the Company continuing to execute elements of its strategic business plan, as the Company's banking subsidiaries continue to attract customers who are dissatisfied with the service level of the area's larger financial institutions. The decrease in residential real estate loans can be attributed to the drop in interest rates during 2001. In contrast to 2000 when the majority of the residential real estate loan customers were opting for adjustable rate mortgage products, some of those same customers are now refinancing their adjustable rate mortgages into longer term fixed rate mortgage products, which are sold into the secondary market.

SUMMARY OF ALLOWANCE FOR LOAN LOSSES

> THREE MONTHS ENDED

MARCH 31, 2001

TWELVE MONTHS ENDED
DECEMBER 31, 2000
(in thousands)

| Balance at beginning of period | 5,179 | 5,830 |
| :--- | :---: | :---: |
| Provision charged to expense | 159 |  |
| Loans charged off | $(54)$ | 361 |
| Recoveries | 34 |  |

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$\$ 5,318$

$=======$$\quad$| 5,179 |
| ---: |
| $=======$ |

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Item 2. (continued)

The balance of the allowance for loan losses increased by $\$ 139,000$ during the first quarter of 2001. The increase in the allowance was due to the fact that net charge offs for the quarter were $\$ 20,000$, and the Company recorded a provision for loan losses of $\$ 159,000$. Based upon the Company's internal analysis of the adequacy of the allowance for loan losses, management of the Company believes the level is adequate to cover probable losses inherent in the loan portfolio under current conditions. The ratio of allowance for loan losses as a percentage of total loans was 1.12\% as of March 31, 2001 compared to 1.12\% and 1.19\% at December 31, 2000 and March 31, 2000.

## NONPERFORMING ASSETS

MARCH 31, 2001
DECEMBER 31, 2000
Nonaccrual loans
Loans past due 90 days or more and still
accruing interest 143

Total nonperforming loans

Other real estate owned

Total nonperforming assets

Ratios:
Total nonperforming loans as \% of total loans 1.00\% 0.98\%
Nonperforming assets as \% of total loans and
other real estate owned
Nonperforming assets as \% of total assets
Allowance for loan losses as a of nonperforming loans
(dollars in thousands)

| (dollars in thousands) |  |
| :---: | :---: |
| $\$ 4,602$ | 4,200 |
| 143 | 339 |

------

4,539

| 4,745 | 4,539 |
| :--- | :--- |
| 1,574 | 1,597 |

------ ------
$\$ 6,319 \quad 6,136$

339

6, 136

| 1.33 | 1.32 |
| ---: | ---: |
| .82 | .83 |

112.08
114.10
$======\quad======$

Nonperforming assets totaled $\$ 6,319,000$ or $.82 \%$ of total assets at March 31, 2001 compared to $\$ 6,136,000$ or . $83 \%$ and $\$ 5,296,000$ or $.77 \%$ at December 31 , 2000 and March 31, 2000, respectively. Nonaccrual loans increased $\$ 402,000$ during the first quarter of 2001 and accounted for the majority of the increase in nonperforming assets.

A loan is reported as impaired when it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement. The Company's loan policy generally requires that a credit meeting
the above criteria be placed on nonaccrual status. Additionally, loans, which are past due more than 90 days as to payment of principal or interest, are also considered to be impaired. These loans are included in the total of nonperforming assets.

Loans past due less than 90 days are generally not considered impaired; however, a loan which is current as to payments may be determined by management to demonstrate some of the characteristics of an impaired loan. In these cases, the loan is classified as impaired while management evaluates the appropriate course of action. The Company's primary basis for measurements of impaired loans is the collateral underlying the identified loan.

Item 2. (continued)

Any loans classified for regulatory purposes, but not included above in nonperforming loans, do not represent material credits about which management is aware of any information which causes management to have serious doubts as to the borrower's ability to comply with the loan repayment terms or which management reasonably expects will materially impact future operating results or capital resources. As of March 31, 2001 , there were no concentrations of loans exceeding $10 \%$ of total loans, which were not disclosed as a category of loans, detailed on page 10.

## INVESTMENTS IN DEBT AND EQUITY SECURITIES

Investments in debt and equity securities have increased $\$ 6,760,000$ since December 31, 2000, due in large part to the deposit growth experienced during the year. With additional loan growth and some certificate of deposit runoff expected during 2001, management anticipates the investment portfolio may decline through investment security maturities and paydowns on mortgage-backed securities.

## DEPOSITS

Total deposits increased $\$ 39,893,000$ during the first quarter of 2001 , due largely to a decision made during 2000 to replace short-term borrowed funds, used to fund loan growth, with certificates of deposit. The increase in time deposits during the first quarter of 2001 was $\$ 26,430,000$. Management continues to monitor the rates being offered, the impact of the deposits on rate sensitivity and the extent to which we are able to cross-sell additional products and services to new time deposit customers. In addition, interest-bearing demand and savings accounts also increased during the first quarter by $\$ 17,583,000$. Much of this increase can be attributed to the volatility in the stock market during the first quarter and customers' desire to increase their cash positions.

## SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

Securities sold under agreements to repurchase (REPOs) decreased $\$ 1,916,000$ during 2001. The majority of the Company's REPOs are used by larger commercial customers as a daily cash management tool, therefore, depending on their individual liquidity positions, the balances in these accounts can vary considerably.

FEDERAL HOME LOAN BANK (FHLB) BORROWINGS

FHLB borrowings are used by the Company for a variety of purposes.

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Approximately $\$ 48,000,000$ of the borrowings has been used to fund leveraged strategies, whereby the Company borrowed funds and used the proceeds to purchase investment securities. The yield on the investments exceeds the borrowing cost and provides the Company with additional net interest income. Approximately $\$ 1,750,000$ of the borrowings has been used by one of the Company's subsidiary banks to fund longer-term fixed rate residential real estate loans. The remaining $\$ 21,000,000$ is used by the Company to meet short-term liquidity needs.

OTHER BORROWINGS

The $\$ 1,900,000$ balance in this category represents borrowings from an unaffiliated financial institution under a $\$ 5$ million line of credit. The line of credit was established to provide the resources necessary to fund the Company's stock repurchase plan announced during the third quarter of 2000 . The plan authorizes the Company to repurchase a total of 430,000 common shares or $5 \%$ of the Company's outstanding shares. To date, the Company has repurchased 200,100 common shares under the repurchase program at an average cost of $\$ 10.29$ per common share.

DEBT OF EMPLOYEE STOCK OWNERSHIP PLAN

The decrease in the debt of the Employee Stock Ownership Plan was due to the annual principal reduction on the loan, which is paid in March each year.

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Item 2. (continued)

## ASSET/LIABILITY MANAGEMENT

As reflected on the Repricing and Interest Rate Sensitivity Analysis on the following page, the Company has a reasonably well-balanced interest rate sensitivity position. The Company's current one-year cumulative gap is $0.96 x$. Management believes a one-year cumulative gap ratio in a range of $0.80 x-1.20 x$ indicates an entity is not subject to undue interest rate risk. A one-year cumulative gap ratio of $1.00 x$ indicates that an institution has an equal amount of assets and liabilities repricing within twelve months. A ratio in excess of 1.00x indicates more assets than liabilities will be repriced during the period indicated, and a ratio less than $1.00 x$ indicates more liabilities than assets will be repriced during the period indicated. However, actual experience may differ because of the assumptions used in the allocation of deposits and other factors, which are beyond management's control. Among the significant assumptions used in preparing the Repricing and Interest Rate Sensitivity Analysis is that interest-bearing demand and savings deposits are not $100 \%$ rate sensitive within the period of three months or less. As a result, these deposits are allocated between the repricing categories based on historical analyses performed by the Company's subsidiary banks. In addition, FHLB borrowings are categorized based on the first available call date of the individual borrowings versus their final maturity.

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Item 2. (continued)

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Additionally, the following analysis includes the available-for-sale securities spread throughout their respective repricing and/or maturity horizons, even though such securities are available for immediate liquidity should the need arise in any particular time horizon.

REPRICING AND INTEREST RATE SENSITIVITY ANALYSIS

MARCH 31, 2001


$$
\begin{array}{rrrr}
325 & -- & -- & \\
37,594 & -- & -- & 48, \\
28,924 & 20,250 & 71,547 & 10, \\
5,888 & 6,973 & 8,670 & 16, \\
285,515 & 45,565 & 127,194 & ----- \\
------- & ------- & -------- & 75, \\
358,246 & 72,788 & 207,411 & ----- \\
-------- & -------- & -------- & 713, \\
358,246 & 431,034 & 638,445 & -----1
\end{array}
$$

41,357

$$
21,129
$$

$$
50,659
$$

$$
4,840
$$

--

$$
31,152
$$

--

$$
791
$$

| 196,610 | 250,637 | 149,928 |
| :---: | :---: | :---: |
| 196,610 | 447,247 | 597,175 |


| $\$ 161,636$ | $(177,849)$ | 57,483 <br> $========$ <br> $========$ <br> $\$ 161,636$ |
| :--- | :---: | ---: |
| $========$ | $(16,213)$ | 41,270 |
| $========$ | $========$ |  |

[^0]$0.96 x$
$=======$
(1) Nonaccrual loans are reported in the "Over 1 year through 5 years" column.

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Item 2. (continued)

## CAPITAL RESOURCES

The regulatory capital guidelines require banking organizations to maintain a minimum total capital ratio of $8 \%$ of risk-weighted assets (of which at least 4\% must be Tier I capital). The Company's total capital ratios under the risk-weighted guidelines were $14.00 \%$, $14.72 \%$ and $15.97 \%$ as of March 31, 2001, December 31, 2000, and March 31, 2000, respectively, which included Tier I capital ratios of $12.98 \%$, $13.66 \%$, and $14.87 \%$, respectively. These ratios are well above the minimum risk-weighted capital requirements.

In addition, the Company and its subsidiary banks must maintain a minimum Tier I leverage ratio (Tier I capital to total adjusted consolidated assets) of at least $3 \%$. Capital, as defined under these guidelines, is total shareholders' equity less goodwill and excluding unrealized gains and losses on available-for-sale securities of the Company. The Company's Tier I leverage ratios were $9.05 \%$, $9.15 \%$, and $9.61 \%$ at March 31, 2001, December 31, 2000, and March 31,2000 , respectively. As of March 31,2001 , all of the Company's subsidiary banks were well capitalized under the regulatory framework for prompt corrective action.

## RESULTS OF OPERATIONS

## EARNINGS SUMMARY

Net income was $\$ 1,553,000$ for the three months ended March 31, 2001 compared to $\$ 1,674,000$ for the three months ended March 31, 2000, which represents a $\$ 121,000$ or a $7 \%$ decrease over the prior year. The decrease in first quarter earnings can be attributed to a combination of factors. First, net interest income declined $\$ 56,000$ on a quarter comparison due to the sharp decline in interest rates during the first quarter. These rate cuts caused the prime-lending rate to decrease 150 basis points during the quarter. Commercial and home equity loans tied to the prime-lending rate and yields on Federal funds sold are adjusted downward instantaneously with these interest rate cuts; however, deposits and borrowing costs typically adjust over time as deposits and borrowings mature and interest rates on transaction and savings deposits are gradually changed to reflect the current interest rate environment. Second, in light of the Company's continued growth, the provision for loan losses increased $\$ 78,000$ in the first quarter of 2001 compared to the prior year first quarter. Finally, noninterest expense was $\$ 169,000$ higher in the first quarter of 2001 compared to 2000.

Basic and diluted earnings per common share were $\$ .19$ and $\$ .18$, respectively, for the first quarter of 2001 , compared to $\$ .20$ and $\$ .20$ for the first quarter of 2000 , respectively. Net income for the first quarter of 2001 resulted in an annualized return on average assets (ROA) of . 83\% compared to
.98\% in the first quarter of 2000, and an annualized return on average shareholders' equity (ROE) of $8.81 \%$ compared to $10.34 \%$ the first quarter of 2000.

NET INTEREST INCOME

As reflected in the Condensed Consolidated Average Balance Sheets and

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Average Interest Rates table on the following page, net interest income on a tax-equivalent basis decreased by $\$ 63,000$ in the first quarter of 2001 when compared to the first quarter of 2000. Net interest income decreased because the yield on average earnings assets remained relatively unchanged, but the Company's cost of funds increased 49 basis points to 4.81 percent. This increase in the cost of funds more than offset the additional interest income generated by a $\$ 69,095,000$ increase in average-earning assets. Much of the asset growth over the past three quarters was funded through an 11-month certificate of deposit promotion. When the prime-lending rate dropped 150 basis points during the first quarter 2001, it caused a very narrow interest margin when matched against the rates offered during the promotion. The deposits will begin to mature during the third quarter of this year. As these deposits reprice in the current interest rate environment, it is expected to provide the Company with some relief from the downward pressure on the net interest margin.

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Item 2. (continued)
I. DISTRIBUTION OF ASSETS, LIABILITIES AND SHAREHOLDERS' EQUITY; INTEREST RATES AND INTEREST DIFFERENTIAL

CONDENSED CONSOLIDATED AVERAGE BALANCE SHEET AND AVERAGE INTEREST RATES

THREE MONTHS ENDED


LIABILITIES AND SHAREHOLDERS' EQUITY

Interest-bearing demand and savings deposits $\quad$ 222,502 1,679 3\%
Time deposits
Short-term borrowings
FHLB borrowings
Other borrowings
Debt of Employees Stock Ownership Plan

| Total interest-bearing |
| ---: |
| expense/overall rate |

Non-interest-bearing demand de
Other liabilities
Shareholders' equity
Total liabilities and s
Net interest income
Net interest margin on average
interest-earning assets

| 296,309 | 4,423 | 5.97 |
| ---: | ---: | ---: |
| 9,651 | 130 | 5.39 |
| 70,934 | 958 | 5.40 |
| 1,900 | 39 | 8.21 |
| 960 | 18 | 7.50 |

602,256 7,247
4.81

71,562
7,037
70,520
\$ 751,375
$=========$
\$ 6,062
$=======$
3.51\%
(1) Interest income includes loan origination fees.
(2) Average balance includes nonaccrual loans.
(3) Interest yields are presented on a tax-equivalent basis. Nontaxable income has been upwardly adjusted by the amount of Federal income tax that would have been paid if the income had been taxable at a rate of $34 \%$, adjusted downward by the disallowance of the interest cost to carry nontaxable loans and securities.
(4) Includes investments available-for-sale.

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Item 2. (continued)

PROVISION FOR LOAN LOSSES

The provision for loan losses increased to $\$ 159,000$ during the first quarter of 2001 from $\$ 81,000$ in 2000 . The increase in the provision for loan losses was largely due to the significant loan growth achieved over the past several quarters resulting in increased risk. With additional loan growth projected in 2001, management anticipates that a larger provision for loan losses, as compared to the prior year, will continue throughout the year. Based on the Company's analysis of the adequacy of the allowance for loan losses, management determined it was appropriate to increase the provisions for loan losses in 2001. Management will continue to assess the adequacy of the allowance for loan losses on a regular basis throughout the year.

## NONINTEREST INCOME

Noninterest income increased $\$ 120,000$ during the first quarter of 2001 in comparison to the first quarter of the prior year. The increase was due in large part to a $\$ 74,000$ increase in the gains on sales of loans. As mentioned previously, with the decrease in interest rates during the first quarter, the

Company experienced a shift in customer preference from adjustable rate loan products to fixed rate mortgage loan products, which are sold into the secondary market. The increase in these gains is directly the result of a significant increase in the volume of loans being sold into secondary market. In addition, increases in service charge and other revenue contributed to the increase in noninterest income.

## NONINTEREST EXPENSE

Noninterest expense increased $\$ 169,000$ during the first quarter of 2001 in comparison to the first quarter of 2000. The increase was mainly the result of a $\$ 217,000$ increase in salaries and employee benefits, which was partially offset by a $\$ 73,000$ decrease in other expense. The increase in salaries and employee benefits was due in part to normal increases, as well as, increased health insurance costs and higher personnel costs resulting from an extremely tight labor market, which forced the Company to make salary adjustments to attract and retain qualified employees. The decrease in other expenses was due to small decreases in a variety of normal operating expenditures.

## INCOME TAXES

Income tax expense for the first quarter of 2001 was $\$ 609,000$ compared to $\$ 671,000$ in the first quarter of 2000 . The Company's combined Federal and state effective tax rate decreased slightly to $28.17 \%$ in 2001 , compared to $28.61 \%$ in 2000. The Company's effective tax rate is impacted by tax-exempt loan and security income, income generated by the company-owned life insurance, which is exempt from Federal and state income taxes and Federal and state tax credits associated with the Company's investment in low- and moderate-income housing projects.

## SUBSEQUENT EVENT

On April 30, 2001, the Company and Allegiant Bancorp, Inc., a Missouri corporation ("Allegiant"), entered into an Agreement and Plan of Merger (the "Merger Agreement"), pursuant to which Allegiant will acquire the Company. The acquisition is structured as the merger (the "Merger") of Allegiant with and into the Company, with the Company as the surviving corporation (the "Surviving Corporation") in the Merger. Although the Merger is expected to be completed during the fourth quarter, there can be no assurance that the Merger will be completed.

In accordance with the terms of the Merger Agreement in connection with the Merger:

- each share of the Company's common stock, par value $\$ 1.00$ per share, and the associated preferred share purchase rights under the Company's Rights Agreement, dated May 27, 1993, (together, the "Southside Common Stock"), issued and outstanding immediately prior to the effective time of the Merger (the "Effective Time") shall be converted into the right to receive either: (i) $\$ 14.00$ in cash; (ii) 1.39 shares of common stock in the Surviving

Item 2. (continued)

Corporation, par value $\$ 0.01$ per share ("Surviving Corporation Common Stock"); or (iii) a combination of cash and shares of Surviving Corporation Common Stock calculated in accordance with the formula set forth in the Merger Agreement (collectively, the

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"Southside Merger Consideration"); and

- each share of Allegiant common stock, par value $\$ 0.01$ per share (the "Allegiant Common Stock"), issued and outstanding immediately prior to the Effective Time shall be converted into one share of Surviving Corporation Common Stock.

Pursuant to the terms of the Merger Agreement, each shareholder of the Company will elect what proportion of cash and Surviving Corporation Common Stock such shareholder desires to receive in exchange for such shareholder's shares of Company Common Stock (the "Shareholder Election"); provided that each such Shareholder Election is subject to reallocation in accordance with the formula set forth in the Merger Agreement to ensure that the aggregate Southside Merger Consideration payable to the Company's shareholders will be comprised of $50 \%$ cash and $50 \%$ stock.

Consummation of the Merger is subject to various conditions, including: (i) approval of the Merger Agreement and the Merger by the shareholders of the Company and Allegiant; (ii) receipt of requisite regulatory approvals from the Board of Governors of the Federal Reserve System and other federal and state regulatory authorities as necessary; (iii) receipt by each of the company and Allegiant of an opinion of counsel in reasonably satisfactory form as to the tax treatment of certain aspects of the Merger; (iv) the registration pursuant to the Securities Act of 1933, as amended (the "Act"), of the shares of Surviving Corporation Common Stock to be issued in the Merger; and (v) satisfaction of other customary conditions included in the Merger Agreement.

The Merger Agreement and the transactions contemplated thereby will be submitted for approval at meetings of the shareholders of the Company and Allegiant, respectively. The Company will file a registration statement with the Securities and Exchange Commission registering under the Act the shares of Surviving Corporation Common Stock to be issued in the Merger. The shares of Surviving Corporation Common Stock will be offered to the Company's shareholders pursuant to a prospectus that will also serve as a proxy statement for the shareholders' meetings.

As a result of the Company and Allegiant entering into the Merger Agreement, all of the conditions to the Company's previously announced tender offer to purchase $1,100,000$ shares of its common stock, which commenced on January 9, 2001, were not satisfied, and, therefore, the Company determined to terminate the tender offer on May 1, 2001. The Company instructed its exchange agent for the tender offer to promptly return all shares of its common stock tendered pursuant to the tender offer and not withdrawn.

## EFFECT OF NEW ACCOUNTING STANDARDS

Statement of Financial Accounting Standards (SFAS) 133, Accounting for Derivative Instruments and Hedging Activities, which was issued in June 1998, establishes accounting and reporting standards for derivative instruments and hedging activities. Under SFAS 133, derivatives are recognized on the balance sheet at fair value as an asset or liability. Changes in the fair value of derivatives are reported as a component of other comprehensive income or recognized as earnings through the income statement depending on the nature of the instrument. In June 1999, the FASB issued SFAS 137 - Accounting for Derivative Instruments and Hedging Activities - Deferral of the Effective Date of FASB Statement No. 133, an Amendment of FASB Statement No. 133, which defers the effective date of SFAS 133 from fiscal years beginning after June 15, 1999 to fiscal years beginning after June 15, 2000. Initial application should be as of the beginning of an entity's fiscal quarter; on that date, hedging relationships must be designated and documented pursuant to the provisions of SFAS 133, as amended. Earlier application of all of the provisions is encouraged but is permitted only as of the beginning of any fiscal quarter that begins

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after the issuance date of SFAS 133, as amended. Additionally, SFAS 133, as amended should not be applied retroactively to financial statements of prior periods. In June 2000, the FASB issued SFAS No. 138 - Accounting for

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Derivative Instruments and Hedging Activities, an Amendment of FASB Statement No. 133, which addresses a limited number of issues causing implementation difficulties for numerous entities that apply SFAS 133, as amended. SFAS 138 amends the accounting and reporting standards of SFAS 133, as amended, for certain derivative instruments, certain hedging activities and for decisions made by the FASB relating to the Derivatives Implementation Group (DIG) process. The adoption of SFAS 133 did not have a material impact on the financial condition and results of operations of the Company. The Company generally does not utilize deriviative instruments in its interest rate management process.

COMMON STOCK - MARKET PRICE AND DIVIDENDS
The table below sets forth the high, low and closing bid prices of the Company's common stock for the periods presented. The Company's common stock is traded on the National Association of Securities Dealers Automated Quotation System/Small-Cap Market System ("NASDAQ/SCM") under the symbol SBCO. Accordingly, information included below represents the high and low bid prices of the common stock reported on NASDAQ/SCM.

|  | HIGH BID |  | LOW BID |  | CLOSE |  | $\begin{aligned} & \text { BOOK } \\ & \text { VALUE } \end{aligned}$ |  | MARKET/ BOOK |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| 1st Quarter - 2001 | \$ | 11.50 | \$ | 7.375 | \$ | 10.875 | \$ | 8.71 | 124.86 |
| 4th Quarter - 2000 |  | 8.50 |  | 6.875 |  | 7.375 |  | 8.42 | 87.59 |
| 3 rd Quarter - 2000 |  | 10.00 |  | 7.375 |  | 8.00 |  | 8.08 | 99.01 |
| 2nd Quarter - 2000 |  | 9.25 |  | 6.50 |  | 7.438 |  | 7.91 | 94.03 |
| 1st Quarter - 2000 |  | 10.00 |  | 7.50 |  | 7.625 |  | 7.75 | 98.39 |

ITEM 3.

QUANTITATIVE AND QUALITATIVE DISCLOSURES REGARDING MARKET RISK

There have been no material changes from the information provided in the December 31, 2000 Annual Report on Form 10-K.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In the normal course of business, the Company had certain routine lawsuits pending at March 31, 2001. In the opinion of management, after consultation with legal counsel, none of these lawsuits will have a material adverse effect on the
consolidated financial condition of the Company.
ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

On May 8, 2001, the Company filed a report on Form 8-K, which included the Agreement and Plan of Merger between Southside Bancshares Corp. and Allegiant Bancorp dated April 30, 2001.

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## SIGNATURES

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

> SOUTHSIDE BANCSHARES CORP.

May 15, 2001

May 15, 2001
_-_-_-_-_-_--
/s/ Thomas M. Teschner

Thomas M. Teschner
President
(Principal Executive Officer)
/s/ Joseph W. Pope

Joseph W. Pope
Senior Vice President and Chief Financial Officer (Principal Financial Officer, Controller, and Principal Accounting Officer)


[^0]:    $1.07 x$

