

BANCORPSOUTH INC  
Form 10-Q  
November 08, 2006

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 10-Q**

(Mark One)

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

**For the quarterly period ended September 30, 2006**

**OR**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number: 1-12991**

**BANCORPSOUTH, INC.**

(Exact name of registrant as specified in its charter)

**Mississippi**

(State or other jurisdiction of incorporation or  
organization)

**64-0659571**

(I.R.S. Employer Identification No.)

**One Mississippi Plaza, 201 South Spring Street  
Tupelo, Mississippi**

(Address of principal executive offices)

**38804**

(Zip Code)

Registrant's telephone number, including area code: (662) 680-2000

**NOT APPLICABLE**

(Former name, former address, and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check One):

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of November 1, 2006, the registrant had outstanding 79,121,573 shares of common stock, par value \$2.50 per share.

**BANCORPSOUTH, INC.  
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**FORWARD-LOOKING STATEMENTS**

Certain statements contained in this Report may not be based on historical facts and are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements may be identified by reference to a future period(s) or by the use of forward-looking terminology, such as anticipate, believe, estimate, expect, foresee, might, will, intend, could, would or plan, or future or conditional verb tenses, and variations or negatives of such terms. These forward-looking statements include, without limitation, those relating to BancorpSouth's net interest margin, net interest revenue, the impact of interest rate volatility on interest earning assets and interest bearing liabilities, the use of demand deposits and maturing investment securities to fund loan growth, payment of dividends, prepayment of Junior Subordinated Debt Securities, valuation of mortgage servicing rights, operating results, noninterest revenue, deposits, key indicators of BancorpSouth's financial performance (such as return on average assets and return on average shareholders' equity), capital resources, BancorpSouth's products and services, liquidity needs and strategies, provision for credit losses, allowance for credit losses, future acquisitions to further BancorpSouth's business strategies, the effect of certain legal claims, the impact of federal and state regulatory requirements for capital, assessment of credit losses for loans to customers in the region affected by Hurricane Katrina, additional share repurchases under BancorpSouth's stock repurchase program, diversification of BancorpSouth's revenue stream, the impact of recent accounting pronouncements and BancorpSouth's future growth and profitability. We caution you not to place undue reliance on the forward-looking statements contained in this report, in that actual results could differ materially from those indicated in such forward-looking statements as a result of a variety of factors. These factors include, but are not limited to, the rate of economic recovery in the areas affected by Hurricane Katrina, the ability of BancorpSouth to increase noninterest revenue and expand noninterest revenue business, the ability of BancorpSouth to fund growth with lower cost liabilities, the ability of BancorpSouth to maintain credit quality, the ability of BancorpSouth to provide and market competitive services and products, the ability of BancorpSouth to diversify revenue, the ability of BancorpSouth to attract, train and retain qualified

personnel, the ability of BancorpSouth to operate and integrate new technology, changes in consumer preferences, changes in BancorpSouth's operating or expansion strategy, changes in economic conditions and government fiscal and monetary policies, legislation and court decisions related to the amount of damages recoverable in legal proceedings, fluctuations in prevailing interest rates and the effectiveness of BancorpSouth's interest rate hedging strategies, the ability of BancorpSouth to balance interest rate, credit, liquidity and capital risks, the ability of BancorpSouth to collect amounts due under loan agreements and attract deposits, laws and regulations affecting financial institutions in general, the ability of BancorpSouth to identify and effectively integrate potential acquisitions, the ability of BancorpSouth to manage its growth and effectively serve an expanding customer and market base, geographic concentrations of BancorpSouth's assets and susceptibility to economic downturns in that area, availability of and costs associated with maintaining and/or obtaining adequate and timely sources of liquidity, the ability of BancorpSouth to compete with other financial services companies, the ability of BancorpSouth to repurchase its common stock on favorable terms, possible adverse rulings, judgments, settlements and other outcomes of pending or threatened litigation, other factors generally understood to affect the financial condition or results of financial services companies and other factors detailed from time to time in BancorpSouth's press releases and filings with the Securities and Exchange Commission. We undertake no obligation to update these forward-looking statements to reflect events or circumstances that occur after the date of this report.

**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS.****BANCORPSOUTH, INC. AND SUBSIDIARIES****Consolidated Balance Sheets**

	September 30, 2006 (Unaudited)	December 31, 2005 (1)
	(In thousands)	
<b>ASSETS</b>		
Cash and due from banks	\$ 377,005	\$ 461,659
Interest bearing deposits with other banks	7,231	6,809
Held-to-maturity securities, at amortized cost	1,684,483	1,412,529
Available-for-sale securities, at fair value	1,184,976	1,353,882
Federal funds sold and securities purchased under agreement to resell	20,851	409,531
Loans and leases	7,819,408	7,401,212
Less: Unearned income	45,726	35,657
Allowance for credit losses	97,391	101,500
Net loans	7,676,291	7,264,055
Loans held for sale	76,590	74,271
Premises and equipment, net	281,349	261,172
Accrued interest receivable	92,099	78,730
Goodwill	143,700	138,754
Other assets	315,367	307,282
<b>TOTAL ASSETS</b>	<b>\$ 11,859,942</b>	<b>\$ 11,768,674</b>
<b>LIABILITIES</b>		
Deposits:		
Demand: Noninterest bearing	\$ 1,753,566	\$ 1,798,892
Interest bearing	2,775,033	2,965,057
Savings	728,168	729,279
Other time	4,235,607	4,114,030
Total deposits	9,492,374	9,607,258
Federal funds purchased and securities sold under agreement to repurchase	715,108	748,139
Other short-term borrowings	200,000	2,000
Accrued interest payable	37,349	24,435
Junior subordinated debt securities	144,847	144,847
Long-term debt	136,096	137,228
Other liabilities	102,809	127,601
<b>TOTAL LIABILITIES</b>	<b>10,828,583</b>	<b>10,791,508</b>
<b>SHAREHOLDERS EQUITY</b>		

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Common stock, \$2.50 par value Authorized - 500,000,000 shares, Issued - 79,131,256 and 79,237,345 shares, respectively	197,828	198,093
Capital surplus	112,644	108,961
Accumulated other comprehensive loss	(13,879)	(16,233)
Retained earnings	734,766	686,345
<b>TOTAL SHAREHOLDERS EQUITY</b>	<b>1,031,359</b>	<b>977,166</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS EQUITY</b>	<b>\$ 11,859,942</b>	<b>\$ 11,768,674</b>

(1) Derived from  
audited financial  
statements.

See accompanying notes to consolidated financial statements.

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**BANCORPSOUTH, INC. AND SUBSIDIARIES**  
**Consolidated Statements of Income**  
(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2006	2005	2006	2005
	(In thousands, except for per share amounts)			
<b>INTEREST REVENUE:</b>				
Loans and leases	\$ 143,712	\$ 115,800	\$ 405,481	\$ 329,479
Deposits with other banks	295	166	612	417
Federal funds sold and securities purchased under agreement to resell	609	1,061	4,431	1,649
Held-to-maturity securities:				
Taxable	16,107	9,160	46,478	28,377
Tax-exempt	2,017	1,667	5,981	4,822
Available-for-sale securities:				
Taxable	10,405	11,761	32,698	38,271
Tax-exempt	1,215	1,481	3,854	4,649
Loans held for sale	878	686	2,987	2,275
<b>Total interest revenue</b>	<b>175,238</b>	<b>141,782</b>	<b>502,522</b>	<b>409,939</b>
<b>INTEREST EXPENSE:</b>				
Deposits	62,964	44,790	173,527	123,127
Federal funds purchased and securities sold under agreement to repurchase	8,498	3,692	20,949	8,443
Other	7,378	4,859	18,498	15,081
<b>Total interest expense</b>	<b>78,840</b>	<b>53,341</b>	<b>212,974</b>	<b>146,651</b>
<b>Net interest revenue</b>	<b>96,398</b>	<b>88,441</b>	<b>289,548</b>	<b>263,288</b>
Provision for credit losses	2,526	14,725	2,252	22,492
<b>Net interest revenue, after provision for credit losses</b>	<b>93,872</b>	<b>73,716</b>	<b>287,296</b>	<b>240,796</b>
<b>NONINTEREST REVENUE:</b>				
Mortgage lending	41	4,207	6,937	7,382
Service charges	17,354	15,860	50,293	46,997
Trust income	2,344	2,161	6,685	6,054
Security gains, net	9	20	36	461
Insurance commissions	17,556	14,830	51,412	45,187
Other	11,930	11,085	40,241	39,024
<b>Total noninterest revenue</b>	<b>49,234</b>	<b>48,163</b>	<b>155,604</b>	<b>145,105</b>

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NONINTEREST EXPENSE:				
Salaries and employee benefits	58,453	52,173	174,402	157,992
Occupancy, net of rental income	8,598	6,751	23,799	20,004
Equipment	5,896	5,501	17,481	16,588
Other	25,714	25,088	77,331	75,193
Total noninterest expense	98,661	89,513	293,013	269,777
Income before income taxes	44,445	32,366	149,887	116,124
Income tax expense	13,818	9,507	46,016	35,730
Net income	\$ 30,627	\$ 22,859	\$ 103,871	\$ 80,394
Earnings per share: Basic	\$ 0.39	\$ 0.29	\$ 1.31	\$ 1.03
Diluted	\$ 0.38	\$ 0.29	\$ 1.31	\$ 1.02
Dividends declared per common share	\$ 0.20	\$ 0.19	\$ 0.59	\$ 0.57

See accompanying notes to consolidated financial statements.

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BANCORPSOUTH, INC. AND SUBSIDIARIES  
Consolidated Statements of Cash Flows  
(Unaudited)

	Nine months ended September 30,	
	2006	2005
	(In thousands)	
<b>Operating Activities:</b>		
Net income	\$ 103,871	\$ 80,394
Adjustment to reconcile net income to net cash provided by operating activities:		
Provision for credit losses	2,252	22,492
Depreciation and amortization	18,910	18,396
Deferred taxes	863	(3,093)
Amortization of intangibles	3,549	10,336
Amortization of debt securities premium and discount, net	10,471	11,933
Security gains, net	(36)	(463)
Net deferred loan origination expense	(5,451)	(5,501)
Excess tax benefit from exercise of stock options	(1,154)	
Increase in interest receivable	(13,369)	(4,575)
Increase in interest payable	12,914	7,882
Realized gain on student loans sold	(2,806)	(2,966)
Proceeds from student loans sold	104,850	110,837
Origination of student loans held for sale	(92,778)	(97,121)
Realized gain on mortgages sold	(3,517)	(5,277)
Proceeds from mortgages sold	417,520	422,530
Origination of mortgages held for sale	(425,588)	(421,748)
Increase in bank-owned life insurance	(4,600)	(4,586)
Other, net	(38,822)	2,400
 Net cash provided by operating activities	 87,079	 141,870
<b>Investing activities:</b>		
Proceeds from calls and maturities of held-to-maturity securities	294,342	204,162
Proceeds from calls and maturities of available-for-sale securities	273,679	239,847
Proceeds from sales of available-for-sale and trading securities	250	36,804
Purchases of held-to-maturity securities	(567,645)	(189,245)
Purchases of available-for-sale securities	(109,568)	(42,938)
Net decrease (increase) in short-term investments	388,680	(166,772)
Net increase in loans and leases	(409,037)	(261,962)
Purchases of premises and equipment	(40,128)	(30,406)
Proceeds from sale of premises and equipment	1,445	474
Net cash paid for acquisitions	(4,840)	(4,376)
Other, net	3,011	192
 Net cash used in investing activities	 (169,811)	 (214,220)
<b>Financing activities:</b>		
Net (decrease) increase in deposits	(114,884)	162,176

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Net increase in short-term debt and other liabilities	164,893	30,431
Repayment of long-term debt	(1,132)	(3,500)
Issuance of common stock	4,740	4,423
Purchase of common stock	(10,143)	(7,103)
Excess tax benefit from exercise of stock options	1,154	
Payment of cash dividends	(46,128)	(50,779)
Net cash (used in) provided by financing activities	(1,500)	135,648
(Decrease) increase in cash and cash equivalents	(84,232)	63,298
Cash and cash equivalents at beginning of period	468,468	322,536
Cash and cash equivalents at end of period	\$ 384,236	\$ 385,834

See accompanying notes to consolidated financial statements.

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**BANCORPSOUTH, INC. AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements**  
**(Unaudited)**

**NOTE 1 BASIS OF FINANCIAL STATEMENT PRESENTATION AND PRINCIPLES OF CONSOLIDATION**

The accompanying unaudited interim consolidated financial statements of BancorpSouth, Inc. (the Company) have been prepared in conformity with accounting principles generally accepted in the United States of America and follow general practices within the industries in which the Company operates. For further information, refer to the audited consolidated financial statements and footnotes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2005. In the opinion of management, all adjustments necessary for a fair presentation of the consolidated financial statements have been included and all such adjustments were of a normal recurring nature. The results of operations for the three-month and nine-month periods ended September 30, 2006 are not necessarily indicative of the results to be expected for the full year.

The consolidated financial statements include the accounts of the Company, its wholly-owned subsidiaries, BancorpSouth Bank (the Bank) and Risk Advantage, Inc., and the Bank's wholly-owned subsidiaries, Century Credit Life Insurance Company, Personal Finance Corporation, BancorpSouth Insurance Services, Inc., BancorpSouth Investment Services, Inc. and BancorpSouth Municipal Development Corporation.

Key employees and directors of the Company and its subsidiaries have been granted stock options under the Company's stock incentive plans. Prior to January 1, 2006, the Company accounted for those plans under the recognition and measurement principles of Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. No stock-based employee compensation cost was reflected in net income, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The fair value of each option granted was estimated on the date of grant using the Black-Scholes option-pricing model. The Company adopted Statement of Financial Accounting Standards (SFAS) No. 123R, Share-Based Payment, on January 1, 2006. As a result of the adoption of SFAS No. 123R, the Company recognized compensation costs for previously granted unvested awards of approximately \$24,000 during the first nine months of 2006. These awards were granted in 2005 with a fair value determined using the Black-Scholes option-pricing model with the following assumptions: ten-year expected option life; 3.40% dividend yield; 21.00% volatility; and 3.50% risk-free interest rate. The Company recognized compensation costs for newly granted unvested awards of approximately \$105,000 during the first nine months of 2006. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123, Accounting for Stock-Based Compensation, for the three months and nine months ended September 30, 2005:

	Three months ended September 30, 2005	Nine months ended September 30, 2005
	(In thousands, except per share amounts)	
Net income, as reported	\$ 22,859	\$ 80,394
Deduct: Stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(180)	(532)
Pro forma net income	\$ 22,679	\$ 79,862
Basic earnings per share: As reported	\$ 0.29	\$ 1.03
Pro forma	0.29	1.02
Diluted earnings per share: As reported	\$ 0.29	\$ 1.02

Pro forma

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0.29

1.02

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

	September 30,		December
	2006	2005	31,
	(In thousands)		2005
Commercial and agricultural	\$ 986,207	\$ 861,700	\$ 930,259
Consumer and installment	385,856	388,347	388,610
Real estate mortgage:			
1-4 Family	2,639,803	2,444,111	2,518,224
Other	3,452,339	3,110,961	3,228,445
Lease financing	310,989	282,643	302,311
Other	44,214	34,450	33,363
Total	\$ 7,819,408	\$ 7,122,212	\$ 7,401,212

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

	September 30,		December
	2006	2005	31,
	(In thousands)		2005
Non-accrual loans	\$ 6,289	\$ 8,103	\$ 8,816
Loans 90 days or more past due	16,859	13,539	17,744
Restructured loans	1,952	2,240	2,239
Total non-performing loans	\$ 25,100	\$ 23,882	\$ 28,799

**NOTE 3 ALLOWANCE FOR CREDIT LOSSES**

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

	Nine months ended		Year ended
	September 30,		December
	2006	2005	31,
	(In thousands)		2005
Balance at beginning of period	\$ 101,500	\$ 91,673	\$ 91,673
Provision charged to expense	2,252	22,492	24,467
Recoveries	3,927	3,652	4,557
Loans and leases charged off	(10,288)	(16,750)	(20,433)
Other, net			1,236
Balance at end of period	\$ 97,391	\$ 101,067	\$ 101,500

**NOTE 4 SECURITIES**

The following table summarizes information pertaining to temporarily impaired held-to-maturity and available-for-sale securities with continuous unrealized loss positions at September 30, 2006:



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	Continuous Unrealized Loss Position					
	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
<b>Held-to-maturity securities:</b>						
U.S. Treasury	\$ 4,956	\$ 11	\$ 5,048	\$ 33	\$ 10,004	\$ 44
U.S. Government agencies	537,027	4,106	726,998	21,271	1,264,025	25,377
Obligations of states and political subdivisions	38,787	349	38,779	730	77,566	1,079
<b>Total</b>	<b>\$ 580,770</b>	<b>\$ 4,466</b>	<b>\$ 770,825</b>	<b>\$ 22,034</b>	<b>\$ 1,351,595</b>	<b>\$ 26,500</b>
<b>Available-for-sale securities:</b>						
U.S. Government agencies	\$ 101,150	\$ 680	\$ 852,874	\$ 23,940	\$ 954,024	\$ 24,620
Obligations of states and political subdivisions	2,440	14	7,346	141	9,786	155
Other	19	1	7,963	37	7,982	38
<b>Total</b>	<b>\$ 103,609</b>	<b>\$ 695</b>	<b>\$ 868,183</b>	<b>\$ 24,118</b>	<b>\$ 971,792</b>	<b>\$ 24,813</b>

Based upon review of the sector credit ratings of these securities, the ability to hold the securities until the impairment has been recovered and the volatility of their market price, the impairments related to these securities were determined to be temporary.

**NOTE 5 PER SHARE DATA**

The computation of basic earnings per share ( EPS ) is based on the weighted average number of common shares outstanding. The computation of diluted earnings per share is based on the weighted average number of common shares outstanding plus the shares resulting from the assumed exercise of all outstanding share-based awards using the treasury stock method.

The following tables provide a reconciliation of the numerators and denominators of the basic and diluted earnings per share computations for the periods shown:

	Three months ended September 30,					
	2006			2005		
	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)	Per Share Amount
(In thousands, except per share amounts)						
<b>Basic EPS</b>						
Income available to common shareholders	\$ 30,627	79,104	\$ 0.39	\$ 22,859	78,224	\$ 0.29
Effect of dilutive share-based awards		473			346	

**Diluted EPS**

Income available to  
common shareholders  
plus assumed exercise of  
all outstanding  
share-based awards

\$ 30,627	79,577	\$ 0.38	\$ 22,859	78,570	\$ 0.29
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	Nine months ended September 30,					
	2006			2005		
	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)	Per Share Amount
	(In thousands, except per share amounts)					
<b>Basic EPS</b>						
Income available to common shareholders	\$ 103,871	79,154	\$ 1.31	\$ 80,394	78,216	\$ 1.03
Effect of dilutive stock options		398			344	
<b>Diluted EPS</b>						
Income available to common shareholders plus assumed exercise	\$ 103,871	79,552	\$ 1.31	\$ 80,394	78,560	\$ 1.02

**NOTE 6 COMPREHENSIVE INCOME**

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

	Three months ended September 30,					
	2006			2005		
	Before tax amount	Tax (expense) benefit	Net of tax amount	Before tax amount	Tax (expense) benefit	Net of tax amount
	(In thousands)					
Unrealized gains on available-for-sale securities:						
Unrealized (losses) gains arising during holding period	\$ 11,137	\$ (4,261)	\$ 6,876	\$ (4,364)	\$ 1,671	\$ (2,693)
Less: Reclassification adjustment for net (gains) losses realized in net income	(2)	1	(1)	(20)	7	(13)
Other comprehensive income (loss)	\$ 11,135	\$ (4,260)	\$ 6,875	\$ (4,384)	\$ 1,678	\$ (2,706)
Net income			30,627			22,859
Comprehensive income			\$ 37,502			\$ 20,153

Nine months ended September 30,  
2006 2005

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	Before tax amount	Tax (expense) benefit	Net of tax amount	Before tax amount	Tax (expense) benefit	Net of tax amount
	(In thousands)					
Unrealized gains on available-for-sale securities: Unrealized (losses) gains arising during holding period	\$ 3,822	\$ (1,460)	\$ 2,362	\$ (15,068)	\$ 5,771	\$ (9,297)
Less: Reclassification adjustment for net (gains) losses realized in net income	(13)	5	(8)	(346)	132	(214)
Other comprehensive income (loss)	\$ 3,809	\$ (1,455)	\$ 2,354	\$ (15,414)	\$ 5,903	\$ (9,511)
Net income			103,871			80,394
Comprehensive income			\$ 106,225			\$ 70,883

**NOTE 7 JUNIOR SUBORDINATED DEBT SECURITIES**

In 2002, the Company issued \$128,866,000 in 8.15% Junior Subordinated Debt Securities to BancorpSouth Capital Trust I (the Trust ), a business trust. The Trust used the proceeds from the issuance of five million shares of

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8.15% trust preferred securities, \$25 face value per share, to acquire the 8.15% Junior Subordinated Debt Securities. Both the Junior Subordinated Debt Securities and the trust preferred securities mature on January 28, 2032 and are callable at the option of the Company after January 28, 2007.

Pursuant to the merger with Business Holding Corporation ( BHC ) on December 31, 2004, the Company assumed the liability for \$6,186,000 in Junior Subordinated Debt Securities issued to Business Holding Company Trust I, a statutory trust. Business Holding Company Trust I used the proceeds from the issuance of 6,000 shares of trust preferred securities to acquire the Junior Subordinated Debt Securities. Both the Junior Subordinated Debt Securities and the trust preferred securities mature on April 7, 2034, and are callable at the option of the Company, in whole or in part, on any January 7, April 7, July 7, or October 7 on or after April 7, 2009. The Junior Subordinated Debt Securities and the trust preferred securities pay a per annum rate of interest, reset quarterly, equal to the three-month London Interbank Offered Rate ( LIBOR ) plus 2.80% from January 30, 2004 to April 7, 2009 and thereafter at LIBOR plus 2.85%.

Pursuant to the merger with Premier Bancorp, Inc. ( Premier ) on December 31, 2004, the Company assumed the liability for \$3,093,000 in Junior Subordinated Debt Securities issued to Premier Bancorp Capital Trust I, a statutory trust. Premier Bancorp Capital Trust I used the proceeds from the issuance of 3,000 shares of trust preferred securities to acquire the Junior Subordinated Debt Securities. Both the Junior Subordinated Debt Securities and the trust preferred securities mature on November 7, 2032, and are callable at the option of the Company, in whole or in part, on any February 7, May 7, August 7 or November 7 on or after November 7, 2007. The Junior Subordinated Debt Securities and the trust preferred securities pay a per annum rate of interest, reset quarterly, equal to the three-month LIBOR plus 3.45%.

Pursuant to the merger with American State Bank Corporation ( ASB ) on December 1, 2005, the Company assumed the liability for \$6,702,000 in Junior Subordinated Debt Securities issued to American State Capital Trust I, a statutory trust. American State Capital Trust I used the proceeds from the issuance of 6,500 shares of trust preferred securities to acquire the Junior Subordinated Debt Securities. Both the Junior Subordinated Debt Securities and the trust preferred securities mature on April 7, 2034, and are callable at the option of the Company, in whole or in part, on July 7, October 7, January 7 or April 7 on or after April 7, 2009. The Junior Subordinated Debt Securities and the trust preferred securities pay a per annum rate of interest, reset quarterly, equal to the three-month LIBOR plus 2.80%.

**NOTE 8 GOODWILL AND OTHER INTANGIBLE ASSETS**

The changes in the carrying amount of goodwill by operating segment for the nine months ended September 30, 2006 were as follows:

	Community Banking	General Corporate and Other (In thousands)	Total
Balance as of December 31, 2005	\$ 103,462	\$ 35,292	\$ 138,754
Goodwill acquired during the period	1,152	3,343	4,495
Purchase accounting adjustments	451		451
Balance as of September 30, 2006	\$ 105,065	\$ 38,635	\$ 143,700

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

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	As of September 30, 2006		As of December 31, 2005	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
	(In thousands)			
Amortized intangible assets:				
Core deposit intangibles	\$ 20,699	\$ 11,151	\$ 20,699	\$ 9,455
Customer relationship intangibles	23,164	9,866	22,890	8,051
Non-solicitation intangibles	65	55	52	35
Total	\$ 43,928	\$ 21,072	\$ 43,641	\$ 17,541
Unamortized intangible assets:				
Trade names	\$ 688	\$	\$ 688	\$
Pension plan intangibles	1,057		1,057	
Total	\$ 1,745	\$	\$ 1,745	\$

	Three months ended September 30, 2006		Nine months ended September 30, 2006	
	2006	2005	2006	2005
	(In thousands)			
Aggregate amortization expense for:				
Core deposit intangibles	\$ 557	\$ 602	\$ 1,696	\$ 1,819
Customer relationship intangibles	571	643	1,815	2,033
Non-solicitation intangibles	4	6	20	19
Total	\$ 1,132	\$ 1,251	\$ 3,531	\$ 3,871

The following table presents information regarding estimated amortization expense on the Company's amortizable identifiable intangible assets for the year ended December 31, 2006, and the succeeding four years:

	Core Deposit Intangibles	Customer Relationship Intangibles	Non- Solicitation Intangibles	Total
	(In thousands)			
Estimated Amortization Expense:				
For year ended December 31, 2006	\$2,240	\$ 2,361	\$ 22	\$4,623
For year ended December 31, 2007	2,015	2,047	7	4,069
For year ended December 31, 2008	1,735	1,811		3,546
For year ended December 31, 2009	1,546	1,554		3,100
For year ended December 31, 2010	1,207	1,360		2,567

**NOTE 9 PENSION AND OTHER POSTRETIREMENT BENEFITS**

The following tables present the components of net periodic benefit costs for the periods indicated:



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	Pension Benefits		Other Benefits	
	Three months ended		Three months ended	
	September 30,		September 30,	
	2006	2005	2006	2005
	(In thousands)			
Service cost	\$ 1,743	\$ 1,820	\$	\$ 1
Interest cost	1,328	1,360	8	37
Expected return on assets	(1,500)	(1,262)		
Amortization of unrecognized transition amount	5	4		
Recognized prior service cost	60	63	166	198
Recognized net (gain) loss	412	516	(7)	
Net periodic benefit costs	\$ 2,048	\$ 2,501	\$ 167	\$ 236

	Pension Benefits		Other Benefits	
	Nine months ended		Nine months ended	
	September 30,		September 30,	
	2006	2005	2006	2005
	(In thousands)			
Service cost	\$ 5,229	\$ 4,608	\$	\$ 3
Interest cost	3,984	3,680	24	111
Expected return on assets	(4,500)	(4,088)		
Amortization of unrecognized transition amount	15	14		
Recognized prior service cost	180	187	498	594
Recognized net (gain) loss	1,236	946	(21)	
Net periodic benefit costs	\$ 6,144	\$ 5,347	\$ 501	\$ 708

**NOTE 10 RECENT PRONOUNCEMENTS**

In March 2006, SFAS No. 156, Accounting for Servicing of Financial Assets, was issued. SFAS No. 156 amends SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, as it relates to the accounting for separately recognized servicing assets and servicing liabilities by requiring that all separately recognized servicing assets and servicing liabilities be initially measured by fair value, if practicable. SFAS No. 156 also permits the subsequent measurement of separately recognized servicing assets and servicing liabilities at fair value. SFAS No. 156 was adopted by the Company effective January 1, 2006 with the Company electing to measure its servicing rights at fair value at each reporting date. The adoption of SFAS No. 156 has had no material impact on the Company's financial statements.

In June 2006, Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes—an interpretation of SFAS 109. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS 109,

Accounting for Income Taxes, and prescribes a recognition threshold and measurement attribute for financial statement disclosure of tax positions taken or expected to be taken on a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the impact that the adoption of FIN 48 will have on the financial position and results of operations of the Company.

In February 2006, SFAS No. 155, Accounting for Certain Hybrid Financial Instruments, an amendment of FASB Statements No. 133 and 140, was issued. SFAS No. 155 permits fair value remeasurement for any hybrid financial

instrument that contains an embedded derivative that otherwise would require bifurcation, clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS No. 133, establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, clarifies that concentrations

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of credit risk in the form of subordination are not embedded derivatives and amends SFAS No. 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. SFAS No. 155 is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The adoption of SFAS No. 155 is expected to have no material impact on the financial position or results of operations of the Company.

In September 2006, SFAS No. 157, Fair Value Measurements, was issued. SFAS No. 157 establishes a framework for measuring fair value in accordance with generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The adoption of SFAS No. 157 is expected to have no material impact on the financial position or results of operations of the Company.

In September 2006, SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of SFAS No. 87, 88, 106, and 132R, was issued. SFAS No. 158 requires an employer to recognize the over-funded or under-funded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. SFAS No. 158 also requires an employer to measure the funded status of a plan as of the date of its year-end statement of financial position. SFAS No. 158 recognition and disclosure requirements are effective as of the end of the fiscal year ending after December 15, 2006. SFAS No. 158 measurement requirements are effective for fiscal years ending after December 15, 2008. Based on the preliminary funding status as of September 30, 2006, the adoption of SFAS No. 158 is expected to have no material impact on the financial position, results of operations or regulatory requirements for capital of the Company.

In September 2006, Staff Accounting Bulletin No. 108 ( SAB 108 ), Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements, was issued. SAB 108 provides interpretative guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. SAB 108 requires registrants to quantify errors using both a balance sheet and an income statement approach and to evaluate whether either approach results in quantifying a misstatement material in light of relevant quantitative and qualitative factors. SAB 108 must be applied to annual financial statements for the first fiscal year ending after November 15, 2006. The application of SAB 108 is expected to have no material impact on the financial position or results of operations of the Company.

In September, 2006, the Emerging Issues Task Force ( EITF ) reached a final consensus on Issue No. 06-4 ( EITF 06-4 ), Accounting for the Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements . EITF 06-4 requires employers to recognize a liability for future benefits provided through endorsement split-dollar life insurance arrangements that extend into postretirement periods in accordance with SFAS No. 106, Employers Accounting for Postretirement Benefits Other Than Pensions or APB Opinion No. 12, Omnibus Opinion 1967. EITF 06-4 is effective for fiscal years beginning after December 15, 2007. Entities should recognize the effects of applying this Issue through either (a) a change in accounting principle through a cumulative-effect adjustment to retained earnings or to other components of equity or net assets in the statement of financial position as of the beginning of the year of adoption or (b) a change in accounting principle through retrospective application to all prior periods. The Company is currently evaluating the impact that the adoption of EITF 06-4 will have on the financial position of the Company.

**NOTE 11 BUSINESS COMBINATIONS**

On December 1, 2005, ASB, a financial holding company with approximately \$358 million in assets headquartered in Jonesboro, Arkansas, merged with and into the Company. Pursuant to the merger, ASB's subsidiary, American State Bank, merged with and into the Bank. Consideration paid to complete this transaction consisted of 1,127,544 shares of the Company's common stock in addition to cash paid to the ASB shareholders in the aggregate amount of \$25,001,242. This transaction was accounted for as a purchase. This acquisition was not material to the financial position or results of operations of the Company.



**Table of Contents****NOTE 12 SEGMENT REPORTING**

The Company's principal activity is community banking, which includes providing a full range of deposit products, commercial loans and consumer loans. The general corporate and other operating segment includes leasing, mortgage lending, trust services, credit card activities, insurance services, investment services and other activities not allocated to community banking.

Results of operations and selected financial information by operating segment for the three-month and nine-month periods ended September 30, 2006 and 2005 were as follows:

	Community Banking	General Corporate and Other (In thousands)	Total
Three months ended September 30, 2006:			
<b>Results of Operations</b>			
Net interest revenue	\$ 86,620	\$ 9,778	\$ 96,398
Provision for credit losses	2,460	66	2,526
Net interest revenue after provision for credit losses	84,160	9,712	93,872
Noninterest revenue	25,905	23,329	49,234
Noninterest expense	67,718	30,943	98,661
Income before income taxes	42,347	2,098	44,445
Income taxes	13,166	652	13,818
Net income	\$ 29,181	\$ 1,446	\$ 30,627
<b>Selected Financial Information</b>			
Total assets (at end of period)	\$ 9,880,324	\$ 1,979,618	\$ 11,859,942
Depreciation and amortization	6,519	1,246	7,765
Three months ended September 30, 2005:			
<b>Results of Operations</b>			
Net interest revenue	\$ 80,572	\$ 7,869	\$ 88,441
Provision for credit losses	14,658	67	14,725
Net interest revenue after provision for credit losses	65,914	7,802	73,716
Noninterest revenue	23,852	24,311	48,163
Noninterest expense	58,876	30,637	89,513
Income before income taxes	30,890	1,476	32,366
Income taxes	9,073	434	9,507
Net income	\$ 21,817	\$ 1,042	\$ 22,859
<b>Selected Financial Information</b>			
Total assets (at end of period)	\$ 9,261,286	\$ 1,803,972	\$ 11,065,258
Depreciation and amortization	6,065	3,470	9,535

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	Community Banking	General Corporate and Other (In thousands)	Total
Nine months ended September 30, 2006:			
<b>Results of Operations</b>			
Net interest revenue	\$ 261,835	\$ 27,713	\$ 289,548
Provision for credit losses	2,167	85	2,252
Net interest revenue after provision for credit losses	259,668	27,628	287,296
Noninterest revenue	79,049	76,555	155,604
Noninterest expense	195,302	97,711	293,013
Income before income taxes	143,415	6,472	149,887
Income taxes	44,029	1,987	46,016
Net income	\$ 99,386	\$ 4,485	\$ 103,871
<b>Selected Financial Information</b>			
Total assets (at end of period)	\$9,880,324	\$1,979,618	\$11,859,942
Depreciation and amortization	18,601	3,858	22,459
Nine months ended September 30, 2005:			
<b>Results of Operations</b>			
Net interest revenue	\$ 240,369	\$ 22,919	\$ 263,288
Provision for credit losses	22,356	136	22,492
Net interest revenue after provision for credit losses	218,013	22,783	240,796
Noninterest revenue	73,828	71,277	145,105
Noninterest expense	176,364	93,413	269,777
Income before income taxes	115,477	647	116,124
Income taxes	35,531	199	35,730
Net income	\$ 79,946	\$ 448	\$ 80,394
<b>Selected Financial Information</b>			
Total assets (at end of period)	\$9,261,286	\$1,803,972	\$11,065,258
Depreciation and amortization	18,159	10,573	28,732

**NOTE 13 MORTGAGE SERVICING RIGHTS**

Mortgage Servicing Rights (MSRs) are capitalized based on the fair value of the servicing right on the date the corresponding mortgage loan is sold. In determining the fair value of capitalized MSRs, the Company utilizes the expertise of an independent third party. An estimate of the fair value of the Company's capitalized MSRs is determined by the independent third party utilizing assumptions about factors such as mortgage interest rates, discount rates, mortgage loan prepayment speeds, market trends and industry demand. The aforementioned estimate and assumptions are reviewed by management. Because the valuation is determined by using discounted cash flow models, the primary risk inherent in valuing the MSRs is the impact of fluctuating interest rates on the estimated life of the servicing revenue stream. The use of different estimates or assumptions could also produce different fair values.

The Company does not hedge the value of capitalized MSR's and, therefore, the Company is susceptible to significant fluctuations in the fair value of its MSR's in changing interest rate environments.

The Company has one class of mortgage servicing assets comprised of closed end loans for one-to-four family residences, secured by first liens. The following table presents the activity in this class for the period indicated:

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	2006 (In thousands)
Fair value as of January 1	\$ 36,456
Additions:	
Origination of servicing assets	4,662
Changes in fair value:	
Due to change in valuation inputs or assumptions used in the valuation model	(3,078)
Other changes in fair value	45
Fair value as of September 30	\$ 38,085

All of the changes to the values of the MSR's are recorded as part of mortgage lending noninterest revenue on the income statement. As part of mortgage lending noninterest revenue, the Company recorded contractual servicing fees of \$2.02 million and \$2.04 million and servicing fees and ancillary fees of \$267,000 and \$291,000 for the third quarter ended September 30, 2006 and 2005, respectively. The Company recorded contractual servicing fees of \$6.06 million and \$6.15 million and servicing fees and ancillary fees of \$748,000 and \$834,000 for the nine months ended September 30, 2006 and 2005, respectively.

**NOTE 14 COMMITMENTS AND CONTINGENT LIABILITIES**

During the second quarter of 2006, the State Tax Commission of the State of Mississippi and the Company resolved the issues related to the State Tax Commission's audit of the Bank's income tax returns for the tax years 1998 through 2001. As a result, the Company paid additional taxes in the amount of \$40,000, plus interest of \$25,000. The balance of the previously recorded liability related to this matter of approximately \$1.95 million was credited against the Company's second quarter's income tax expense.

**NOTE 15 SUBSEQUENT EVENTS**

On October 31, 2006, the Company announced the signing of a definitive agreement to acquire City Bancorp, parent company of The Signature Bank headquartered in Springfield, Missouri, with approximately \$847 million in assets and approximately \$600 million in deposits as of September 30, 2006. The Signature Bank operates six full service banking locations in Springfield, Missouri and one loan production office in Clayton (St. Louis), Missouri. The transaction is valued at approximately \$170 million and is expected to be completed during the first quarter of 2007, subject to approval of City Bancorp's shareholders, federal and state banking regulators and other customary closing conditions.

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

BancorpSouth, Inc. (the Company) is a regional financial holding company with approximately \$11.9 billion in assets headquartered in Tupelo, Mississippi. BancorpSouth Bank (the Bank), the Company's wholly-owned banking subsidiary, has commercial banking operations in Mississippi, Tennessee, Alabama, Arkansas, Texas and Louisiana. During the third quarter of 2006, the Bank entered the Florida market by opening a full-service bank office in Destin, Florida. The Bank and its consumer finance, credit insurance, insurance agency and brokerage subsidiaries provide commercial banking, leasing, mortgage origination and servicing, insurance, brokerage and trust services to corporate customers, local governments, individuals and other financial institutions through an extensive network of branches and offices.

Management's discussion and analysis provides a narrative discussion of the Company's financial condition and results of operations. For a complete understanding of the following discussion, you should refer to the unaudited consolidated financial statements for the three-month and nine-month periods ended September 30, 2006 and 2005

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and the notes to such financial statements found under Part I, Item 1. Financial Statements. of this report. This discussion and analysis is based on reported financial information. The information that follows is provided to enhance comparability of financial information between periods and to provide a better understanding of the Company's operations.

As a financial holding company, the financial condition and operating results of the Company are heavily influenced by economic trends nationally and in the specific markets in which the Company's subsidiaries provide financial services. Most of the revenue of the Company is derived from the operation of its principal operating subsidiary, the Bank. The financial condition and operating results of the Bank are affected by the level and volatility of interest rates on loans, investment securities, deposits and other borrowed funds, and the impact of economic cycles on loan demand and creditworthiness of existing borrowers. The financial services industry is highly competitive and heavily regulated. The Company's success depends on its ability to compete aggressively within its markets while maintaining sufficient asset quality and cost controls to generate net income.

The tables below summarize the Company's net income, net income per share, return on average assets and return on average shareholders' equity for the three months and nine months ended September 30, 2006 and 2005. Management believes these amounts and ratios are key indicators of the Company's financial performance.

	Three months ended September 30,		% Change
	2006	2005	
(Dollars in thousands, except per share amounts)			
Net income	\$ 30,627	\$ 22,859	33.98%
Net income per share: Basic	\$ 0.39	\$ 0.29	34.48
Diluted	\$ 0.38	\$ 0.29	31.03
Return on average assets (annualized)	1.03%	0.83%	24.10
Return on average shareholders' equity (annualized)	11.94%	9.70%	23.09

	Nine months ended September 30,		% Change
	2006	2005	
(Dollars in thousands, except per share amounts)			
Net income	\$ 103,871	\$ 80,394	29.20%
Net income per share: Basic	\$ 1.31	\$ 1.03	27.18
Diluted	\$ 1.31	\$ 1.02	28.43
Return on average assets (annualized)	1.18%	0.99%	19.19
Return on average shareholders' equity (annualized)	13.95%	11.61%	20.16

Net income increased for the three months and nine months ended September 30, 2006 compared to the three months and nine months ended September 30, 2005. The increase in net income is attributable to several factors. The Company's primary source of revenue, net interest revenue earned by the Bank, reflected continued positive trends for the three months and nine months ended September 30, 2006 compared to the same periods of 2005. Net interest revenue is the difference between interest earned on loans and investments and interest paid on deposits and other obligations. The Company's net interest revenue was positively impacted by increases in interest rates as well as the increased loan demand resulting from favorable economic activity throughout most of the Bank's markets and the Company's continued focus on funding this growth with maturing investment securities and lower-cost liabilities, as well as FHLB short-term borrowings as needed. These factors combined to increase the Company's net interest revenue to \$96.40 million for the third quarter of 2006, a \$7.96 million, or 9.00%, increase from \$88.44 million for the third quarter of 2005. Net interest revenue increased to \$289.55 million for the first nine months of 2006, a \$26.26 million, or 9.97%, increase from \$263.29 million for the first nine months of 2005. Also positively impacting net income was the decrease in the Company's provision for credit losses in the third quarter of 2006 compared to the third quarter of 2005. In the third quarter of 2005, the Company increased its provision for credit losses by

approximately \$10.38 million, primarily as a result of Hurricane Katrina's impact on the Mississippi Gulf Coast region and estimates of the effect on the Company's customers. Because the actual effect of Hurricane

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Katrina on the Company's customers has been less than what was estimated in the third quarter of 2005, in the first nine months of 2006 the Company has been able to reverse \$5.90 million of the allowance for credit losses recorded in the third quarter of 2005.

In recent years, the Company has taken steps to diversify its revenue stream by increasing its noninterest revenue from mortgage lending activities, insurance agency activities, brokerage activities and other bank-related fees. Management believes this diversification is important to reduce the impact of fluctuations in net interest revenue on the overall operating results of the Company. These diversification efforts resulted in an overall increase in noninterest revenue of 2.22% and 7.24% for the third quarter and first nine months of 2006, respectively, compared to the same periods in 2005. One of the primary contributors to the increase in noninterest revenue was insurance commissions, as commissions increased 18.38% and 13.78% for the third quarter and first nine months of 2006, respectively, compared to the same periods in 2005. While insurance commission revenue increased, the Company's mortgage lending revenue decreased during the third quarter and first nine months of 2006 compared to the same periods in 2005. The decrease in mortgage lending revenue primarily resulted from the impact of a \$3.67 million net decrease in the fair value of the Company's mortgage servicing asset for the third quarter of 2006 compared to a \$662,000 reversal of the previous impairment of the Company's mortgage servicing asset during the third quarter of 2005. Other noninterest revenue increased 7.62% and 3.12% for the third quarter and first nine months of 2006, respectively, compared to the same periods in 2005 as the Company recorded receipt of an additional \$1.00 million in insurance proceeds related to Hurricane Katrina during the third quarter of 2006. The Company also recorded a gain of \$732,000 from the redemption of Class B shares of MasterCard common stock in connection with its initial public offering during the second quarter of 2006. Life insurance proceeds of \$1.4 million received in the second quarter of 2006 were reclassified as a bad debt recovery in the third quarter of 2006 as they related to a previously charged off loan. Improved asset quality resulted in annualized net charge-offs falling to 0.07% of average loans for the third quarter of 2006 from 0.27% of average loans for the third quarter of 2005 and to 0.11% of average loans for the first nine months of 2006 from 0.25% of average loans for the first nine months of 2005. Noninterest expense totaled \$98.66 million for the third quarter of 2006 compared to \$89.51 million for the third quarter of 2005, an increase of \$9.15 million, or 10.22%. For the first nine months of 2006 and 2005, noninterest expense totaled \$293.01 million and \$269.78 million, respectively, representing an increase of 8.61%. The increase in noninterest expense for the third quarter and first nine months of 2006 resulted primarily from the impact of costs related to the integration and operation of American State Bank Corporation that was acquired and merged into the Company on December 1, 2005 and increased costs related to additional locations and facilities added since September 30, 2005. The major components of net income are discussed in more detail in the various sections that follow.

**CRITICAL ACCOUNTING POLICIES**

During the nine months ended September 30, 2006, there was no significant change in the Company's critical accounting policies and no significant change in the application of critical accounting policies as presented in the Company's Annual Report on Form 10-K for the year ended December 31, 2005, with the exception of the following change regarding mortgage servicing rights.

**Mortgage Servicing Rights**

The Company recognizes as assets the rights to service mortgage loans for others, known as MSR's. Prior to the Company's adoption of SFAS No. 156, MSR's were capitalized based on the relative fair value of the servicing right and the mortgage loan on the date the mortgage loan is sold. As a result of the Company's adoption of SFAS No. 156 on January 1, 2006, the Company carries MSR's at fair value. In determining the fair value of capitalized MSR's, the Company utilizes the expertise of an independent third party. An estimate of the fair value of the Company's capitalized MSR's is determined by the independent third party utilizing assumptions about factors such as mortgage interest rates, discount rates, mortgage loan prepayment speeds, market trends and industry demand. The aforementioned estimate and the assumptions used by the independent third party to arrive at the estimate are reviewed by management. Because the valuation is determined by using discounted cash flow models, the primary risk inherent in valuing the MSR's is the impact of fluctuating interest rates on the estimated life of the servicing revenue stream. The use of different estimates or assumptions could also produce different fair values.





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The Company does not hedge the value of capitalized MSR's and, therefore, the Company is susceptible to significant fluctuations in the fair value of its MSR's in changing interest rate environments. At September 30, 2006, the Company's mortgage servicing asset was valued at \$38.09 million.

**RESULTS OF OPERATIONS****Net Interest Revenue**

Net interest revenue is the difference between interest revenue earned on assets, such as loans, leases and securities, and interest expense paid on liabilities, such as deposits and borrowings, and continues to provide the Company with its principal source of revenue. Net interest revenue is affected by the general level of interest rates, changes in interest rates and changes in the amount and composition of interest earning assets and interest bearing liabilities. The Company's long-term objective is to manage those assets and liabilities to maximize net interest revenue, while balancing interest rate, credit, liquidity and capital risks. For purposes of the following discussion, revenue from tax-exempt loans and investment securities has been adjusted to a fully taxable equivalent basis, using an effective tax rate of 35%.

Net interest revenue was \$98.95 million for the three months ended September 30, 2006, compared to \$90.75 million for the same period in 2005, representing an increase of \$8.20 million, or 9.03%. For the first nine months of 2006 and 2005, net interest revenue was \$297.06 million and \$270.12 million, respectively, representing an increase of \$26.94 million or 9.97%. The increase in net interest revenue for the third quarter and first nine months of 2006 is primarily a result of growth in loans made by the Bank in a rising interest rate environment and the Company's continued focus on funding this growth with maturing investment securities and lower-cost liabilities.

Interest revenue increased \$33.69 million, or 23.38%, to \$177.79 million for the three months ended September 30, 2006 from \$144.09 million for the three months ended September 30, 2005. The increase in interest revenue for the three months ended September 30, 2006 is attributable to a \$754.88 million, or 7.58%, increase in average interest earning assets to \$10.72 billion for the third quarter of 2006 from \$9.96 billion for the third quarter of 2005 and an increase in the yield of those assets of 84 basis points to 6.58% for the third quarter of 2006 from 5.74% for the third quarter of 2005. For the first nine months of 2006 and 2005, interest revenue was \$510.03 million and \$416.77 million, respectively, representing an increase of 22.37%.

Interest expense increased \$25.50 million, or 47.80%, to \$78.84 million for the three months ended September 30, 2006 from \$53.34 million for the three months ended September 30, 2005. This increase in interest expense is attributable to a larger amount of interest bearing liabilities and a higher average rate paid on those liabilities for the three months and nine months ended September 30, 2006 as compared to the same periods ended September 30, 2005. Average interest bearing liabilities increased \$616.30 million, or 7.39%, to \$8.95 billion for the third quarter of 2006 from \$8.34 billion for the third quarter of 2005. The average rate paid on those liabilities also increased 95 basis points to 3.49% for the third quarter of 2006 from 2.54% for the third quarter of 2005. For the first nine months of 2006 and 2005, interest expense was \$212.97 million and \$146.65 million, respectively, representing an increase of \$66.32 million or 45.23%.

The relative performance of the Company's lending and deposit-raising functions is frequently measured by two calculations—net interest margin and net interest rate spread. Net interest margin is determined by dividing fully taxable equivalent net interest revenue by average earning assets. Net interest rate spread is the difference between the average fully taxable equivalent yield earned on interest earning assets (earning asset yield) and the average rate paid on interest bearing liabilities. Net interest margin is generally greater than the net interest rate spread because of the additional income earned on those assets funded by noninterest bearing liabilities, or free funding, such as noninterest bearing demand deposits and shareholders' equity.

Net interest margin for the third quarter of 2006 and 2005 was 3.66% and 3.61%, respectively, representing an increase of 5 basis points. Net interest margin for the nine months ended September 30, 2006 and 2005 was 3.71% and 3.64%, respectively, representing an increase of 7 basis points. Net interest rate spread for the third quarter of 2006 was 3.09%, a decrease of 11 basis points from 3.20% for the same period of 2005. Net interest rate spread for the nine month period ended September 30, 2006 was 3.18%, a decrease of 8 basis points from 3.26% for the same

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period of 2005. The decrease in the net interest rate spread for the third quarter of 2006 as compared to the same period of 2005 was primarily a result of the larger increase in the average rate paid on interest bearing liabilities, from 2.54% for the third quarter of 2005 to 3.49% for the third quarter of 2006, than the increase in the average rate earned on interest earning assets from 5.74% for the third quarter of 2005 to 6.58% for the third quarter of 2006. The decrease in the net interest rate spread for the first nine months of 2006 as compared to the same period of 2005 was also primarily a result of the larger increase in the average rate paid on interest bearing liabilities, from 2.35% for the first nine months of 2005 to 3.20% for the first nine months of 2006, than the increase in the average rate earned on interest earning assets from 5.61% for the first nine months of 2005 to 6.38% for the first nine months of 2006. The increase in the net interest margin for both the third quarter and first nine months of 2006 as compared to the same periods of 2005 resulted from a larger percentage increase in the earning asset yield relative to the percentage increase in the average earning assets. The earning asset yield increase for the third quarter of 2006 was a result of favorable economic activity throughout most of the Bank's markets, resulting in stronger loan demand. The Company has also invested funds from maturing securities in higher rate loans or new higher rate short- and intermediate-term investments.

**Interest Rate Sensitivity**

The interest rate sensitivity gap is the difference between the maturity or repricing opportunities of interest sensitive assets and interest sensitive liabilities for a given period of time. A prime objective of the Company's asset/liability management is to maximize net interest margin while maintaining a reasonable mix of interest sensitive assets and liabilities. The following table presents the Company's interest rate sensitivity at September 30, 2006:

	Interest Rate Sensitivity    Maturing or Repricing Opportunities			
	0 to 90 Days	91 Days to 1 Year	Over 1 Year to 5 Years	Over 5 Years
	(In thousands)			
<b>Interest earning assets:</b>				
Interest bearing deposits with banks	\$ 7,231	\$	\$	\$
Federal funds sold and securities purchased under agreement to resell	20,851			
Held-to-maturity securities	25,001	138,349	1,137,067	384,066
Available-for-sale and trading securities	147,738	294,161	339,462	403,615
Loans and leases, net of unearned income	4,043,200	1,450,544	2,138,499	141,439
Loans held for sale	76,590			
<b>Total interest earning assets</b>	<b>4,320,611</b>	<b>1,883,054</b>	<b>3,615,028</b>	<b>929,120</b>
<b>Interest bearing liabilities:</b>				
Interest bearing demand deposits and savings	3,273,062	230,139		
Other time deposits	940,676	2,194,451	1,096,516	3,964
Federal funds purchased and securities sold under agreement to repurchase and other short-term borrowings	915,108			
Long-term debt and junior subordinated debt securities	524	1,624	57,448	221,347
Other	16	85	194	71
<b>Total interest bearing liabilities</b>	<b>5,129,386</b>	<b>2,426,299</b>	<b>1,154,158</b>	<b>225,382</b>
<b>Interest rate sensitivity gap</b>	<b>\$ (808,775)</b>	<b>\$ (543,245)</b>	<b>\$ 2,460,870</b>	<b>\$ 703,738</b>

Cumulative interest sensitivity gap	\$ (808,775)	\$ (1,352,020)	\$ 1,108,850	\$ 1,812,588
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**Provision for Credit Losses and Allowance for Credit Losses**

The provision for credit losses is the periodic cost of providing an allowance or reserve for estimated probable losses on loans and leases. The Bank employs a systematic methodology for determining its allowance for credit losses that considers both qualitative and quantitative factors and requires that management make material estimates and assumptions that are particularly susceptible to significant change. Some of the quantitative factors considered by the Bank include loan and lease growth, changes in nonperforming and past due loans and leases, historical loan and lease loss experience, delinquencies, management's assessment of loan and lease portfolio quality, the value of collateral and concentrations of loans and leases to specific borrowers or industries. Some of the qualitative factors that the Bank considers include existing general economic conditions and the inherent risks of individual loans and leases.

The allowance for credit losses is based principally upon the Bank's loan and lease classification system, delinquencies and historic loss rates. The Bank has a disciplined approach for assigning credit ratings and classifications to individual credits. Each credit is assigned a grade by the appropriate loan officer, which serves as a basis for the credit analysis of the entire portfolio. The assigned grade reflects the borrower's creditworthiness, collateral values, cash flows and other factors. An independent loan review department of the Bank is responsible for reviewing the credit rating and classification of individual credits and assessing trends in the portfolio, adherence to internal credit policies and procedures and other factors that may affect the overall adequacy of the allowance. The work of the loan review department is supplemented by governmental regulatory agencies in connection with their periodic examinations of the Bank, which provides an additional independent level of review. The loss factors assigned to each classification are based upon the attributes of the loans and leases typically assigned to each grade (such as loan to collateral values and borrower creditworthiness). Management periodically reviews the loss factors assigned in light of the general economic environment and overall condition of the loan and lease portfolio and modifies the loss factors assigned to each classification as management deems appropriate. The overall allowance generally includes a component representing the results of other analyses intended to ensure that the allowance is adequate to cover other probable losses inherent in the portfolio. This component considers analyses of changes in credit risk resulting from the differing underwriting criteria in acquired loan and lease portfolios, industry concentrations, changes in the mix of loans and leases originated, overall credit criteria and other economic indicators.

The provision for credit losses, the allowance for credit losses as a percentage of loans and leases outstanding at September 30, 2006 and 2005, net charge-offs and net charge-offs as a percentage of average loans and leases (annualized) for the three months and nine months ended September 30, 2006 and 2005 are shown in the following tables:

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	Three months ended September 30,		
	2006	2005	% Change
	(Dollars in thousands)		
Provision for credit losses	\$ 2,526	\$ 14,725	(82.85)%
Net charge-offs	\$ 1,399	\$ 4,734	(70.45)
Net charge-offs as a percentage of average loans and leases (annualized)	0.07%	0.27%	(74.07)
	Nine months ended September 30,		
	2006	2005	% Change
	(Dollars in thousands)		
Provision for credit losses	\$ 2,252	\$ 22,492	(89.99)%
Net charge-offs	\$ 6,361	\$ 13,098	(51.44)
Net charge-offs as a percentage of average loans and leases (annualized)	0.11%	0.25%	(56.00)
Allowance for credit losses as a percentage of loans and leases outstanding at period end	1.25%	1.43%	(12.59)

The provision for credit losses for the three-month and nine-month periods ended September 30, 2006 compared to the three-month and nine-month periods ended September 30, 2005 decreased significantly as the Company recorded a \$10.38 million pre-tax increase in the provision for credit losses during the third quarter of 2005, primarily as a result of Hurricane Katrina's impact on the Mississippi Gulf Coast region. The Company recorded a \$5.90 million pre-tax reduction in the allowance for credit losses during the first nine months of 2006 as contacts with many customers were re-established and losses related to loans in the impacted area are not expected to be as great as originally anticipated immediately following the hurricane. The Company will continue its assessment of credit losses for loans to customers in the affected region. At September 30, 2006, approximately \$1.00 million of the allowance for credit losses was specifically related to loans to customers in the impacted area. In addition to the reduction in the allowance for credit losses, the Company experienced an improvement in net charge-offs during the third quarter and first nine months of 2006 compared to the third quarter and first nine months of 2005 as net charge-offs decreased 70.45% to \$1.40 million for the third quarter of 2006 compared to \$4.73 million for the third quarter of 2005 and decreased 51.44% to \$6.36 million for the first nine months of 2006 compared to \$13.10 million for the first nine months of 2005.

The breakdown of the allowance by loan and lease category is based, in part, on evaluations of specific loan and lease histories and on economic conditions within specific industries or geographical areas. Accordingly, because all of these conditions are subject to change, the allocation is not necessarily indicative of the breakdown of any future allowance or losses. The following table presents (a) the breakdown of the allowance for credit losses by loan and lease category and (b) the percentage of each category in the loan and lease portfolio to total loans and leases at the dates indicated:

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	September 30,		2005		December 31,	
	2006	% of	Allowance	% of	Allowance	% of
	for	Total	for	Total	for	Total
	Credit	Loans	Credit	Loans	Credit	Loans
		and		and		and
	Losses	Leases	Losses	Leases	Losses	Leases
	(Dollars in thousands)					
Commercial and agricultural	\$ 11,442	12.61%	\$ 11,179	12.10%	\$ 12,171	12.57%
Consumer and installment	6,923	4.93%	9,995	5.45%	10,458	5.25%
Real estate mortgage	75,771	77.91%	76,577	78.00%	75,570	77.64%
Lease financing	2,921	3.98%	3,066	3.97%	3,014	4.08%
Other	334	0.57%	250	0.48%	287	0.46%
Total	\$ 97,391	100.00%	\$ 101,067	100.00%	\$ 101,500	100.00%

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

	Nine months ended		Year ended December 31, 2005
	September 30, 2006	September 30, 2005	
	(Dollars in thousands)		
Balance, beginning of period	\$ 101,500	\$ 91,673	\$ 91,673
Loans and leases charged off:			
Commercial and agricultural	(714)	(1,806)	(2,172)
Consumer and installment	(3,656)	(5,875)	(7,651)
Real estate mortgage	(5,737)	(8,646)	(10,187)
Lease financing	(181)	(423)	(423)
Total loans charged off	(10,288)	(16,750)	(20,433)
Recoveries:			
Commercial and agricultural	1,581	946	1,063
Consumer and installment	1,828	1,832	2,384
Real estate mortgage	460	857	1,089
Lease financing	58	17	21
Total recoveries	3,927	3,652	4,557
Net charge-offs	(6,361)	(13,098)	(15,876)
Provision charged to operating expense	2,252	22,492	24,467

Other, net			1,236
Balance, end of period	\$ 97,391	\$ 101,067	\$ 101,500
Average loans for period	\$ 7,506,656	\$ 6,979,161	\$ 7,026,009
Ratios:			
Net charge-offs to average loans (annualized)	0.11%	0.25%	0.23%

**Noninterest Revenue**

The components of noninterest revenue for the three months and nine months ended September 30, 2006 and 2005 and the corresponding percentage changes are shown in the following tables:

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	Three months ended		
	September 30,		
	2006	2005	% Change
	(Dollars in thousands)		
Mortgage lending	\$ 41	\$ 4,207	(99.03)%
Service charges	17,354	15,860	9.42
Trust income	2,344	2,161	8.47
Securities gains, net	9	20	(55.00)
Insurance commissions	17,556	14,830	18.38
Other	11,930	11,085	7.62
<b>Total noninterest revenue</b>	<b>\$ 49,234</b>	<b>\$ 48,163</b>	<b>2.22%</b>

	Nine months ended		
	September 30,		
	2006	2005	% Change
	(Dollars in thousands)		
Mortgage lending	\$ 6,937	\$ 7,382	(6.03)%
Service charges	50,293	46,997	7.01
Trust income	6,685	6,054	10.42
Securities gains, net	36	461	(92.19)
Insurance commissions	51,412	45,187	13.78
Other	40,241	39,024	3.12
<b>Total noninterest revenue</b>	<b>\$ 155,604</b>	<b>\$ 145,105</b>	<b>7.24%</b>

The Company's revenue from mortgage lending typically fluctuates as mortgage interest rates change and is primarily attributable to two activities—origination of new mortgage loans and servicing mortgage loans. The Company's normal practice is to generate mortgage loans to sell them in the secondary market and to either retain or release the associated MSR with the loan sold. The Company adopted SFAS No. 156 on January 1, 2006, and, as a result, records MSRs at fair value. For more information, see **CRITICAL ACCOUNTING POLICIES—Mortgage Servicing Rights** under **Part I, Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations** of this report.

Origination revenue, a component of mortgage lending, is comprised of gains or losses from the sale of the mortgage loans originated and the capitalized value of the MSRs. Origination volume of \$166.47 million and \$165.36 million produced origination revenue of \$1.42 million and \$1.21 million for the quarters ended September 30, 2006 and 2005, respectively. Origination volume of \$455.27 million and \$445.81 million produced origination revenue of \$3.21 million and \$3.78 million for the first nine months ended September 30, 2006 and 2005, respectively. While origination volume was consistent for the nine months ended September 30, 2006 as compared to the nine months ended September 30, 2005, competitive pricing pressure, which is common in a rising mortgage interest rate environment, resulted in lower revenue for the nine months ended September 30, 2006 as compared to the same period in 2005.

Revenue from the servicing process, the other component of mortgage lending revenue, includes fees from the actual servicing of loans and the recognition of changes in the valuation of the Company's MSRs. Revenue from the servicing of loans was \$2.29 million and \$2.33 million for the quarters ended September 30, 2006 and 2005, respectively. For the nine months ended September 30, 2006 and 2005, revenue from the servicing of loans was \$6.81 million and \$6.98 million, respectively. Revenues from changes in the valuation gains or losses on the Company's MSRs are



generally a result of changes in mortgage rates from the previous reporting date. An increase in mortgage rates typically results in an increase in the value of the MSR's while a decrease in mortgage rates typically results in a decrease in the value of MSR's. The Company does not hedge the value of its MSR's and is susceptible to significant fluctuations in their value in changing interest rate environments. The valuation loss on MSR's was \$3.67 million for the quarter ended September 30, 2006 compared to a reversal of a previous impairment of \$662,000 for the quarter ended September 30, 2005. For the nine months ended September 30, 2006, the

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valuation loss on MSRs was \$3.08 million compared to a valuation loss of \$3.38 million for the nine months ended September 30, 2005.

Service charges on deposit accounts increased for the third quarter and nine months ending September 30, 2006 when compared to the third quarter and nine months ending September 30, 2005 because of higher volumes of items processed and growth in the number of deposit accounts. Trust income increased 8.47% for the third quarter of 2006 compared to the third quarter of 2005 and 10.42% for the nine months ending September 30, 2006 compared to the nine months ending September 30, 2005 as a result of increases in the value of assets under care (either managed or in custody).

Insurance commissions grew 18.38% to \$17.56 million for the third quarter of 2006 compared to the same period in 2005 and 13.78% to \$51.41 million for the nine months ending September 30, 2006 compared to the same period in 2005. The increase in insurance commissions is primarily a result of the increase in policies written since September 30, 2005, including substantial new business generated in the Mississippi Gulf Coast, coupled with higher policy premiums. The Company plans to continue to expand the products and services offered by its insurance agencies.

Other noninterest revenue for the first nine months of 2006 included a gain of \$2.81 million from the sale of student loans originated by the Company compared to a \$2.97 million gain for sales of student loans in the first nine months of 2005. Other noninterest revenue for the first nine months of 2006 also included a gain of \$732,000 from the redemption of Class B shares of MasterCard common stock in connection with its initial public offering during the second quarter of 2006 as well as the receipt of an additional \$1.00 million in insurance proceeds related to Hurricane Katrina. Life insurance proceeds of \$1.4 million received in the second quarter of 2006 were reclassified as a bad debt recovery in the third quarter of 2006 as they related to a previously charged off loan. Other noninterest revenue for the first nine months of 2005 included a \$765,000 gain related to the sale of certain insurance agency accounts and a \$1.70 million gain on the sale of the Company's membership in the PULSE network, an electronic banking network which the Company retains access.

**Noninterest Expense**

The components of noninterest expense for the three months and nine months ended September 30, 2006 and 2005 and the corresponding percentage changes are shown in the following tables:

	Three months ended September 30,		% Change
	2006	2005	
	(Dollars in thousands)		
Salaries and employee benefits	\$ 58,453	\$ 52,173	12.04%
Occupancy, net of rental income	8,598	6,751	27.36
Equipment	5,896	5,501	7.18
Other	25,714	25,088	2.50
Total noninterest expense	\$ 98,661	\$ 89,513	10.22%

	Nine months ended September 30,		% Change
	2006	2005	
	(Dollars in thousands)		
Salaries and employee benefits	\$ 174,402	\$ 157,992	10.39%
Occupancy, net of rental income	23,799	20,004	18.97
Equipment	17,481	16,588	5.38
Other	77,331	75,193	2.84

Total noninterest expense	\$ 293,013	\$ 269,777	8.61%
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Salaries and employee benefits expense for the three months and nine months ended September 30, 2006 increased compared to the same periods in 2005, primarily as a result of the salaries and employee benefits of employees of American State Bank Corporation acquired on December 1, 2005 and the hiring of employees to staff locations and facilities added during 2005 and 2006. Occupancy expense also increased on a comparable three-month and nine-month period basis primarily because of additional locations and facilities opened since September 30, 2005, including the acquisition in December 2005. Equipment expense increased for the comparable three-month and nine-month periods because of increased depreciation related to the equipment replacement purchases made during the last four months of 2005 as a result of the damage caused by Hurricane Katrina, coupled with increases in various maintenance contracts. The increase in other noninterest expense primarily reflected accruals for loss contingencies and the accrual for litigation contingencies as well as normal increases and general inflation in the cost of services and supplies purchased by the Company during the first nine months of 2006 compared to the first nine months of 2005.

**Income Tax**

Income tax expense was \$13.82 million for the third quarter of 2006, a 45.34% increase from \$9.51 million for the third quarter of 2005. For the nine-month period ending September 30, 2006, income tax expense was \$46.02 million compared to \$35.73 million for the same period in 2005, representing an increase of 28.79%. The increase in income tax expense in the third quarter and first nine months of 2006 compared to the third quarter and first nine months of 2005 was primarily the result of the increase in net income before tax, as net income before tax increased 37.32% for the third quarter of 2006 compared to the third quarter of 2005 and increased 29.08% when comparing the first nine months of 2006 to the first nine months of 2005. The effective tax rates for the third quarter of 2006 and 2005 were 31.09% and 29.37%, respectively, and the effective tax rates for the nine-month periods ended September 30, 2006 and 2005 were 30.70% and 30.77%, respectively. The increase in the effective tax rate for the third quarter of 2006 compared to the third quarter of 2005 was the result of the receipt of approximately \$228,000 in state tax refunds during the third quarter of 2005, with no such refunds received in the third quarter of 2006. The effective tax rate for the first nine months of 2006 included the effect of the reversal of a previously recorded tax contingency of approximately \$1.95 million. The previously recorded tax contingency was related to a tax assessment resulting from an audit performed by the State Tax Commission of the State of Mississippi for tax years 1998 through 2001. The issues related to the audit were resolved in June 2006. With approximately \$1.95 million of the previously recorded contingency no longer deemed necessary, that amount was credited against the 2006 second quarter income tax expense. See Note 14 to the consolidated financial statements included in this report for additional information about the resolution of the Mississippi tax audit.

**FINANCIAL CONDITION****Earning Assets**

The percentage of earning assets to total assets measures the effectiveness of management's efforts to invest available funds into the most efficient and profitable uses. Earning assets at September 30, 2006 were \$10.75 billion, or 90.62% of total assets, compared with \$10.62 billion, or 90.26% of total assets, at December 31, 2005.

The securities portfolio is used to make various term investments, to provide a source of liquidity and to serve as collateral to secure certain types of deposits. Held-to-maturity securities at September 30, 2006 were \$1.68 billion, compared with \$1.41 billion at December 31, 2005, a 19.25% increase. Available-for-sale securities were \$1.18 billion at September 30, 2006, compared to \$1.35 billion at December 31, 2005, a 12.48% decrease.

The Bank's loan and lease portfolio makes up the single largest component of the Company's earning assets. The Bank's lending activities include both commercial and consumer loans and leases. Loan and lease originations are derived from a number of sources, including direct solicitation by the Bank's loan officers, real estate broker referrals, mortgage loan companies, current depositors and loan customers, builders, attorneys, walk-in customers and, in some instances, other lenders. The Bank has established disciplined and systematic procedures for approving and monitoring loans and leases that vary depending on the size and nature of the loan or lease. Loans

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and leases, net of unearned income, totaled \$7.77 billion at September 30, 2006, which represented a 5.54% increase from \$7.37 billion at December 31, 2005.

At September 30, 2006, the Company did not have any concentrations of loans in excess of 10% of total loans outstanding. Loan concentrations are considered to exist if there are amounts loaned to a multiple number of borrowers engaged in similar activities, which would cause them to be similarly impacted by economic or other conditions. However, the Company does conduct a significant portion of its business in a geographically concentrated area, and the ability of the Company's borrowers to repay loans is to some extent dependent upon the economic conditions prevailing in the Company's market areas.

In the normal course of business, management becomes aware of possible credit problems in which borrowers exhibit potential for the inability to comply with the contractual terms of their loans, but which do not currently meet the criteria for disclosure as non-performing loans. Historically, some of these loans are ultimately restructured or placed in non-accrual status. At September 30, 2006, no loans of material significance were known to be potential non-performing loans.

Collateral for some of the Company's loans is subject to fair value evaluations that fluctuate with market conditions and other external factors. In addition, while the Company has certain underwriting obligations related to such evaluations from a review standpoint, evaluations of some real property and other collateral are dependent upon third-party independent appraisers employed either by the Company's customers or as independent contractors of the Company.

The Company's policy provides that loans, other than installment loans, are generally placed in non-accrual status if, in management's opinion, payment in full of principal or interest is not expected or payment of principal or interest is more than 90 days past due, unless the loan is both well-secured and in the process of collection. Non-performing loans were 0.32% of loans and leases, net of unearned income, at September 30, 2006 and 0.39% of loans and leases, net of unearned income, at December 31, 2005.

**Deposits and Other Interest Bearing Liabilities**

Deposits originating within the communities served by the Bank continue to be the Company's primary source of funding its earning assets. The Company has been able to compete effectively for deposits in its primary market areas, while continuing to manage the exposure to rising interest rates. Deposits totaled \$9.49 billion at September 30, 2006 as compared to \$9.61 billion at December 31, 2005, representing a 1.20% decrease. Noninterest bearing demand deposits decreased by \$45.33 million, or 2.52%, to \$1.75 billion at September 30, 2006 from \$1.80 billion at December 31, 2005, and interest bearing demand, savings and time deposits decreased \$69.56 million, or 0.89%, to \$7.74 billion at September 30, 2006 from \$7.81 billion at December 31, 2005. By using maturing investment securities and lower cost demand deposits to fund recent loan growth, the Bank has restricted its growth in higher priced deposits. The Bank also relied on short term borrowings from the FHLB as an additional source of funding the loan growth in the third quarter of 2006.

**Liquidity and Capital Resources**

One of the Company's goals is to provide adequate funds to meet increases in loan demand or any potential increase in the normal level of deposit withdrawals. This goal is accomplished primarily by generating cash from the Bank's operating activities and maintaining sufficient short-term liquid assets. These sources, coupled with a stable deposit base and a strong reputation in the capital markets, allow the Company to fund earning assets and maintain the availability of funds. Management believes that the Bank's traditional sources of maturing loans and investment securities, sales of loans held for sale, cash from operating activities and a strong base of core deposits are adequate to meet the Company's liquidity needs for normal operations over both the short-term and the long-term.

To provide additional liquidity, the Company utilizes short-term financing through the purchase of federal funds and securities lending arrangements. Further, the Company maintains a borrowing relationship with the Federal Home Loan Bank, which provides liquidity to fund term loans with borrowings of matched or longer maturities.

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If the Company's traditional sources of liquidity were constrained, the Company would be forced to pursue avenues of funding not typically used and the Company's net interest margin could be impacted negatively. The Company utilizes, among other tools, maturity gap tables, interest rate shock scenarios and an active asset and liability management committee to analyze, manage and plan asset growth and to assist in managing the Company's net interest margin and overall level of liquidity. The Company's approach to providing adequate liquidity has been successful in the past and management does not anticipate any near- or long-term changes to its liquidity strategies.

**Off-Balance Sheet Arrangements**

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

**Regulatory Requirements for Capital**

The Company is required to comply with the risk-based capital guidelines established by the Board of Governors of the Federal Reserve System. These guidelines apply a variety of weighting factors that vary according to the level of risk associated with the assets. Capital is measured in two Tiers: Tier I consists of common shareholders' equity and qualifying noncumulative perpetual preferred stock, less goodwill and certain other intangible assets; and Tier II consists of general allowance for losses on loans and leases, hybrid debt capital instruments and all or a portion of other subordinated capital debt, depending upon remaining term to maturity. Total capital is the sum of Tier I and Tier II capital. The Company's Tier I capital and total capital, as a percentage of total risk-adjusted assets, was 12.38% and 13.58%, respectively, at September 30, 2006. Both ratios exceeded the required minimum levels for these ratios of 4% and 8%, respectively, at September 30, 2006. In addition, the Company's Tier I leverage capital ratio (Tier I capital divided by total assets, less goodwill) was 8.71% at September 30, 2006, compared to the required minimum leverage capital ratio of 4%.

The Federal Deposit Insurance Corporation's capital-based supervisory system for insured financial institutions categorizes the capital position for banks into five categories, ranging from well capitalized to critically undercapitalized. For a bank to classify as well capitalized, the Tier I capital, total capital and leverage capital ratios must be at least 6%, 10% and 5%, respectively. The Bank met the criteria for the well capitalized category at September 30, 2006 as its Tier I capital, total capital and leverage capital ratios were 11.92%, 13.13%, and 8.37%, respectively.

There are various legal and regulatory limits on the extent to which the Bank may pay dividends or otherwise supply funds to the Company. In addition, federal and state regulatory agencies have the authority to prevent a bank, bank holding company or financial holding company from paying a dividend or engaging in any other activity that, in the opinion of the agency, would constitute an unsafe or unsound practice. The Company does not expect these limitations to cause a material adverse effect with regard to its ability to meet its cash obligations. As discussed in Part I. Item 1. Notes to Consolidated Financial Statements (Unaudited) Note 10 Recent Pronouncements, the Company does not expect that the adoption of SFAS 158 will have a material impact on the regulatory requirements for capital of the Company.

**Uses of Capital**

The Company may pursue acquisitions of depository institutions and businesses closely related to banking that further the Company's business strategies. The Company anticipates that consideration for any such transactions would be shares of the Company's common stock, cash or a combination thereof. For example, the merger of

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American State Bank Corporation was completed on December 1, 2005, and the consideration in that transaction was a combination of shares of the Company's common stock and cash.

On April 27, 2005, the Company announced a new stock repurchase program pursuant to which the Company may acquire up to 3.0 million shares of its common stock in the open market at prevailing market prices or in privately negotiated transactions during the period from May 1, 2005 through April 30, 2007. The extent and timing of any repurchases will depend on market conditions and other corporate considerations. Repurchased shares will be held as authorized but unissued shares. These authorized but unissued shares will be available for use in connection with the Company's stock option plans, other compensation programs, other transactions or for other corporate purposes as determined by the Company's Board of Directors. As of September 30, 2006, 735,500 shares had been repurchased under this program. No shares were repurchased during the third quarter of 2006. The Company will continue to evaluate additional share repurchases under this repurchase program and will evaluate whether to adopt a new stock repurchase program before the current program expires. The Company conducts its stock repurchase program by using funds received in the ordinary course of business. The Company has not experienced, and does not expect to experience, a material adverse effect on its capital resources or liquidity in connection with its stock repurchase program during the terms of the program.

From January 1, 2001 through September 30, 2006, the Company repurchased approximately 11.3 million shares of its common stock under various repurchase plans authorized by the Company's Board of Directors.

In 2002, the Company issued \$128,866,000 in 8.15% Junior Subordinated Debt Securities to BancorpSouth Capital Trust I (the "Trust"), a business trust. The Trust used the proceeds from the issuance of five million shares of 8.15% trust preferred securities, \$25 face value per share, to acquire the 8.15% Junior Subordinated Debt Securities. Both the Junior Subordinated Debt Securities and the trust preferred securities mature on January 28, 2032, and are callable at the option of the Company after January 28, 2007. The \$125 million in trust preferred securities issued by the Trust qualifies as Tier I capital under Federal Reserve Board guidelines. The Company may prepay the Junior Subordinated Debt Securities, and in turn the trust preferred securities, at a prepayment price of 100% of the principal amount of these securities within 90 days of a determination by the Federal Reserve Board that trust preferred securities will no longer qualify as Tier I capital.

The Company assumed \$9.28 million in Junior Subordinated Debt Securities and the related \$9.00 million in trust preferred securities pursuant to the mergers on December 31, 2004 with Premier Bancorp, Inc. and Business Holding Corporation and assumed \$6.70 million in Junior Subordinated Debt Securities and the related \$6.50 million in trust preferred securities pursuant to the merger on December 1, 2005 with American State Bank Corporation (see Note 7 to the consolidated financial statements included in this report). The Company's aggregate \$15.50 million in assumed trust preferred securities qualifies as Tier I capital under Federal Reserve Board guidelines.

**Certain Litigation Contingencies**

The Company and its subsidiaries are engaged in lines of business that are heavily regulated and involve a large volume of financial transactions with numerous customers through offices in seven states. Although the Company and its subsidiaries have developed policies and procedures to minimize the impact of legal noncompliance and other disputes, litigation presents an ongoing risk.

As such, the Company and its subsidiaries are defendants in various lawsuits arising out of the normal course of business, including claims against entities to which the Company is a successor as a result of business combinations. In the opinion of management, the ultimate resolution of such matters should not have a material adverse effect on the Company's consolidated financial position or results of operations. Litigation is, however, inherently uncertain, and the Company cannot make assurances that it will prevail in any of these actions, nor can it estimate with reasonable certainty the amount of damages that it might incur.

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

During the nine months ended September 30, 2006, there were no significant changes to the quantitative and qualitative disclosures about market risks presented in the Company's Annual Report on Form 10-K for the year ended December 31, 2005.

**ITEM 4. CONTROLS AND PROCEDURES.**

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

**PART II  
OTHER INFORMATION**

**ITEM 1A. RISK FACTORS.**

There have been no material changes from the risk factors previously disclosed in our annual report on Form 10-K for the year ended December 31, 2005.

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

The Company did not repurchase any shares of its common stock during the three months ended September 30, 2006.

**ITEM 6. EXHIBITS.**

- (3.1) Restated Articles of Incorporation of the Company (filed as Exhibit 3.1 to the Company's Registration Statement on Form S-4 (Registration No. 33-88274) filed on January 6, 1995, and incorporated herein by reference).
- (3.2) Amendment to Restated Articles of Incorporation of the Company (filed as Exhibit 3.2 to the Company's Registration Statement on Form S-4 (Registration No. 33-88274) filed on January 6, 1995, and incorporated herein by reference).
- (3.3) Amended and Restated Bylaws of the Company (filed as Exhibit 3(b) to the Company's Annual Report on Form 10-K for the year ended December 31, 1998 (file No. 1-12991) and incorporated herein by reference).
- (3.4) Amendment to Amended and Restated Bylaws (filed as Exhibit 3(c) to the Company's Annual Report on Form 10-K for the year ended December 31, 2000 (file No. 1-12991) and incorporated herein by reference).
- (4.1) Specimen Common Stock Certificate (filed as Exhibit 4 to the Company's Annual Report on Form 10-K for the year ended December 31, 1994 (file number 0-10826) and incorporated herein by reference).
- (4.2) Rights Agreement, dated as of April 24, 1991, including as Exhibit A the forms of Rights Certificate and of Election to Purchase and as Exhibit B the summary of Rights to Purchase Common Shares (filed as Exhibit 1 to the Company's registration statement on Form 8-A filed April 24, 1991 (file number 0-10826) and incorporated herein by reference).



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- (4.3) First Amendment to Rights Agreement, dated as of March 28, 2001 (filed as Exhibit 2 to the Company's amended registration statement on Form 8-A/A filed March 28, 2001 (file number 1-12991) and incorporated herein by reference).
- (4.4) Amended and Restated Certificate of Trust of BancorpSouth Capital Trust I, dated as of October 31, 2001 (filed as Exhibit 4.12 to the Company's Registration Statement on Form S-3 filed on November 2, 2001 (Registration No. 33-72712) and incorporated herein by reference).
- (4.5) Second Amended and Restated Trust Agreement of BancorpSouth Capital Trust I, dated as of January 28, 2002 (filed as Exhibit 4.13 to the Company's Current Report on Form 8-K filed on January 28, 2002 and incorporated herein by reference).
- (4.6) Junior Subordinated Indenture, dated as of January 28, 2002 (filed as Exhibit 4.8 to the Company's Current Report on Form 8-K filed on January 28, 2002 (file number 1-12991) and incorporated herein by reference).
- (4.7) Guarantee Agreement (filed as Exhibit 4.25 to the Company's Current Report on Form 8-K filed on January 28, 2002 (file number 1-12991) and incorporated herein by reference).
- (4.8) Junior Subordinated Debt Security Specimen (filed as an exhibit to the Company's Current Report on Form 8-K filed on January 28, 2002 (file number 1-12991) and incorporated herein by reference).
- (4.9) Trust Preferred Security Certificate for BancorpSouth Capital Trust I (filed as an exhibit to the Company's Current Report on Form 8-K filed on January 28, 2002 (file number 1-12991) and incorporated herein by reference).
- (4.10) Certain instruments defining the rights of certain holders of long-term debt securities of the Registrant are omitted pursuant to Item 601(b)(4)(iii)(A) of Regulation S-K. The Registrant hereby agrees to furnish copies of these instruments to the SEC upon request.
- (31.1) Certification of the Chief Executive Officer of BancorpSouth, Inc. pursuant to Rule 13a-14 or 15d-14 of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.\*
- (31.2) Certification of the Chief Financial Officer of BancorpSouth, Inc. pursuant to Rule 13a-14 or 15d-14 of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.\*
- (32.1) Certification of the Chief Executive Officer of BancorpSouth, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.\*
- (32.2) Certification of the Chief Financial Officer of BancorpSouth, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.\*

\* Filed herewith.

**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.

BancorpSouth, Inc.

(Registrant)

DATE: November 8, 2006

/s/ L. Nash Allen, Jr.

L. Nash Allen, Jr.

Treasurer and Chief Financial Officer

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**INDEX TO EXHIBITS**

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