

MID-STATE BANCSHARES
Form 10-Q
May 08, 2002

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United States
Securities and Exchange Commission

Washington, D.C. 20429

FORM 10-Q

- ý **Quarterly report under Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended March 31, 2002.**
- o **Transition report under Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from N/A to N/A.**
Commission File Number 000-23925
-

MID-STATE BANCSHARES

(Exact name of registrant as specified in its charter)

California **77-0442667**
(State or Other Jurisdiction of Incorporation or (I.R.S. Employer Identification No.)
Organization)

1026 Grand Ave. Arroyo Grande, CA **93420-0580**
(Address of Principal Executive Offices) (Zip Code)

Issuer's Telephone Number: **(805) 473-7700**

Securities to be registered under Section 12(b) of the Act: **None**

Securities to be registered under Section 12(g) of the Act:

Common Stock, no par value

(Title of class)

Check whether the Company (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or 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 ý No o

As of May 2, 2002, the aggregate market value of the common stock held by non-affiliates of the Company was: \$464,086,387.

Number of shares of common stock of the Company outstanding as of May 2, 2002: 24,079,613 shares.

Mid-State Bancshares

March 31, 2002

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PART I FINANCIAL INFORMATION

Item 1 Financial Statements

Mid-State Bancshares

Consolidated Statements of Financial Position

(Interim Periods Unaudited figures in 000's)

| | <u>Mar. 31, 2002</u> | <u>Dec. 31, 2001</u> | <u>Mar. 31, 2001</u> |
|--|----------------------|----------------------|----------------------|
|--|----------------------|----------------------|----------------------|

ASSETS

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| | Mar. 31, 2002 | Dec. 31, 2001 | Mar. 31, 2001 |
|------------------------------------------------------------------------------------------|---------------------|---------------------|---------------------|
| Cash and Due From Banks | \$ 93,403 | \$ 102,970 | \$ 73,534 |
| Fed Funds Sold | 90,000 | 73,000 | 28,720 |
| Securities Available For Sale | 464,754 | 451,345 | 360,042 |
| Loans, net of unearned income | 1,148,782 | 1,149,703 | 946,103 |
| Allowance for Loan Losses | (19,000) | (19,073) | (12,071) |
| Net Loans | 1,129,782 | 1,130,630 | 934,032 |
| Premises and Equipment, Net | 25,617 | 25,851 | 27,566 |
| Accrued Interest Receivable | 12,432 | 11,060 | 11,162 |
| Investments in Real Estate, Net | 234 | 233 | 228 |
| Goodwill | 33,448 | 33,448 | 1,314 |
| Other Intangibles | 9,185 | 9,294 | 443 |
| Other Assets | 14,401 | 15,833 | 9,365 |
| Total Assets | \$ 1,873,256 | \$ 1,853,664 | \$ 1,446,406 |
| LIABILITIES AND EQUITY | | | |
| Non Interest Bearing Demand | \$ 364,923 | \$ 367,370 | \$ 259,636 |
| NOW Accounts, Money Market and Savings Deposits | 809,586 | 769,173 | 616,795 |
| Time Deposits Under \$100 | 271,874 | 280,667 | 234,706 |
| Time Deposits \$100 or more | 160,300 | 166,956 | 137,201 |
| Total Deposits | 1,606,683 | 1,584,166 | 1,248,338 |
| Other Borrowings | 4,790 | 17,714 | 839 |
| Allowance for Losses Unfunded Commitments | 1,687 | 1,586 | 1,479 |
| Accrued Interest Payable and Other Liabilities | 23,601 | 15,647 | 12,750 |
| Total Liabilities | 1,636,761 | 1,619,113 | 1,263,406 |
| Shareholders' Equity: | | | |
| Common Stock and Surplus (Shares Outstanding of 24,094, 24,089 and 22,019, respectively) | 84,810 | 84,872 | 49,992 |
| Retained Earnings | 147,748 | 143,257 | 128,837 |
| Accumulated Other Comprehensive Income, Net | 3,937 | 6,422 | 4,171 |
| Total Equity | 236,495 | 234,551 | 183,000 |
| Total Liabilities and Equity | \$ 1,873,256 | \$ 1,853,664 | \$ 1,446,406 |

Mid-State Bancshares

Consolidated Statements of Income

(Unaudited figures in 000's except earnings per share data)

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| | Three Month Period Ended March 31, | |
|----------------------------------------------|---------------------------------------|-----------------|
| | 2002 | 2001 |
| Interest Income: | | |
| Interest and fees on loans | \$ 22,248 | \$ 22,279 |
| Interest on investment securities taxable | 3,498 | 3,371 |
| Interest on investment securities tax exempt | 1,774 | 1,648 |
| Interest on fed funds sold, other | 336 | 356 |
| | <hr/> | <hr/> |
| Total Interest Income | 27,856 | 27,654 |
| | <hr/> | <hr/> |
| Interest Expense: | | |
| Interest on NOW, money market and savings | 1,230 | 2,195 |
| Interest on time deposits less than \$100 | 2,262 | 3,089 |
| Interest on time deposits of \$100 or more | 1,229 | 1,858 |
| Interest on mortgages, other | 69 | 79 |
| | <hr/> | <hr/> |
| Total Interest Expense | 4,790 | 7,221 |
| | <hr/> | <hr/> |
| Net Interest Income Before Provision | 23,066 | 20,433 |
| Less: Provision for loan losses | 300 | 300 |
| | <hr/> | <hr/> |
| Net Interest Income After Provision | 22,766 | 20,133 |
| | <hr/> | <hr/> |
| Other Operating Income: | | |
| Service charges and fees | 2,204 | 1,893 |
| Other non interest income | 3,779 | 3,267 |
| | <hr/> | <hr/> |
| Total Other Operating Income | 5,983 | 5,160 |
| | <hr/> | <hr/> |
| Other Operating Expense: | | |
| Salaries and employee benefits | 9,545 | 8,394 |
| Occupancy and furniture | 2,707 | 2,242 |
| Other operating expenses | 5,635 | 4,111 |
| | <hr/> | <hr/> |
| Total Other Operating Expense | 17,887 | 14,747 |
| | <hr/> | <hr/> |
| Income before taxes | 10,862 | 10,546 |
| Provision for income taxes | 3,962 | 3,900 |
| | <hr/> | <hr/> |
| Net Income | \$ 6,900 | \$ 6,646 |
| | <hr/> | <hr/> |
| Earnings per share basic | \$ 0.29 | \$ 0.30 |
| diluted | \$ 0.28 | \$ 0.30 |

Consolidated Statements of Comprehensive Income

(Unaudited figures in 000's)

| | Three Month Period Ended March 31, | |
|-----------------------------------------------------------------------|---------------------------------------|----------|
| | 2002 | 2001 |
| Net Income | \$ 6,900 | \$ 6,646 |
| Other Comprehensive Income Before Taxes: | | |
| Unrealized gains (losses) on securities available for sale: | | |
| Unrealized holding (losses) gains arising during period | (4,144) | 5,001 |
| Reclassification adjustment for Losses (gains) included in net income | 2 | (61) |
| Other comprehensive (loss) income, before tax | (4,142) | 4,940 |
| Income tax (benefit) expense related to items in comprehensive income | (1,657) | 1,976 |
| Other Comprehensive (Loss) Income, Net of Taxes | (2,485) | 2,964 |
| Comprehensive Income | \$ 4,415 | \$ 9,610 |

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Mid-State Bancshares

Consolidated Statements of Cash Flows

(Unaudited figures in 000's)

| | Three Month Period Ended March 31, | |
|-----------------------------------------------------------------------------------|---------------------------------------|--------------|
| | 2002 | 2001 |
| OPERATING ACTIVITIES | | |
| Net Income | \$ 6,900 | \$ 6,646 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Provision for credit losses | 300 | 300 |
| Depreciation and amortization | 985 | 986 |
| Net amortization of prem./discounts investments | 847 | 219 |
| Change in deferred loan fees | 151 | (330) |
| Changes in assets and liabilities: | | |
| Accrued interest receivable | (1,372) | 591 |
| Other intangibles, net | 109 | 14 |
| Other assets, net | 3,089 | (355) |
| Other liabilities | 8,055 | (4,584) |
| Net cash provided by operating activities | 19,064 | 3,487 |

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| | Three Month Period Ended March 31, | |
|-----------------------------------------------------|---------------------------------------|------------|
| | _____ | _____ |
| INVESTING ACTIVITIES | | |
| Proceeds from sales and maturities of investments | 22,176 | 62,738 |
| Purchases of investments | (40,574) | (10,597) |
| Decrease (Increase) in loans | 397 | (25,836) |
| Purchases of premises and equipment, net | (752) | (549) |
| | _____ | _____ |
| Net cash (used in) provided by investing activities | (18,753) | 25,756 |
| | _____ | _____ |
| FINANCING ACTIVITIES | | |
| Increase in deposits | 22,517 | 17,176 |
| Decrease in short-term borrowings | (12,924) | (29,401) |
| Exercise of stock options | 329 | 75 |
| Cash dividends paid | (2,409) | (1,972) |
| Retirement of company stock | (391) | (1,855) |
| | _____ | _____ |
| Net cash provided by (used in) financing activities | 7,122 | (15,977) |
| | _____ | _____ |
| Increase in cash and cash equivalents | 7,433 | 13,266 |
| Cash and cash equivalents, beginning of period | 175,970 | 88,988 |
| | _____ | _____ |
| Cash and cash equivalents, end of period | \$ 183,403 | \$ 102,254 |
| | _____ | _____ |
| Supplemental disclosure of cash flow information: | | |
| Cash paid during the period for interest | \$ 4,945 | \$ 7,211 |
| Cash paid during the period for taxes on income | 950 | 800 |

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Mid-State Bancshares

Notes to Consolidated Financial Statements

(Information with respect to interim periods is unaudited)

NOTE A BASIS OF PRESENTATION AND MANAGEMENT REPRESENTATION

The accompanying consolidated financial statements include the accounts of Mid-State Bancshares and its wholly owned subsidiary Mid-State Bank & Trust and the Bank's subsidiaries, MSB Properties and Mid Coast Land Company (collectively the "Company," "Bank" or "Mid-State"). All significant inter-company transactions have been eliminated in consolidation. These consolidated financial statements should be read in conjunction with the Form 10-K Annual Report for the year ended December 31, 2001 of Mid-State Bancshares. A summary of the Company's significant accounting policies is set forth in the Notes to Consolidated Financial Statements contained therein.

These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States on a basis consistent with the accounting policies reflected in the audited consolidated financial statements included in the Annual Report

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on Form 10-K for the year ended December 31, 2001. They do not, however, include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments including normal recurring accruals considered necessary for a fair presentation have been included. Operating results for the interim periods presented are not necessarily indicative of the results that may be expected for any other interim period or for the year as a whole.

NOTE B EARNINGS PER SHARE

The following is a reconciliation of net income and shares outstanding to the income and number of shares used to compute Earnings Per Share ("EPS"). Figures are in thousands, except earnings per share data.

| | Three Month Period Ended March 31, 2002 | | | Three Month Period Ended March 31, 2001 | | |
|-----------------------------------------|--------------------------------------------|--------|---------|--------------------------------------------|--------|---------|
| | Earnings | Shares | EPS | Earnings | Shares | EPS |
| Net Income as reported | \$ 6,900 | | | \$ 6,646 | | |
| Basic Earnings Per Share: | | | | | | |
| Income available to Common Shareholders | \$ 6,900 | 24,089 | \$ 0.29 | \$ 6,646 | 21,960 | \$ 0.30 |
| Effect of dilutive securities: | | | | | | |
| Stock Options | | 839 | | | 492 | |
| Diluted Earnings Per Share: | | | | | | |
| Income available to Common Shareholders | \$ 6,900 | 24,928 | \$ 0.28 | \$ 6,646 | 22,452 | \$ 0.30 |

NOTE C RECENT ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 addresses financial accounting and reporting for business combinations and is effective for all business combinations accounted for by the purchase method completed after June 30, 2001. SFAS No. 141 requires all business combinations be accounted for using the purchase method. The acquisition of Americorp, parent of the American Commercial Bank, during the third quarter of 2001 was accounted for in accordance with SFAS No. 141. Management adopted

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SFAS No. 141 on January 1, 2002. The adoption of SFAS No. 141 did not have a material impact on the Company's results of operations or financial condition

SFAS No. 142 addresses financial accounting and reporting for acquired goodwill and other intangible assets. With the adoption of SFAS No. 142, goodwill is no longer subject to amortization over its estimated useful life, rather goodwill will be subject to at least an annual assessment for impairment. SFAS No. 142 is effective for fiscal years beginning after December 15, 2001, with a provision that states goodwill acquired in a business combination for which the acquisition date is after June 30, 2001 should not be amortized. Management adopted SFAS No. 142 on January 1, 2002. The adoption of SFAS No. 142 resulted in \$570 thousand not being recognized as amortization expense for the period ended March 31, 2002.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 supersedes SFAS No. 121 and the accounting and reporting provisions of Accounting Principles Board Opinion No. 30. It addresses financial accounting and reporting for the impairment of long-lived assets to be disposed of. SFAS No. 144 is effective for fiscal years beginning after December 15, 2001. Management adopted SFAS No. 144 on January 1, 2002. The adoption of SFAS No. 144 did not have a material impact on the Company's results of operation or financial condition.

Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations

Selected Financial Data Summary. The following table provides certain selected consolidated financial data as of and for the three months ended March 31, 2002 and 2001 (unaudited).

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| | Year-to-Date | |
|-----------------------------------------------------|--------------------------|---------------|
| | Mar. 31, 2002 | Mar. 31, 2001 |
| | (Unaudited In thousands) | |
| Interest Income (not taxable equivalent) | \$ 27,856 | \$ 27,654 |
| Interest Expense | 4,790 | 7,221 |
| Net Interest Income | 23,066 | 20,433 |
| Provision for Loan Losses | 300 | 300 |
| Net Interest Income after provision for loan losses | 22,766 | 20,133 |
| Non-interest income | 5,983 | 5,160 |
| Non-interest expense | 17,887 | 14,747 |
| Income before income taxes | 10,862 | 10,546 |
| Provision for income taxes | 3,962 | 3,900 |
| Net Income | \$ 6,900 | \$ 6,646 |

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| | Year-to-Date | |
|------------------------------------------------------------|---------------------------------------|---------------|
| | Mar. 31, 2002 | Mar. 31, 2001 |
| | (In thousands, except per share data) | |
| Per share: | | |
| Net Income basic | \$ 0.29 | \$ 0.30 |
| Net Income diluted | \$ 0.28 | \$ 0.30 |
| Weighted average shares used in Basic E.P.S. calculation | 24,089 | 21,960 |
| Weighted average shares used in Diluted E.P.S. calculation | 24,928 | 22,452 |
| Cash dividends | \$ 0.10 | \$ 0.09 |
| Book value at period-end | \$ 9.82 | \$ 8.35 |
| Tangible book value at period end | \$ 8.05 | \$ 8.27 |
| Ending Shares | 24,094 | 21,915 |
| Financial Ratios | | |
| Return on assets | 1.51% | 1.89% |
| Return on tangible assets | 1.55% | 1.89% |
| Return on equity | 11.88% | 14.97% |
| Return on tangible equity | 14.51% | 15.12% |
| Net interest margin (not taxable equivalent) | 5.57% | 6.28% |
| Net interest margin (taxable equivalent yield) | 5.85% | 6.63% |
| Net loan losses to avg. loans | 0.10% | 0.01% |
| Efficiency ratio | 61.6% | 57.6% |
| Period Averages | | |
| Total Assets | \$ 1,849,338 | \$ 1,427,361 |
| Total Tangible Assets | 1,806,736 | 1,425,603 |
| Total Loans | 1,130,367 | 920,436 |
| Total Earning Assets | 1,680,663 | 1,318,574 |
| Total Deposits | 1,584,075 | 1,236,340 |
| Common Equity | 235,523 | 180,071 |
| Common Tangible Equity | 192,921 | 178,313 |

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| | Mar. 31, 2002 | Mar. 31, 2001 |
|---------------------------------------------------------------|--------------------------|---------------|
| | (Unaudited In thousands) | |
| Balance Sheet At Period-End | | |
| Cash and due from banks | \$ 93,403 | \$ 73,534 |
| Investments and Fed Funds Sold | 554,754 | 388,762 |
| Loans, net of deferred fees, before allowance for loan losses | 1,148,782 | 946,103 |
| Allowance for Loan Losses | (19,000) | (12,071) |
| Goodwill and other intangibles | 42,633 | 1,757 |
| Other assets | 52,684 | 48,321 |
| | _____ | _____ |
| Total Assets | \$ 1,873,256 | \$ 1,446,406 |
| | _____ | _____ |
| Non-interest bearing deposits | \$ 364,923 | \$ 259,636 |
| Interest bearing deposits | 1,241,760 | 988,702 |
| Other borrowings | 4,790 | 839 |
| Allowance for losses unfunded commitments | 1,687 | 1,479 |
| Other liabilities | 23,601 | 12,750 |
| Shareholders' equity | 236,495 | 183,000 |
| | _____ | _____ |
| Total Liabilities and Shareholders' equity | \$ 1,873,256 | \$ 1,446,406 |
| | _____ | _____ |
| Asset Quality & Capital At Period-End | | |
| Non-accrual loans | \$ 3,586 | \$ 6,038 |
| Loans past due 90 days or more | 110 | 950 |
| Other real estate owned | | |
| | _____ | _____ |
| Total non performing assets | \$ 3,696 | \$ 6,988 |
| | _____ | _____ |
| Allowance for losses to loans, gross(1) | 1.8% | 1.4% |
| Non-accrual loans to total loans, gross | 0.3% | 0.6% |
| Non performing assets to total assets | 0.2% | 0.5% |
| Allowance for losses to non performing loans(1) | 559.7% | 193.9% |
| Equity to average assets (leverage ratio) | 10.6% | 12.4% |
| Tier One capital to risk-adjusted assets | 14.0% | 15.7% |
| Total capital to risk-adjusted assets | 15.2% | 16.8% |

(1) Includes allowance for loan losses and allowance for losses unfunded commitments

Performance Summary. The Company posted net income of \$6.9 million for the three months ended March 31, 2002 compared to \$6.6 million in the like 2001 period. These earnings represent an annualized return on assets of 1.51% and 1.89%, respectively. The annualized return on equity was 11.88% for the first quarter of 2002 compared to 14.97% in the first quarter of 2001. On a per share basis, diluted earnings per share were \$0.29 in the 2002 period compared to \$0.30 in the like quarter of 2001.

On September 28, 2001, the Company acquired Americorp, the parent company of American Commercial Bank in Ventura. As a result of that merger, goodwill and other intangibles in the amount of \$40.4 million were created. Average goodwill and other intangible assets in the first quarter of 2002 amounted to \$42.6 million compared to \$1.8 million in the like period one year earlier. Adjusting for the impact of these intangible assets, the return on tangible assets in the first quarter of 2002 was 1.55% compared to 1.89% in the 2001 period. Return on tangible equity was 14.51% compared to 15.12% in the first quarter of 2001.

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Net Interest Income. Mid-State's year-to-date annualized yield on interest earning assets was 6.72% for the first three months of 2002 (7.01% on a taxable equivalent basis) compared to 8.51% in the like 2001 period (8.84% on a taxable equivalent basis). The decrease in yield is related to the general

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decline in interest rates. The Prime Rate, to which many of the Bank's loans are tied, remained at 4.75% in the 2002 period compared to an average of 8.62% in the 2001 period. Conversely, annualized interest expense as a percent of earning assets decreased from 2.23% in the first three months of 2001 to 1.15% in this year's first three months. Overall, Mid-State's annualized Net Interest Income, expressed as a percent of earning assets, decreased from 6.28% for the three month period of 2001 (6.63% on a taxable equivalent basis) to 5.57% in the comparable 2002 period (5.85% on a taxable equivalent basis). Annualized Net Interest Income as a percent of average total assets declined from 5.81% in the first three months of 2001 (6.12% taxable equivalent) to 5.06% in the comparable 2002 period (5.32% taxable equivalent).

Average earnings assets for the three months ended March 31, 2002 increased from the like 2001 period (\$1,680.7 million compared to \$1,318.6 million). Average deposits in this same time-frame were up \$347.8 million, (\$1,584.1 million compared to \$1,236.3 million). The unusual increase is in large part due to the acquisition of American Commercial Bank noted above.

Provision and Allowance for Loan Losses. Mid-State made provisions for loan losses in the first quarter of 2002 in the amount of \$300 thousand, which is identical to the first quarter of 2001.

During the first quarter, Management reclassified the portion of its allowance for loan losses related to unfunded commitments and letters of credit to allowance for losses unfunded commitments. This change was undertaken to be in conformity with accounting principles generally accepted in the United States. Both the allowance for loan losses and the allowance for losses unfunded commitments, are available to absorb inherent credit losses.

Management continues to believe that the allowances for loan losses and unfunded commitments, which collectively stand at 1.8% of total loans at March 31, 2002, up from 1.4% one year earlier, are adequate to cover inherent losses. The \$20.7 million total allowance for credit losses is approximately 560% of the level of non performing assets which stand at \$3.7 million compared to \$7.0 million one year earlier. Non performing assets consist of loans on non-accrual and accruing loans 90 days or more past due. While continuing efforts are made to improve overall asset quality, Management is unable to estimate with certainty, how and under what terms, problem assets will be resolved.

Changes in the allowance for loan losses (in thousands) for the periods ended March 31, 2002 and 2001 are as follows:

| | March 31, | |
|---------------------------------------------------------------|-----------|-----------|
| | 2002 | 2001 |
| Allowance for loan losses at beginning of period | \$ 20,659 | \$ 13,280 |
| Provision for loan losses | 300 | 300 |
| Reclassification of allowance for losses unfunded commitments | (1,687) | (1,479) |
| Loans charged off | (450) | (253) |
| Recoveries of loans previously Charged-off | 178 | 223 |
| | \$ 19,000 | \$ 12,071 |
| Allowance for losses Unfunded Commitments | \$ 1,687 | \$ 1,479 |
| Total allowance for credit losses | \$ 20,687 | \$ 13,550 |

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At March 31, 2002, the recorded investments in loans, which have been identified as impaired totaled \$6,223,000. Of this amount, \$2,541,000 related to loans with no valuation allowance and \$3,682,000 related to loans with a corresponding valuation allowance of \$1,370,000. Impaired loans totaled \$8,804,000 at March 31, 2001, all of which were tied to corresponding valuation allowances totaling \$2,120,000. The valuation allowance for impaired loans is included within the general allowance shown above and netted against loans on the consolidated statements of financial position. For the quarter ended March 31, 2002, the average recorded investment in impaired loans was \$7,706,000 compared to \$5,981,000 in the 2001 period. A loan is identified as impaired when it is probable that interest and principal will not be collected according to the contractual terms of the loan agreement. Because this definition is very similar to that used by bank regulators to determine on which loans interest should not be accrued, the Bank expects that most impaired loans will be on non-accrual status.

Non-interest Income. Non-interest income for the first three months of 2002 was \$6.0 million, up from \$5.2 million earned in the 2001 period, an increase of 15.9%. The increase was related to higher service charge income of approximately \$311 thousand over the comparable period, an increase in the Company's merchant mastercard income of about \$154 thousand, a \$100 thousand increase in ATM and debit card fee income, and an increase in other fee income of \$235 thousand. Much of these increases in non-interest income are related to the activity generated by the customers of the former American Commercial Bank in Ventura.

Non-interest Expense. Non-interest expense for the first three months of 2002 was \$17.9 million. This compares to \$14.7 million in the comparable 2001 period. This increase was primarily the result of increases in salaries and benefits of approximately \$1.2 million, an increase in occupancy expense of \$465 thousand, a \$235 thousand increase in intangible amortization, outsourcing charges for the Company's internal audit function of \$88 thousand and operating losses of \$116 thousand. Most of the increases in salaries and benefits, occupancy expenses and intangible amortization are related to the merger with American Commercial Bank.

Provision for Income Taxes. The year-to-date provision for income taxes was \$4.0 million, compared to \$3.9 million for the same period in 2001. The effective tax rate in 2002 was 36.5% compared to 37.0% in 2001. While the normal combined federal and state statutory tax rate is 42% for Mid-State Bancshares, the tax exempt income generated by its municipal bond portfolio is the primary reason that the effective rate is lower.

Balance Sheet. Total assets at March 31, 2002 totaled \$1,873.3 million, compared to \$1,446.4 million the same period one year earlier. Approximately \$307.3 million of the \$426.9 million increase is a result of the merger with Americorp on September 28, 2001. A comparison of selected balance sheet

components from one year earlier and the contribution toward that change from the merger are presented in the table below:

Mid-State Bancshares

Condensed Balance Sheet At Period-End

| | Mar. 30, 2002 | Mar. 30, 2001 | \$ Change | Approximate Portion of \$ Change due to Merger |
|-----------------------------------------|--------------------------|---------------------|-------------------|---------------------------------------------------------|
| | (Unaudited In thousands) | | | |
| Cash and due from banks | \$ 93,403 | \$ 73,534 | \$ 19,869 | 4,665 |
| Investments and Fed Funds Sold | 554,754 | 388,762 | 165,992 | 66,606 |
| Loans, before allowance for loan losses | 1,148,782 | 946,103 | 202,679 | 190,043 |
| Allowance for Loan Losses | (19,000) | (12,071) | (6,929) | (5,464) |
| Goodwill and Other Intangibles | 42,633 | 1,757 | 40,876 | 40,400 |
| Other assets | 52,684 | 48,321 | 4,363 | 11,045 |
| Total Assets | \$ 1,873,256 | \$ 1,446,406 | \$ 426,850 | \$ 307,295 |

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| | Mar. 30, 2002 | Mar. 30, 2001 | \$ Change | Approximate Portion of \$ Change due to Merger |
|---------------------------------------------------|---------------------|---------------------|-------------------|---------------------------------------------------------|
| Non-interest bearing deposits | \$ 364,923 | \$ 259,636 | \$ 105,287 | 83,048 |
| Interest bearing deposits | 1,241,760 | 988,702 | 253,058 | 170,951 |
| Other borrowings | 4,790 | 839 | 3,951 | |
| Other liabilities | 25,288 | 14,229 | 11,059 | 10,040 |
| Shareholders' equity | 236,495 | 183,000 | 53,495 | 43,256 |
| Total Liabilities and Shareholders' equity | \$ 1,873,256 | \$ 1,446,406 | \$ 426,850 | \$ 307,295 |

Mid-State's loan to deposit ratio of 71.5% at March 31, 2002 is down from the 75.8% ratio one year earlier. There is ample internal liquidity to fund improvements in this ratio through Mid-State's investment portfolio which is categorized as available for sale.

Investment Securities. Fed funds sold represent \$90.0 million of the \$554.8 million portfolio noted above. Of the remaining \$464.8 million, 9% is invested in U.S. Treasury securities, 33% is invested in U.S. Government agency obligations, 54% is invested in securities issued by states and political subdivisions in the U.S. and 4% is invested in mortgage-backed securities and other securities. Sixty-seven percent of all investment securities mature prior to March 31, 2007. Approximately 29% of the total portfolio matures in less than one year. The Bank's investment in mortgage-backed securities consist of investments in FNMA and FHLMC pools which have contractual maturities of up to 17 years. The actual time of repayment may be shorter due to prepayments made on the underlying collateral.

Capital Resources. The Company announced on May 1, 2002 that it has authorized a stock repurchase program for up to five percent (5%) of its outstanding shares. Based on current outstanding shares, the buyback may result in the purchase of up to approximately 1,203,580 shares. These repurchases will be made from time to time by the Company in the open market or in block purchases or in privately negotiated transactions in compliance with the Securities and Exchange Commission rules. The program began in early May 2002 and is expected by Management to be effective for one year. The company's previous stock repurchase program began in April 2000 and saw the repurchase of 1,130,000 shares of stock. The new authorization allowed the Company to continue its buy-back program uninterrupted.

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Total stockholders' equity increased from \$183.0 million at March 31, 2001 to \$236.5 million at March 31, 2002. Changes in stockholders' equity over this 12 month period includes activity outlined in the following table:

| | Common Stock & Surplus | Undivided Profits | Accumulated Comp. Income | Total |
|----------------------------------------------------------|---------------------------|----------------------|-----------------------------|----------------|
| Ending Equity at March 31, 2001 | 49,992 | 128,837 | 4,171 | 183,000 |
| Net Income 9 Mos 2001 (Apr. - Dec.) | | 20,756 | | 20,756 |
| Common Stock Repurchased 9 Mos. 2001 (Apr. - Dec.) | (5,660) | | | (5,660) |
| Stock Options Exercised 9 Mos. 2001 (Apr. - Dec.) | 639 | | | 639 |
| Regular Dividends 9 Mos. 2001 (Apr. - Dec.) | | (6,336) | | (6,336) |
| Chg. Accumulated Other Comprehensive Income (FAS 115) | | | 2,251 | 2,251 |

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| | <u>Common Stock & Surplus</u> | <u>Undivided Profits</u> | <u>Accumulated Comp. Income</u> | <u>Total</u> |
|-------------------------------------------------------|---------------------------------------|------------------------------|-------------------------------------|----------------|
| Merger with American Commercial Bank | 39,178 | | | 39,178 |
| Value of Stock Options Impacting Goodwill | 723 | | | 723 |
| Ending Equity at December 31, 2001 | 84,872 | 143,257 | 6,422 | 234,551 |
| Net Income 3 Mos. Y-T-D 2002 | | 6,900 | | 6,900 |
| Common Stock Repurchased 3 Mos. Y-T-D 2002 | (391) | | | (391) |
| Stock Options Exercised 3 Mos Y-T-D | 329 | | | 329 |
| Regular Dividend Q1-2002 | | (2,409) | | (2,409) |
| Chg. Accumulated Other Comprehensive Income (FAS 115) | | | (2,485) | (2,485) |
| Ending Equity at March 31, 2002 | 84,810 | 147,748 | 3,937 | 236,495 |

Liquidity. The focus of the Company's liquidity management is to ensure its ability to meet cash requirements. Sources of liquidity include cash, due from bank balances (net of Federal Reserve requirements to maintain reserves against deposit liabilities), fed funds sold, investment securities (net of pledging requirements), loan repayments, deposits and fed funds borrowing lines. Typical demands on liquidity are deposit run-off from demand deposits and savings accounts, maturing time deposits, which are not renewed, and anticipated funding under credit commitments to customers.

The Bank has adequate liquidity at the present time. Its loan to deposit ratio at March 31, 2002 was 71.5% versus 75.8% one year earlier. The Bank normally strives for a loan to deposit ratio in the 65% to 75% range. The Bank's internally calculated liquidity ratio stands at 36.2% at March 31, 2002, which is above its minimum policy of 15% and above the 33.5% level of March 31, 2001. Management is not aware of any future capital expenditures or other significant demands or commitments which would severely impair liquidity.

Off Balance Sheet Transactions. The Company is contingently liable for letter of credit accommodations made to its customers in the ordinary course of business totaling \$29.7 million at March 31, 2002, down from \$30.2 million one year earlier. Additionally, the Company has undisbursed loan commitments, also made in the ordinary course of business, totaling \$318.7 million, which was down from the \$393.1 million outstanding one year earlier.

There are no Special Purpose Entity ("SPE") trusts, corporations, or other legal entities established by Mid-State which reside off-balance sheet. There are no other off-balance sheet items other than the aforementioned items related to letter of credit accommodations and un-disbursed loan commitments.

Critical Accounting Policies and Estimates This "Management's Discussion and Analysis of Financial Condition and Results of Operations," as well as, disclosures included elsewhere in this Form 10-Q, are based upon the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements require Management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosure of contingencies. A summary of the more significant accounting policies of the Company can be found in Footnote One to the financial statements which is included in Item 8 of the Company's Annual Report on Form 10-K. Additionally, because it involves some of the more significant judgments and estimates used in preparation of the consolidated financial statements, the reader's attention is directed to the earlier section on page 11 addressing the allowance for loan losses.

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Important Factors Relating to Forward-Looking Statements. The Private Securities Litigation Reform Act of 1995 provides a "safe harbor" for forward-looking statements so long as those statements are identified as forward-looking and are accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those projected in such statements. All of the statements contained in this Quarterly Report on Form 10-Q, including those in Items 2 and 3, which are not identified as historical should be considered forward-looking. In connection with certain forward-looking statements contained in this Quarterly Report on Form 10-Q and those that may be made in the future by or on behalf of the Company which are identified as forward-looking, the Company notes that there are various factors that could cause actual results to differ materially from those set forth in any such forward-looking statements. Such factors include, but are not limited to, the real estate market, the availability of loans at acceptable prices, the general level of economic activity both locally and nationally, interest rates, the actions by the Company's regulatory agencies, actions by competitors of the Company and other factors referenced in the Company's filings with the Securities and Exchange Commission. Accordingly, there can be no assurance that the forward-looking statements contained in this Quarterly Report on Form 10-Q will be realized or that actual results will not be significantly higher or lower. The forward-looking statements have not been audited by, examined by or subjected to agreed-upon procedures by independent accountants, and no third-party has independently verified or reviewed such statements. Readers of this Quarterly Report on Form 10-Q should consider these facts in evaluating the information contained herein. The inclusion of the forward-looking statements contained in this Quarterly Report on Form 10-Q should not be regarded as a representation by the Company or any other person that the forward-looking statements contained in this Quarterly Report on Form 10-Q will be achieved. In light of the foregoing, readers of this Quarterly Report on Form 10-Q are cautioned not to place undue reliance on the forward-looking statements contained herein. The Company disclaims any obligation to update any such factors or to publicly announce the results of any revisions to any of the forward-looking statements contained herein to reflect future events or developments.

Item 3 Quantitative and Qualitative Disclosure About Market Risk

The Bank expects its risk exposure to changes in interest rates to remain manageable and well within acceptable policy ranges. A recent review as of the end of 2001 of the potential changes in the Bank's net interest income over a 12 month time horizon showed that it could fluctuate under very extreme alternative rate scenarios from between +3.6% and -6.1% of the base case (rates unchanged) of \$97.4 million. The Bank's policy is to maintain a structure of assets and liabilities which are such that net interest income will not vary more than plus or minus 15% of the base forecast over the next

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12 months. Management expects that its exposure to interest rate risk is manageable and it will continue to strive for an optimal trade-off between risk and earnings.

The following table presents a summary of the Bank's net interest income forecasted for the coming 12 months under alternative interest rate scenarios.

| | Change From Base |
|------------------------------------------------------------------------|---------------------|
| Rates Down Very Significant (Prime down to 1.75% over 12 months) | (6.1)% |
| Rates Down Significant (Prime down to 2.75% over 12 months) | (3.1)% |
| Rates Down Modestly (Prime down to 3.75% over 12 months) | (1.3)% |
| Base Case Rates Unchanged (Prime unchanged at 4.75% over 12 months) | |
| Rates Up Modestly (Prime up to 5.75% over 12 months) | 1.8% |
| Rates Up Aggressive (Prime up to 7.00% over 12 months) | 3.6% |
| Rates Up Very Aggressive (Prime up to 8.00% over 12 months) | 2.2% |

Net interest income under the above scenarios is influenced by the characteristics of the Bank's assets and liabilities. In the case of N.O.W., savings and money market deposits (total \$809.6 million) interest is based on rates set at the discretion of management ranging from 0.25% to 1.21%. In a downward rate environment, there is a limit to how far these deposit instruments can be re-priced and this behavior is similar to that of fixed rate instruments. In an upward rate environment, the magnitude and timing of changes in rates on these deposits is assumed to be more

reflective of variable rate instruments.

It is important to note that the above table is a summary of several forecasts and actual results may vary. The forecasts are based on estimates and assumptions of management that may turn out to be different and may change over time. Factors affecting these estimates and assumptions include, but are not limited to competitors' behavior, economic conditions both locally and nationally, actions taken by the Federal Reserve Board, customer behavior, and management's responses. Changes that vary significantly from the assumptions and estimates may have significant effects on the Bank's net interest income. Therefore the results of this analysis should not be relied upon as indicative of actual future results. Historically, the Bank has been able to manage its Net Interest Income in a fairly narrow range reflecting the Bank's relative insensitivity to interest rate changes. The impact of prepayment behavior on mortgages, real estate loans, mortgage backed securities, securities with call features, etc. is not considered material to the sensitivity analysis. Over the last 5 years, the Bank's net interest margin (which is net interest income divided by average earning assets of the Bank) has ranged from a low of 5.77% to a high of 6.44% (not taxable equivalent). The Bank's net interest margin in 2001 of 6.06% is in the middle of this range by historical standards, coming off the higher levels experienced in recent years. For the first quarter of 2002, the net interest margin was somewhat below this historical range at 5.57% (not taxable equivalent), while the first quarter of 2001 was 6.28%. The net interest margin under the alternative scenarios reported above ranges from 5.25% to 5.79%. Management feels this range of scenarios, while low by historical standards, is consistent with current experience and interest rate levels, but no assurances can be given that actual future experience will fall within this range.

The Bank's exposure with respect to interest rate derivatives, exchange rate fluctuations, and/or commodity price movements is nil. The Bank does not own any instruments within these markets.

PART II OTHER INFORMATION

Item 1 Legal Proceedings

Mid-State is not a party to any material legal proceeding.

Item 2 Changes in Securities and Use of Proceeds

There were no material changes in securities and uses of proceeds during the period covered by this report.

Item 3 Defaults Upon Senior Securities

Not applicable.

Item 4 Submission of Matters to a Vote of Security Holders

No matters were submitted to the Shareholders for a vote during the first quarter of 2002.

Item 5 Other Information

Not applicable.

Item 6 Exhibits and Reports on Form 8-K

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Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations

Mid-State Bancshares Condensed Balance Sheet - At Period-End

Item 3 Quantitative and Qualitative Disclosure About Market Risk

PART II OTHER INFORMATION

Item 1 Legal Proceedings

Item 2 Changes in Securities and Use of Proceeds

Item 3 Defaults Upon Senior Securities

Item 4 Submission of Matters to a Vote of Security Holders

Item 5 Other Information

Item 6 Exhibits and Reports on Form 8-K

SIGNATURES