NBC CAPITAL CORP
Form 10-Q
May 14, 2002

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

For the quarterly period ended March 31, 2002.

Commission File Number 1-15773

NBC CAPITAL CORPORATION
(Exact name of registrant as specified in its charter.)

Mississippi	64-0694775
(State of other jurisdiction of incorporation or organization)	(I. R. S. Employer Identification No.)

NBC Plaza, P. O. Box 1187, Starkville, Mississippi	39760
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (662) 323-1341

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 [X] NO [ ]

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date:

Common Stock, $1 Par Value - 6,172,160 shares as of March 31, 2002.

PART I - FINANCIAL INFORMATION

NBC CAPITAL CORPORATION

CONSOLIDATED STATEMENTS OF INCOME FOR

THREE MONTHS ENDED MARCH 31, 2002 AND 2001

(Unaudited)

(Amounts in thousands, except per share data)

	2002	2001
INTEREST INCOME:		
Interest and Fees on Loans	$10,578	$14,319
Interest And Dividends On Investment Securities	4,819	4,257
Other Interest Income	83	399
Total Interest Income	15,480	18,975
INTEREST EXPENSE:		
Interest on Deposit	4,726	8,650
Interest on Borrowed Funds	1,430	1,279
Total Interest Expense	6,156	9,929
Net Interest Income	9,324	9,046
Provision for Possible Loan Losses	630	180
Net Interest Income After Provision for Loan Losses	8,694	8,866
NON-INTEREST INCOME:		
Income from Fiduciary Activities	439	427
Service Charge on Deposit Accounts	1,600	1,382
Insurance Commissions, Fees, and Premiums	901	880
Mortgage Loan Fee Income	403	234
Other Non-Interest Income	735	643
Total Non-Interest Income	4,078	3,566
Gains (Losses) on Securities	91	49
NON-INTEREST EXPENSE:		
Salaries and Employee Benefits	4,860	4,606
Expense of Premises and Fixed Assets	1,146	1,183
Other Non-Interest Expense	2,051	2,192
Total Non-Interest Expense	8,057	7,981
Income Before Income Taxes	4,806	4,500
Income Taxes	1,278	1,152
NET INCOME	$ 3,528	$ 3,348
Net Earnings Per Share:		
Basic	$ 0.57	$ 0.47
Diluted	$ 0.57	$ 0.47

NBC CAPITAL CORPORATION

CONSOLIDATED BALANCE SHEETS

	Mar. 31, 2002	Dec. 31, 2001
	(Unaudited)	(Audited)
ASSETS:		
Cash and Balances Due From Banks:		
Noninterest -Bearing Balances	$ 22,469	$ 28,752
Interest-bearing Balances	914	1,263
Total Cash and Due From Banks	23,383	30,015
Held-To-Maturity Securities (Market value of $49,866 at March 31, 2002 and $50,623 at December 31, 2001)	46,891	47,683
Available-For-Sale Securities	312,140	293,043
Total Securities	359,031	340,726
Federal Funds Sold and Securities Purchased Under Agreement to Resell	15,623	13,510
Loans	592,486	622,940
Less: Reserve for Loan Losses	(7,078)	(6,753)
Net Loans	585,408	616,187
Bank Premises and Equipment (Net)	15,122	15,377
Interest Receivable	7,892	8,352
Intangible Assets	2,825	2,857
Other Assets	24,267	23,778
TOTAL ASSETS	$1,033,551	$1,050,802
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-Interest Bearing	$ 105,752	$ 101,569
Interest Bearing Deposits	691,929	709,134
Total Deposits	797,681	810,703
Federal Funds Purchased and Securities Sold Under Agreements to Repurchase	15,351	16,625
Other Borrowed Funds	105,052	110,594
Interest Payable	1,944	2,284
Other Liabilities	11,041	7,669
TOTAL LIABILITIES	931,069	947,875
Shareholders' Equity:		
Common Stock $1 par Value, Authorized 10,000,000 shares, Issued 7,212,662	7,213	7,213
Surplus and Undivided Profits	121,844	120,061
Accumulated Other Comprehensive Income	(256)	1,650
Treasury Stock, at cost (1,040,502 at March 31,2002 and 1,029,702 at December 31, 2001	(26,319)	(25,997)
TOTAL SHAREHOLDERS' EQUITY	102,482	102,927
TOTAL LIABILITIES & SHAREHOLDERS' EQUITY	$1,033,551	$1,050,802

NBC CAPITAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE THREE MONTHS ENDED MARCH 31, 2002 AND 2001

(Unaudited)

(Amounts in thousands)

	2002	2001
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income	$ 3,528	$ 3,348
Adjustments to Reconcile Net Income to Net Cash:		
Depreciation and Amortization	536	634
Deferred Income Taxes (Credits)	1,858	(2,113)
Provision for Loan Losses	630	180
Loss (Gain) on Sale of Securities	(91)	(49)
(Increase) Decrease in Interest Receivable	460	653
(Increase) Decrease in Other Assets	(1,412)	(9,841)
Increase (Decrease) in Interest Payable	(340)	114
Increase (Decrease) in Other Liabilities	3,372	1,913
Net Cash Provided by Operating Activities	8,541	(5,161)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from Maturities and calls of Securities	9,607	11,774
Proceeds from Sale of Securities	4,909	5,065
Purchase of Securities	(35,618)	(51,224)
(Increase) Decrease in Loans	30,149	2,270
(Additions) Disposal of Bank Premises and Equipment	(216)	(805)
Net Cash Used in Investing Activities	8,831	(32,920)
CASH FLOWS FROM FINANCING ACTIVITIES		
Increase (Decrease) in Deposits	(13,022)	29,147
Dividend Paid on Common Stock	(1,731)	(1,794)
Increase (Decrease) in Borrowed Funds	(6,816)	43,853
Purchase of Treasury Stock	(322)	(24,392)
Net Cash Provided by Financing Activities	(21,891)	46,814
Net Increase (decrease) in Cash and Cash Equivalents	(4,519)	8,733
Cash and Cash Equivalents at Beginning of Year	43,525	45,150

Cash and Cash Equivalents at End of Quarter	$ 39,006	$ 53,883
Interest	$ 6,496	$ 9,815
Income Taxes	$ -	$ -

NBC CAPITAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The accompanying unaudited consolidated financial statements include the accounts of NBC Capital Corporation ("Corporation") and its subsidiaries, National Bank of Commerce and First National Finance Company. All significant intercompany accounts and transactions have been eliminated. In the normal decision making process, management makes certain estimates and assumptions that affect the reported amounts that appear in these statements. Although management believes that the estimates and assumptions are reasonable and are based on the best information available, actual results could differ.

In the opinion of management, all adjustments necessary for the fair presentation of the financial statement presented in this report have been made. Such adjustments were of a normal recurring nature.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with Generally Accepted Accounting Principles have been condensed or omitted.

Note 1. Accounting Pronouncements

In June 2001, the FASB issued Statement No. 142, "Goodwill and Other Intangible Assets." According to this Statement, goodwill and those intangible assets that have indefinite lives are not amortized, but tested for impairment. Statement No. 142 is effective for years beginning after December 15, 2001. Management is of the opinion the impact of the adoption of the statement on the Corporation's consolidated financial statements will not be significant. If Statement 142 was in effect for all periods presented, its impact on net income and net income per share would have been as follows for the period ended March 31, 2001:

(In thousands, except per share data)	
Reported net income	$3,348
Add:	
Goodwill Amortization	66
Adjusted Net Income	$3,414
Basic and Diluted net income per share:	
Reported net income	$ 0.47
Goodwill amortization	.01
Adjusted net income	$ 0.48

Note 2. Stock Options

The Corporation accounts for stock options in accordance with Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and, accordingly, no compensation expense is recognized for stock options granted.

Had compensation for the stock options been determined based on FASB Statement No. 123, "Accounting for Stock Based Compensation," net income and per share amounts would have been as follows:

	Three Months Ended March 31, 2002	2001
Net income:		
As reported	$3,528	$3,348
Pro forma	3,488	3,348
Basic net earnings per share:		
As reported	$ .57	$ .47
Pro forma	.56	.47
Diluted net earnings per share:		
As reported	$ .57	$ .47
Pro forma	.56	.47

PART I. ITEM 2

MANAGEMENT'S DISCUSSION AND ANALYSIS

MARCH 31, 2002

DISCLOSURE REGARDING FORWARD LOOKING INFORMATION

The following provides a narrative discussion and analysis of significant changes in the Corporation's results of operations and financial condition the quarter ended March 31, 2002. Certain information included in this discussion contains forward-looking statements and information that are based on management's conclusions, drawn from certain assumptions and information currently available. The Private Securities Litigation Act of 1995 encourages the disclosure of forward-looking information by management by providing a safe harbor for such information. This discussion includes "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. Although the Corporation believes that the expectations reflected in such forward-looking statements are reasonable, such forward-looking statements are based on numerous assumptions (some of which may prove to be incorrect) and are subject to risks and uncertainties which could cause the actual results to differ materially from the Corporation's expectations. The forward-looking statements made in this document are based on management's beliefs, as well as assumptions made by and information currently available to management. When used in the Corporation's documents, the words "anticipate," "estimate," "expect," "objective," "projection," "forecast," "goal" and similar expressions are intended to identify forward-looking statements. In addition to any assumptions and other factors referred to specifically in connection with forward-looking statements, factors that could cause the Corporation's actual results to differ materially from those contemplated in any forward-looking statements include, among others, increased competition, regulatory factors, economic conditions, changing interest rates, changing market conditions, availability or cost of capital, employee workforce factors, cost and other effects of legal and administrative proceedings, and changes in federal, state or local laws and regulations. The Corporation undertakes no obligation to update or revise any forward-looking statements, whether as a result of changes in actual results, changes in assumptions or other factors affecting such statements.

The two major trends that can have a material impact on the Corporation's financial condition and results of operations are the trend in interest rates and the overall trend in the economy. Currently, management expects, based on the available information, that interest rates will trend upward and the overall economy in its market will improve somewhat during later half of 2002. The Corporation's 2002 projections, budgets and goals are based on these expectations. If these trends move differently than expected in either direction or speed, it could have a material impact on the Corporation's financial condition and results of operations. The areas of the Corporation's operations most directly impacted would be net interest margin, loan and deposit growth and provision for loan losses.

ACCOUNTING ISSUES

Note A of the Notes to Consolidated Financial Statements included in the Corporation's Form 10-K for the year ended December 31, 2001, contains a summary of the Corporation's accounting policies. Management is of the opinion that Note A, read in conjunction with all other information in the annual report, including management's letter to shareholders and management's discussion and analysis, is sufficient to provide the reader with the information needed to understand the Corporation's financial condition and results of operations. This information is also sufficient to enable the reader to identify the areas in which management is required to make the most difficult, subjective and /or complex judgments.

In the normal course of business, the Corporation's wholly-owned subsidiary, National Bank of Commerce, makes loans to related parties, including directors and executive officers of the Corporation and their relatives and affiliates. These loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other parties. Also, they are consistent with sound banking practices and within the applicable regulatory and lending limitations.

The Corporation does not have investments in any unconsolidated entities over which it exercises management or control. The Corporation does not have relationships with limited or special purpose entities that it relies on to provide financing, liquidity or market and credit risk support.

RESULTS OF OPERATIONS

First quarter of 2002 compared to the first quarter of 2001

Earnings for the first quarter of 2002 increased by 5.4% to $3.53 million or $.57 per share. This compares to $3.35 million or $.47 per share for the first quarter of 2001. On an annualized basis, these 2002 totals equate to a 1.4% return on average assets and a 13.9% return on average equity. For this same period in 2001, return on average assets was 1.3% and return on average equity was 12.4%.

Net interest income for the first quarter of 2002 was $9.32 million compared to $9.05 million for 2001. This represents an increase of 3.1%. This increase resulted from a nine basis point increase in the net interest margin and a $7.2 million increase in average earning assets. The primary reason for the increase in margin was that the Corporation was able to decrease its cost of funds by 180 basis points from the first quarter of 2001 to the first quarter of 2002. During the same time period it lost 147 basis points from the repricing of its earning assets. The small increase in earning assets resulted from the slow economy of 2001 and the first quarter of 2002. The stable rate environment of the first quarter of 2002 helped from the standpoint that it allowed the repricing of the deposits to continue to catch up with the repricing of the loans that occurred throughout 2001 and to a lesser extent during the first quarter of 2002. Management believes that if the Federal Reserve will continue the flat to slightly increasing rate environment for the remainder of the year, the Corporation's net interest income should improve as the margin continues to increase. For additional information, see the table entitled "Analysis of Net Interest Earnings" at the end of this section.

The Corporation's Provision for Loan Losses is utilized to replenish the Reserve for Loan Losses on its balance sheet. The reserve is maintained at a level deemed adequate by the Board of Directors after its evaluation of the risk exposure contained in the Corporation's loan portfolio. The methodology used to make this determination is performed on a quarterly basis. An overall analysis of the portfolio is performed by the senior credit officers and the loan review staff. As a part of this evaluation, certain loans are individually reviewed to determine if there is an impairment of the bank's ability to collect the loan and the related interest. This determination is generally made based on collateral value. If it is determined that an impairment exist, a specific portion of the reserve is allocated to these individual loans. All other loans are grouped into homogeneous pools and risk exposure is determined by considering the following list of factors (this list is not all inclusive and the factors reviewed may change as circumstances change): Historical loss experiences; trends in delinquencies and non-accruals and national, regional and local economic conditions. These economic conditions would include, but not be limited to, general real estate conditions, the current interest rate environment and trends, unemployment levels and other information, as deemed appropriate. Classified loan to capital was 19.1% at March 31, 2002, compared to 20.7% at March 31, 2001. The percentage of loans past due 30 days or more was 2.41% system wide. The Reserve for Loan Losses as a percentage of total loans has increase from 1.08% of net loans at the end of 2001 to 1.20% at the end of the first quarter of 2002. During this quarter, net charge-offs totaled $305,000 compared to $419,000 for the same quarter of 2001. Overall, Loan quality remains good. At the end of the first quarter of 2002, the ratio of non-performing loans to total loans remained low at .52%. This compares to .63% at December 31, 2001 and .59% at March 31, 2001. Management is committed to not relaxing its underwriting standards. Based on these evaluations, the reserve amounts maintained at the end of the first quarter of 2002 and at the end of 2001 were deemed adequate to cover exposure within the Corporation's loan portfolio.

The Provision for Loan Losses has increased from $180,000 during the first quarter of 2001 to $630,000 in the same quarter of 2002. The level of the provision for the first quarter of 2002 was increased due to the overall condition of the economy and the continued softness of the Corporation's markets to a level management anticipates will protect the Corporation from any unforeseen deterioration in the quality of the loan portfolio.

Non-interest income grew 14.4% resulting from a 2.8% increase in income from the Company's Trust and Financial Management activities, a 15.8% increase in income from deposit accounts, and a 72.2% increase in fees from mortgage-related activities. The solid increase in income from deposit accounts largely resulted from a new program related to fees on overdrafts. This program is part of our upgraded technology platform that includes more sophisticated account modeling. Mortgage fee income benefited from the continued demand for loans in this low interest rate environment. The pipeline for new mortgage loans remains strong into the second quarter. Other non-interest income increased by $92,000 or 14.3%. This increase came from an increase in earnings from a $10 million purchase of Bank Owned Life Insurance during the second quarter of 2001. Insurance commissions, fees and premiums increased by $21,000 or 2.4%. This change in insurance commissions, fees and premiums relates directly to the volume of insurance product sold during these periods.

The Corporation recognized $91,000 in securities gains during the first quarter of 2002, compared to a gain of $49,000 during the first quarter of 2001. The gains in both periods resulted from securities that had been purchased at a discount being called because of the low rate environment.

Non-interest expenses for the first quarter of 2002 increased by less than 1% over the same period of 2001. This small increase resulted from a continued focus on managing these expenses. Salaries and employee benefits were up 5.5%, primarily due to higher benefit cost. The benefit cost increased due to the effects of a lower rate environment on the present value calculations and low returns in the investment portfolio due to a weak equity market. This increase was somewhat offset by reductions in other operating expenses and net premises expenses.

Changes in the Corporation's income tax expense have generally paralleled changes in income. The Corporation's effective tax rate increased from 25.6% for the first quarter of 2001 to 26.6% for the first quarter of 2002. This increase in the effective tax rate for the quarter resulted primarily from a decline in the portfolio of tax exempt securities. The Corporation's ability to reduce income tax expense by acquiring additional tax-free investments is limited by the Alternative Minimum Tax Provision, the market supply of acceptable municipal securities, the level of tax exempt yields and the Corporation's normal liquidity and balance sheet structure requirements.

FINANCIAL CONDITION

The Corporation's balance sheet shows a decrease in total assets from $1,051 million to $1,034 million during the first quarter of 2002. During this period, loans declined by $30.5 million. There were several reasons for the continued decline in loans; including the continuing refinancing of variable rate mortgage loans to fixed rate loans (which the Corporation does not hold in its portfolio), tighter underwriting standards in our personal loan portfolio and two large commercial credits that were paid out during the first quarter. Because of lower loan demand, the Corporation decided not to aggressively price deposits, resulting in a $13.0 million decline in deposits. The Corporation used the excess cash flow to increase the investment securities portfolio by $18.3 million and to reduce the Federal Home Loan Bank borrowings by $5.5 million. The increase in other liabilities was primarily due to an increase in accrued taxes payable in both the current and deferred accounts.

Stockholders' equity decreased from $102.9 million to $102.5 million during the first quarter of 2002. During this period there was a decrease in the market value of the available-for-sale portion of the investment securities portfolio. This resulted in the Accumulated Other Comprehensive Income component of Stockholders' Equity decreasing from an unrealized gain of $1,650,000 at December 31, 2001 to an unrealized loss of $256,000 at March 31, 2002. Also, during the first quarter of the year the Company declared a dividend of approximately $1,729,000, payable on April 1, 2002. Also, the Corporation repurchased 10,800 shares of its common stock in the open market under the announced stock repurchase plan for approximately $322,000. These declines were largely offset with the net earnings for the quarter.

The Corporation's bank subsidiary is required to maintain a minimum amount of capital to total risk weighted assets as defined by the banking regulators. At March 31, 2002, the bank's Tier I, Tier II and Total Capital Ratios exceeded the well-capitalized standards developed under the referenced regulatory guidelines.

Dividends paid by the Corporation are provided from dividends received from the subsidiary bank. Under the regulations controlling national banks, the payment of dividends by the bank without prior approval from the Comptroller of the Currency is limited in amount to the current year's net profit and the retained net earnings of the two preceding years. To fund the 976,676 share repurchase transaction in March of 2001, the Corporation's subsidiary bank borrowed funds from the Federal Home Loan Bank and with special permission from the Office of the Comptroller of the Currency, declared a special dividend to the Corporation to purchase this stock. As a result, the subsidiary bank is limited to its current year's net profits to pay dividends to the Corporation during 2002, without obtaining further approval from the Comptroller of Currency. At March 31, 2002, without approval, the subsidiary bank was limited to approximately $1.8 million.

Also, under regulations controlling national banks, the bank is limited in the amount it can lend to the Corporation and such loans are required to be on a fully secured basis. At March 31, 2002, there were no borrowings between the Corporation and its subsidiary bank.

ANALYSIS OF NET INTEREST EARNINGS

The table below shows, for the periods indicated, an analysis of net interest earnings, including the average amount of interest-earning assets and interest-bearing liabilities outstanding during the period, the interest earned or paid on such amounts, the average yields/rates paid and the net yield on interest-earning assets:

	($ In Thousands) Average Balance	
	Three Months Ended 3/31/02	Year Ended 12/31/01
EARNING ASSETS:		
Net loans	$603,260	$629,248
Federal funds sold and other interest-bearing Assets	19,286	22,816
Securities:		
Taxable	225,206	185,076
Nontaxable	129,555	132,200
Totals	977,307	969,340
INTEREST-BEARING LIABILITIES:		
Interest-bearing deposits	714,092	714,491
Borrowed funds, federal funds purchased and securities sold and other	127,734	115,764
Totals	841,826	830,255
Net amounts	$135,481	$139,085

	($ In Thousands) Interest for		Yields Earned and Rates Paid (%)	
	Three Months Ended 3/31/02	Year Ended 12/31/01	Three Months Ended 3/31/02	Year Ended 12/31/01
EARNING ASSETS:				
Net loans	$ 10,578	$ 51,852	7.11	8.24
Federal funds sold and other interest-bearing assets	83	950	1.75	4.16
Securities:				
Taxable	3,231	11,165	5.82	6.03
Nontaxable	1,588	6,803	4.97	5.14
Totals	$ 15,480	$ 70,770	6.42	7.30

INTEREST-BEARING LIABILITIES:				
Interest-bearing deposits	$ 4,726	$ 29,866	2.68	4.18
Borrowed funds, federal funds sold and other	1,430	6,135	4.54	5.30
Totals	6,156	36,001	2.97	4.34
Net interest income	$ 9,324	$ 34,769		
Net yield on earning assets			3.87	3.59

Note: Yields on a tax equivalent basis would be:

Nontaxable securities	7.65	7.92
Total earning assets	6.78	7.68
Net yield on earning assets	4.22	3.96

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

National Bank of Commerce is a defendant in a lawsuit in which a class is pursuing unspecified and punitive damages as a result of the placement of collateral protection insurance. The Bank has vigorously defended its position and, as of March 15, 2001, has reached a preliminary settlement in the amount of $450,000. The settlement is yet to be approved by the court. This settlement, if approved, will not have a material impact on the future earnings of the Corporation.

There are no other pending proceedings of a material nature to which the Corporation, or its subsidiaries, are a party.

Item 2. Changes in Securities

None

Item 3. Defaults Upon Senior Debt

None

Item 4. Submission of Matters to a Vote of Security Holders

The 2002 Annual Meeting of Shareholders was held on April 16, 2002. The only item submitted for shareholder vote was the election of directors. Since the proxies were solicited under Regulation 14A, there were no solicitations in opposition to the Board of Directors' nominees and all nominees were elected, no additional information is required to be disclosed.

Item 5. Other Information

None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

11 Statement re computation of per-share earnings

The financial information furnished herein has not been audited by independent accountants; however, in the opinion of management, all adjustments necessary for a fair presentation on the results of operations for the three month period ended March 31, 2002, have been included.

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

NBC CAPITAL CORPORATION
Registrant

May 8, 2002	/s/ Richard T. Haston
Date	Richard T. Haston
	Executive Vice President,
	Chief Financial Officer
	and Treasurer