

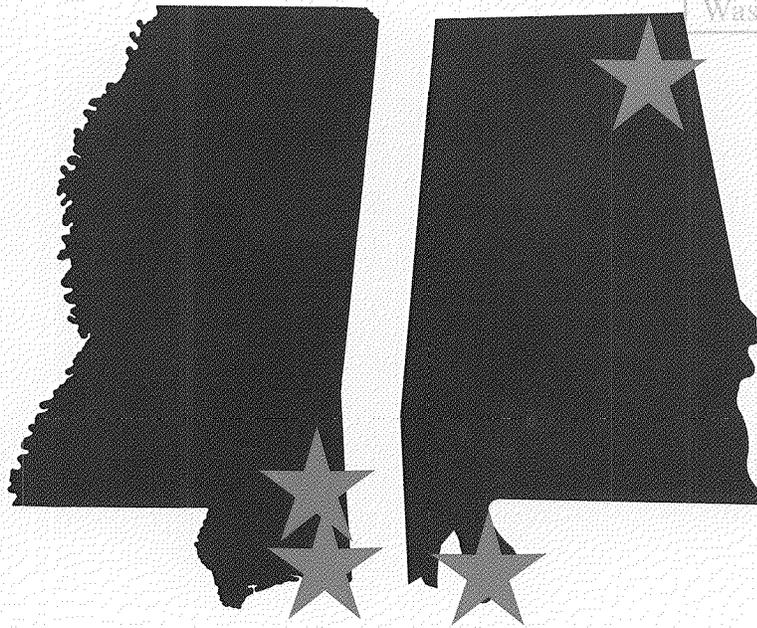


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MERCHANTS & MARINE  
BANCORP, INC.

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*Proudly Serving Jackson and George Counties, Mississippi  
Baldwin and DeKalb Counties, Alabama*

# 2011

## ANNUAL REPORT

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Washington, DC  
**121**

March 9, 2012

To Our Shareholders:

The 2011 Annual Report reflects another strong performance for Merchants & Marine Bank. Net income of \$4.1 million or \$3.11 per share is lower than 2010, but includes one-time extraordinary expense associated with the purchase of two Alabama bank branches in mid- December. Total assets purchased and liabilities assumed totaled \$52.4 million with \$52 million in deposits and \$30.4 million in loans.

Merchants & Marine Bank's return on average assets was in the top tier among our peer banks in the Gulf Coast region again. The 2011 performance is significant because it was accomplished at a time when the entire banking industry is seriously impacted by low, recession era interest rates and burdensome federal regulations. This solid performance is the reason we can maintain our string of 246 quarterly dividend payments – that's sixty-one and a half years of continuous dividends without reduction or interruption.

Looking forward we see encouraging signs for a slowly improving economy. Real estate markets are advancing with sales increasing and values easing upward. There is also a growing awareness and appreciation of community banks. The Alabama market should provide new opportunity, and we are encouraged by the positive reception there.

Your support is greatly appreciated and vitally important to the continued success of Merchants & Marine Bank. I look forward to visiting with each of you at our annual shareholder meeting on April 5, 2012.

Sincerely,

A handwritten signature in black ink, appearing to read 'Royce Cumbest', written over a white background.

Royce Cumbest  
Chief Executive Officer



**Wolfe • McDuff & Oppie**  
CERTIFIED PUBLIC ACCOUNTANTS  
(A Professional Association)

Jack A. Oppie, CPA  
C. Scott Rankin, CPA

Lindsey M. Henley, CPA  
Carolyn H. Rossignol, CPA  
K. Jessica Mavromihalis, CPA  
Jesse J. Wolfe, CPA (1927-2009)  
Grover B. McDuff, CPA (Retired)

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors  
Merchants & Marine Bancorp, Inc.

We have audited the accompanying consolidated balance sheets of Merchants & Marine Bancorp, Inc. (the "Bancorp") and subsidiary as of December 31, 2011 and 2010, and the related statements of income, comprehensive income, changes in stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 2011. These financial statements are the responsibility of the Bancorp's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Bancorp is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bancorp's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Merchants & Marine Bancorp, Inc. and subsidiary as of December 31, 2011 and 2010, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2011, in conformity with accounting principles generally accepted in the United States of America.

*Wolfe, McDuff & Oppie*

Pascagoula, Mississippi  
February 6, 2012

Membership in:  
American Institute of Certified Public Accountants • Mississippi Society of Certified Public Accountants • AICPA Private Companies Practice Section  
AICPA Governmental Audit Quality Center • AICPA Center for Audit Quality • AICPA Employee Benefit Plan Audit Quality Center



**MERCHANTS & MARINE BANCORP, INC. AND SUBSIDIARY**  
**CONSOLIDATED BALANCE SHEETS**  
December 31, 2011 and 2010

	<b>2011</b>	<b>2010</b>
<b>ASSETS</b>		
Cash and due from banks	\$ 72,797,389	20,010,142
Federal funds sold	97,000	3,147,000
Securities:		
Available-for-sale at fair value	111,755,320	116,333,500
Held-to-maturity at amortized cost	93,132,029	112,981,596
Non-marketable equity securities	900,060	900,060
Loans	238,016,070	219,779,834
Less:		
Allowance for loan losses	3,744,819	3,268,217
Unearned income	9,139	41,271
Loans, net	234,262,112	216,470,346
Property and equipment, net	17,661,027	15,727,476
Other real estate owned	5,615,468	2,275,723
Accrued income	2,553,933	2,401,057
Goodwill, net	2,974,824	880,398
Other assets	13,683,686	12,267,658
Total assets	\$ 555,432,848	503,394,956
<b>LIABILITIES</b>		
Deposits:		
Non-interest bearing demand	\$ 90,034,763	79,614,176
Interest bearing savings, demand and other time deposits	386,032,877	348,586,934
Total deposits	476,067,640	428,201,110
Securities sold under agreements to repurchase	12,275,294	13,729,528
Accrued expense and other liabilities	12,446,480	9,113,767
Total liabilities	500,789,414	451,044,405
<b>STOCKHOLDERS' EQUITY</b>		
Common stock - \$2.50 par value per share, 5,000,000 shares authorized, 1,330,338 shares issued and outstanding	3,325,845	3,325,845
Surplus	14,500,000	14,500,000
Retained earnings	41,349,035	39,013,928
Accumulated other comprehensive loss	(4,531,446)	(4,489,222)
Total stockholders' equity	54,643,434	52,350,551
Total liabilities and stockholders' equity	\$ 555,432,848	503,394,956

**MERCHANTS & MARINE BANCORP, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF INCOME**  
For the Years Ended December 31, 2011, 2010 and 2009

	<u>2011</u>	<u>2010</u>	<u>2009</u>
<b>Interest income</b>			
Interest and fees on loans	\$ 13,683,128	14,030,856	14,100,737
Interest on investment securities:			
Taxable	5,733,234	5,255,077	5,575,643
Exempt from federal and state income tax	1,026,922	718,925	431,597
Interest on federal funds sold	77,216	59,957	53,167
Other interest income	<u>23,896</u>	<u>93,556</u>	<u>2,043</u>
Total interest income	<u>20,544,396</u>	<u>20,158,371</u>	<u>20,163,187</u>
<b>Interest expense</b>			
Interest on deposits	3,017,027	3,586,035	4,957,500
Interest on federal funds purchased and securities sold under agreements to repurchase	<u>25,966</u>	<u>23,587</u>	<u>39,592</u>
Total interest expense	<u>3,042,993</u>	<u>3,609,622</u>	<u>4,997,092</u>
Net interest income	17,501,403	16,548,749	15,166,095
Provision for loan losses	<u>2,454,756</u>	<u>1,027,127</u>	<u>780,890</u>
Net interest income after provision for loan losses	<u>15,046,647</u>	<u>15,521,622</u>	<u>14,385,205</u>
<b>Non-interest income</b>			
Service charges on deposit accounts	4,590,068	4,452,383	4,155,103
Other service charges, commissions and fees	1,305,086	1,085,112	1,044,066
Gain on sale of securities	536,821	365,401	-
Gain on sale of other real estate owned	-	955,615	47,279
Other	<u>798,373</u>	<u>700,160</u>	<u>925,622</u>
Total non-interest income	<u>7,230,348</u>	<u>7,558,671</u>	<u>6,172,070</u>
<b>Non-interest expense</b>			
Salaries and employee benefits	7,459,239	7,677,966	7,654,312
Occupancy expense	2,903,638	2,985,133	3,205,066
Services and fees expense	1,676,467	1,761,635	1,141,629
Loss on sale of other real estate owned	22,073	-	-
Advertising expense	401,108	333,873	288,411
Other	<u>4,294,407</u>	<u>3,858,028</u>	<u>3,521,616</u>
Total non-interest expense	<u>16,756,932</u>	<u>16,616,635</u>	<u>15,811,034</u>
Income before income taxes	5,520,063	6,463,658	4,746,241
Income taxes	<u>1,389,000</u>	<u>1,548,000</u>	<u>1,435,000</u>
Net income	<u>\$ 4,131,063</u>	<u>4,915,658</u>	<u>3,311,241</u>
Net income per common share	<u>\$ 3.11</u>	<u>3.70</u>	<u>2.49</u>

See accompanying notes to financial statements.

**MERCHANTS & MARINE BANCORP, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
For the Years Ended December 31, 2011, 2010 and 2009

	<b>2011</b>	<b>2010</b>	<b>2009</b>
Net income	\$ 4,131,063	4,915,658	3,311,241
Other comprehensive income, net of tax:			
Unrealized gain (loss) on securities available-for-sale	1,928,415	(2,133,264)	(327)
Unrealized gain (loss) on pension plan assets	<u>(1,970,638)</u>	<u>45,493</u>	<u>409,082</u>
Comprehensive income	<u>\$ 4,088,840</u>	<u>2,827,887</u>	<u>3,719,996</u>

**MERCHANTS & MARINE BANCORP, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS CHANGES IN STOCKHOLDERS' EQUITY**  
For the Years Ended December 31, 2011, 2010 and 2009

	Common Stock			Retained Earnings	Accumulated Other Comprehensive Income (Loss)
	Shares Issued	Amount	Surplus		
<b>Balance, January 1, 2009</b>	1,330,338	\$ 3,325,845	14,500,000	34,045,240	(2,810,206)
Net income	-	-	-	3,311,241	-
Cash dividends, \$1.35 per share	-	-	-	(1,795,957)	-
Change in unrealized gain (loss) on securities available-for-sale, net of taxes of (\$168)	-	-	-	-	(327)
Change in unrealized gain (loss) on pension plan, net of taxes of \$210,739	-	-	-	-	409,082
<b>Balance, December 31, 2009, as originally reported</b>	1,330,338	3,325,845	14,500,000	35,560,524	(2,401,451)
Prior period adjustment of \$333,702 (see Note 17)	-	-	-	333,702	-
<b>Balance, December 31, 2009, as restated</b>	<u>1,330,338</u>	<u>3,325,845</u>	<u>14,500,000</u>	<u>35,894,226</u>	<u>(2,401,451)</u>
Net income	-	-	-	4,915,658	-
Cash dividends, \$1.35 per share	-	-	-	(1,795,956)	-
Change in unrealized gain (loss) on securities available-for-sale, net of taxes of (\$1,098,954)	-	-	-	-	(2,133,264)
Change in unrealized gain (loss) on pension plan, net of taxes of \$23,435	-	-	-	-	45,493
<b>Balance, December 31, 2010</b>	<u>1,330,338</u>	<u>3,325,845</u>	<u>14,500,000</u>	<u>39,013,928</u>	<u>(4,489,222)</u>
Net income	-	-	-	4,131,063	-
Cash dividends, \$1.35 per share	-	-	-	(1,795,956)	-
Change in unrealized gain (loss) on securities available-for-sale, net of taxes of \$993,426	-	-	-	-	1,928,414
Change in unrealized gain (loss) on pension plan, net of taxes of (\$1,015,177)	-	-	-	-	(1,970,638)
<b>Balance, December 31, 2011</b>	<u>1,330,338</u>	<u>\$ 3,325,845</u>	<u>14,500,000</u>	<u>41,349,035</u>	<u>(4,531,446)</u>

See accompanying notes to financial statements.

**MERCHANTS & MARINE BANCORP, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
For the Years Ended December 31, 2011, 2010 and 2009

	2011	2010	2009
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income	\$ 4,131,063	4,915,658	3,311,241
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	1,266,468	1,395,506	1,446,905
Provision for loan losses	2,454,756	1,027,127	780,890
Writedowns on real estate owned	-	-	80
(Accretion) amortization of securities premium/discount	178,151	122,445	2,053
(Gain) loss on sale of assets	22,073	(962,365)	(47,279)
(Gain) on sale of securities	(536,821)	(365,401)	-
(Increase) decrease in accrued income	(34,109)	98,582	586,894
(Increase) in interest payable	(94,148)	(108,596)	(413,805)
Other, net	(977,193)	1,835,120	(2,479,986)
Net cash provided by operating activities	6,410,240	7,958,076	3,186,993
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Net (increase) decrease in federal funds sold and securities purchased under agreements to resell	3,050,000	13,303,000	(5,411,000)
Proceeds from sales and maturities of securities available-for-sale	227,599,272	100,232,140	51,065,000
Purchases of securities available-for-sale	(216,132,217)	(186,093,370)	(54,156,709)
Proceeds from maturities of securities held-to-maturity	42,090,000	133,145,000	126,792,593
Purchases of securities held-to-maturity	(22,528,927)	(102,305,295)	(124,236,466)
Purchase of non-marketable equity securities	-	-	(300,000)
Net (increase) decrease in loans	8,294,295	(10,783,494)	(11,644,680)
Purchases of property and equipment	(453,920)	(113,037)	(475,507)
Proceeds from sale of assets	402,577	1,382,972	221,400
Cash received from acquisition of Alabama branches - net of cash paid	11,539,459	-	-
Net cash provided (used) by investing activities	53,860,539	(51,232,084)	(18,145,369)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Net increase (decrease) in deposits	(4,233,342)	45,333,097	15,622,900
Net increase (decrease) in federal funds purchased and securities sold under agreements to repurchase	(1,454,234)	5,295,896	(2,483,335)
Dividends paid	(1,795,956)	(1,795,956)	(1,795,957)
Net cash provided (used) by financing activities	(7,483,532)	48,833,037	11,343,608
Net increase (decrease) in cash and due from banks	52,787,247	5,559,029	(3,614,768)
Cash and due from banks, beginning	20,010,142	14,451,113	18,065,881
Cash and due from banks, ending	\$ 72,797,389	20,010,142	14,451,113

**MERCHANTS & MARINE BANCORP, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
For the Years Ended December 31, 2011, 2010 and 2009

	2011	2010	2009
Supplemental disclosures of cash flow information:			
Cash paid during the year for:			
Interest	\$ 3,137,141	3,718,218	5,410,897
Income taxes	1,830,000	900,000	1,680,000
Acquisition of Heritage First Bank branches in Alabama:			
Assets acquired:			
Investments and related accrued income	\$ 3,319,870		
Loans receivable and accrued income	30,585,020		
Property and equipment	2,746,099		
Other real estate	1,811,786		
Intangible and other assets	2,094,426		
Total non-cash assets acquired	40,557,201		
Deposit liabilities and accrued expenses assumed	52,096,660		
Cash received from acquisition - net of cash paid	\$ 11,539,459		

**MERCHANTS & MARINE BANCORP, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
December 31, 2011, 2010 and 2009

**NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Nature of Operations:

Merchants & Marine Bancorp, Inc. (the "Bancorp") is a bank holding company whose principal activity is the ownership and management of its wholly-owned subsidiary, Merchants & Marine Bank (the "Bank"). The Bancorp generates commercial, mortgage and consumer loans and receives deposits from customers located in Jackson and George Counties in Mississippi and Baldwin and DeKalb Counties in Alabama. The Bancorp operates under a state bank charter and provides full banking services. As a state bank, the Bancorp is subject to regulation by the Mississippi Department of Banking and Consumer Finance, the Federal Deposit Insurance Corporation, Securities Exchange Commission, and the Federal Reserve Bank.

The Bancorp is locally owned and strongly community oriented. The Bancorp's goal is to offer all the products and services of the larger banks and multi-bank holding corporations, while maintaining the personalized, local service of a community bank.

Basis of Consolidation:

The consolidated financial statements include the accounts of the Bancorp and its wholly-owned subsidiary, the Bank, after elimination of all material intercompany transactions and balances.

Use of Estimates:

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The determination of the allowance for loan losses is a material estimate that is particularly subject to significant change in the economic environment and market conditions. In connection with the determination of the estimated losses on loans, management obtains independent appraisals for significant collateral.

The Bancorp's loans are generally secured by specific items of collateral including real property, consumer assets and business assets.

While management uses available information to recognize losses on loans, further reductions in the carrying amounts of loans may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the estimated losses on loans. Such agencies may require the Bancorp to recognize additional losses based on their judgments about information available to them at the time of their examination. Because of these factors, it is reasonably possible that the estimated losses on loans may change materially in the near term. However, the amount of the change that is reasonably possible cannot be estimated.

**MERCHANTS & MARINE BANCORP, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
December 31, 2011, 2010 and 2009

**NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

Cash and Cash Equivalents:

For the purpose of presentation in the Consolidated Statements of Cash Flows, cash and cash equivalents include cash on hand and amounts due from banks.

Securities:

Securities have been classified into one of three categories: trading, held-to-maturity or available-for-sale. Management determines the appropriate classification of debt and equity securities at the time of purchase and re-evaluates this classification periodically. Trading account securities are held for resale in anticipation of short-term market movements. Debt securities are classified as held-to-maturity when management has the positive intent and ability to hold the securities to maturity. Securities not classified as held-to-maturity or trading are classified as available-for-sale. The Bancorp had no trading securities during the three-year period ended December 31, 2011. Held-to-maturity securities are stated at amortized cost. Debt and equity securities available-for-sale are stated at fair value, with unrealized gains and losses, net of income taxes, reported as a separate component of stockholders' equity until realized.

The amortized cost of debt securities classified as held-to-maturity or available-for-sale is adjusted for amortization of premiums and accretion of discounts to maturity over the estimated life of the security. Amortization, accretion and accrued interest are included in interest on investment securities. Realized gains and losses and declines in fair value judged to be other-than-temporary are included in net security gains (losses). Gains and losses on the sale of securities available-for-sale are determined using the specific identification method.

The Bancorp also holds non-marketable securities. These securities are restricted and do not have readily determinable fair values. These securities are carried at their acquisition cost and are accounted for by the cost method.

Loans:

Loans are stated at the amount of unpaid principal. Interest on commercial and real estate mortgage loans is accrued and credited to income based on the principal amount outstanding. Income on installment loans is credited to income based on a method that approximates the interest method. The accrual of interest on loans is discontinued once the loan reaches 90 days past due. Upon such discontinuance, all unpaid accrued interest is reversed and payments subsequently received are applied first to principal. Interest income is recorded after principal has been satisfied and as payments are received. Loans are returned to accrual status when all the principal and interest contractually due are brought current and future amounts are reasonably assured.

**MERCHANTS & MARINE BANCORP, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
December 31, 2011, 2010 and 2009

**NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

Loans (continued):

A loan is considered impaired when, based on current information and events, it is probable that the Bancorp will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. A valuation allowance is measured on a loan-by-loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price or the fair value of the collateral if the loan is collateral dependent. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Bancorp does not separately identify individual consumer and residential loans for impairment disclosures, unless such loans are the subject of a restructuring agreement.

Loan origination fees are recognized as income when received. Revenue from these fees is not material to the financial statements.

Allowance for Loan Losses:

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the remaining loan balance will go uncollected. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific and general components. The specific component relates to loans that are classified as impaired. For loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors.

**MERCHANTS & MARINE BANCORP, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
December 31, 2011, 2010 and 2009

**NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

Non-Accrual Policy:

It is the bank's policy to cease the accrual of interest on any loan when principal or interest are in default for 90 days or more, unless the loan is well secured and in the process of collection.

Loan Collection Policy:

All loans are considered past due one day beyond the payment due date. However, when a loan becomes fifteen days past due a late notice is mailed.

Loan Impairment Policy:

Loans are considered to be impaired using a number of factors including but not limited to, loans on the bank's internal watch list, large loans classified, i.e., watch, substandard, doubtful, exposure size, non-accrual status, etc. A loan determined to be impaired is then measured for impairment using the guidelines set forth in ASC 310-40.

Property and Equipment, Net:

Property and equipment are stated at cost, less accumulated depreciation. The provision for depreciation is computed by the straight-line method over the estimated useful lives of the related assets. Leasehold improvements are amortized over the shorter of the term of the lease or the asset's useful life.

Other Real Estate Owned:

Real estate properties acquired through or in lieu of loan foreclosure are initially recorded at the lower of cost or fair value less estimated selling costs at the date of foreclosure. Fair value is based primarily on independent appraisals and other relevant factors. Any write-downs based on the asset's fair value at the date of acquisition are charged to the allowance for loan losses. After foreclosure, valuations are periodically performed by management and any subsequent write-downs are recorded as a charge to operations, if necessary, to reduce the carrying value of a property to the lower of its cost or fair value less cost to sell. Costs of significant property improvements are capitalized, whereas costs relating to holding property are expensed and included in non-interest expense. The portion of interest costs relating to development of real estate is capitalized.

Goodwill:

Goodwill represents costs in excess of the fair value of net assets acquired in connection with purchase business combinations. The Bancorp tests its goodwill for impairment annually. If indicators of impairment were present in goodwill and undiscounted future cash flows were not expected to be sufficient to recover the asset's carrying amount, an impairment loss would be charged to expense in the period identified. No impairment charges were recognized during the three years ended December 31, 2011.

**MERCHANTS & MARINE BANCORP, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
December 31, 2011, 2010 and 2009

**NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

Income Taxes:

Provisions for income taxes are based on taxes payable or refundable for the current year (after exclusion of non-taxable income such as interest on state and municipal securities) and deferred taxes on temporary differences between the amount of taxable and pretax financial income and between the tax basis of assets and liabilities and their reported amounts in the financial statements. Deferred taxes on temporary differences are calculated at the currently enacted tax rates applicable to the period in which the deferred tax assets, liabilities, income or expense are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

Comprehensive Income:

Comprehensive income includes net income and other comprehensive income which, in the case of the Bancorp, includes unrealized gains and losses on securities available-for-sale and the gains or losses and prior service cost or credits that arise during the period related to the Bancorp's defined benefit pension plan but are not recognized as components of net periodic benefit cost. All items of comprehensive income are stated net of tax.

Fair Value Measurements:

The Bancorp records fair value measurements using a specified hierarchy of valuation techniques based upon whether the inputs to those valuation techniques reflect assumptions other market participants would use based upon market data obtained from independent sources (observable inputs). The following summarizes the fair value hierarchy:

- Level 1 inputs are unadjusted quoted prices in active markets for identical securities.
- Level 2 inputs include quoted prices for similar securities in active markets, quoted prices from those willing to trade in markets that are not active, or other inputs that are observable or can be corroborated by market data for the term of the investments. Such inputs include market interest rates, volatilities and yield curves.
- Level 3 inputs are unobservable (supported by little or no market activity) and significant to the fair value measurement including the reporting entity's own assumptions in determining the fair value of the investment.

**MERCHANTS & MARINE BANCORP, INC. AND SUBSIDIARY**  
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**NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

Fair Value Measurements (continued):

The Bancorp uses observable market data, when available, in making fair value measurements. When inputs used to measure fair value fall within different levels of the hierarchy, the level within the fair value measurement is categorized based on the lowest level input that is significant to the fair value measurements. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

**NOTE 2. SECURITIES**

The amortized cost of securities and their estimated fair values are as follows (dollars in thousands):

	December 31, 2011				December 31, 2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:								
US Government Agency Funds	\$ 108,535	145	(231)	108,449	119,168	5	(2,956)	116,217
Mortgage-backed securities	2,546	3	(1)	2,548	-	-	-	-
State, county and municipal securities	587	-	-	587	-	-	-	-
Equity securities	72	99	-	171	72	45	-	117
Total	<u>\$ 111,740</u>	<u>247</u>	<u>(232)</u>	<u>111,755</u>	<u>119,240</u>	<u>50</u>	<u>(2,956)</u>	<u>116,334</u>
Held-to-maturity:								
US Government Agency Funds	\$ 42,505	452	-	42,957	83,157	1,219	-	84,376
State, county and municipal securities	50,627	2,090	(110)	52,607	29,825	587	(399)	30,013
Total	<u>\$ 93,132</u>	<u>2,542</u>	<u>(110)</u>	<u>95,564</u>	<u>112,982</u>	<u>1,806</u>	<u>(399)</u>	<u>114,389</u>

The amortized cost and estimated fair value of securities held-to-maturity and available-for-sale at December 31, 2011 by contractual maturity are as follows (dollars in thousands):

	Available-For-Sale		Held-To-Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Amounts maturing in:				
One year or less	\$ 276	375	2,674	2,696
After one year through five years	1,917	1,918	46,610	47,707
After five years through ten years	109,443	109,358	24,892	25,936
Greater than ten years	104	104	18,956	19,225
	<u>\$ 111,740</u>	<u>111,755</u>	<u>93,132</u>	<u>95,564</u>

**MERCHANTS & MARINE BANCORP, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**NOTE 2. SECURITIES (continued)**

Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

Proceeds from sales of available-for-sale securities were approximately \$81,496,506 in 2011, including a realized gain of \$536,821. Proceeds from sales of available-for-sale securities were approximately \$38,052,000, in 2010 including a realized gain of \$365,401. There were no sales of securities in 2009.

Securities with a carrying value of approximately \$141,920,442 and \$130,295,000, respectively, were pledged at December 31, 2011 and 2010 to secure certain deposits. Information pertaining to securities with gross unrealized losses at December 31, 2011 and 2010 aggregated by investment category and length of time that individual securities have been in a continuous loss position follows (dollars in thousands):

	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
December 31, 2011:						
US Government Agency Funds	\$ 46,876	(231)	-	-	46,876	(231)
Mortgage-backed securities	674	(1)	-	-	674	(1)
State, county and municipal securities	9,697	(110)	-	-	9,697	(110)
Total	<u>\$ 57,247</u>	<u>(342)</u>	<u>-</u>	<u>-</u>	<u>57,247</u>	<u>(342)</u>

	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
December 31, 2010:						
US Government Agency Funds	\$ 101,212	(2,956)	-	-	101,212	(2,956)
State, county and municipal securities	9,786	(399)	-	-	9,786	(399)
Total	<u>\$ 110,998</u>	<u>(3,355)</u>	<u>-</u>	<u>-</u>	<u>110,998</u>	<u>(3,355)</u>

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and to the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer and (3) the intent and ability of the Bancorp to retain its investments in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

**MERCHANTS & MARINE BANCORP, INC. AND SUBSIDIARY**  
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**NOTE 2. SECURITIES (continued)**

At December 31, 2011, the 39 debt securities with unrealized losses have depreciated 0.59% from the Bancorp's amortized cost basis. These securities are guaranteed by either the U.S. Government or other governments. These unrealized losses relate principally to current interest rates for similar types of securities and not credit quality. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred and the results of reviews of the issuer's financial condition. As management has the ability to hold debt securities until maturity, or for the foreseeable future if classified as available-for-sale, no declines are deemed to be other-than-temporary.

The Bancorp also holds non-marketable equity securities. These securities are restricted and do not have readily determinable market values. These securities are carried at their acquisition cost and are accounted for by the cost method.

The acquisition cost of these non-marketable securities as of December 31, 2011 and 2010 are as follows:

	<b>2011</b>	<b>2010</b>
Beginning balance	\$ 900,060	900,060
Purchases of non-marketable equity securities	-	-
Ending balance	\$ 900,060	900,060

**NOTE 3. LOANS**

Loans outstanding at December 31, 2011 and 2010, by major lending classification, were as follows (in thousands):

	<b>2011</b>	<b>2010</b>
Loans secured by real estate:		
Construction	\$ 34,887	28,111
Farmland	971	1,708
Revolving, open-end secured		
by 1-4 family residential property	2,579	1,021
1-4 family residential properties	48,228	43,568
Multifamily (5 or more) residential properties	447	398
Nonfarm nonresidential properties	89,643	83,461
Commercial and industrial	26,208	27,210
Loans to individuals for household, family and other personal expenditures	31,163	29,544
Municipal and government	2,547	3,670
Other	1,343	1,089
	\$ 238,016	219,780

**MERCHANTS & MARINE BANCORP, INC. AND SUBSIDIARY**  
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**NOTE 3. LOANS (continued)**

Major loan classifications by age for the year ended December 31, 2011 and 2010, is as follows (in thousands):

December 31, 2011:	30-89 Days Past Due	90 or More Days Past Due - Still Accruing	90 or More Days Past Due - Non Accrual	Total Past Due	Current	Total Loans
Residential	\$ 3,076	-	1,028	4,104	82,037	86,141
Non-Residential	4,961	89	1,694	6,744	83,870	90,614
Commercial	1,706	8	265	1,979	26,776	28,755
Consumer	2,360	114	143	2,617	29,889	32,506
	<u>\$ 12,103</u>	<u>211</u>	<u>3,130</u>	<u>15,444</u>	<u>222,572</u>	<u>238,016</u>

December 31, 2010:	30-89 Days Past Due	90 or More Days Past Due - Still Accruing	90 or More Days Past Due - Non Accrual	Total Past Due	Current	Total Loans
Residential	\$ 559	-	110	669	72,429	73,098
Non-Residential	1,846	-	3,556	5,402	79,767	85,169
Commercial	4,485	-	130	4,615	26,265	30,880
Consumer	2,886	189	121	3,196	27,437	30,633
	<u>\$ 9,776</u>	<u>189</u>	<u>3,917</u>	<u>13,882</u>	<u>205,898</u>	<u>219,780</u>

Changes in the allowance for loan losses for the years ended December 31, 2011, 2010 and 2009 are as follows (in thousands):

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Balance, January 1,	\$ 3,268	3,100	3,100
Recoveries	536	646	337
Loans charged off	(2,514)	(1,505)	(1,118)
Provision for loan losses	2,455	1,027	781
Balance, December 31,	<u>\$ 3,745</u>	<u>3,268</u>	<u>3,100</u>

**MERCHANTS & MARINE BANCORP, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**NOTE 3. LOANS (continued)**

Changes in the allowance for loan losses by major loan classifications for the year ended December 31, 2011 and 2010 are as follows (in thousands):

December 31, 2011:	Residential	Non-Residential	Consumer	Commercial	Alabama Acquisition	Total
Beginning Balance	\$ 392	2276	541	59	-	3,268
Charge-Offs	(327)	(1457)	(698)	(32)	-	(2,514)
Recoveries	10	187	336	3	-	536
Provision	496	888	321	272	478	2,455
Ending Balance	<u>\$ 571</u>	<u>1894</u>	<u>500</u>	<u>302</u>	<u>478</u>	<u>3,745</u>

Ending Balance: individually evaluated for impairment	<u>\$ 93</u>	<u>965</u>	<u>-</u>	<u>268</u>	<u>-</u>	<u>1,326</u>
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Ending Balance: collectively evaluated for impairment	<u>\$ 478</u>	<u>929</u>	<u>500</u>	<u>34</u>	<u>478</u>	<u>2,419</u>
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December 31, 2010:	Residential	Non-Residential	Consumer	Commercial	Total
Beginning Balance	\$ 392	1511	977	220	3,100
Charge-Offs	(68)	(268)	(1022)	(147)	(1,505)
Recoveries	8	8	507	123	646
Provision	60	1025	79	(137)	1,027
Ending Balance	<u>\$ 392</u>	<u>2276</u>	<u>541</u>	<u>59</u>	<u>3,268</u>

Ending Balance: individually evaluated for impairment	<u>\$ 99</u>	<u>1579</u>	<u>-</u>	<u>-</u>	<u>1,678</u>
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Ending Balance: collectively evaluated for impairment	<u>\$ 293</u>	<u>697</u>	<u>541</u>	<u>59</u>	<u>1,590</u>
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**MERCHANTS & MARINE BANCORP, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
December 31, 2011, 2010 and 2009

**NOTE 3. LOANS (continued)**

At December 31, 2011 and 2010, the carrying amounts of nonaccrual loans, which are considered for impairment analysis were \$3,129,517 and \$3,916,546, respectively. When a loan is deemed impaired, the full difference between the carrying amount of the loan and the most likely estimate of the asset's fair value less cost to sell, is assessed for allowance. At December 31, 2011 and 2010, specifically evaluated impaired loans totaled \$13,767,980 and \$5,788,306, respectively. The average carrying amounts of specifically evaluated impaired loans for 2011, 2010 and 2009 were \$8,276,016, \$3,486,377 and \$2,188,012, respectively. The Bancorp had \$1,326,496, \$1,677,759 and \$1,130,179 of specific allowance related to impaired loans at December 31, 2011, 2010 and 2009, respectively. The amount of interest that would have been recorded on nonaccrual loans had the loans not been classified as nonaccrual in 2011, 2010 and 2009, was \$289,161, \$266,909 and \$826,345, respectively. No material interest income was recognized on impaired or nonaccrual loans for the years ended December 31, 2011, 2010 and 2009.

Transfers from loans to other real estate owned amounted to approximately \$1,953,000, \$468,000 and \$2,135,000 for the years ended 2011, 2010 and 2009, respectively.

The Bancorp's lending activities are concentrated in Jackson and George Counties in Mississippi and Baldwin and DeKalb Counties in Alabama.

**NOTE 4. PROPERTY AND EQUIPMENT, NET**

Property and equipment as of December 31, 2011 and 2010 are stated at cost less accumulated depreciation as follows (in thousands):

	<b>2011</b>	<b>2010</b>
Land and buildings	\$ 22,194	19,389
Furniture and equipment	5,574	5,179
	27,768	24,568
Accumulated depreciation	(10,107)	(8,840)
Net property and equipment	\$ 17,661	15,728

Depreciation expense for the years ended December 31, 2011, 2010 and 2009 amounted to \$1,266,468, \$1,395,506 and \$1,446,905, respectively.

**NOTE 5. INCOME TAXES**

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Bancorp's deferred tax assets and liabilities as of December 31, 2011 and 2010 are as follows (in thousands):

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**NOTE 5. INCOME TAXES (continued)**

	<u>2011</u>	<u>2010</u>
Deferred tax assets:		
Provision for loan losses not currently deductible	\$ 958	890
Write-down of other real estate not currently deductible	627	224
Deferred compensation	1,745	1,655
Loan origination costs not currently deductible	331	318
Accrued interest on non-accrual loans	98	91
Underfunded pension	468	835
Losses on defined benefit plan assets	2,340	1,325
Unrealized losses on securities available-for-sale	-	988
Gross deferred tax asset	<u>6,567</u>	<u>6,326</u>
Deferred tax liabilities:		
Book basis of fixed assets greater than tax	(2,815)	(2,851)
Discount accretion	64	(10)
Prepaid pension obligation	(703)	-
Unrealized gains on securities available-for-sale	(5)	-
Gross deferred tax liability	<u>(3,459)</u>	<u>(2,861)</u>
Net deferred tax asset	<u>\$ 3,108</u>	<u>3,465</u>

The Bancorp has evaluated the need for a valuation allowance and, based on the weight of the available evidence, has determined that it is more likely than not that all deferred tax assets will be realized.

Income taxes consisted of the following components for the years ended December 31, 2011, 2010 and 2009 (in thousands):

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Currently payable	\$ 1,948	1,946	1,519
Deferred	(559)	(398)	(84)
Total income taxes	<u>\$ 1,389</u>	<u>1,548</u>	<u>1,435</u>

Income taxes amounted to less than the amounts computed by applying the U.S. Federal income tax rate of 34% to income before taxes. The reasons for the differences for the years ended December 31, 2011, 2010 and 2009 are as follows (in thousands):

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**NOTE 5. INCOME TAXES (continued)**

	2011		2010		2009	
	Amount	%	Amount	%	Amount	%
Taxes computed at statutory rate	\$ 1,877	34.0	2,198	34.0	1,614	34.0
Increase (decrease) in taxes resulting from:						
Tax exempt life insurance income (net of expense)	(83)	(1.5)	(151)	(2.3)	(61)	(1.3)
Tax exempt interest income	(317)	(5.7)	(300)	(4.6)	(141)	(3.0)
Tax credits available	-	-	(181)	(2.8)	-	-
Miscellaneous permanent differences	(88)	(1.6)	(18)	(0.3)	23	0.5
	\$ 1,389	25.2	1,548	24.0	1,435	30.2

The Bancorp adopted policies for income taxes which prescribes a recognition threshold and measurement attribute for the recognition and measurement of tax positions taken or expected to be taken on income tax returns. There were no material uncertain tax positions at December 31, 2011. The Bancorp does not expect that unrecognized tax benefits will significantly increase or decrease within the next 12 months.

It is the Bancorp's policy to recognize interest and penalties accrued relative to unrecognized tax benefits in income tax expense. As of December 31, 2011, no interest or penalties were accrued on the Bancorp's Consolidated Balance Sheet.

The Bancorp and its subsidiary file consolidated income tax returns with federal and Mississippi taxing authorities. Its filed income tax returns are no longer subject to examination by taxing authorities for years prior to 2008.

**NOTE 6. DEPOSITS**

Deposit account balances at December 31, 2011 and 2010 are summarized as follows (in thousands):

	2011	2010
Non-interest bearing demand	\$ 90,035	79,614
Interest bearing demand	205,090	190,373
Savings	50,059	44,056
Certificates of deposit	130,884	114,158
Total deposits	\$ 476,068	428,201

**MERCHANTS & MARINE BANCORP, INC. AND SUBSIDIARY**  
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**NOTE 6. DEPOSITS (continued)**

Certificates by contractual maturity as of December 31, 2011 are as follows (in thousands):

2012	\$ 79,928
2013	18,006
2014	4,858
2015	1,082
2016	18,174
Thereafter	<u>8,836</u>
	<u>\$ 130,884</u>

Certificates of deposit in excess of \$100,000 aggregated approximately \$70,847,000 and \$56,773,000 at December 31, 2011 and 2010, respectively. Interest expense on these certificates amounted to approximately \$852,000 and \$971,000 for the years ended December 31, 2011 and 2010, respectively.

Overdrawn demand deposits reclassified as loans totaled approximately \$1,328,000 and \$532,000 at December 31, 2011 and 2010, respectively.

**NOTE 7. LINES OF CREDIT**

The Bancorp has established various lines of credit with financial institutions, allowing for maximum borrowings of \$27,800,000 at rates determined by the lender when borrowed. At December 31, 2011 and 2010, the Bancorp had no outstanding balance on these lines of credit.

**NOTE 8. EMPLOYEE BENEFIT PLANS**

The Bancorp has a non-contributory pension plan covering all employees who qualify under length of service and other requirements. The plan calls for benefits to be paid to eligible employees at retirement based primarily upon years of service and average earnings for the five consecutive plan years which produce the highest average. Data relative to the pension plan as of December 31, 2011, 2010 and 2009 follows (in thousands):

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**NOTE 8. EMPLOYEE BENEFIT PLANS (continued)**

	December 31,		
	2011	2010	2009
Reconciliation of benefit obligation:			
Projected benefit obligation at beginning of period	\$ 11,794	10,660	9,662
Service cost	382	405	320
Interest cost	598	601	587
Actuarial loss	2,932	519	439
Distributions	(466)	(391)	(348)
Projected benefit obligation at end of period	<u>15,240</u>	<u>11,794</u>	<u>10,660</u>
Reconciliation of plan assets:			
Fair value of plan assets at beginning of period	9,337	8,753	7,830
Actual return on plan assets	528	1,082	1,355
Employer Contributions	582	-	-
Benefit payments	(466)	(391)	(348)
Expenses	(116)	(107)	(84)
Fair value of plan assets at end of period	<u>9,865</u>	<u>9,337</u>	<u>8,753</u>
Funded status, included in other liabilities	<u>\$ (5,375)</u>	<u>(2,457)</u>	<u>(1,907)</u>
Amounts recognized in accumulated other comprehensive income:			
Net loss	<u>\$ 6,882</u>	<u>3,896</u>	<u>3,965</u>
Net periodic pension expense:			
Service cost	\$ 382	406	320
Interest cost	598	601	587
Actual gain on plan assets	(725)	(660)	(549)
Amortization of loss	258	272	336
Net periodic pension cost	<u>\$ 513</u>	<u>619</u>	<u>694</u>

The accumulated benefit obligation for the defined benefit plan was \$13,868,551 and \$11,072,217 at December 31, 2011 and 2010, respectively.

Rate assumptions:	2011	2010	2009
Discount rate	4.15%	5.19%	5.77%
Long term rate of investment return	7.75%	7.75%	7.75%
Rate of compensation increase	4.00%	4.00%	4.00%

**MERCHANTS & MARINE BANCORP, INC. AND SUBSIDIARY**  
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**NOTE 8. EMPLOYEE BENEFIT PLANS (continued)**

The investment portfolio objective is to seek a balance of investment risk and return by investing in fixed income and equities using tactical asset allocation. In addition, the portfolio seeks to meet current beneficiary liabilities while at the same time grow the principal of the portfolio through price appreciation, dividend income and interest income. The Bancorp's Pension Plan Investment Committee, in establishing these objectives, acknowledges that any investment other than cash entails a risk of loss of principal value, but expects the evaluation of the risk to the potential return to be a significant factor in the selection of the investment assets. The Bancorp's asset allocation targets are 30% fixed income and 70% equity, with no more than 15% of the total equity investment concentrated in international investments.

The fair values of the Bancorp's pension plan assets at December 31, 2011 and 2010 by asset category are as follows:

	<b>Total</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
December 31, 2011:				
Asset category:				
Cash and cash equivalents	\$ 465,328	465,328	-	-
Equity securities:				
US Companies	3,719,471	3,719,471	-	-
International companies	170,823	170,823	-	-
Fixed income securities:				
US Government securities	77,560	-	77,560	-
Corporate bonds	50,670	-	50,670	-
Mutual funds	<u>5,381,602</u>	<u>5,381,602</u>	<u>-</u>	<u>-</u>
Total pension plan assets	<u>\$ 9,865,454</u>	<u>9,737,224</u>	<u>128,230</u>	<u>-</u>
	<b>Total</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
December 31, 2010:				
Asset category:				
Cash and cash equivalents	\$ 161,320	161,320	-	-
Equity securities:				
US Companies	3,709,080	3,550,897	158,183	-
International companies	110,115	110,115	-	-
Fixed income securities:				
US Government securities	61,534	-	61,534	-
Corporate bonds	95,087	-	95,087	-
Mutual funds	<u>5,200,324</u>	<u>5,200,324</u>	<u>-</u>	<u>-</u>
Total pension plan assets	<u>\$ 9,337,460</u>	<u>9,022,656</u>	<u>314,804</u>	<u>-</u>

On the basis of the actuarial valuation, it has been determined that a contribution in the amount of \$809,807 is required for the plan year ended December 31, 2011.

**MERCHANTS & MARINE BANCORP, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**NOTE 8. EMPLOYEE BENEFIT PLANS (continued)**

The following benefit payments which reflect expected future service, as appropriate, are expected to be paid:

2012	\$	554,005
2013		661,209
2014		695,340
2015		710,544
2016		884,340
2017-2021		5,268,761

The Bancorp also has a 401(k) retirement plan which covers all employees who have completed one year of service of 1,000 hours or more and have attained the age of 21. The employees may voluntarily contribute up to twenty percent (20%) of their wages to the plan on a tax-deferred basis subject to IRS limitations. The Bancorp contributes a matching fifty percent (50%) of the first six percent (6%) of employee contributions. The Bancorp's contributions to the plan were \$119,389, \$126,699 and \$122,635 for the years ended December 31, 2011, 2010 and 2009, respectively.

**NOTE 9. REGULATORY CAPITAL**

The Bank is subject to various regulatory capital requirements administered by its primary federal regulator, the Federal Deposit Insurance Corporation ("FDIC"). Failure to meet the minimum regulatory capital requirements can initiate certain mandatory and possible additional discretionary actions by regulators that if undertaken, could have a direct material effect on the Bank and the financial statements.

Under the regulatory capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines involving quantitative measures of the Bank's assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification under the prompt corrective action guidelines are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of: total risk-based capital and Tier I capital to risk-weighted assets (as defined in the regulations), and Tier I capital to adjusted total assets (as defined in the regulations). Management believes, as of December 31, 2011, the Bank meets all the capital adequacy requirements to which it is subject.

As of December 31, 2011, the Bank was well capitalized under the regulatory framework for prompt corrective action according to the most recent notification from the FDIC. To remain categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier I risk-based and Tier I leverage ratios as disclosed in the table below. There are no conditions or events since the most recent notification that management believes have changed the Bank's prompt corrective action category.

**MERCHANTS & MARINE BANCORP, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
December 31, 2011, 2010 and 2009

**NOTE 9. REGULATORY CAPITAL (continued)**

The Bank's actual and required capital amounts and ratios as of December 31, 2011 and 2010 are as follows (in thousands):

	Actual		For Capital Adequacy Purposes		To be Well Capitalized Under the Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2011:						
Total Capital (to Risk-weighted Assets)	\$ 59,243	17.67%	26,828	8.00%	33,536	10.00%
Tier I Capital (to Risk-weighted Assets)	55,420	16.53%	13,414	4.00%	20,121	6.00%
Tier I Leverage Capital	55,420	10.23%	16,258	3.00%	27,096	5.00%
December 31, 2010:						
Total Capital (to Risk-weighted Assets)	58,744	19.85%	23,669	8.00%	29,587	10.00%
Tier I Capital (to Risk-weighted Assets)	55,359	18.71%	11,835	4.00%	17,752	6.00%
Tier I Leverage Capital	55,359	11.06%	15,022	3.00%	25,036	5.00%

**NOTE 10. RELATED PARTIES**

The Bancorp has entered into transactions with its officers, directors, significant stockholders and their affiliates. Such transactions were made in the ordinary course of business on substantially the same terms and conditions, including interest rates and collateral, as those prevailing at the same time for comparable transactions with other customers, and did not, in the opinion of management, involve more than normal credit risk or present other unfavorable features. A summary of the 2011, 2010 and 2009 activity with respect to loans to and deposits from related parties follows (in thousands):

	2011	2010	2009
Loans:			
Balance, January 1	\$ 2,691	2,945	2,041
New loans	406	704	2,713
Payments	(468)	(958)	(1,809)
Change in officers and directors	(231)	-	-
Balance, December 31	<u>\$ 2,398</u>	<u>2,691</u>	<u>2,945</u>
Deposits:			
Balance, January 1	\$ 5,118	5,012	3,326
Net change	(452)	106	1,686
Balance, December 31	<u>\$ 4,666</u>	<u>5,118</u>	<u>5,012</u>

During the ordinary course of business, the Bancorp may purchase goods and services from companies that have a relationship with individuals who are considered related parties to the Bancorp. Significant transactions of this type include the purchase of legal services, consulting services and outsourced internal auditing services.

During the years ended December 31, 2011, 2010 and 2009, the Bancorp paid \$241,073, \$238,919 and \$244,215 in fees to a law firm of which one of the partners is a member of the Bancorp's Board of Directors.

**MERCHANTS & MARINE BANCORP, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
December 31, 2011, 2010 and 2009

**NOTE 10. RELATED PARTIES (continued)**

The Bancorp's Chairman serves as the Bancorp's nominee to Mississippi National Banker's Bank headquartered in Jackson, Mississippi and serves on the Board of Mississippi National Banker's Bank. The Mississippi National Banker's Bank acts like a cooperative, providing banking services and products to community banks throughout the State of Mississippi. The Chairman has ownership of ten (10) shares of Mississippi National Banker's Bank stock, which is required to serve on the Board of Directors. The shares are subject to an irrevocable option to purchase granted to the Bancorp, and upon his leaving the Board of Directors of the Mississippi National Banker's Bank, the ten (10) shares would immediately be transferred to the Bancorp. The Bancorp, a founding member of Mississippi National Banker's Bank, owns 2,505 shares of Mississippi National Banker's Bank stock. During the years ended December 31, 2011, 2010 and 2009, the Bancorp paid \$29,253, \$30,670 and \$30,969, respectively, in fees to Mississippi National Banker's Bank for correspondent services.

**NOTE 11. FAIR VALUE**

Assets and liabilities measured at fair value on a recurring basis are summarized below (dollars in thousands).

	<b>Total</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
Assets at December 31, 2011:				
Securities available-for-sale:				
U.S. Government Agency funds	\$ 108,449	-	108,449	-
Mortgage-backed securities	2,548	-	2,548	-
State, county and municipal securities	587	-	587	-
Equity securities	171	171	-	-
Assets at December 31, 2010:				
Securities available-for-sale:				
US Government Agency funds	\$ 116,217	-	116,217	-
Equity securities	117	117	-	-

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

The fair values of equity securities available-for-sale are determined by quoted market prices.

The following represents assets and liabilities measured at fair value on a non-recurring basis as of December 31, 2011 and 2010.

**MERCHANTS & MARINE BANCORP, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
December 31, 2011, 2010 and 2009

**NOTE 11. FAIR VALUE (continued)**

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Assets at December 31, 2011:				
Impaired loans	\$ 12,441,484	-	-	12,441,484
Assets at December 31, 2010:				
Impaired loans	\$ 4,110,547	-	-	4,110,547

Impaired loans are loans for which it is probable the Bancorp will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Specific allowances for impaired loans are based on the fair value of the collateral.

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

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Assets at December 31, 2011:				
Other real estate owned	\$ 5,615,468	-	-	5,615,468
Assets at December 31, 2010:				
Other real estate owned	\$ 2,275,723	-	-	2,275,723

The fair value of other real estate owned is based primarily on independent appraisals, less costs to sell. The appraisals are generally discounted based on management's historical knowledge, changes in market conditions from the time of valuation and/or management's expertise and knowledge of the client and client's business.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

Cash and Federal Funds Sold:

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

Investment Securities:

Fair values for investment securities are based on quoted market price, where available. If quoted market prices are not available, fair values are based on quoted market prices for similar securities.

Loans:

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

**MERCHANTS & MARINE BANCORP, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
December 31, 2011, 2010 and 2009

**NOTE 11. FAIR VALUE (continued)**

Deposits:

The fair value of demand deposits, savings accounts and certain money market deposits is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is estimated using the rates currently offered for deposits of similar remaining maturities.

Federal Funds Purchased and Securities Sold Under Agreements to Repurchase:

The carrying amount is a reasonable estimate of fair value.

The estimated fair values of the Bancorp's financial instruments are as follows at December 31, 2011 and 2010 (in thousands):

	2011		2010	
	Carrying Amount	Fair Value	Carrying Value	Fair Value
Financial assets:				
Cash and federal funds sold	\$ 72,894	72,894	23,157	23,157
Securities:				
Available-for-sale	111,755	111,755	116,334	116,334
Held-to-maturity	93,132	95,564	112,982	114,389
Non-marketable	900	900	900	900
Loans, net of allowance	234,262	237,484	216,470	216,162
Financial liabilities:				
Deposits	476,068	477,707	428,201	428,195
Federal funds purchased and securities sold under agreements to repurchase	12,275	12,275	13,730	13,730

**NOTE 12. CONCENTRATIONS OF CREDIT**

All of the Bancorp's loans, commitments, commercial and standby letters of credit have been granted to customers in the Bancorp's market area. The concentrations of credit by type of loan are set forth in Note 3. Commercial and standby letters of credit were granted primarily to commercial borrowers. Regulations limit the amount of credit the Bancorp can extend to any single borrower or group of related borrowers.

**NOTE 13. FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK**

The Bancorp is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit, which are not reflected in the accompanying financial statements until they are funded or related fees are incurred or received.

**MERCHANTS & MARINE BANCORP, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
December 31, 2011, 2010 and 2009

**NOTE 13. FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK (continued)**

The Bancorp's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of these instruments. The Bancorp uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments and may require collateral or other credit support for financial instruments with credit risk. These obligations are summarized below as of December 31, 2011 and 2010 (in thousands):

	2011	2010
Commitments to extend credit	\$ 33,256	30,164
Standby letters of credit	733	858

Commitments to extend credit are agreements to lend to a customer as long as conditions established in the agreement have been satisfied. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since commitments often expire without being fully drawn, the total commitment amounts do not necessarily represent future cash requirements. The Bancorp continually evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if it is deemed necessary by the Bancorp upon extension of credit, is based on management's credit evaluation of the counterparty. Standby letters of credit are conditional commitments issued by the Bancorp to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending a loan.

The Bancorp had due from bank balances in excess of the \$250,000 federal insurance limit with the following banks as of December 31, 2011 (in thousands):

Mississippi National Banker's Bank	\$ 73
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**NOTE 14. COMMITMENTS AND CONTINGENCIES**

The Bancorp is a defendant in legal actions arising from its normal business activities. Management, on advice from counsel, believes that those actions are without merit or that the ultimate liability resulting from them, if any, will not materially affect the Bancorp's financial position.

The Bancorp acquires space for several of its ATMs under operating leases that are currently under month-to-month terms. In the past, the Bancorp has also leased buildings and land under operating leases. Lease expense under operating leases was approximately \$21,200, \$24,000 and \$24,000 during the years ended December 31, 2011, 2010 and 2009, respectively.

Because the Bancorp's operating leases are presently under month-to-month terms, there are no future minimum payments required under non-cancelable leases, as of December 31, 2011.

**MERCHANTS & MARINE BANCORP, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
December 31, 2011, 2010 and 2009

**NOTE 15. RECLASSIFICATION**

Certain reclassifications were made to prior year financial statements in order to conform to the 2011 financial statements presentation.

**NOTE 16. ACQUISITION OF ASSETS**

In 2011, the Bancorp bought certain assets and assumed certain liabilities of the branch offices of Heritage First Bank located in Crossville and Gulf Shores, Alabama. The following is a schedule of consideration, based on fair values at the acquisition date:

Assets Acquired	
Cash	\$ 11,839,459
Investments	3,319,870
Loans	30,466,253
Property and equipment	2,746,099
Other Real Estate Owned	1,811,786
Accrued Income	<u>118,767</u>
	<u>50,302,234</u>
Cost of Assets	
Deposits assumed	52,072,698
Accrued interest payable	23,962
Cash payment	<u>300,000</u>
	<u>52,396,660</u>
Amount paid over value of assets (Goodwill)	<u>\$ 2,094,426</u>

Conversion costs, including professional fees, relating to the acquisition amounted to approximately \$648,000 and were expensed in the current period.

**NOTE 17. PRIOR PERIOD ADJUSTMENT**

The Bancorp recorded certain corrections of in prior years, as follows:

Retained earnings at December 31, 2009, as originally presented	\$ 35,560,524
To correct valuation of other real estate owned	109,225
To correct valuation of bank property	<u>224,477</u>
Total prior period adjustment	<u>333,702</u>
Retained earnings at December 31, 2009, as restated	<u>\$ 35,894,226</u>

**MERCHANTS & MARINE BANCORP, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
December 31, 2011, 2010 and 2009

**NOTE 18. ADVERTISING EXPENSE**

The Bancorp expenses advertising costs as they are incurred. Advertising expenses amounted to \$401,108, \$333,873 and \$288,411 in 2011, 2010, and 2009, respectively.

**NOTE 19. SUBSEQUENT EVENTS**

The Bancorp has evaluated subsequent events through February 6, 2012, the date of issuance of the financial statements. No material subsequent events have occurred since December 31, 2011 that required recognition or disclosure in the financial statements.

**MERCHANTS & MARINE BANCORP, INC.**  
**SUMMARY OF OPERATIONS**  
Quarterly Financial Data (unaudited)

Quarterly financial data are summarized below:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	(all amounts in thousands, except per share data)			
<b>For the year ended December 31, 2011:</b>				
Interest income	\$ 5,184	5,410	5,145	4,806
Interest expense	910	811	702	620
Net interest income	4,274	4,599	4,443	4,186
Provision for loan losses	242	1,067	499	647
Net interest income after provision for loan losses	4,032	3,532	3,944	3,539
Non-interest income	1,455	1,612	1,936	2,227
Non-interest expense	4,006	3,652	4,240	4,859
Income before income taxes	1,481	1,492	1,640	907
Income taxes	360	519	426	84
Net income	<u>\$ 1,121</u>	<u>973</u>	<u>1,214</u>	<u>823</u>
Net income per common share	<u>\$ 0.84</u>	<u>0.73</u>	<u>0.91</u>	<u>0.62</u>
<b>For the year ended December 31, 2010:</b>				
Interest income	\$ 4,894	5,092	4,974	5,199
Interest expense	1,002	926	864	818
Net interest income	3,892	4,166	4,110	4,381
Provision for loan losses	132	244	209	442
Net interest income after provision for loan losses	3,760	3,922	3,901	3,939
Non-interest income	1,657	2,064	2,398	1,439
Non-interest expense	4,403	4,324	4,213	3,676
Income before income taxes	1,014	1,662	2,086	1,702
Income taxes	246	506	636	160
Net income	<u>\$ 768</u>	<u>1,156</u>	<u>1,450</u>	<u>1,542</u>
Net income per common share	<u>\$ 0.58</u>	<u>0.87</u>	<u>1.09</u>	<u>1.16</u>
<b>For the year ended December 31, 2009:</b>				
Interest income	\$ 5,212	4,940	4,988	5,023
Interest expense	1,352	1,328	1,226	1,091
Net interest income	3,860	3,612	3,762	3,932
Provision for loan losses	74	60	304	343
Net interest income after provision for loan losses	3,786	3,552	3,458	3,589
Non-interest income	1,420	1,653	1,629	1,423
Non-interest expense	4,101	3,892	3,951	3,820
Income before income taxes	1,105	1,313	1,136	1,192
Income taxes	336	500	270	329
Net income	<u>\$ 769</u>	<u>813</u>	<u>866</u>	<u>863</u>
Net income per common share	<u>\$ 0.58</u>	<u>0.61</u>	<u>0.65</u>	<u>0.65</u>

\* Certain reclassifications have been made to the quarterly data previously disclosed in order to conform to the 2011 financial statement presentation.

**MERCHANTS & MARINE BANCORP, INC.****SUMMARY OF OPERATIONS**

Years Ended December 31,

	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Interest income	\$ 20,544,396	20,158,371	20,163,187	23,864,224	27,890,994
Interest expense	<u>3,042,993</u>	<u>3,609,622</u>	<u>4,997,092</u>	<u>7,137,225</u>	<u>9,219,867</u>
Net interest income	17,501,403	16,548,749	15,166,095	16,726,999	18,671,127
Provision for loan losses	<u>2,454,756</u>	<u>1,027,127</u>	<u>780,890</u>	<u>563,178</u>	<u>560,590</u>
Net interest income after provision for loan losses	15,046,647	15,521,622	14,385,205	16,163,821	18,110,537
Non-interest income	7,230,348	7,558,671	6,124,791	6,992,953	6,130,556
Non-interest expense	<u>16,756,932</u>	<u>16,616,635</u>	<u>15,763,755</u>	<u>16,199,124</u>	<u>14,246,174</u>
Income before income taxes	5,520,063	6,463,658	4,746,241	6,957,650	9,994,919
Income taxes	<u>1,389,000</u>	<u>1,548,000</u>	<u>1,435,000</u>	<u>2,228,000</u>	<u>3,272,000</u>
Net income	<u>\$ 4,131,063</u>	<u>4,915,658</u>	<u>3,311,241</u>	<u>4,729,650</u>	<u>6,722,919</u>
Net income per common share	<u>\$ 3.11</u>	<u>3.70</u>	<u>2.49</u>	<u>3.56</u>	<u>5.05</u>
Dividends per common share	<u>\$ 1.35</u>	<u>1.35</u>	<u>1.35</u>	<u>1.35</u>	<u>1.35</u>

**MERCHANTS & MARINE BANCORP, INC.**  
**FINANCIAL HIGHLIGHTS**

IN THOUSANDS, EXCEPT PER SHARE DATA  
AS OF DECEMBER 31,

	2011	2010	2009	2008	2007
<b>BALANCE SHEET:</b>					
Total assets end of year	\$ 555,433	503,395	450,474	436,283	459,533
Loans, net	234,262	216,470	207,113	198,383	200,812
Securities	205,787	230,215	178,183	177,350	183,367
Deposits	476,068	428,201	382,868	367,245	383,423
Stockholders' equity	54,643	52,351	50,985	49,061	48,441
<b>INCOME STATEMENT:</b>					
Interest income	20,545	20,158	20,163	23,864	27,891
Interest expense	3,043	3,609	4,997	7,137	9,220
Net interest income	17,502	16,549	15,166	16,727	18,671
Provision for possible loan losses	2,455	1,027	781	563	561
Net interest income after provision for possible loan losses	15,047	15,522	14,385	16,164	18,110
Non-interest income	7,230	7,559	6,125	6,993	6,131
Non-interest expense	16,757	16,617	15,764	16,199	14,246
Net income	4,131	4,916	3,311	4,730	6,723
Cash dividends declared	1,796	1,796	1,796	1,796	1,796
<b>PER SHARE DATA:</b>					
Net income	3.11	3.70	2.49	3.56	5.05
Cash dividends	1.35	1.35	1.35	1.35	1.35
Book value	41.07	39.34	38.32	36.88	36.41
<b>RATIOS:</b>					
Return on average equity	7.72	9.44	6.67	9.44	14.73
Return on average assets	0.76	1.00	0.73	1.01	1.35
Capital to assets	9.84	10.40	11.32	11.25	10.47
Dividends declared as percentage of income	43.48	36.53	54.24	37.97	26.71

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## MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of Merchants & Marine Bancorp, Inc. is responsible for establishing and maintaining adequate internal control over financial reporting. This internal control system was designed to provide reasonable assurance to the company's management and board of directors regarding the preparation and fair presentation of published financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Merchants & Marine Bancorp, Inc. management assessed the effectiveness of the company's internal control over financial reporting as of December 31, 2011. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control—Integrated Framework*. Based on our assessment, we believe that, as of December 31, 2011, the company's internal control over financial reporting is effective based on those criteria.

This annual report does not include an attestation report of the company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the company's registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the company to provide only management's report in this annual report.

A handwritten signature in black ink, appearing to read 'Royce Cumbest', is positioned above the printed name.

Royce Cumbest  
Chief Executive Officer  
February 6, 2012

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

### **Forward-looking Statements**

This Annual Report contains certain forward-looking statements (any statement other than those made solely with respect to historical fact) based upon management's beliefs as well as assumptions made by and data currently available to management. Investors are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. Merchants & Marine Bancorp, Inc. (the "Company") undertakes no obligation to publicly release any modification or revisions to these forward-looking statements to reflect events or circumstances occurring after the date hereof or to reflect the occurrence of unanticipated events. In connection with the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995, the Company cautions investors that future financial and operating results may differ materially from those projected in forward-looking statements made by, or on behalf of, the Company. The words "expect," "intend," "should," "may," "could," "believe," "suspect," "anticipate," "seek," "plan," "estimate" and similar expressions are intended to identify such forward-looking statements, but other statements not based on historical fact may also be considered forward-looking. Such forward-looking statements involve known and unknown risks, uncertainties, and other factors that may cause the actual results, performance, or achievements of the Company to be materially different from any future results, performance, or achievements expressed or implied by such forward-looking statements. Risks and uncertainties that could cause actual results to differ materially include those described in "Item 1A.-Risk Factors" of the Company's Annual Report on Form 10-K and, without limitation, (i) the Company's ability to effectively execute its business plans; (ii) greater than anticipated deterioration or lack of sustained growth in the national or local economies; (iii) rapid fluctuations or unanticipated changes in interest rates; (iv) continuation of the historically low short-term interest rate environment; (v) increased competition with other financial institutions in the markets that the Company serves; (vi) continuing consolidation in the financial services industry; (vii) losses, customer bankruptcies, claims and assessments; (viii) changes in state and federal legislation, regulations or policies applicable to banks or other financial service providers, including regulatory or legislative developments arising out of current unsettled conditions in the economy, including implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act; (ix) the effects of weather and natural disasters such as hurricanes; and (x) changes in accounting policies or procedures as may be required by the Financial Accounting Standards Board ("FASB") or other regulatory agencies.

### **Formation of Holding Company**

On April 24, 2008, the Company consummated its acquisition of 100% of the outstanding shares of Merchants & Marine Bank (the "Bank") common stock pursuant to the terms of an Agreement and Plan of Share Exchange, dated as of February 5, 2008, by and between the Company and the Bank. In connection with the Share Exchange, the holders of Bank common stock exchanged their shares of Bank common stock for a like number of shares of Company common stock. Following consummation of the Share Exchange, the Company is a bank holding company registered under the Bank Holding Company Act of 1956, as amended, and is subject to regulation by the Board of Governors of the Federal Reserve Bank. The common stock of the Bank constitutes substantially all of the assets of the Company. The Company has no other subsidiaries and the Bank accounts for substantially all of the Company's assets, liabilities, income and expenses.

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

## Executive Summary

The Company is a one bank holding company which acquired 100% of the Bank's common stock on April 24, 2008 and is the successor issuer to the Bank pursuant to Rule 12g-3(a) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). The Bank, a state-chartered institution since 1932, is a full service, federally insured bank serving Jackson and George Counties, Mississippi and DeKalb and Baldwin Counties, Alabama. The main office of the Bank is located in Pascagoula. Branch offices in Mississippi are located in Moss Point, Gautier, Escatawpa, Ocean Springs, Wade, Hurley, St. Martin and Lucedale. There are also branches in Gulf Shores and Crossville, Alabama. The Bank offers commercial and individual financial services consisting of business and personal checking accounts, certificates of deposit, various forms of real estate, commercial and industrial and personal consumer financing. *U.S. Banker* magazine has ranked the Bank as one of the Top 200 Community Banks in the nation and Bauer Financial, Inc. has given the Bank a 5-Star rating for the 73rd consecutive quarter indicating that the Bank is one of the strongest banks in the nation. The Company is subject to regulation, supervision and examination by the Mississippi Department of Banking and Consumer Finance, the SEC, the Federal Reserve and the FDIC. At December 31, 2011, the Company's assets totaled \$555 million and it employed 144 persons on a full-time equivalent basis.

Hurricane Katrina hit the Mississippi Gulf Coast on August 29, 2005. Katrina's wide spread devastation will be felt for years to come. Some of the challenges still facing our service area include insurance availability and settlements, housing, building code changes, flood elevation revisions, population shifts and business and staffing needs.

## Acquisition

On December 9, 2011, the Bank, acquired substantially all of the assets and certain liabilities of Heritage First Bank pursuant to a purchase and assumption agreement with Heritage First Bank, an Alabama state banking corporation and Heritage First Bankshares, Inc., a Georgia corporation, dated as of August 3, 2011. Heritage First Bank had total assets of approximately \$52 million (including goodwill) and operated two branches in Alabama at the time of the acquisition. See Notes to Consolidated Financial Statements - Note 16. Acquisition of Assets.

## Earnings Highlights

The Company's net income for 2011 was \$4,131,000, a decrease of 16.0% from \$4,916,000 for the year 2010 and an increase of 24.8% when compared to 2009 year-end results. The decrease in net income is primarily due to an increase in the provision for loan losses and acquisition costs incurred in acquiring two branches in Alabama. The following discussions, tables and the accompanying financial statements presented outline the change in earnings from 2011 to 2010 to 2009. Return on average assets for 2011 was 0.76% compared to 1.00% for 2010 and 0.73% for 2009. Return on average equity was 7.7%, 9.4% and 6.7% in 2011, 2010 and 2009, respectively. Earnings per share were \$3.11, \$3.70 and \$2.49 in 2011, 2010 and 2009, respectively.

## Earning Assets

A detailed comparison of the Company's average earning assets and non-earning assets for 2011, 2010 and 2009 is presented in Table 1 of this report. The Company's earning assets include loans, investments, and federal funds sold. Average earning assets for 2011 totaled \$495,833,000, an increase of

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

9.5%, compared to \$453,000,000 for 2010 and \$407,522,000 for 2009, an increase of 11.2% in 2010 and a decrease of 1.3% in 2009, respectively. Average net loans increased by \$3,979,000 or 1.8% in 2011, \$6,200,000 or 3.0% in 2010 and \$9,689,000 or 4.9% in 2009. Average securities increased by \$33,970,000 or 16.6% in 2011 and \$36,507,000 or 21.8% in 2010 compared to a decrease of \$19,509,000 or 10.4% in 2009. Average federal funds sold decreased by \$8,147,000 or 98.8% at year-end 2011 and \$22,514,000 or 73.2% at year-end 2010, compared to an increase of \$4,510,000 or 17.2% at year-end 2009. The decreases in 2011 and 2010 are due to the Company's excess funds being placed in an account at the Federal Reserve Bank. This account had an average balance of \$38,316,000 in 2011 and \$25,285,000 in 2010.

### **Net Interest Income**

The major source of the Company's income comes from gathering funds from deposit sources and investing them in loans and securities. Net interest income is the revenue generated from earning assets less the cost of interest paid on deposits and other interest bearing liabilities. Balancing interest rate, credit, liquidity, and capital risks, while managing its assets and liabilities to maximize income growth is the Company's primary long-term objective.

A bank's net interest margin is a prime indicator of its profitability. The net interest margin reflects the spread between interest earning asset yields and interest bearing liability costs and the percentage of interest earning assets funded by interest bearing liabilities. The net margin, on a tax equivalent basis, was 3.5%, 3.6% and 3.7%, at year-end 2011, 2010 and 2009, respectively. Tax equivalent net interest income increased by 7.6% at year-end 2011 and 8.3% at year-end 2010 and decreased by 9.1% at year-end 2009.

Average net loans increased by \$3,979,000 or 1.8% and loan interest income decreased by \$348,000 or 2.5% at year-end 2011. Average net loans increased by \$6,200,000 or 3.0% and loan interest income decreased \$70,000 or 0.5% at year-end 2010. Average net loans increased by \$9,689,000 or 4.9% and loan interest income decreased \$622,000 or 4.2% at year-end 2009. The decrease in loan income in 2009 through 2011 is a result of lower yields. Yields on taxable securities decreased as market rates were lower in 2009 through 2011. The average volume of all securities increased by 16.6% in 2011 and 21.8% in 2010, compared to a decrease of 10.4% in 2009, and total securities income increased by \$786,000 or 13.2% due to increased volumes in 2011, compared to a decrease of \$63,000 or 1.0% due to decreased rates in 2010. The increase in securities volume in 2011 is a result of an increase in deposits. The average balance of federal funds sold decreased by \$8,147,000 or 98.8% for 2011 and \$22,514,000 or 73.2% for 2010 when compared to 2009. Yields on these funds decreased 18 basis points from year-end 2010 to 2011, resulting in income from these funds decreasing by 97.8%.

Total average deposits increased by \$37,547,000 or 8.8% in 2011 and \$45,830,000 or 11.6% in 2010, compared to a decrease of \$13,489,000 or 3.3% in 2009. The reason for the large increase in deposits in 2011 was due to the acquisition of two branches in Alabama. A major reason for the large increase in deposits in 2010 was the addition of a new public fund customer. Total average interest bearing liabilities increased by 9.7% in 2011 and 42.0% in 2010 compared to a decrease of 14.9%, in 2009. Rates paid on these funds decreased by 23, 95 and 42 basis points in 2011, 2010 and 2009, respectively. The decrease in rates paid resulted in decreases in interest expense of 15.7%, 27.8% and 30.0% in 2011, 2010 and 2009, respectively. Average interest bearing checking, MMF, and savings accounts average balances increased by 13.6% and 74.8% in 2011 and 2010 and decreased by 21.2% in 2009. Interest expense on these deposits decreased 13.5%, 14.2% and 30.6% in 2011, 2010 and 2009, respectively.

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

Rates paid on these funds decreased 16 basis points in 2011 and 72 basis points in 2010. Average time deposit balances decreased by 0.1% in 2011 compared to an increase of 3.6% in 2010 and a decrease of 0.9% in 2009, respectively. The average rate paid on these funds was 1.4% in 2011, 1.8% in 2010 and 2.9% in 2009. Interest expense on time deposits decreased 17.9% in 2011, 36.3% in 2010 and 24.9% in 2009. The decreases in 2011, 2010 and 2009 were due to decreased rates. Average federal funds purchased and securities sold under agreements to repurchase increased in 2011 by 21.9% and in 2010 by 0.1% compared to a decrease in 2009 of 35.2%. Rates on these funds decreased 2, 13 and 140 basis points in 2011, 2010 and 2009, respectively. Interest expense on these funds increased by 8.3% in 2011 due to higher volumes and decreased by 40.0% in 2010 and 87.7% in 2009, due to lower volumes and rates paid. Tables 1 and 2 provide more information on the Company's net interest income and rate and volume variances.

### **Interest Rate Sensitivity**

Managing interest rate risk is an integral part of the financial success of the Company. The process of interest rate risk management includes the monitoring of each component of the balance sheet and its sensitivity to interest rate changes. Management monitors the day-to-day exposure to changes in interest rates in response to loan and deposit flows and makes adjustments accordingly.

The Company uses an earnings forecast model that simulates multiple interest rate scenarios and the effects on the Company's net margin, in addition to using traditional gap tables. The model analyzes the earnings risk by revealing the probability of reaching future income levels based on balance sheet changes caused by interest rate fluctuations. The model and traditional gap analysis indicate the Company is liability sensitive, which means that in a rising rate environment, the Company's net interest margin should decrease. See Table 14 for a detailed analysis of the Company's interest rate sensitivity.

The Company's operations are not ordinarily impacted by inflationary factors. However, because the Company's assets are largely monetary in nature, its operations are subject to changes in interest rates.

### **Loans**

One of the largest components of the Company's earning assets is its loan portfolio. Loans are the highest yielding asset category and also contain the largest amount of risk. Meeting the credit needs of Jackson, George, Baldwin and DeKalb Counties, with special emphasis on consumer and small business loans, continues to be the primary goal of the Company.

Average loans, net of unearned income, as a percentage of average earning assets, was 44.2%, 47.5% and 51.2%, for the years 2011, 2010 and 2009, respectively. The average loan to deposit ratio was 47.5% at year-end 2011, 48.9% at year-end 2010 and 52.9% at year-end 2009. Average net loans increased by \$3,979,000 or 1.8% in 2011, \$6,200,000 or 3.0% in 2010 and \$9,689,000 or 4.9% in 2009.

Loan growth in the real estate portfolio resulted in an increase in loans secured by real estate from \$142,787,000 at year-end 2009, to \$159,589,000 at year-end 2010, to \$176,755,000 at year-end 2011. Commercial and industrial loans and loans to municipal and local governments totaled \$28,755,000, \$30,880,000 and \$31,325,000 at year-end 2011, 2010 and 2009, respectively. Consumer loans increased to \$31,154,000 in 2011 compared to \$28,222,000 and \$35,535,000 in 2010 and 2009, respectively. Other loans increased to \$1,343,000 in 2011 and \$1,069,000 in 2010 compared to \$599,000 in 2009. See Table 6 of this report for comparison of the loan portfolio composition.

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### **Allowance for Loan Losses**

Historical losses, trends and management's opinion of the adequacy of the allowance for loan losses ("ALL") determine the allocations made to the loan loss reserve. Management considers the following factors in determining the adequacy of the allowance: 1) periodic reviews of individual credits, 2) gross and net charge-offs, 3) loan portfolio growth, 4) historical levels of the allowance to total loans, 5) the value of collateral securing loans, 6) the level of past due and non-accruing loans, and 7) current and future economic conditions and their potential impact on the loan portfolio.

The allowance to total loans was 1.6% at year-end 2011, 1.5% at year-end 2010 and 1.5% at year-end 2009.

The Company immediately charges off any loan when it is determined to be uncollectible. However, experience shows that certain losses exist in the portfolio that have not been identified. The allowance is allocated to absorb losses on all loans and is not restricted to any one group of loans. Company management has determined that the balance of the ALL is adequate to cover potential future losses. The provision for loan losses totaled \$2,455,000 for year-end 2011, \$1,027,000 for year-end 2010 and \$781,000 for year-end 2009. The provision increased during 2011 and 2010 due to sustained weakness in business and economic conditions and its effect on our commercial and consumer customers. Net charge offs for 2011 totaled \$1,978,000. The provision also increased due to the loans acquired from Heritage First Bank on December 9, 2011. See Tables 8 and 9 for a detailed analysis of the Company's allowance for loan losses.

### **Critical Accounting Policies**

The accounting principles the Company follows and our methods of applying these principles conform to accounting principles generally accepted in the United States and general practices within the banking industry. In connection with the application of those principles to the determination of the Company's ALL, the Company has made judgments and estimates, which have significantly impacted our financial position and results of operations.

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

The Company establishes the allocated amount separately for two different risk groups: (1) unique loans (commercial loans, including those loans considered impaired); and (2) homogenous loans (generally consumer loans). The allocation for unique loans is done primarily on risk rating grades assigned to each of these loans as a result of our loan management and review processes. Each risk-rating grade is assigned an estimated loss ratio, which is determined based on the experience of management, discussions with regulators, historical and current economic conditions and our independent loan review process. Management estimates losses on impaired loans based on estimated cash flows at the loan's original effective interest rate or the underlying collateral value. Estimated loss ratios are also assigned to our consumer portfolio. However, the estimated loss ratios for these homogenous loans are based on the historical loss rates of the category of consumer credit (e.g., automobile, residential mortgage, home equity) and not on the results of individual loan reviews.

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

The resulting ALL balance is then tested by comparing the balance in the allowance account to historical trends and peer information. Management then evaluates the result of the procedures performed, including the testing results, and concludes on the appropriateness of the balance of the ALL in its entirety. The Company's audit committee of its board of directors reviews the assessment prior to the filing of quarterly financial information.

In assessing the adequacy of the ALL, the Company also relies on an ongoing loan review process. This process is undertaken to ascertain whether there are loans in the portfolio whose credit quality has weakened over time and to assist in the overall evaluation of the risk characteristics of the entire loan portfolio. The loan review process includes the judgment of management, the input from our independent loan reviewer, who is not an employee of the Company, and reviews that may have been conducted by regulatory agencies as part of their usual examination process. Management estimates losses on impaired loans based on estimated cash flows or fair value of underlying collateral.

Management believes the reserve is adequate at this time, based on a review of the portfolio and discussions with regulatory officials. If economic conditions deteriorate beyond management's current expectations, an increase to the provision for loan losses may be necessary.

The Company does not use derivatives and therefore no allowance for such instruments is made on the Company's financial statements.

### **Asset Quality**

Non-performing assets include non-accruing loans that are 90 days or more past due and other real estate acquired through foreclosure or property purchased by the Company for future Company expansion.

Total non-performing assets at year-end 2011 were \$8,745,000 and at year-end 2010 were \$6,382,000, compared to \$3,146,000 at year-end 2009. Non-performing assets, as a percentage of total loans, were 3.7% at year-end 2011, 2.9% at year-end 2010 and 1.5% at year-end 2009. Non-accrual loans and accruing loans over 90 days past due were \$3,130,000 or 1.3%, \$4,106,000 or 1.9% and, \$951,000 or 0.5%, of total loans at year-end 2011, 2010 and 2009, respectively. Other real estate totaled \$5,615,000 or 2.6% at year-end 2011, \$2,276,000 or 1.0% at year-end 2010 and \$2,195,000 or 1.0% of total loans at year-end 2009. The increase in nonperforming assets is due to the weakened economy. Approximately \$1.8 million of the \$3.3 million increase in other real estate owned is due to the acquisition of two branches from Heritage First Bank. See Table 10 for additional information concerning the Company's non-performing assets.

### **Securities Available for Sale and Investment Securities**

The Company's securities portfolio is another large component of the Company's earning assets and had book values totaling \$205,787,000, \$230,216,000 and \$178,184,000 for the years ending 2011, 2010 and 2009, respectively.

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

The securities portfolio is divided into two classifications, available for sale and held to maturity. The available for sale portion contains all securities which management believes could be subject to sale prior to their stated maturity. This category allows Company management to meet liquidity needs, as well as affording the Company the opportunity to take advantage of market shifts or anticipated changes in interest rates, yield curve changes and inter-market spread relationships. This portion of the portfolio is also used to help manage the Company's interest rate and credit risks in the overall balance sheet. In accordance with Accounting Standards Codification Topic 320, Investments in Debt and Equity Securities, securities in the available for sale category are accounted for at fair market value with unrealized gains or losses excluded from earnings and reported as a separate component of stockholder's equity until realized. Unrealized gains, net of taxes, of \$10,000 and losses, net of taxes, of \$1,918,000 and \$215,000 were included in stockholder's equity at year-end 2011, 2010 and 2009, respectively. The held to maturity portion of the portfolio contains debt securities which the Company intends to hold until their contractual maturity date. These securities provide the Company with a long term, relatively stable source of income with minimal credit risk. The securities in this category are carried at their amortized costs. A portion of the Company's investment portfolio is pledged as collateral against public deposits and securities sold under agreements to repurchase.

Yields on taxable securities decreased as market rates were lower in 2011, 2010 and 2009. Yields on tax-exempt securities increased 3 basis points in 2011 and decreased by 4 basis points in 2010 as maturing securities were reinvested in lower rate securities. The average volume of all securities increased by \$33,970,000 or 16.6% in 2011, \$36,507,000 or 21.8% in 2010 and decreased by 10.4% in 2009 when compared to 2008. Total securities income increased by \$786,000 or 13.2% in 2011 and decreased \$63,000 or 1.0% due to decreased rates in 2010. The increase in securities volume was a result of an increase in total deposits for 2011 and 2010. The average balance of federal funds sold decreased by \$88,000 or 1.1% for 2011, \$22,514,000 or 73.2% for 2010, compared to an increase of \$4,510,000 or 17.2% for 2009 when compared to 2008. The decreases in 2011 and 2010 are attributable to reinvesting a large portion of excess funds into a Federal Reserve Excess Balance account. Yields on these funds increased 18 basis points from year-end 2011 to 2010 and decreased 6 basis points from year-end 2010 to 2009. See Tables 4 and 5 for more information about the Company's securities portfolio composition yields and maturity distributions.

### **Deposits**

The Company's primary funding source for loans and investments is its deposit base. Deposits consist of checking, savings and certificates of deposit. The Company's ability to maintain a strong deposit base is of utmost importance in the growth and profitability of the Company. Managing the deposit mix and pricing is designed to be flexible, so that changes in interest rate movements and liquidity needs do not conflict or have an adverse effect on the Company's balance sheet. The Company relies on local consumer, retail, corporate and governmental agencies for its deposit base. Average total deposits increased by \$37,547,000 or 8.8% in 2011, \$45,830,000 or 11.6% in 2010, compared to a decrease of \$13,489,000 or 3.3% in 2009. The increase in average deposits for 2011 is due to the acquisition of two branches in Alabama and the increase in 2010 is due to the addition of a public fund deposit customer. See Tables 11 and 12 for more information about the Company's deposits and maturity distribution.

### **Liquidity**

Liquidity for a financial institution can be expressed in terms of maintaining sufficient funds available to meet both expected and unanticipated obligations in a cost-effective manner. The Company closely

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

monitors its liquidity position to ensure it has ample funds available to meet its obligations. The Company relies on maturing loans and investments, federal funds and its core deposit base to fund its day-to-day liquidity needs. By monitoring asset and liability maturities and the levels of cash on hand, the Company is able to meet expected demands for cash. The Company also has access to federal funds at correspondent banks and to an inventory of readily marketable government securities to meet unexpected cash needs. Average federal funds purchases and securities sold under agreement to repurchase represented 3.1%, 2.8% and 3.2% of total average deposits for the years 2011, 2010 and 2009, respectively. See Table 13 for more information concerning the Company's short-term borrowings.

### **Off Balance Sheet Arrangements**

As of December 31, 2011, the Company had unfunded loan commitments outstanding of \$33,257,000 and outstanding standby letters of credit of \$733,000. Because these commitments generally have fixed expiration dates and many will expire without being drawn upon, the total commitment level does not necessarily represent future cash requirements. If needed to fund these outstanding commitments, the Company has the ability to liquidate federal funds sold or securities available-for-sale or on a short-term basis to borrow and purchase federal funds from other financial institutions. The Company historically has been a net seller of federal funds. A detailed statement of cash flows can be found in the accompanying notes to the financial statements.

### **Contractual Obligations**

The Company has certain contractual obligations that arise from its normal course of business. Each category of deposit represents an obligation to pay. While certain categories of deposits (e.g., certificates of deposit) have a contracted expiration date, checking accounts and savings are subject to immediate withdrawal. Table 15 and the notes to the financial statements detail the Company's deposit and lease contractual obligations.

The Company also has a defined benefit plan for substantially all of its employees, as well as former employees, who have retired from the Company; consequently, the Company is contractually obligated to pay these benefits to its retired employees. As of December 31, 2011, the plan was underfunded by \$5,374,000, compared to an unfunded amount of \$2,457,000 and \$1,907,000 at year-end 2010 and 2009. The underfunded status is the result of poor market conditions and the performance of the plan's investment assets. Management is monitoring the funded status of its defined benefit plan closely and will contribute additional funding to the plan in 2012. See Notes to Consolidated Financial Statements - Note 8. Employee Benefit Plans.

### **Risk-Based Capital/Stockholders' Equity**

The Company has always placed a great emphasis on maintaining its strong capital base. The Company's management and Board of Directors continually evaluate business decisions that may have an impact on the level of stockholders' equity. It is their goal that the Company maintains a "well-capitalized" equity position. Based on the capital levels defined by regulators as part of the provisions of the Federal Deposit Insurance Corporation Improvement Act of 1991, a "well-capitalized" institution is one that has at least a 10% total risk-based capital ratio, a 6% Tier 1 risk-based capital ratio, and a 5% leverage ratio. The Company's solid capital base is reflected in its regulatory capital ratios. The risk-based capital ratio was 17.6%, 19.7% and 20.1% at year-end 2011, 2010 and 2009, respectively. The Tier 1 risk-based was 16.5% at year-end 2011, 18.6% at year-end 2010 and 19.1% at year-end 2009. The leverage ratio was 10.2%, 11.1% and 11.5% at year-end 2011, 2010 and 2009, respectively.

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The Company's capital ratios surpass the minimum requirements of 8.0% for the total risk-based capital ratio, 4.0% for Tier 1 risk-based capital ratio and 3.0% for the leverage ratio. Stockholders' equity to total assets at year-end 2011, 2010 and 2009 was 9.8%, 10.4% and 11.3%, respectively.

### **Non-Interest Income**

Non-interest income includes service charges on deposit accounts, safe-deposit box rent, check cashing fees, data processing income, commissions and charges, and other fees. Service charges on deposit accounts income increased by 3.1% in 2011, compared to a decrease of 7.2% in 2010 and an increase of 4.1% in 2009. The increase in 2011 is due to an increase in the amount of non-sufficient fund charge income recognized in 2011, compared to 2010. Other service charges, commissions, fees, and non-interest income increased by 20.3%, 3.9% and 1.1%, in 2011, 2010 and 2009, respectively. The increase in 2011 is due to an increase in ATM interchange fee income received. Non-interest income includes gains recognized on three sales of real estate owned during 2010 in the amount of \$955,615.

### **Non-Interest Expense**

The Company's goal is to enhance customer service through efficient and effective delivery of its products and services. Enhancing operational resources, while containing overhead expenses, is a top priority of the Company. While interest expense is one of the largest expenses of the Company, employee's salaries, equipment and building expenses, legal fees, FDIC insurance, and other expenses combined make up the largest category of the Company's expenses. Proper management of these costs is extremely important to the profitability of the Company.

Salary and employee benefits expense decreased 2.9% during 2011 compared to increases of 0.3% and 12.5% in the years 2010 and 2009, respectively. The increase in 2009 is attributed to increases in employee raises and an increase in the defined benefit pension plan expense. Occupancy and equipment expense decreased by 2.7% and 6.9% in 2011 and 2010 compared to an increase of \$468,000 or 17.1% in 2009. The decrease in 2010 is due to a reduction in the amount of property taxes paid for 2010. The increase in 2009 is primarily a result of increases in property taxes, insurance, and depreciation of two new branch offices. Other expenses increased by 13.3% and 20.2% in 2011 and 2010, compared to a decrease of 26.3% in 2009. The increase in 2011 was due to the costs incurred in acquiring the two Alabama branches. The increase in 2010 was due to an increase in FDIC insurance assessments and a change in the computation of director's deferred compensation. Total non-interest expense increased 0.8% in 2011 and 5.1% in 2010, compared a decrease of 3.3% in 2009.

### **Income Taxes**

Income tax expense totaled \$1,389,000, \$1,548,000 and \$1,435,000, for the years 2011, 2010 and 2009, respectively. The Company's effective tax rate was 25.2% in 2011, 23.9% in 2010 and 30.2% in 2009.

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
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**TABLE 1  
COMPARATIVE AVERAGE BALANCES - YIELDS AND RATES**

(Dollars in Thousands)

The following table shows the major categories of interest-earning assets and interest-bearing liabilities with their corresponding average daily balances, related interest income or expense and the resulting yield or rate for the three years ended December 31, 2011, 2010 and 2009:

Assets	2011			2010			2009		
	Average Balance	Interest Income/Expense	Average Yield/Rate	Average Balance	Interest Income/Expense	Average Yield/Rate	Average Balance	Interest Income/Expense	Average Yield/Rate
Interest-earning assets:									
Loans, net of unearned income	\$ 219,107	\$ 13,683	6.24%	\$ 215,128	\$ 14,031	6.52%	\$ 208,928	\$ 14,101	6.75%
Securities held to maturity:									
Taxable	63,050	1,443	2.29%	122,745	3,642	2.97%	104,730	4,212	4.02%
Exempt from Federal income tax	36,888	1,156	3.13%	23,201	719	3.10%	13,747	432	3.14%
Securities available for sale:									
Taxable	138,375	4,162	3.01%	58,397	1,614	2.76%	49,359	1,394	2.82%
Other interest earning assets	38,316	100	0.26%	25,285	51	0.20%	-	-	0.00%
Federal funds sold and securities purchased under agreements to resell									
	97	0	0.29%	8,244	9	0.11%	30,758	53	0.17%
Total interest-earning assets	\$ 495,833	20,544	4.14%	\$ 453,000	20,066	4.43%	\$ 407,522	20,192	4.95%
Non interest-earning assets:									
Cash and due from banks	17,536			17,038			16,673		
Bank premises and equipment	15,523			16,228			17,423		
Other assets	19,179			18,425	48,231		14,807	-	
Allowance for possible loan losses	(3,175)			(3,091)			(3,056)		
Total assets	\$ 544,896			\$ 501,600			\$ 453,369		

MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
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**TABLE 1 (continued)**  
**COMPARATIVE AVERAGE BALANCES - YIELDS AND RATES (continued)**  
(Dollars in Thousands)

Liabilities	2011			2010			2009		
	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Average Balance	Interest Income/ Expense	Average Yield/ Rate
Interest-bearing liabilities:									
INT DDA's, MMF & Savings	\$ 276,973	1,444	0.52%	\$ 243,902	1,670	0.68%	\$ 139,557	1,947	1.40%
Time Deposits	109,350	1,573	1.44%	109,505	1,916	1.75%	105,666	3,010	2.85%
Federal funds purchased, securities sold under agreements to repur- chase and other short- term borrowings	14,841	26	0.18%	12,171	24	0.20%	12,153	40	0.33%
Total interest-bearing liabilities	\$ 401,164	3,043	0.76%	\$ 365,578	3,610	0.99%	\$ 257,376	4,997	1.94%
Noninterest-bearing liabilities:									
Deposits	79,555			74,924			137,296		
Other liabilities	9,828			8,990			9,028		
Total liabilities	490,547			449,492			403,700		
Stockholder's equity	54,349			52,108			49,669		
Total liabilities and stockholders' equity	\$ 544,896			\$ 501,600			\$ 453,369		
Net interest income/ margin-tax equivalent		\$ 17,501	3.53%		\$ 16,456	3.63%		\$ 15,195	3.73%
Tax equivalent adjustment:									
Loans		111			148			185	
Investment securities		1,027			719			432	
Securities available for sale		-			-			-	
Other									
Total tax equivalent adjustment		1,138			867			617	
Net interest income		\$ 18,639			\$ 17,323			\$ 15,812	

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

**TABLE 2**  
**TAXABLE EQUIVALENT RATE/VOLUME VARIANCE ANALYSIS**  
(Dollars In Thousands)

The following table sets forth, for the periods indicated, a summary of the changes in interest income and interest expense resulting from changes in volume and changes in rates.

	Year ended December, 2011					
	2011 Compared to 2010			2010 Compared to 2009		
	Increase(Decrease) Due To			Increase(Decrease) Due To		
	Volume	Rate	Net	Volume	Rate	Net
Interest income on:						
Loans	\$ 3,979	\$ (348)	\$ 3,631	\$ 6,200	\$ (70)	\$ 6,130
Investment securities:						
Taxable	(59,695)	(2,199)	(61,894)	18,015	(570)	17,445
Exempt from Federal income tax	13,687	437	14,124	9,454	287	9,741
Securities available for sale:						
Taxable	79,978	2,548	82,526	9,038	220	9,258
Other interest earning assets	13,031	49		25,285	51	-
Federal funds sold and securities purchased under agreements to resell	(8,147)	(9)	(8,156)	(22,514)	(44)	(22,558)
<b>Total</b>	<b>\$ 42,833</b>	<b>\$ 478</b>	<b>\$ 30,231</b>	<b>\$ 45,478</b>	<b>\$ (126)</b>	<b>\$ 20,016</b>
Interest expense on:						
Int DDA's & Savings deposits	\$ 33,071	\$ (226)	\$ 32,845	\$ 104,345	\$ (277)	\$ 104,068
Time deposits	(155)	(343)	(498)	3,839	(1,094)	2,745
Federal funds purchased, and securities sold under agreements to repurchase	2,670	2	2,672	18	(16)	2
<b>Total</b>	<b>\$ 35,586</b>	<b>\$ (567)</b>	<b>\$ 35,019</b>	<b>\$ 108,202</b>	<b>\$ (1,387)</b>	<b>\$ 106,815</b>
Changes in net interest income-tax equivalent	<b>\$ 7,247</b>	<b>\$ 1,045</b>	<b>\$ (4,788)</b>	<b>\$ (62,724)</b>	<b>\$ 1,261</b>	<b>\$ (86,799)</b>

The increase(decrease) due to changes in average balances reflected in the above table was calculated by applying the preceding year's rate to the current year's change in the average balance. The increase (decrease) due to changes in average rates was calculated by applying the current year's change in the average rates to the current year's average balance. Using this method of calculating increases(decreases), any increase or decrease due to both changes in average balances and rates is reflected in the changes attributable to average rate changes.

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

**TABLE 3**  
**SECURITIES AVAILABLE FOR SALE AND PORTFOLIO SECURITIES**  
(Dollars In Thousands)

The available for sale classification of securities, includes all portfolio securities which management believes may be subject to sale prior to their contractual maturities, and are stated at aggregate market value. Investment securities include all portfolio securities that the Company intends to hold to maturity and are carried at amortized cost. The carrying amounts of securities available for sale and portfolio securities are presented as of the dates indicated.

	<b>DECEMBER 31,</b>		
	<b>2011</b>	<b>2010</b>	<b>2009</b>
<b>Securities available for sale</b>			
U. S. Treasury and other U. S. Government agencies	\$ 108,449	\$ 116,217	\$ 33,178
Obligations of states and political subdivisions	587	-	-
Mortgage-backed securities	2,548	-	-
Other securities	171	117	148
	<u>111,755</u>	<u>116,334</u>	<u>33,326</u>
Total securities available for sale	\$ 111,755	\$ 116,334	\$ 33,326
<b>Investment securities</b>			
U. S. Treasury and other U. S. Government agencies	\$ 42,505	\$ 83,157	\$ 123,670
Obligations of states and political subdivisions	50,627	29,825	20,288
Mortgage-backed securities	-	-	-
Other securities	900	900	900
	<u>94,032</u>	<u>113,882</u>	<u>144,858</u>
Total investment securities	94,032	113,882	144,858
<b>Total securities available for sale and investment securities</b>	<u>\$ 205,787</u>	<u>\$ 230,216</u>	<u>\$ 178,184</u>

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

**TABLE 4**  
**MATURITY DISTRIBUTION AND YIELDS OF SECURITIES AVAILABLE FOR SALE AND**  
**INVESTMENT SECURITIES**  
(Dollars in Thousands)

The following table shows the maturities and weighted average yields of the Company's securities available for sale and investment securities at December 31, 2011:

	<b>Maturing</b>								Carrying Amount	
	Within 1 Year		After 1 Yr But Within 5 Yrs		After 5 Yrs But Within 10 Yrs		After 10 Yrs.			
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	
<b>Securities available for sale</b>										
U.S. Treasury and other U.S. Government agencies.....	\$ 176	0.15%	\$ -	0.00%	\$ 108,273	2.58%	\$ -	0.00%	\$ 108,449	
Obligations of states and political subdivisions....	\$ -	0.00%	\$ 250	3.24%	\$ 233	2.49%	\$ 104	0.28%	\$ 587	
Mortgage-backed securities	\$ 23	1.45%	\$ 1,673	1.81%	\$ 852	2.43%	\$ -	\$ -	\$ 2,548	
Other securities...	\$ 171	0.71%								
<b>Total securities available for sale.....</b>	<b>\$ 370</b>	<b>0.80%</b>	<b>\$ 1,923</b>	<b>2.23%</b>	<b>\$ 109,358</b>	<b>2.59%</b>	<b>\$ 104</b>	<b>0.28%</b>	<b>\$ 111,755</b>	
<b>Investment securities</b>										
U.S. Treasury and other U.S. Government agencies.....	\$ 1,000	1.80%	\$ 31,505	2.03%	\$ 10,000	2.20%	\$ -	0.00%	\$ 42,505	
Obligations of states and political subdivisions....	1,674	4.69%	15,105	4.02%	14,892	4.39%	18,956	5.17%	50,627	
Other securities...	900								900	
<b>Total investment securities....</b>	<b>\$ 3,574</b>	<b>3.50%</b>	<b>\$ 46,610</b>	<b>3.22%</b>	<b>\$ 24,892</b>	<b>3.45%</b>	<b>\$ 18,956</b>	<b>4.92%</b>	<b>\$ 94,032</b>	
<b>Total securities available for sale and investment securities....</b>	<b>\$ 3,944</b>	<b>3.50%</b>	<b>\$ 48,533</b>	<b>3.22%</b>	<b>\$ 134,250</b>	<b>3.45%</b>	<b>\$ 18,956</b>	<b>4.92%</b>	<b>\$ 205,787</b>	

At December 31, 2011, the Company held investment securities issued by the State of Mississippi with an aggregate carrying amount of \$30.1 million and a market value of \$32.5 million. The yield on obligations of states and political subdivisions has been calculated on a fully tax equivalent basis.

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

**TABLE 5**  
**SECURITIES AVAILABLE FOR SALE AND HELD TO MATURITY**  
(Dollars in Thousands)

SECURITIES AVAILABLE-FOR-SALE DECEMBER 31, 2011					SECURITIES HELD-TO-MATURITY DECEMBER 31, 2011				
	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	FAIR VALUE	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	FAIR VALUE	
U.S. GOVERNMENT AND AGENCY SECURITIES	\$ 108,535,000	\$ 145,000	\$ (231,000)	\$ 108,449,000	\$ 42,505,000	\$ 452,000	\$ -	\$ 42,957,000	
STATE AND MUNICIPAL SECURITIES	587,000	-	-	587,000	50,627,000	2,090,000	(110,000)	52,607,000	
MBS AND CMO SECURITIES	2,547,000	2,000	(1,000)	2,548,000					
OTHER SECURITIES	72,000	99,000	-	171,000	900,000	-	-	900,000	
<b>TOTAL</b>	<b>\$ 111,741,000</b>	<b>\$ 246,000</b>	<b>\$ (232,000)</b>	<b>\$ 111,755,000</b>	<b>\$ 94,032,000</b>	<b>\$ 2,542,000</b>	<b>\$ (110,000)</b>	<b>\$ 96,464,000</b>	

SECURITIES AVAILABLE-FOR-SALE DECEMBER 31, 2010					SECURITIES HELD-TO-MATURITY DECEMBER 31, 2010				
	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	FAIR VALUE	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	FAIR VALUE	
U.S. GOVERNMENT AND AGENCY SECURITIES	\$ 119,168,000	\$ 5,000	\$ (2,956,000)	\$ 116,217,000	\$ 83,157,000	\$ 1,219,000	\$ -	\$ 84,376,000	
STATE AND MUNICIPAL SECURITIES	-	-	-	-	29,825,000	587,000	(399,000)	30,013,000	
OTHER SECURITIES	72,000	45,000	-	117,000	900,000	-	-	900,000	
<b>TOTAL</b>	<b>\$ 119,240,000</b>	<b>\$ 50,000</b>	<b>\$ (2,956,000)</b>	<b>\$ 116,334,000</b>	<b>\$ 113,882,000</b>	<b>\$ 1,806,000</b>	<b>\$ (399,000)</b>	<b>\$ 115,289,000</b>	

SECURITIES AVAILABLE-FOR-SALE DECEMBER 31, 2009					SECURITIES HELD-TO-MATURITY DECEMBER 31, 2009				
	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	FAIR VALUE	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	FAIR VALUE	
U.S. GOVERNMENT AND AGENCY SECURITIES	\$ 32,927,000	\$ 279,000	\$ (28,000)	\$ 33,178,000	\$ 123,670,000	\$ 1,043,000	\$ (240,000)	\$ 124,473,000	
STATE AND MUNICIPAL SECURITIES	-	-	-	-	20,288,000	826,000	(41,000)	21,073,000	
OTHER SECURITIES	72,000	76,000	-	148,000	900,000	-	-	900,000	
<b>TOTAL</b>	<b>\$ 32,999,000</b>	<b>\$ 355,000</b>	<b>\$ (28,000)</b>	<b>\$ 33,326,000</b>	<b>\$ 144,858,000</b>	<b>\$ 1,869,000</b>	<b>\$ (281,000)</b>	<b>\$ 146,446,000</b>	

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

**TABLE 6**  
**LOAN PORTFOLIO**  
(Dollars in Thousands)

Loans outstanding at the end of the year indicated are shown in the following table classified by type of loans:

	<b>2011</b>	<b>2010</b>	<b>2009</b>
Commercial , Industrial & Governmental	\$ 28,755	\$ 30,880	\$ 31,325
Real Estate	176,755	159,589	142,787
Consumer Loans	31,154	28,222	35,492
Other Loans	1,343	1,069	599
<b>Total Loans</b>	<b>\$ 238,007</b>	<b>\$ 219,760</b>	<b>\$ 210,203</b>

**TABLE 7**  
**LOAN MATURITIES & INTEREST RATE SENSITIVITY**  
(Dollars In Thousands)

The following table shows the amount of loans outstanding as of December 31, 2011 (excluding those in non-accrual status) based on the scheduled repayments of principal:

Remaining Maturity Fixed Rate	
3 months or less	\$ 23,491
Over 3 months through 12 months	39,563
Over 1 year through 5 years	161,832
Over 5 years	10,000
<b>Total Loans</b>	<b>\$ 234,886</b>

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

**TABLE 8**  
**ANALYSIS OF THE ALLOWANCE FOR LOAN LOSSES**  
(Dollars in Thousands)

The following table outlines the activity for the allowance for loan losses for the past three years:

	<b>Year ended December 31,</b>		
	<b>2011</b>	<b>2010</b>	<b>2009</b>
Beginning Balance	\$ 3,268	\$ 3,100	\$ 3,100
<b>Charge Offs:</b>			
Commercial & Industrial	32	147	83
Real Estate	1,784	336	296
Consumer	698	1,022	739
Other			
Total Charge Offs	<u>2,514</u>	1,505	1,118
<b>Recoveries:</b>			
Commercial & Industrial	3	123	54
Real Estate	197	25	-
Consumer	336	498	283
Other			
Total Recoveries	<u>536</u>	646	337
Net Charge Offs	1,978	859	781
Provision for Possible Losses	<u>2,455</u>	1,027	781
Ending Balance	<u>\$ 3,745</u>	<u>\$ 3,268</u>	<u>\$ 3,100</u>
Total Loans Outstanding	<u>\$ 238,007</u>	<u>\$ 219,760</u>	<u>\$ 210,203</u>
Average daily loans	<u>\$ 219,107</u>	<u>\$ 215,128</u>	<u>\$ 208,928</u>
<b>Percentages:</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>
Allowance for loan losses to end of quarter total loans	1.6%	1.5%	1.5%
Allowance for loan losses to average loans	1.7%	1.5%	1.5%
Allowance for loan losses to nonperforming assets	42.8%	51.2%	98.5%
Net charge offs to average loans	0.9%	0.4%	0.4%

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

**TABLE 9**  
**ALLOCATION OF THE ALLOWANCE FOR LOAN LOSSES**  
(Dollars in Thousands)

The following table represents the allocation of the allowance for loan losses by loan categories and is based on an analysis of individual credits, historical losses, and other factors. This allocation is for analytical purposes only as the aggregate allowance is available to absorb losses on any and all loans.

	December 31,					
	2011		2010		2009	
	% Gross Loans Outstanding	Loan Loss Allowance Allocation	% Gross Loans Outstanding	Loan Loss Allowance Allocation	% Gross Loans Outstanding	Loan Loss Allowance Allocation
Commercial & Industrial	1.80	\$ 302	1.80	\$ 59	7.09	\$ 220
Real Estate	81.66	2,943	81.66	2,669	61.39	1,903
Consumer	12.29	353	12.29	402	23.20	719
Other	4.25	147	4.25	139	7.99	248
Unallocated	-	-	-	-	0.33	10
	<b>100.00</b>	<b>\$ 3,745</b>	100.00	<b>\$ 3,268</b>	100.00	<b>\$ 3,100</b>

**TABLE 10**  
**NONPERFORMING ASSETS**  
(Dollars in Thousands)

This table summarizes the amount of nonperforming assets at the end of the years indicated.

	December 31,		
	2011	2010	2009
Non-accrual Loans & Accruing Loans Past Due 90 Days or more	\$ 3,130	\$ 4,106	\$ 951
Other Real Estate	5,615	2,276	2,195
	<b>\$ 8,745</b>	<b>\$ 6,382</b>	<b>\$ 3,146</b>
Nonperforming Assets as % of Total Loans	3.7%	2.9%	1.5%
Non-accrual Loans & Loans Past Due 90 Days or More as % of Total Loans	1.3%	1.9%	0.5%

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

**TABLE 11**  
**AVERAGE DEPOSITS**  
(Dollars In Thousands)

The daily average amounts of deposits for the periods indicated are summarized in the following table:

	YEAR ENDED DECEMBER 31,		
	2011	2010	2009
Non-interest bearing deposits	\$ 79,555	\$ 74,924	\$ 77,927
Interest-bearing deposits	276,973	243,902	199,147
Interest-bearing time deposits	109,350	109,505	106,107
Total	<u>\$ 465,878</u>	<u>\$ 428,331</u>	<u>\$ 383,181</u>

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**TABLE 12**  
**TIME DEPOSITS OF \$100,000 OR MORE, MATURITY DISTRIBUTION**  
(Dollars In Thousands)

Maturities of time certificates of deposits \$100,000 or more outstanding at December 31, 2011 are summarized in the following table:

<b>Time remaining until maturity</b>	
3 months or less	\$ 13,884
Over 3 through 12 months	36,306
Over 12 months	<u>14,106</u>
Total	<u>\$ 64,296</u>

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

**TABLE 13**  
**SHORT-TERM BORROWINGS**

(Dollars in Thousands)

The following table presents a summary of the Company's short-term borrowings at December 31, for each of the last three years and the corresponding interest rates:

	December Balance	Daily Average Balance	Average Interest Rate*	Maximum Month-End Balance
<b>2011</b>				
Federal funds purchased and securities sold under agreements to repurchase	\$ 12,275	\$ 14,841	0.18%	\$ 12,275
<b>2010</b>				
Federal funds purchased and securities sold under agreements to repurchase	\$ 13,730	\$ 12,171	0.20%	\$ 13,730
<b>2009</b>				
Federal funds purchased and securities sold under agreements to repurchase	\$ 8,434	\$ 12,153	0.33%	\$ 8,434

\*on daily average balance

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

**TABLE 14**  
**INTEREST SENSITIVITY**  
(Dollars In Thousands)

The following table reflects the interest sensitivity of the Company over various periods as of December 31, 2011, based on contractual maturities as of that date:

	0-3 Months	4-12 Months	1-5 Years	Over 5 Years	Total
<b>Assets</b>					
Interest-earning assets:					
Loans, net of unearned income. . . . .	\$ 26,612	\$ 39,563	\$ 161,832	\$ 10,000	\$ 238,007
Investment securities. . . . .	-	3,574	46,610	43,848	94,032
Securities available for sale. . . . .	370	-	1,923	109,462	111,755
Federal funds sold and securities purchased under agreements to resell. . . . .	97	-	-	-	97
<b>Total interest-earning assets. . . . .</b>	<b>27,079</b>	<b>43,137</b>	<b>210,365</b>	<b>163,310</b>	<b>443,891</b>
Noninterest-earning assets . . . . .				111,542	111,542
<b>Total assets . . . . .</b>	<b>\$ 27,079</b>	<b>\$ 43,137</b>	<b>\$ 210,365</b>	<b>\$ 274,852</b>	<b>\$ 555,433</b>
<b>Liabilities and stockholders' equity</b>					
Interest-bearing liabilities:					
Int DDAs, MMF, Savings deposits . . . . .	\$ 22,963	\$ 73,993	\$ 158,193	\$ -	\$ 255,149
Time deposits. . . . .	27,712	74,682	28,490	-	130,884
Federal funds purchased, and securities sold under agreements to repurchase. . .	12,275	-	-	-	12,275
<b>Total interest-bearing liabilities . . . . .</b>	<b>62,950</b>	<b>148,675</b>	<b>186,683</b>	<b>-</b>	<b>398,308</b>
Noninterest-bearing deposits. . . . .	15,305	45,018	29,712	-	90,035
Other liabilities . . . . .				12,447	12,447
Stockholders' equity. . . . .				54,643	54,643
<b>Total liabilities and stockholders' equity. . . . .</b>	<b>\$ 78,255</b>	<b>\$ 193,693</b>	<b>\$ 216,395</b>	<b>\$ 67,090</b>	<b>\$ 555,433</b>
Interest sensitive gap. . . . .	\$ (51,176)	\$ (150,556)	\$ (6,030)	\$ 207,762	
Cumulative interest sensitive gap . . . . .	\$ (48,828)	\$ (199,384)	\$ (205,414)	\$ 2,348	
Cumulative interest sensitive gap as a percent of total assets. . . . .	-8.79%	-35.90%	-36.98%	0.42%	

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

**TABLE 15**

**CONTRACTUAL OBLIGATIONS, COMMITMENTS, CONTINGENT LIABILITIES, AND  
OFF-BALANCE SHEET ARRANGEMENTS**

(Dollars In Thousands)

The following table presents, as of December 31, 2011, significant fixed and determinable contractual obligations to third parties by payment date:

	PAYMENTS DUE IN				TOTAL
	ONE YEAR OR LESS	ONE TO THREE YEARS	THREE TO FIVE YEARS	OVER FIVE YEARS	
Deposits without a stated maturity	\$ 156,503	\$ 94,341	\$ 94,340	\$ -	\$ 345,184
Consumer certificates of deposit	102,394	15,436	13,054	-	130,884
Federal funds borrowed & repurchase agreements	12,275	-	-	-	12,275
Operating leases	-	-	-	-	-
Purchase obligations	-	-	-	-	-

**COMMITMENTS**

The following table details the amounts and expected maturities of significant commitments as of December 31, 2011:

	ONE YEAR OR LESS	ONE TO THREE YEARS	THREE TO FIVE YEARS	OVER FIVE YEARS	TOTAL
	Commitments to extend credit:				
Commercial	\$ 8,109	\$ 249	\$ -	\$ -	\$ 8,358
Residential real estate	5	-	-	-	5
Revolving home equity and credit card lines	-	826	-	-	826
Other	23,980	88	-	-	24,068
Standby letters of credit	\$ 733	\$ -	\$ -	\$ -	\$ 733

**PENSION EXPENSE (Net Periodic Pension Cost)**

	2011 Annual	2011 Quarterly	2010 Annual	2010 Quarterly
	(1) Service cost	\$ 381,676	\$ 95,419	\$ 405,474
(2) Interest cost	598,201	149,550	601,251	150,313
(3) Expected return on assets	(725,063)	(181,266)	(659,804)	(164,951)
(4) Amortization of transition (asset) or liability	-	-	-	-
(5) Amortization of prior service cost	-	-	-	-
(6) Amortization of (gain) or loss	258,460	64,615	271,928	67,982
(7) Total	<u>\$ 513,274</u>	<u>\$ 128,318</u>	<u>\$ 618,849</u>	<u>\$ 154,713</u>

## OTHER INFORMATION

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

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

Interest rate risk management is an integral part of the financial success of the Company. The process of interest rate risk management includes the monitoring of each component of the balance sheet and its sensitivity to interest rate changes. Management monitors the day-to-day exposure to changes in interest rates in response to loan and deposit flows and makes adjustments accordingly.

In addition to using traditional gap tables, the Company uses an earnings forecast model that simulates multiple interest rate scenarios and the effects on the Company's net interest margin. The model analyzes the earnings risk by revealing the probability of reaching future income levels based on balance sheet changes caused by interest rate fluctuations. The model and traditional gap analysis indicate the Company is liability sensitive, which means that in a rising rate environment, the Company's net interest margin will generally decrease.

There has been no material changes in reported market risks during the year ended December 31, 2011.

### **Controls and Procedures**

The Company maintains disclosure controls and procedures, as defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934 (the "Exchange Act"), that are designed to ensure that information required to be disclosed by it in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure. The Company carried out an evaluation under the supervision and with the participation of its management, including its principal executive officer and principal financial officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of the end of the period covered by this report. Based on the evaluation of these disclosure controls and procedures, the Company's principal executive officer and principal financial officer concluded that the Company's disclosure controls and procedures were effective.

There were no changes in the Company's internal control over financial reporting for the quarter ended December 31, 2011 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

### **Information Relating to Common Stock**

At December 31, 2011, the Company's authorized capital stock consisted of 5,000,000 shares of common stock, par value \$2.50 per share, of which 1,330,338 were issued and outstanding. The common stock is not traded on an exchange nor is there a known active trading market. As of December 31, 2011, the common stock of the Company was held of record by 974 stockholders. Based solely on information

## OTHER INFORMATION

made available to the Company from limited numbers of buyers and sellers, the Company believes that the following table sets forth the quarterly range of sales prices for the Company's stock during the years 2011 and 2010.

### Stock Prices

<u>2011</u>	<u>High</u>	<u>Low</u>
1 <sup>st</sup> Quarter	\$40.00	\$40.00
2 <sup>nd</sup> Quarter	40.00	40.00
3 <sup>rd</sup> Quarter	40.00	40.00
4 <sup>th</sup> Quarter	40.00	40.00

<u>2010</u>	<u>High</u>	<u>Low</u>
1 <sup>st</sup> Quarter	\$40.50	\$40.00
2 <sup>nd</sup> Quarter	40.00	40.00
3 <sup>rd</sup> Quarter	40.00	40.00
4 <sup>th</sup> Quarter	40.00	40.00

During each quarter of 2011 and 2010, cash dividends on common stock were paid as follows:

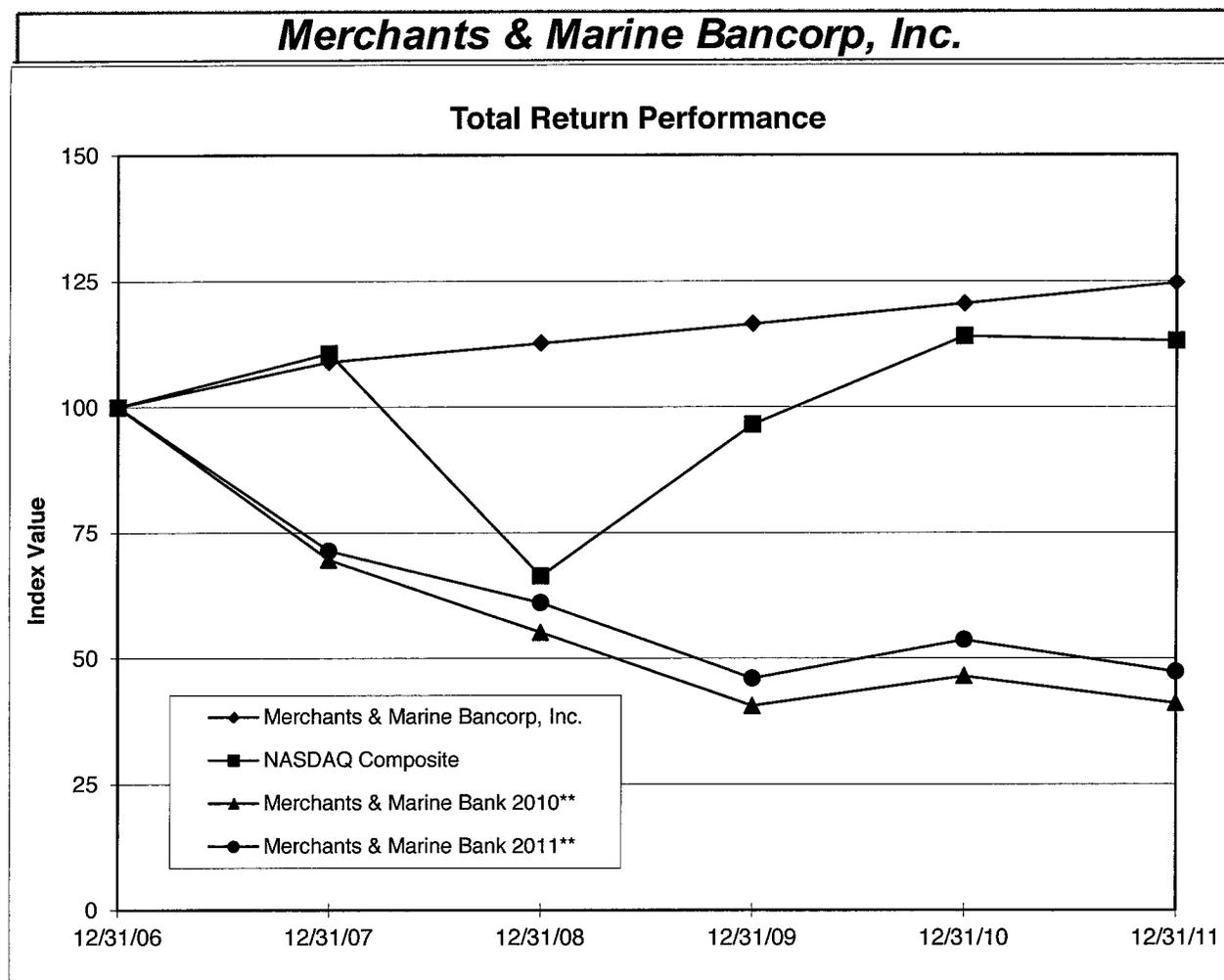
	<u>2011</u>	<u>2010</u>
1 <sup>st</sup> Quarter	\$ .55	\$ .25
2 <sup>nd</sup> Quarter	.25	.30
3 <sup>rd</sup> Quarter	.30	.25
4 <sup>th</sup> Quarter	<u>.25</u>	<u>.55</u>
Total	\$1.35	\$1.35

Although no assurances can be given, the Company anticipates that cash dividends on shares of the Company's common stock will continue to be paid during 2012, subject to the discretion of the Board of Directors.

### Form 10-K Annual Report

The Company files an Annual Report with the Securities and Exchange Commission on Form 10-K that is due March 30, 2012. Immediately after such filing, a copy of such report will be available, without charge, to any shareholder by writing to Royce Cumbest, Chairman of the Board, President and Chief Executive Officer, Merchants & Marine Bancorp, Inc., Post Office Box 729, Pascagoula, Mississippi 39568-0729.

OTHER INFORMATION



	<b>Period Ending</b>					
<b>Index</b>	<b>12/31/06</b>	<b>12/31/07</b>	<b>12/31/08</b>	<b>12/31/09</b>	<b>12/31/10</b>	<b>12/31/11</b>
Merchants & Marine Bancorp, Inc.	100.00	108.97	112.69	116.54	120.53	124.64
NASDAQ Composite	100.00	110.66	66.42	96.54	114.06	113.16
Merchants & Marine Bank 2010**	100.00	69.61	55.18	40.57	46.49	41.06
Merchants & Marine Bank 2011**	100.00	71.38	61.12	46.02	53.68	47.34

\*Prices and dividend information was supplied to SNL Financial LC by company.

Merchants & Marine Bank 2010 Peer Group\*\* consist of American National Bankshares Inc. (AMNB), Ameris Bancorp (ABCB), Bank of Granite Corporation (GRAN - This is now historical), Britton & Koontz Capital Corporation (BKBK), Capital City Bank Group Inc. (CCBG), Colony Bancorp, Inc. (CBAN), Fidelity Southern Corporation (LION), First Bancorp (FBNC), National Bankshares, Inc. (NKSH), PAB Bankshares, Inc. (PABK - This is now historical), Renasant Corporation (RNST) and Seacoast Banking Corporation of Florida (SBCF)

Merchants & Marine Bank 2011 Peer Group\*\* consist of American National Bankshares Inc. (AMNB), Ameris Bancorp (ABCB), Britton & Koontz Capital Corporation (BKBK), Capital City Bank Group Inc. (CCBG), Colony Bancorp, Inc. (CBAN), Fidelity Southern Corporation (LION), First Bancorp (FBNC), National Bankshares, Inc. (NKSH), Renasant Corporation (RNST) and Seacoast Banking Corporation of Florida (SBCF)

Source : SNL Financial LC, Charlottesville, VA  
[www.snl.com](http://www.snl.com)

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**MERCHANTS & MARINE BANCORP, INC.**  
**AND**  
**MERCHANTS & MARINE BANK**  
**BOARD OF DIRECTORS**

Royce Cumbest  
*Chairman, President and Chief Executive Officer*  
*Merchants & Marine Bancorp, Inc. and*  
*Merchants & Marine Bank*

Paul H. (Hal) Moore, Jr., M.D.  
*Radiologist*  
*Singing River Radiology Group*

Mrs. Lynda J. Gautier  
*Retired Certified Public Accountant*

Diann M. Payne  
*Executive Director*  
*Jackson County Civic Action*

John F. Grafe  
*Retired Businessman*

Gerald J. St. Pé  
*President*  
*St. Pé & Associates*

Frank J. Hammond, III  
*Attorney*  
*Watkins & Eager, PLLC*

Thomas B. Van Antwerp  
*Executive Director*  
*Providence Hospital Foundation*

Scott B. Lemon  
*Co-Owner*  
*Lemon-Mohler Insurance Agency*

Julius A. (Jay) Willis, Jr., DMD  
*Dentist*  
*Willis and Parker Family Dentistry, P.A.*

**HONORARY DIRECTORS**

Jerry L. Lee  
*President and Chief Executive Officer*  
*Jerry Lee's Grocery, Inc.*

Paul H. Moore, Sr., M.D.  
*Retired Radiologist*  
*Singing River Radiology Group*

**MERCHANTS & MARINE BANCORP, INC.**  
**Officers as of December 31, 2011**

Royce Cumbest  
*Chairman of the Board, President and Chief Executive Officer*

Elise Bourgeois  
*Senior Vice President and Chief Financial Officer*

C. Henry Fox, Jr.  
*Executive Vice President*

Barbara B. Bass  
*Corporate Secretary*

Herman E. Smith  
*Executive Vice President*

**MERCHANTS & MARINE BANK**  
**Officers as of December 31, 2011**

Royce Cumbest\*  
*Chairman of the Board, President and Chief Executive Officer*

C. Henry Fox, Jr\*  
*Executive Vice President/Chief Operating Officer*

Herman E. Smith\*  
*Executive Vice President/Chief Credit Officer*

Martin J. (Marty) Regan\*  
*Senior Vice President/Operations*

Elise Bourgeois\*  
*Senior Vice President/Cashier/Chief Financial Officer*

James M. Wheat\*  
*Senior Vice President/Investment Officer/Security Officer*

Todd Trenchard\*  
*Senior Vice President/Marketing and Business Development*

Barbara B. Bass  
*Corporate Governance Officer/Corporate Secretary*

T. J. Golson  
*Vice President/Retail Banking*

Clayton Legear  
*Vice President/Compliance Manager*

Brenda Tingle  
*Vice President/Branch Manager*

Bobbie Jo Cline  
*Vice President/Human Resource Director*

Noel Grafe  
*Vice President/Credit Analyst*

Diana Miles  
*Compliance Officer/Bank Secrecy Act Officer*

Glenda Walker  
*Assistant Vice President/Collections*

Mike Grimme  
*Data Processing Manager*

Dottie Garris  
*Vice President/Branch Manager*

JoAnn Rogers  
*Assistant Vice President*

James Easterling  
*Assistant Vice President/Loan Officer*

*\*Executive Officers*

John Wright  
*Data Processing Officer*

Richard Cauley  
*Building Facilitator*

Joyce Johnson  
*Branch Operations Officer*

Sara Gammill  
*Audit Manager*

James Watkins  
*Purchasing Officer*

Landon McCarty  
*Loan Officer*

S.T. Phillips  
*Assistant Vice President/Branch Manager*

Sherrill Edwards  
*Loan Officer/Branch Manager*

Karen Whitford  
*Vice President/Branch Manager*

Mack Rushing  
*Vice President/Branch Manager*

Amy Lemon  
*Mortgage Officer*

Stephanie Broussard  
*Vice President/Branch Manager*

Kristi Burge  
*Assistant Vice President/Branch Manager*

Scott Hicks  
*Vice President/Branch Manager*

Connie Buckhalter  
*Loan Officer/Branch Operations Supervisor*

Tom Peresich  
*Assistant Bank Secrecy Act Officer*

Jimmy Conyers  
*Vice President/Loan Officer*

Bennie Clayton  
*Vice President/Branch Manager*

Joy Potter  
*Operations Officer*

## **MERCHANTS & MARINE BANK**

### **Locations of Mississippi Bank Offices and On Premises Automated Teller Machines**

Pascagoula Office  
3118 Pascagoula Street, Pascagoula

Bel Air Branch  
2600 Old Mobile Highway, Pascagoula

Market Street Branch  
1825 Market Street, Pascagoula

Moss Point Office  
4619 Main Street, Moss Point

St. Martin Office  
6416 N. Washington Avenue, Ocean Springs

Lucedale Office  
11283 Old Highway 63 South, Lucedale

Escatawpa Office  
7616 Highway 613, Moss Point

Gautier Office  
2235 Highway 90, Gautier

Ocean Springs Office  
2802 Bienville Boulevard, Ocean Springs

Wade Branch  
16831 Highway 63, Moss Point

Hurley Office  
21536 Highway 613, Moss Point

### **Locations of Alabama Bank Offices and On Premises Automated Teller Machines**

Gulf Shores Office  
1829 Gulf Shores Parkway, Gulf Shores

Crossville Office  
8331 Alabama Highway 227, Crossville

### **Locations of Off Premises Automated Teller Machines**

Jerry Lee's Grocery  
1804 Ingalls Avenue, Pascagoula  
*Cash Dispensing*

Wayne Lee's Grocery  
1317 Telephone Road, Pascagoula  
*Cash Dispensing*

Singing River Mall  
2800 Highway 90, Gautier  
*Cash Dispensing*

Jerry Lee's Grocery & Market  
2425 Highway 90, Gautier  
*Cash Dispensing*

Chevron #5  
1027 Denny Avenue, Pascagoula  
*Cash Dispensing*

Walgreens #4172  
2405 Pass Road, Biloxi  
*Cash Dispensing*

Food Tiger Shopping Center  
11628 Highway 57, Vancleave  
*Cash Dispensing/Night Depository*

Broome's Grocery #1  
1801 Government Street, Ocean Springs  
*Cash Dispensing*

ATT Call Center  
3051 Bienville Boulevard, Ocean Springs  
*Cash Dispensing*

Chevron #1  
6818 Highway 63, Moss Point  
*Cash Dispensing*

Texaco #16  
4008 Popp's Ferry Road, D'Iberville  
*Cash Dispensing*

Walgreens #9545  
120 W. Railroad Street, Gulfport  
*Cash Dispensing*

# MANDMBANK.COM

## Mississippi

Pascagoula – Moss Point – Escatawpa – Gautier – Ocean Springs – St. Martin – Wade – Hurley – Lucedale



**Alabama**  
Gulf Shores – Crossville

