SOUTHSIDE BANCSHARES INC
Form 10-Q
May 08, 2009

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2009

OR

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

For the transition period from ____________ to ____________

Commission file number 0-12247

SOUTHSIDE BANCSHARES, INC.
(Exact name of registrant as specified in its charter)

TEXAS (State or other jurisdiction of incorporation or organization)	75-1848732 (I.R.S. Employer Identification No.)
1201 S. Beckham, Tyler, Texas (Address of principal executive offices)	75701 (Zip Code)

903-531-7111
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

The number of shares of the issuer's common stock, par value $1.25, outstanding as of April 24, 2009 was 14,845,817 shares.

PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)
(in thousands, except share amounts)

ASSETS	March 31, 2009	December 31, 2008
Cash and due from banks	$ 44,391	$ 64,067
Interest earning deposits	33,554	557
Federal funds sold	8,000	2,150
Total cash and cash equivalents	85,945	66,774
Investment securities:		
Available for sale, at estimated fair value	154,756	278,378
Held to maturity, at cost	478	478
Mortgage-backed and related securities:		
Available for sale, at estimated fair value	1,136,827	1,026,513
Held to maturity, at cost	223,876	157,287
Federal Home Loan Bank stock, at cost	39,459	39,411
Other investments, at cost	2,063	2,065
Loans held for sale	3,882	511
Loans:		
Loans	1,012,460	1,022,549
Less: allowance for loan loss	(17,432)	(16,112)
Net Loans	995,028	1,006,437
Premises and equipment, net	43,925	42,722
Goodwill	22,034	22,034
Other intangible assets, net	1,377	1,479
Interest receivable	13,686	16,352
Deferred tax asset	1,829	2,852
Other assets	38,707	36,945
TOTAL ASSETS	$ 2,763,872	$ 2,700,238
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Noninterest bearing	$ 377,356	$ 390,823
Interest bearing	1,302,588	1,165,308
Total Deposits	1,679,944	1,556,131
Short-term obligations:		
Federal funds purchased and repurchase agreements	10,853	10,629
FHLB advances	85,037	229,385
Other obligations	3,033	1,857
Total Short-term obligations	98,923	241,871
Long-term obligations:		
FHLB advances	657,864	655,489
Long-term debt	60,311	60,311
Total Long-term obligations	718,175	715,800
Other liabilities	90,367	25,347

TOTAL LIABILITIES	2,587,409	2,539,149
Off-Balance-Sheet Arrangements, Commitments and Contingencies (Note 12)		
Shareholders' equity:		
Common stock - $1.25 par, 20,000,000 shares authorized, 16,592,417 shares issued in 2009 (including 707,808 shares declared on April 9, 2009 as a stock dividend) and 15,756,096 shares issued in 2008	20,740	19,695
Paid-in capital	144,564	131,112
Retained earnings	32,836	34,021
Treasury stock (1,762,261 and 1,731,570 shares at cost)	(23,545)	(23,115)
Accumulated other comprehensive income (loss)	1,635	(1,096)
TOTAL SOUTHSIDE BANCSHARES, INC. SHAREHOLDERS' EQUITY	176,230	160,617
Noncontrolling interest	233	472
TOTAL SHAREHOLDERS' EQUITY	176,463	161,089
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 2,763,872	$ 2,700,238

The accompanying notes are an integral part of these consolidated financial statements.

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SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)
(in thousands, except per share data)

	Three Months Ended March 31, 2009	2008
Interest income		
Loans	$ 18,313	$ 18,296
Investment securities – taxable	319	680
Investment securities – tax-exempt	1,494	818
Mortgage-backed and related securities	16,404	11,973
Federal Home Loan Bank stock and other investments	104	262
Other interest earning assets	26	67
Total interest income	36,660	32,096
Interest expense		
Deposits	6,372	10,755
Short-term obligations	1,165	3,300
Long-term obligations	6,886	2,671
Total interest expense	14,423	16,726
Net interest income	22,237	15,370
Provision for loan losses	3,590	2,239
Net interest income after provision for loan losses	18,647	13,131
Noninterest income		
Deposit services	4,035	4,417
Gain on sale of securities available for sale	13,796	2,092
Total other-than-temporary impairment losses	(5,627)	-
Portion of loss recognized in other comprehensive income (before taxes)	4,727	-
Net impairment losses recognized in earnings	(900)	-
Gain on sale of loans	335	465
Trust income	563	593
Bank owned life insurance income	301	310
Other	784	825
Total noninterest income	18,914	8,702
Noninterest expense		
Salaries and employee benefits	10,484	8,713
Occupancy expense	1,418	1,388
Equipment expense	375	312
Advertising, travel & entertainment	509	464
ATM and debit card expense	299	288
Director fees	146	144
Supplies	212	177
Professional fees	630	434
Postage	188	184
Telephone and communications	281	258
FDIC Insurance	536	236

Other		1,439		1,705
Total noninterest expense		16,517		14,303
Income before income tax expense		21,044		7,530
Provision for income tax expense		6,146		1,936
Net Income		14,898		5,594
Less: Net income attributable to the noncontrolling interest		(753)		(48)
Net income attributable to Southside Bancshares, Inc.	$	14,145	$	5,546
Earnings per common share – basic	$	0.96	$	0.38
Earnings per common share – diluted	$	0.95	$	0.37
Dividends paid per common share	$	0.13	$	0.12

The accompanying notes are an integral part of these consolidated financial statements.

SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
(UNAUDITED)
(in thousands, except share amounts)

	Compre-hensive Income	Common Stock	Paid-in Capital	Retained Earnings	Treasury Stock	Accumu-lated Other Compre-hensive Income (Loss)	Non-controlling Interest	Total Equity
Balance at December 31, 2007		$ 18,581	$ 115,250	$ 26,187	$ (22,983)	$ (4,707)	$ 498	$ 132,826
Net Income	$ 5,594			5,546			48	5,594
Other comprehensive income, net of tax								
Unrealized gains on securities, net of reclassification adjustment (see Note 3)	5,723					5,723		5,723
Adjustment to net periodic benefit cost (see Note 3)	193					193		193
Comprehensive income	$ 11,510							
Common stock issued (18,634 shares)		23	241					264
Stock compensation expense			7					7
Tax benefit of incentive stock options			14					14
Cumulative effect of adoption of a new accounting principle on January 1, 2008				(351)				(351)
Dividends paid on common stock				(1,577)				(1,577)
Capital distribution							(286)	(286)
Stock dividend		824	13,422	(14,246)				-
Balance at March 31, 2008		$ 19,428	$ 128,934	$ 15,559	$ (22,983)	$ 1,209	$ 260	$ 142,407
Balance at December 31, 2008		$ 19,695	$ 131,112	$ 34,021	$ (23,115)	$ (1,096)	$ 472	$ 161,089
Net Income	$ 14,898			14,145			753	14,898
Other comprehensive income, net of tax	2,522					2,522		2,522

Unrealized gains on securities, net of reclassification adjustment (see Note 3)								
Adjustment to net periodic benefit cost (see Note 3)	209					209		209
Comprehensive income	$ 17,629							
Common stock issued (128,513 shares)		160	668					828
Tax benefit of incentive stock options			164					164
Dividends paid on common stock				(1,825)				(1,825)
Purchase of 30,691 shares of common stock					(430)			(430)
Capital distribution							(992)	(992)
Stock dividend declared		885	12,620	(13,505)				-
Balance at March 31, 2009		$ 20,740	$ 144,564	$ 32,836	$ (23,545)	$ 1,635	$ 233	$ 176,463

The accompanying notes are an integral part of these consolidated financial statements.

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SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
(in thousands)

	Three Months Ended March 31, 2009	2008
OPERATING ACTIVITIES:		
Net income	$ 14,898	$ 5,594
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation	601	604
Amortization of premium	2,193	1,914
Accretion of discount and loan fees	(995)	(1,114)
Provision for loan losses	3,590	2,239
Stock compensation expense	-	7
Decrease (increase) in interest receivable	2,666	(585)
Decrease in other assets	670	396
Net change in deferred taxes	(455)	(61)
Decrease in interest payable	(498)	(367)
Increase in other liabilities	8,708	1,245
Increase in loans held for sale	(3,371)	(55)
Gain on sale of securities available for sale	(13,796)	(2,092)
Net other-than-temporary impairment losses	900	-
Loss on sale of assets	-	2
Loss on sale of other real estate owned	1	6
Net cash provided by operating activities	15,112	7,733
INVESTING ACTIVITIES:		
Proceeds from sales of investment securities available for sale	124,567	9,341
Proceeds from sales of mortgage-backed securities available for sale	53,170	95,755
Proceeds from maturities of investment securities available for sale	40,800	31,114
Proceeds from maturities of mortgage-backed securities available for sale	48,759	28,394
Proceeds from maturities of mortgage-backed securities held to maturity	9,653	7,877
Purchases of investment securities available for sale	(30,720)	(100,812)
Purchases of mortgage-backed securities available for sale	(184,673)	(116,652)
Purchases of mortgage-backed securities held to maturity	(41,461)	(1,664)
Purchases of FHLB stock and other investments	(46)	(6,325)
Net decrease (increase) in loans	4,715	(21,614)
Purchases of premises and equipment	(1,804)	(652)
Proceeds from sales of premises and equipment	-	358
Proceeds on bank owned life insurance	511	-
Proceeds from sales of other real estate owned	217	75
Proceeds from sales of repossessed assets	594	860
Net cash provided by (used in) investing activities	24,282	(73,945)

The accompanying notes are an integral part of these consolidated financial statements.

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SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)
(UNAUDITED)
(in thousands)

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2008
FINANCING ACTIVITIES:		
Net decrease in demand and savings accounts	(19,520)	(2,084)
Net increase (decrease) in certificates of deposit	143,301	(86,679)
Net increase in federal funds purchased and repurchase agreements	224	1,997
Proceeds from FHLB Advances	1,195,000	4,012,699
Repayment of FHLB Advances	(1,336,973)	(3,871,772)
Net capital distributions from non-controlling interest in consolidated entities	(992)	(286)
Tax benefit of incentive stock options	164	14
Purchase of common stock	(430)	-
Proceeds from the issuance of common stock	828	264
Dividends paid	(1,825)	(1,577)
Net cash (used in) provided by financing activities	(20,223)	52,576
Net increase (decrease) in cash and cash equivalents	19,171	(13,636)
Cash and cash equivalents at beginning of period	66,774	76,004
Cash and cash equivalents at end of period	$ 85,945	$ 62,368
SUPPLEMENTAL DISCLOSURES FOR CASH FLOW INFORMATION:		
Interest paid	$ 14,921	$ 17,093
Income taxes paid	500	500
SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Acquisition of other repossessed assets and real estate through foreclosure	$ 4,238	$ 1,240
5% stock dividend	13,505	14,246
Adjustment to pension liability	(321)	(121)
Unsettled trades to purchase securities	(58,307)	(6,899)
Unsettled trades to sell securities	-	19,287

The accompanying notes are an integral part of these consolidated financial statements

SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO FINANCIAL STATEMENTS

1. Basis of Presentation

In this report, the words "the Company," "we," "us," and "our" refer to the combined entities of Southside Bancshares, Inc and its subsidiaries. The words "Southside" and "Southside Bancshares" refer to Southside Bancshares, Inc. The words "Southside Bank" and "the Bank" refer to Southside Bank (which, subsequent to the internal merger of Fort Worth National Bank ("FWNB") with and into Southside Bank, includes FWNB). The word "FWBS" refers to Fort Worth Bancshares, Inc. The word "SFG" refers to Southside Financial Group, LLC., of which Southside owns a 50% interest and consolidates for financial reporting.

The consolidated balance sheet as of March 31, 2009, and the related consolidated statements of income, shareholders' equity and cash flows and notes to the financial statements for the three month period ended March 31, 2009 and 2008 are unaudited; in the opinion of management, all adjustments necessary for a fair presentation of such financial statements have been included. Such adjustments consisted only of normal recurring items. All significant intercompany accounts and transactions are eliminated in consolidation. The preparation of these consolidated financial statements in conformity with U.S. generally accepted accounting principles ("GAAP") requires the use of management's estimates. These estimates are subjective in nature and involve matters of judgment. Actual amounts could differ from these estimates.

Interim results are not necessarily indicative of results for a full year. These financial statements should be read in conjunction with the financial statements and notes thereto in our Annual Report on Form 10-K for the year ended December 31, 2008. For a description of our significant accounting and reporting policies, refer to Note 1 of the Notes to Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2008.

On April 9, 2009, we declared a 5% stock dividend payable to shareholders of record as of April 28, 2009, and payable on May 14, 2009. All share data has been adjusted to give retroactive recognition to stock splits and stock dividends.

2. Earnings Per Share

Earnings per share attributable to Southside Bancshares, Inc. on a basic and diluted basis has been adjusted to give retroactive recognition to stock splits and stock dividends and is calculated as follows (in thousands, except per share amounts):

	Three Months Ended March 31,	
	2009	2008
Basic and Diluted Earnings:		
Net Income - Southside Bancshares, Inc.	$ 14,145	$ 5,546
Basic weighted-average shares outstanding	14,750	14,496
Add: Stock options	210	372
Diluted weighted-average shares outstanding	14,960	14,868
Basic Earnings Per Share:		
Net Income - Southside Bancshares, Inc.	$ 0.96	$ 0.38

Diluted Earnings Per Share:				
Net Income - Southside Bancshares, Inc.	$	0.95	$	0.37

For the three month period ended March 31, 2009 and 2008, there were no antidilutive options.

3. Comprehensive Income

The components of other comprehensive income are as follows (in thousands):

	Three Months Ended March 31, 2009		
	Before-Tax Amount	Tax (Expense) Benefit	Net-of-Tax Amount
Unrealized gains on securities:			
Unrealized holding gains arising during period	$ 16,776	$ (5,872)	$ 10,904
Less: reclassification adjustment for gains included in net income	13,796	(4,829)	8,967
Less: other-than-temporary impairment charges on AFS securities included in net income	(900)	315	(585)
Net unrealized gains on securities	3,880	(1,358)	2,522
Change in pension plans	321	(112)	209
Other comprehensive income	$ 4,201	$ (1,470)	$ 2,731

	Three Months Ended March 31, 2008		
	Before-Tax Amount	Tax (Expense) Benefit	Net-of-Tax Amount
Unrealized gains on securities:			
Unrealized holding gains arising during period	$ 10,963	$ (3,880)	$ 7,083
Less: reclassification adjustment for gains included in net income	2,092	(732)	1,360
Net unrealized gains on securities	8,871	(3,148)	5,723
Change in pension plans	121	72	193
Other comprehensive income	$ 8,992	$ (3,076)	$ 5,916

4. Securities

The amortized cost and estimated market value of investment and mortgage-backed securities as of March 31, 2009 and December 31, 2008, are reflected in the tables below (in thousands):

	March 31, 2009			
AVAILABLE FOR SALE:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
Investment Securities:				
U.S. Treasury	$ 4,972	$ 14	$ -	$ 4,986
Government Sponsored Enterprise Debentures	30,402	129	1	30,530
State and Political Subdivisions	119,599	1,302	2,485	118,416
Other Stocks and Bonds	5,811	-	4,987	824
Mortgage-backed Securities:				
U.S. Government Agencies	163,414	4,782	1	168,195
Government Sponsored Enterprises	941,657	27,196	221	968,632
Total	$ 1,265,855	$ 33,423	$ 7,695	$ 1,291,583

	March 31, 2009			
HELD TO MATURITY:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
Investment Securities:				
Other Stocks and Bonds	$ 478	$ -	$ 17	$ 461
Mortgage-backed Securities:				
U.S. Government Agencies	21,358	481	-	21,839
Government Sponsored Enterprises	202,518	3,651	59	206,110
Total	$ 224,354	$ 4,132	$ 76	$ 228,410

	December 31, 2008			
AVAILABLE FOR SALE:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
Investment Securities:				
U.S. Treasury	$ 5,008	$ 23	$ –	$ 5,031
Government Sponsored Enterprise Debentures	60,325	227	1	60,551
State and Political Subdivisions	203,052	10,154	1,612	211,594
Other Stocks and Bonds	6,711	–	5,509	1,202
Mortgage-backed Securities:				
U.S. Government Agencies	166,123	2,405	229	168,299
Government Sponsored Enterprises	841,737	17,984	1,507	858,214
Total	$ 1,282,956	$ 30,793	$ 8,858	$ 1,304,891

	December 31, 2008			
	Amortized	Gross Unrealized	Gross Unrealized	Estimated Market

HELD TO MATURITY:	Cost	Gains	Losses	Value
Investment Securities:				
Other Stocks and Bonds	$ 478	$ 9	$ –	$ 487
Mortgage-backed Securities:				
U.S. Government Agencies	22,778	300	–	23,078
Government Sponsored Enterprises	134,509	1,890	26	136,373
Total	$ 157,765	$ 2,199	$ 26	$ 159,938

The following table represents the unrealized loss on securities for the three months ended March 31, 2009 and year ended December 31, 2008 (in thousands):

	Less Than 12 Months		More Than 12 Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
As of March 31, 2009:						
Available for Sale						
Government Sponsored Enterprise Debentures	$ 4,993	$ 1	$ –	$ –	$ 4,993	$ 1
State and Political Subdivisions	54,904	2,012	6,944	473	61,848	2,485
Other Stocks and Bonds	–	–	824	4,987	824	4,987
Mortgage-Backed Securities	34,157	164	12,976	58	47,133	222
Total	$ 94,054	$ 2,177	$ 20,744	$ 5,518	$ 114,798	$ 7,695
Held to Maturity						
Other Stocks and Bonds	$ 461	$ 17	$ –	$ –	$ 461	$ 17
Mortgage-Backed Securities	11,276	59	–	–	11,276	59
Total	$ 11,737	$ 76	$ –	$ –	$ 11,737	$ 76
As of December 31, 2008:						
Available for Sale						
Government Sponsored Enterprise Debentures	$ 29,999	$ 1	$ –	$ –	$ 29,999	$ 1
State and Political Subdivisions	45,686	1,496	1,193	116	46,879	1,612
Other Stocks and Bonds	253	89	949	5,420	1,202	5,509
Mortgage-Backed Securities	116,616	1,517	17,174	219	133,790	1,736
Total	$ 192,554	$ 3,103	$ 19,316	$ 5,755	$ 211,870	$ 8,858
Held to Maturity						
Mortgage-Backed Securities	$ 1,212	$ 1	$ 4,540	$ 25	$ 5,752	$ 26
Total	$ 1,212	$ 1	$ 4,540	$ 25	$ 5,752	$ 26

The turmoil in the capital markets had a significant impact on our estimate of fair value for certain of our securities. We believe the market values are reflective of a combination of illiquidity and credit impairment. At March 31, 2009 we have, in Available for Sale ("AFS") Other Stocks and Bonds, $5.1 million cost basis in pooled trust preferred securities ("TRUPs"). Those securities are structured products with cash flows dependent upon securities issued by U.S. financial institutions, including banks and insurance companies. Our estimate of fair value at March 31, 2009 for the TRUPs is approximately $373,000 and reflects the market illiquidity. With the exception of the TRUPs, to the best of management's knowledge and based on our consideration of the qualitative factors associated with each security, there were no securities in our investment and mortgage-backed securities portfolio at March 31, 2009 with an other-than-temporary impairment.

Given the facts and circumstances associated with the TRUPs we performed detailed cash flow modeling for each TRUP using an industry accepted model. Prior to loading the required assumptions into the model we reviewed the financial condition of each of the underlying issuing banks within the TRUP collateral pool that had not deferred or defaulted as of March 31, 2009. Management's best estimate of a deferral assumption was assigned to each issuing bank based on the category in which it fell. Our analysis of the underlying cash flows contemplated various default, deferral and recovery scenarios to arrive at our best estimate of cash flows. Based on that detailed analysis we have concluded that the other-than-temporary impairment which captures the credit component in compliance with the new Financial Accounting Standards Board ("FASB") Staff Position ("FSP"), SFAS 115-2 and SFAS 124-2, "Recognition and Presentation of Other-Than-Temporary Impairments," was estimated at $900,000 at March 31, 2009 and the non credit charge to other comprehensive income was estimated at $4.7 million. Therefore, the carrying amount of the TRUPs was written down with $900,000 recognized in earnings as of March 31, 2009. The cash flow model assumptions represent management's best estimate and consider a variety of qualitative factors, which include, among others, the credit rating downgrades, severity and duration of the mark-to-market loss, and structural nuances of each TRUP. Management believes the detailed review of the collateral and cash flow modeling support the conclusion that the TRUPs had an other-than-temporary impairment at March 31, 2009. We will continue to update our assumptions and the resulting analysis each reporting period to reflect changing market conditions. Additionally, we do not currently intend to sell the TRUPs and it is not more likely than not that we will be required to sell the TRUPs before the anticipated recovery of their amortized cost basis.

The table below provides more detail on the TRUPs (dollars in thousands).

TRUP	Par	Credit Loss	Amortized Cost	Fair Value	Tranche	Credit Rating
1	$ 2,000	$ 200	$ 1,800	$ 87	C1	Ca
2	2,000	50	1,950	169	B1	Ca
3	2,000	650	1,350	117	B1	Ca

Amounts related to credit losses recognized in earnings as of March 31, 2009 are as follows (in thousands):

Beginning Balance	$ –
Addition for the amount related to credit loss for which an other-than-temporary impairment was not previously recognized	900
Ending balance of amount related to credit losses on debt securities held by the entity at the end of the period for which a portion of an other-than-temporary impairment was recognized in comprehensive income	$ 900

There were no securities transferred from AFS to HTM during the three months ended March 31, 2009 and 2008. There were no sales from the HTM portfolio during the three months ended March 31, 2009 or 2008. There were $224.4 million of securities classified as HTM for the three months ended March 31, 2009. There were $157.8 million of securities classified as HTM for the year ended December 31, 2008.

Of the $13.8 million in net securities gains from the AFS portfolio for the three months ending March 31, 2009, there were $13.9 million in realized gains and $0.1 million in realized losses. Of the $2.1 million in net securities gains from the AFS portfolio for the three months ending March 31, 2008, there were $2.1 million in realized gains and $3,000 in realized losses.

The amortized cost and fair value of securities at March 31, 2009, are presented below by contractual maturity. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations. Mortgage-backed securities are presented in total by category due to the fact that mortgage-backed securities typically are issued with stated principal amounts, and the securities are backed by pools of mortgages that have loans with varying maturities. The characteristics of the underlying pool of mortgages, such as fixed-rate or adjustable-rate, as well as prepayment risk, are passed on to the certificate holder. The term of a mortgage-backed pass-through security thus approximates the term of the underlying mortgages and can vary significantly due to prepayments.

	March 31, 2009	
	Amortized Cost	Fair Value
	(in thousands)	
Available for sale securities:		
Investment Securities		
Due in one year or less	$ 38,990	$ 39,190
Due after one year through five years	12,304	12,601
Due after five years through ten years	21,915	22,175
Due after ten years	87,575	80,790
	160,784	154,756
Mortgage-backed securities	1,105,071	1,136,827
Total	$ 1,265,855	$ 1,291,583

	Amortized Cost	Fair Value
	(in thousands)	
Held to maturity securities:		
Investment Securities		
Due in one year or less	$ –	$ –
Due after one year through five years	–	–
Due after five years through ten years	478	461
Due after ten years	–	–
	478	461
Mortgage-backed securities	223,876	227,949
Total	$ 224,354	$ 228,410

Investment and mortgage-backed securities with book values of $932.1 million at March 31, 2009 and $952.6 million at December 31, 2008 were pledged to collateralize Federal Home Loan Bank ("FHLB") advances, repurchase agreements, public funds and trust deposits or for other purposes as required by law.

5. Loans and Allowance for Probable Loan Losses

The following table sets forth loan totals by category for the periods presented (in thousands):

	At March 31, 2009	At December 31, 2008
Real Estate Loans:		
Construction	$ 109,842	$ 120,153
1-4 Family Residential	238,403	238,693
Other	182,838	184,629
Commercial Loans	164,331	165,558
Municipal Loans	136,533	134,986
Loans to Individuals	180,513	178,530
Total Loans	$ 1,012,460	$ 1,022,549

The summaries of the Allowance for Loan Losses and Reserve for Unfunded Loan Commitments are as follows (in thousands):

	Three Months Ended March 31, 2009	2008
Allowance for Loan Losses		
Balance at beginning of period	$ 16,112	$ 9,753
Provision for loan losses	3,590	2,239
Loans charged off	(2,704)	(1,858)
Recoveries of loans charged off	434	477
Balance at end of period	$ 17,432	$ 10,611
Reserve for Unfunded Loan Commitments		
Balance at beginning of period	$ 7	$ 50
Provision for losses on unfunded loan commitments	–	20
Balance at end of period	$ 7	$ 70

6. Goodwill and Core Deposit Intangible Assets

Goodwill. Goodwill totaled $22.0 million at March 31, 2009 and December 31, 2008.

We measured our goodwill for impairment at December 31, 2008. As a result of merging FWNB into Southside Bank in the third quarter of 2008, we have identified Southside Bank as the sole operating segment and reporting unit for our impairment assessment.

Step one of the impairment test involves comparing the fair value of the reporting unit which, in our case, is the entire entity, to the carrying value of the reporting unit. If the fair value of the reporting unit is greater than the carrying value of the reporting unit, no additional testing is required. If the fair value of the reporting unit is less than the carrying value of the reporting unit, step two of the impairment test must be performed. At December 31, 2008, the fair value of the reporting unit was greater than the carrying value of the reporting unit. As a result, we did not record any goodwill impairment for the year ended December 31, 2008. As of March 31, 2009, there were no trigger events to warrant an updated impairment analysis.

During the fourth quarter of 2007, we recorded core deposit intangibles totaling $2.0 million in connection with the acquisition of FWBS. Core deposit intangibles are amortized on an accelerated basis over their estimated lives, which range from four to ten years.

Core Deposit Intangibles. Core deposit intangible assets were as follows (in thousands):

	Gross Intangible Assets	Accumulated Amortization	Net Intangible Assets
March 31, 2009			
Core deposits	$ 2,047	$ (670)	$ 1,377
	$ 2,047	$ (670)	$ 1,377
December 31, 2008			
Core deposits	$ 2,047	$ (568)	$ 1,479
	$ 2,047	$ (568)	$ 1,479

For the three months ended March 31, 2009 and 2008, amortization expense related to intangible assets totaled $102,000 and $117,000, respectively. The estimated aggregate future amortization expense for intangible assets remaining as of March 31, 2009 is as follows (in thousands):

Remainder of 2009	$ 281
2010	319
2011	255
2012	198
2013	146
Thereafter	178
	$ 1,377

7. Long-term Obligations

Long-term obligations are summarized as follows (in thousands):

	March 31, 2009	December 31, 2008
Federal Home Loan Bank Advances (1)		
Varying maturities to 2028	$ 657,864	$ 655,489
Long-term Debt (2)		
Southside Statutory Trust III Due 2033 (3)	20,619	20,619
Southside Statutory Trust IV Due 2037 (4)	23,196	23,196
Southside Statutory Trust V Due 2037 (5)	12,887	12,887
Magnolia Trust Company I Due 2035 (6)	3,609	3,609
Total Long-term Debt	60,311	60,311
Total Long-term Obligations	$ 718,175	$ 715,800

(1) At March 31, 2009, the weighted average cost of these advances was 3.63%.
(2) This long-term debt consists of trust preferred securities that qualify under the risk-based capital guidelines as Tier 1 capital, subject to certain limitations.
(3) This debt carries an adjustable rate of 4.16% through June 29, 2009 and adjusts quarterly at a rate equal to three-month LIBOR plus 294 basis points.
(4) This debt carries a fixed rate of 6.518% through October 30, 2012 and thereafter, adjusts quarterly at a rate equal to three-month LIBOR plus 130 basis points.
(5) This debt carries a fixed rate of 7.48% through December 15, 2012 and thereafter, adjusts quarterly at a rate equal to three-month LIBOR plus 225 basis points.
(6) This debt carries an adjustable rate of 3.05063% through May 25, 2009 and thereafter, adjusts quarterly at a rate equal to three-month LIBOR plus 180 basis points.

8. Employee Benefit Plans

The components of net periodic benefit cost are as follows (in thousands):

	Three Months Ended March 31,			
	Defined Benefit Pension Plan		Restoration Plan	
	2009	2008	2009	2008
Service cost	$ 339	$ 327	$ 23	$ 15
Interest cost	641	618	60	45
Expected return on assets	(678)	(732)	–	–
Net loss recognition	293	113	39	19
Prior service credit amortization	(10)	(10)	(1)	(1)
Net periodic benefit cost	$ 585	$ 316	$ 121	$ 78

Employer Contributions

We previously disclosed in our financial statements for the year ended December 31, 2008, that we expected to contribute $6.0 million to our defined benefit pension plan and $80,000 to our post retirement benefit plan in 2009. On April 9, 2009, a $3.0 million contribution was made to the defined benefit plan. Contributions of $20,000 had been made to the post retirement benefit plan as of March 31, 2009.

9. Incentive Stock Options

In April 1993, we adopted the Southside Bancshares, Inc. 1993 Incentive Stock Option Plan ("the ISO Plan"), a stock-based incentive compensation plan. The ISO Plan expired March 31, 2003.

As of March 31, 2009 and 2008, there were no nonvested shares. For the three months ended March 31, 2009, there was no stock-based compensation expense. For the three months ended March 31, 2008, we recorded approximately $7,000 of stock-based compensation expense. As of March 31, 2009 and 2008, there was no unrecognized compensation cost related to the ISO Plan for nonvested options granted in March 2003.

The fair value of each stock option granted is estimated on the date of grant using the Black-Scholes method of option pricing with the following weighted-average assumptions for grants in 2003: dividend yield of 1.93%; risk-free interest rate of 4.93%; expected life of six years; and expected volatility of 28.90%.

Under the ISO Plan, we were authorized to issue shares of common stock pursuant to "Awards" granted in the form of incentive stock options (intended to qualify under Section 422 of the Internal Revenue Code of 1986, as amended). Before the ISO Plan expired, awards were granted to selected employees and directors. No stock options have been available for grant under the ISO Plan since its expiration in March 2003.

The ISO Plan provided that the exercise price of any stock option not be less than the fair market value of the common stock on the date of grant. The outstanding stock options have contractual terms of ten years. All options vest on a graded schedule, 20% per year for five years, beginning on the first anniversary date of the grant date.

A summary of the status of our stock options as of March 31, 2009 and the changes during the three months ended on those dates is presented below:

	Number of Options		Weighted Average Exercise Prices	Weighted Average Remaining Contract Life (Years)		Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2008	333,474	$	5.16	–		–
Exercised	(122,576)	$	4.96	–		–
Cancelled	–	$	–	–		–
Outstanding at March 31, 2009	210,898	$	5.27	1.39	$	2,687
Exercisable at March 31, 2009	210,898	$	5.27	1.39	$	2,687

The total intrinsic value (i.e., the amount by which the fair value of the underlying common stock exceeds the exercise price of a stock option on exercise date) of stock options exercised during the three months ended March 31, 2009 and 2008 were $1.2 million and $136,000, respectively.

Cash received from stock option exercises for the three months ended March 31, 2009 and 2008 was $178,000 and $52,000, respectively. The tax benefit realized for the deductions related to the stock option exercises were $164,000 and $14,000 for the three months ended March 31, 2009 and 2008, respectively.

On April 16, 2009, our shareholders approved the Southside Bancshares, Inc. 2009 Incentive Plan (the “2009 Incentive Plan”), a stock-based incentive compensation plan. A total of 1,000,000 shares of our common stock are reserved and available for issuance pursuant to awards granted under the 2009 Incentive Plan. As of May 1, 2009, no awards had been granted under this plan. The 2009 Incentive Plan was filed as Exhibit 99.1 to our Form 8-K filed April 20, 2009.

10. Fair Value Measurement

Effective January 1, 2008, we adopted the provisions of Statement of Financial Accounting Standards (“SFAS”) 157, "Fair Value Measurements," for financial assets. In accordance with FSP No. 157-2, "Effective Date of FASB Statement No. 157," we delayed application of SFAS 157 for non-financial assets, until January 1, 2009. SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with GAAP and expands disclosures about fair value measurements. The application of SFAS 157 in situations where the market for a financial asset is not active was clarified by the issuance of FSP No. SFAS 157-3, “Determining the Fair Value of a

Financial Asset When the Market for That Asset Is Not Active," in October 2008. FSP No. SFAS 157-3 became effective for our interim financial statements as of September 30, 2008 and did not significantly impact the methods by which we determine the fair value of our financial assets at March 31, 2009.

FSP SFAS 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly." FSP SFAS 157-4 affirms that the objective of fair value when the market for an asset is not active is the price that would be received to sell the asset in an orderly transaction, and clarifies and includes additional factors for determining whether there has been a significant decrease in market activity for an asset when the market for that asset is not active. FSP SFAS 157-4 requires an entity to base its conclusion about whether a transaction was not orderly on the weight of the evidence. FSP SFAS 157-4 also amended SFAS 157, "Fair Value Measurements," to expand certain disclosure requirements. We adopted the provisions of FSP 157-4 during the first quarter of 2009. Adoption of FSP SFAS 157-4 did not significantly impact our financial statements.

SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact and (iv) willing to transact.

SFAS 157 requires the use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. SFAS 157 also requires an entity to consider all aspects of nonperforming risk, including the entities' own credit standing when measuring fair value of a liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. SFAS 157 establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

Level 1 Inputs - Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 Inputs - Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatilities, prepayment speeds, credit risks, etc.) or inputs that are derived principally from or corroborated by market data by correlation or other means.

Level 3 Inputs - Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

A description of the valuation methodologies used for assets and liabilities measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

Securities Available for Sale - Securities classified as available for sale primarily consist of U. S. Treasuries, government sponsored enterprise debentures, mortgage-backed securities, and municipal bonds and to a lesser extent TRUPs and equity securities. We use quoted market prices of identical assets on active exchanges, or Level 1 measurements where possible. Where such quoted market prices are not available, we typically employ quoted market prices of similar instruments (including matrix pricing) and/or discounted cash flows using observable inputs to estimate a value of these securities, or Level 2 measurements. Discounted cash flow analyses are typically based on market interest rates, prepayment speeds and/or option adjusted spreads. Level 3 measurements include a range of fair value estimates in the marketplace as a result of the illiquid market specific to the type of security or discounted cash flow analyses based on assumptions that are not readily observable in the market place. Such assumptions include projections of future cash flows, including loss assumptions and discount rates.

Certain financial assets are measured at fair value on a potentially recurring basis in accordance with GAAP. Adjustments to the fair value of these assets usually result from the application of lower-of-cost-or-market accounting or write-downs of individual assets.

Loans Held for Sale - These loans are reported at the lower of cost or fair value. Fair value is determined based on expected proceeds based on sales contracts and commitments and are considered Level 2 inputs. At March 31, 2009, based on our estimates of fair value no valuation allowance was recognized.

Impaired Loans – Certain impaired loans may be reported at the fair value of the underlying collateral if repayment is expected solely from the collateral. Collateral values are estimated using Level 3 inputs based on customized discounting criteria or appraisals. At March 31, 2009, the impact of loans with specific reserves based on the fair value of the collateral were reflected in our allowance for loan losses.

Certain non-financial assets and non-financial liabilities measured at fair value on a recurring basis include reporting units measured at fair value in the first step of a goodwill impairment test. Certain non-financial assets measured at fair value on a non-recurring basis include non-financial assets and non-financial liabilities measured at fair value in the second step of a goodwill impairment test, as well as intangible assets and other non-financial long-lived assets (such as real estate owned) are measured at fair value in the event of an impairment. The framework prescribed by SFAS 157 became applicable to these fair value measurements beginning January 1, 2009.

The following tables summarize financial assets and financial liabilities measured at fair value on a recurring basis as of March 31, 2009 and December 31, 2008, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value (in thousands):

	As of March 31, 2009			
Securities Available For Sale	Level 1 Input	Level 2 Input	Level 3 Input	Total Fair Value
Investment Securities:				
U.S. Treasury	$ 4,986	$ –	$ –	$ 4,986
Government Sponsored Enterprise Debentures	–	30,530	–	30,530
State and Political Subdivisions	–	118,416	–	118,416
Other Stocks and Bonds	451	–	373	824
Mortgage-backed Securities:				
U.S. Government Agencies	–	168,195	–	168,195
Government Sponsored Enterprise	–	968,632	–	968,632
Total	$ 5,437	$ 1,285,773	$ 373	$ 1,291,583

	As of December 31, 2008			
Securities Available For Sale	Level 1 Input	Level 2 Input	Level 3 Input	Total Fair Value
Investment Securities:				
U.S. Treasury	$ 5,031	$ –	$ –	$ 5,031
Government Sponsored Enterprise Debentures	–	60,551	–	60,551
State and Political Subdivisions	–	211,594	–	211,594
Other Stocks and Bonds	556	–	646	1,202
Mortgage-backed Securities:				
U.S. Government Agencies	–	168,299	–	168,299
Government Sponsored Enterprise	–	858,214	–	858,214
Total	$ 5,587	$ 1,298,658	$ 646	$ 1,304,891

The following table presents additional information about financial assets and liabilities measured at fair value at March 31, 2009 and 2008 on a recurring basis and for which we have utilized Level 3 inputs to determine fair value (in thousands):

	March 31, 2009	March 31, 2008
Other Stocks and Bonds		

Balance at Beginning of Period	$ 646	$ 5,541
Total gains or losses (realized/unrealized):		
Included in earnings (or changes in net assets)	(900)	–
Included in other comprehensive income (loss)	627	