FIRST BANCSHARES INC /MS/
Form 10-K
March 28, 2013

U.S. SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2012

OR

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

For the transition period from ____ to ____

Commission file no. 33-94288

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

Mississippi	64-0862173
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)

6480 U.S. Hwy. 98 West	
Hattiesburg, Mississippi	39402
(Address of principal executive offices)	(Zip Code)

Issuer's telephone number: (601) 268-8998

Securities registered under Section 12(b) of the Exchange Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, $1.00 par value	The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in rule 405 of the Securities Act.

Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d)

of the Act.

Yes ¨ No x

Note – Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Exchange Act from their obligations under those Sections.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, 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 x No ¨

Indicate by check mark if disclosure of delinquent filers in response to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this

Form 10-K x

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

Indicate by check mark whether the registrant is a large accelerated file, 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 ¨ Accelerated filer ¨ Non-accelerated filer x Smaller reporting company ¨

Based on the price at which the registrant's Common Stock was last sold on March 21, 2013, at that date, the aggregate market value of the registrant's Common Stock held by non-affiliates of the registrant (assuming solely for the purposes of this calculation that all directors and executive officers of the registrant are "affiliates") was $30,527,159.

State the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date 3,142,235 on March 21, 2013.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the following documents are incorporated by reference to Parts II and III of the Form 10-K report: Proxy Statement dated April 23, 2013, and the Annual Report to the Stockholders for the year ended December 31, 2012.

THE FIRST BANCSHARES, INC.

FORM 10-K

TABLE OF CONTENTS

		Page
	PART I	
ITEM 1.	BUSINESS	1
ITEM 1A.	RISK FACTORS	14
ITEM 1B.	UNRESOLVED STAFF COMMENTS	20
ITEM 2.	PROPERTIES	20
ITEM 3.	LEGAL PROCEEDINGS	20
ITEM 4.	MINE SAFETY DISCLOSURES	20
	PART II	
ITEM 5.	MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES	21
ITEM 6.	SELECTED FINANCIAL DATA	21
ITEM 7.	MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS	21
ITEM 7A.	QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK	21
ITEM 8.	FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA	21
ITEM 9.	CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE	21
ITEM 9A.	CONTROLS AND PROCEDURES	21
ITEM 9B.	OTHER INFORMATION	22
	PART III	
ITEM 10.	DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE	22
ITEM 11.	EXECUTIVE COMPENSATION	23
ITEM 12.	SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS	23
ITEM 13.	CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE	23
	PRINCIPAL ACCOUNTANT FEES AND SERVICES	23

ITEM 14.		
	PART IV	
ITEM 15.	EXHIBITS AND FINANCIAL STATEMENT SCHEDULES	23

THE FIRST BANCSHARES, INC.

FORM 10-K

PART I

This Report contains statements which constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and the Securities Exchange Act of 1934. These statements appear in a number of places in this Report and include all statements regarding the intent, belief or current expectations of the Company, its directors or its officers with respect to, among other things: (i) the Company's financing plans; (ii) trends affecting the Company's financial condition or results of operations; (iii) the Company's growth strategy and operating strategy; and (iv) the declaration and payment of dividends. Investors are cautioned that any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties, and that actual results may differ materially from those projected in the forward-looking statements as a result of various factors discussed herein and those factors discussed in detail in the Company's filings with the Securities and Exchange Commission.

ITEM 1. BUSINESS

BUSINESS OF THE COMPANY

General

The First Bancshares, Inc. (the "Company") was incorporated on June 23, 1995 to serve as a bank holding company for The First, A National Banking Association ("The First" or the "Bank") located in Hattiesburg, Mississippi. The First began operations on August 5, 1996 from its main office in the Oak Grove community, which was on the outskirts of Hattiesburg but now is included in the city of Hattiesburg. The First currently operates its main office and two branches in Hattiesburg, one in Laurel, one in Purvis, one in Picayune, one in Pascagoula, one in Bay St. Louis, one in Wiggins, four in Gulfport, one in Biloxi, one in Long Beach and one in Diamondhead, Mississippi, as well as one branch in Bogalusa, Louisiana. See Note C of Notes to Consolidated Financial Statements for information regarding branch acquisition. The Company and its subsidiary bank engage in a general commercial and retail banking business characterized by personalized service and local decision-making, emphasizing the banking needs of small to medium-sized businesses, professional concerns and individuals. The First is a wholly-owned subsidiary bank of the Company.

Location and Service Area

The First serves the cities of Hattiesburg, Laurel, Purvis, Picayune, Pascagoula, Bay St. Louis, Wiggins, Gulfport, Biloxi, Long Beach, Diamondhead, Mississippi and Bogalusa, Louisiana, and the surrounding areas of Lamar, Forrest, Jones, Pearl River ,Jackson, Hancock, Stone and Harrison Counties in Mississippi and Washington Parish in Louisiana. The First has a main office located in the city of Hattiesburg, Mississippi, in Lamar County. The First has a branch office located on Highway 589 in the city of Purvis, Mississippi, also in Lamar County, a third office located at the intersection of Lincoln Road and South 28th Avenue in Hattiesburg, a fourth location at 110 S. 40th Ave. in Hattiesburg, a fifth location on Hwy 15 North in Laurel, a sixth location on Hwy 43 South in Picayune, a seventh location on Jackson Avenue in Pascagoula, an eighth location on Hwy 90 in Bay St. Louis, a ninth location on Border Ave. in Wiggins a tenth location at Hwy 49 and O'Neal Rd in Gulfport, Mississippi, and eleventh location and a motorbank on 25th Ave in Gulfport, Mississippi, a twelfth location on Courthouse Road in Gulfport, MS, a thirteenth location on Hwy 49 in Gulfport, Mississippi, a fourteenth location on Pass Road in Biloxi, Mississippi, a fifteenth location on Klondyke Road in Biloxi, Mississippi, a sixteenth location on Kalani Drive in Diamondhead, Mississippi, and a seventeenth location on Columbia Street in Bogalusa, Louisiana. On February 18, 2013, The First opened a branch in Ocean Springs in Jackson County at 1517 Bienville Blvd, Ocean Springs, MS.

The main office primarily serves the area in and around the northern portion of Lamar County. The Purvis office primarily serves the area in and around Purvis, Mississippi, which is in the east-central part of Lamar County and is the county seat. Lamar County is located in the southeastern section of Mississippi. Hattiesburg, one of the largest cities in Mississippi, is located in Forrest and Lamar Counties. The Laurel office serves the city of Laurel and the surrounding area of Jones County, Mississippi. The Picayune office primarily serves the area in and around Picayune, Mississippi, including areas of north Hancock County and Pearl River, LA and Slidell, LA. Picayune is located in the southern part of Pearl River County. Pearl River County is located in the southern section of Mississippi. The Pascagoula office primarily serves the area in and around Pascagoula, Mississippi, including areas of Jackson County. Hattiesburg can be reached via U.S. Highways 98 and 49 and Interstate 59. Major employers located in the Lamar and Forrest County areas include Forrest General Hospital, the University of Southern Mississippi, Wesley Medical Center, Camp Shelby, the Hattiesburg Public Schools, the Hattiesburg Clinic, the City of Hattiesburg, and Marshall Durbin Poultry. The principal components of the economy of the Lamar and Forrest County areas include service industries, wholesale and retail trade, manufacturing, and transportation and public utilities. The Laurel branch is located at 1945 Highway 15 North, Laurel, MS, with the majority of its retail business coming from the local area and the remaining business coming from other areas of Jones County, as well as portions of Jasper County, Wayne County, Smith County, and Covington County. Major employers in the Jones County area include Howard Industries, Sanderson Farms, Inc., and South Central Regional Medical Center. Major employers in the Pearl River County area include Stennis Space Center, Chevron, Texaco, Arizona Chemical, American Crescent Elevator Co., City of Picayune, Crosby Memorial Hospital and the public schools. The principal components of the economy of the Pearl River County area include timber, service industries, wholesale and retail trade, manufacturing, and transportation and public utilities. Major employers in the Jackson County area include Northrop Grumman, Singing River Hospital, and Shell Oil Company. The Bay St. Louis and Diamondhead offices serve the city of Bay St. Louis, Diamondhead and the surrounding area of Hancock County, Mississippi. Bay St. Louis and Diamondhead can be reached via U.S. Highway 90. Major employers in the Hancock area include the City of Bay St. Louis, Hancock County, and Stennis Space Center. The Wiggins office serves the city of Wiggins and the surrounding area of Stone County, Mississippi. Stone County is south of Forrest County and north of Harrison County. Wiggins can be reached via U. S. Highway 49. The Gulfport, Biloxi, and Long Beach offices serve the city of Gulfport and the surrounding area of Harrison County, Mississippi. Gulfport can be reached via U.S. Highway 49. Major employers in the Harrison County area include Keesler Air Force Base and a vast array of casinos. The Bogalusa office serves the city of Bogalusa and the surrounding area of Washington Parish, Louisiana. The major employers in the Washington Parish area include Temple-Inland, the Bogalusa School System, and LSU-Washington/St. Tammany Regional Medical Center.

Banking Services

The Company strives to provide its customers with the breadth of products and services comparable to those offered by large regional banks, while maintaining the quick response and personal service of a locally owned and managed bank. In addition to offering a full range of deposit services and commercial and personal loans, The First offers products such as mortgage loan originations. The following is a description of the products and services offered or planned to be offered by the Bank.

! *Deposit Services.* The Bank offers a full range of deposit services that are typically available in most banks and savings and loan associations, including checking accounts, NOW accounts, savings accounts, and other time

deposits of various types, ranging from daily money market accounts to longer-term certificates of deposit. The transaction accounts and time certificates are tailored to the Bank's principal market area at rates competitive to those offered by other banks in the area. In addition, the Bank offers certain retirement account services, such as Individual Retirement Accounts (IRAs). All deposit accounts are insured by the Federal Deposit Insurance Corporation (the "FDIC") up to the maximum amount allowed by law. The Bank solicits these accounts from individuals, businesses, associations and organizations, and governmental authorities.

Loan Products. The Bank offers a full range of commercial and personal loans. Commercial loans include both secured and unsecured loans for working capital (including loans secured by inventory and accounts receivable), business expansion (including acquisition of real estate and improvements), and purchase of equipment and machinery. Consumer loans include equity lines of credit and secured and unsecured loans for financing automobiles, home improvements, education, and personal investments. The Bank also makes real estate construction and acquisition loans. The Bank’s lending activities are subject to a variety of lending limits imposed by federal law. While differing limits apply in certain circumstances based on the type of loan or the nature of the borrower (including the borrower's relationship to the Bank), in general the Bank is subject to a loans-to-one-borrower limit of an amount equal to 15% of the Bank's unimpaired capital and surplus. The Bank may not make any loans to any director, executive officer, or 10% shareholder unless the loan is approved by the Board of Directors of the Bank and is made on terms not more favorable to such a person than would be available to a person not affiliated with the Bank.

! *Mortgage Loan Divisions.* The Bank has mortgage loan divisions which originate loans to purchase existing or construct new homes and to refinance existing mortgages.

! *Other Services.* Other Bank services include on-line internet banking services, voice response telephone inquiry service, commercial sweep accounts, cash management services, safe deposit boxes, travelers checks, direct deposit of payroll and social security checks, and automatic drafts for various accounts. The Bank is associated with the Interlink, Plus, Pulse, Star, and Community Cash networks of automated teller machines that may be used by the Bank's customers throughout Mississippi and other regions. The Bank also offers VISA and MasterCard credit card services through a correspondent bank.

Competition

The Bank generally competes with other financial institutions through the selection of banking products and services offered, the pricing of services, the level of service provided, the convenience and availability of services, and the degree of expertise and the personal manner in which services are offered. Mississippi law permits statewide branching by banks and savings institutions, and many financial institutions in the state have branch networks. Consequently, commercial banking in Mississippi is highly competitive. Many large banking organizations currently operate in the Company's market area, several of which are controlled by out-of-state ownership. In addition, competition between commercial banks and thrift institutions (savings institutions and credit unions) has been intensified significantly by the elimination of many previous distinctions between the various types of financial institutions and the expanded powers and increased activity of thrift institutions in areas of banking which previously had been the sole domain of commercial banks. Federal legislation, together with other regulatory changes by the primary regulators of the various financial institutions, has resulted in the almost total elimination of practical distinctions between a commercial bank and a thrift institution. Consequently, competition among financial institutions of all types is largely unlimited with respect to legal ability and authority to provide most financial services.

The Company faces increased competition from both federally-chartered and state-chartered financial and thrift institutions, as well as credit unions, consumer finance companies, insurance companies, and other institutions in the Company's market area. Some of these competitors are not subject to the same degree of regulation and restriction imposed upon the Company. Many of these competitors also have broader geographic markets and substantially greater resources and lending limits than the Company and offer certain services such as trust banking that the Company does not currently provide. In addition, many of these competitors have numerous branch offices located throughout the extended market areas of the Company that may provide these competitors with an advantage in geographic convenience that the Company does not have at present.

Currently there are numerous other commercial banks, savings institutions, and credit unions operating in The First's primary service area.

Employees

As of March 21, 2013 the Company had 206 full-time employees and 6 part-time employees.

SUPERVISION AND REGULATION

The Company and the Bank are subject to state and federal banking laws and regulations which impose specific requirements or restrictions on and provide for general regulatory oversight with respect to virtually all aspects of operations. These laws and regulations are generally intended to protect depositors, not shareholders. To the extent that the following summary describes statutory or regulatory provisions, it is qualified in its entirety by reference to the particular statutory and regulatory provisions. Any change in applicable laws or regulations may have a material effect on the business and prospects of the Company. Beginning with the enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA") and following with the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"), and now most recently the sweeping Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”), numerous additional regulatory requirements have been placed on the banking industry in the past several years, and additional changes have been proposed. The operations of the Company and the Bank may be affected by legislative changes and the policies of various regulatory authorities. The Company is unable to predict the nature or the extent of the effect on its business and earnings that fiscal or monetary policies, economic control, or new federal or state legislation may have in the future.

Legislative and Regulatory Initiatives to Address Financial and Economic Crises

The Congress, Treasury Department and the federal banking regulators, including the FDIC, have taken broad action since early September 2008 to address volatility in the U.S. banking system.

Emergency Economic Stabilization Act of 2008: Troubled Asset Relief Program. In October 2008, the Emergency Economic Stabilization Act of 2008 ("EESA") was enacted. The EESA authorized the Treasury Department to purchase from financial institutions and their holding companies up to $700 billion in mortgage loans, mortgage-related securities and certain other financial instruments, including debt and equity securities issued by financial institutions and their holding companies in a troubled asset relief program ("TARP"). The purpose of TARP is to restore confidence and stability to the U.S. banking system and to encourage financial institutions to increase their lending to customers and to each other. The Treasury Department allocated $250 billion towards the TARP Capital Purchase Program ("CPP"), pursuant to which the Treasury Department purchased debt or equity securities from participating institutions. The TARP also includes the Community Development Capital Initiative ("CDCI"), which was made available only to certified Community Development Financial Institutions ("CDFIs") and imposed a lower dividend or interest rate, as applicable, than the CPP funding. Participants in the TARP are subject to executive compensation limits and are encouraged to expand their lending and mortgage loan modifications.

On February 6, 2009, as part of the CPP, the Company entered into a Letter Agreement and Securities Purchase Agreement (collectively, the "Purchase Agreement") with the Treasury Department, pursuant to which the Company sold (i) 5,000 shares of the Company's Fixed Rate Cumulative Perpetual Preferred Stock, Series UST (the "CPP Preferred Stock") and (ii) a warrant (the "Warrant") to purchase 54,705 shares of the Company's Common Stock for an exercise price of $13.71 per share. On September 29, 2010, after successfully obtaining CDFI certification, the Company exited the CPP by refinancing its CPP funding into lower-cost CDCI funding and also accepted additional CDCI funding. In connection with this transaction, the Company retired its CPP Preferred Stock and issued to the Treasury Department 17,123 shares of the Company's Fixed Rate Cumulative Perpetual Preferred Stock, Series CD (the "CDCI Preferred Stock"). Including refinanced funding and newly obtained funding, the Company's total CDCI funding is $17,123,000.

The CDCI Preferred Stock qualifies as Tier 1 capital and, provided that the Company maintains its CDFI eligibility and certification, is entitled to cumulative dividends at a rate of 2% per annum until 2018, and 9% per annum thereafter. The Warrant has a 10-year term and is immediately exercisable upon its issuance, and its exercise price is subject to anti-dilution adjustments.

In order to benefit from the lower dividend rate associated with the CDCI Preferred Stock, the Company is required to maintain compliance with the eligibility requirements of the CDFI Program. These eligibility requirements include the following:

- The Company must have a primary mission of promoting community development, based on criteria set forth in 12 C.F.R. 1805.201(b)(1);

- The Company must provide Financial Products, Development Services, and/or other similar financing as a predominant business activity in arm's-length transactions, as provided in 12 C.F.R. 1805.201(b)(2);

- The Company must serve a Target Market by serving one or more Investment Areas and/or Targeted Populations, substantially in the manner set forth in 12 C.F.R. 1805.201(b)(3);

- The Company must provide Development Services in conjunction with its Financial Products, either directly, through an Affiliate, or through a contract with a third-party provider, as provided in 12 C.F.R. 1805.201(b)(4);

- The Company must maintain accountability to residents of the applicable Investment Area(s) and/or Targeted Population(s) through representation on its governing Board of Directors or otherwise, as provided in 12 C.F.R. 1805.201(b)(5); and

- The Company must remain a non-governmental entity which is not an agency or instrumentality of the United States of America, or any State or political subdivision thereof, as described in 12 C.F.R. 1805.201(b)(6) and within the meaning of any supplemental regulations or interpretations of 12 C.F.R. 1805.201(b)(6) or such supplemental regulations published by the Fund.

As used in the discussion above, the terms “Affiliate,” “Financial Products,” “Development Services,” “Target Market,” “Investment Area(s),” and “Targeted Population(s)” have the meanings ascribed to such terms in 12 C.F.R. 1805.104.

EESA also temporarily increased FDIC deposit insurance on most accounts from $100,000 to $250,000. However, with the passage of the Dodd-Frank Act, this increase in the basic coverage limit has been made permanent.

Following a systemic risk determination, the FDIC established a Temporary Liquidity Guarantee Program (“TLGP”) on October 14, 2008. The TLGP included the Transaction Account Guarantee Program (“TAGP”), which provided unlimited deposit insurance coverage for noninterest-bearing transaction accounts (typically business checking accounts) and certain funds swept into noninterest-bearing savings accounts. Institutions participating in the TAGP paid a 10 basis points fee (annualized) on the balance of each covered account in excess of $250,000 while the extra deposit insurance was in place. The TAGP was set to expire on December 31, 2010. However, with the passage of the Dodd-Frank Act, the insurance coverage provided under the Transaction Account Guarantee Program was extended until December 31, 2012, with some changes.

American Reinvestment and Recovery Act of 2009. On February 17, 2009, President Obama signed into law the America Reinvestment and Recovery Act of 2009 (“ARRA”). ARRA contained expansive new restrictions on executive compensation for financial institutions and other companies participating in the TARP. These restrictions apply to us and are further detailed in implementing regulations found at 31 CFR Part 30. (Any reference to “ARRA” herein includes a reference to the implementing regulations.)

ARRA prohibits bonus and similar payments to the most highly compensated employee of the Company. The prohibition does not apply to bonuses payable pursuant to “employment agreements” in effect prior to February 11, 2009. “Long-term” restricted stock is excluded from ARRA’s bonus prohibition, but only to the extent the value of the stock does not exceed one-third of the total amount of annual compensation of the employee receiving the stock, the

stock does not "fully vest" until after all TARP-related obligations have been satisfied, and any other conditions which the Treasury may specify have been met.

ARRA prohibits any payment to the principal executive officer, the principal financial officer, and any of the next eight most highly compensated employees upon departure from the Company for any reason for as long as any TARP-related obligations remain outstanding.

Under ARRA TARP-participating companies are required to recover any bonus or other incentive payment paid to the principal executive officer, the principal financial officer, or any of the next 23 most highly compensated employees on the basis of materially inaccurate financial or other performance criteria.

ARRA prohibits TARP participants from implementing any compensation plan that would encourage manipulation of the reported earnings of the Company in order to enhance the compensation of any of its employees.

ARRA requires the principal executive officer and the principal financial officer of any publicly-traded TARP-participating company to provide a written certification of compliance with the executive compensation restrictions in ARRA in the Company's annual filings with the SEC beginning in 2010.

ARRA requires each TARP-participating company to implement a company-wide policy regarding excessive or luxury expenditures, including excessive expenditures on entertainment or events, office and facility renovations, aviation or other transportation services.

ARRA directs the Treasury to review bonuses, retention awards, and other compensation paid to the principal executive officer and the next four other highest paid executive officer of the Company and the next 20 most highly compensated employees of each company receiving TARP assistance before ARRA was enacted, and to "seek to negotiate" with the TARP recipient and affected employees for reimbursement if it finds any such payments were inconsistent with TARP or otherwise in conflict with the public interest.

ARRA also prohibits the payment of tax gross-ups; required disclosures related to perquisite payments and the engagement, if any, by the TARP participant of a compensation consultant; and prohibits the deduction for tax purposes of executive compensation in excess of $500,000 for each applicable senior executive.

These standards could change based on subsequent guidance issued by the Treasury or the Internal Revenue Service. As long as the Treasury continues to hold equity interests in the Company issued under the TARP, the Company will monitor its compensation arrangements and modify such compensation arrangements, agree to limit and limit its compensation deductions, and take such other actions as may be necessary to comply with the standards discussed above, as they may be modified from time to time. The Company does not anticipate that any material changes to its existing executive compensation structure will be required to comply with the executive compensation standards included in the TARP.

Dodd-Frank Act. The enactment during 2010 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") has resulted in increased regulation of the financial services industry. Provisions affecting the activities of the Company and the Bank include, without limitation, the following:

- *Asset-based deposit insurance assessments*. FDIC deposit insurance premium assessments will be based on bank assets rather than domestic deposits.

- *Deposit insurance limit increase*. The deposit insurance coverage limit has been permanently increased from $100,000 to $250,000.

- *Extension of Transaction Account Guarantee Program*. Unlimited deposit insurance coverage was extended for non-interest-bearing transaction accounts and certain other accounts until December 31, 2012.

- *Establishment of the Consumer Financial Protection Bureau (CFPB)*. The CFPB is housed within the Federal Reserve and, in consultation with the Federal banking agencies, makes rules relating to consumer protection. The CFPB has the authority, should it wish to do so, to rewrite virtually all of the consumer protection regulations governing banks, including those implementing the Truth in Lending Act, the Real Estate Settlement Procedures Act (or RESPA), the Truth in Savings Act, the Electronic Funds Transfer Act, the Equal Credit Opportunity Act, the Home Mortgage Disclosure Act, the S.A.F.E. Mortgage Licensing Act, the Fair Credit Reporting Act (except Sections 615(e) and 628), the Fair Debt Collection Practices Act, and the Gramm-Leach-Bliley Act (sections 502 through 509 relating to privacy), among others.

- *Risk-retention rule*. Banks originating loans for sale on the secondary market or securitization must retain 5 percent of any loan they sell or securitize, except for mortgages that meet low-risk standards to be developed by regulators.

- *Limitation on federal preemption*. Limitations have been imposed on the ability of national bank regulators to preempt state law. Formerly, the national bank and federal thrift regulators possessed preemption powers with regard to transactions, operating subsidiaries and attorney general civil enforcement authority. These preemption requirements have been limited by the Dodd-Frank Act, which will likely impact state banks by affecting activities previously permitted through parity with national banks.

- *Changes to regulation of bank holding companies*. Under Dodd-Frank, bank holding companies must be well-capitalized and well-managed to engage in interstate transactions. In the past, only the subsidiary banks were required to meet those standards. The Federal Reserve Board's "source of strength doctrine" has now been codified, mandating that bank holding companies such as the Company serve as a source of strength for their subsidiary banks, meaning that the bank holding company must be able to provide financial assistance in the event the subsidiary bank experiences financial distress.

- *Executive compensation limitations*. The Dodd-Frank Act codified executive compensation limitations similar to those previously imposed on TARP recipients.

Summary. The foregoing is a brief summary of certain statutes, rules and regulations affecting the Company and the Bank. It is not intended to be an exhaustive discussion of all the statutes and regulations having an impact on the operations of such entities. Additional bills may be introduced in the future in the United States Congress and state legislatures to alter the structure, regulation and competitive relationships of financial institutions. It cannot be predicted whether and what form any of these proposals will be adopted or the extent to which the business of the Company and the Bank may be affected thereby.

The Company

Because it owns the outstanding capital stock of the Bank, the Company is a bank holding company within the meaning of the Federal Bank Holding Company Act of 1956 (the "BHCA").

The BHCA. Under the BHCA, the Company is subject to periodic examination by the Federal Reserve and is required to file periodic reports of its operations and such additional information as the Federal Reserve may require. The Company's and the Bank's activities are limited to banking, managing or controlling banks, furnishing services to or performing services for its subsidiaries, and engaging in other activities that the Federal Reserve determines to be so closely related to banking or managing or controlling banks as to be a proper incident thereto.

The Dodd-Frank Act has removed many limitations on the Federal Reserve Board's authority to make examinations of banks that are subsidiaries of bank holding companies. Under the Dodd-Frank Act, the Federal Reserve Board will generally be permitted to examine bank holding companies and their subsidiaries, provided that the Federal Reserve Board must rely on reports submitted directly by the institution and examination reports of the appropriate regulators (such as the OCC) to the fullest extent possible; must provide reasonable notice to, and consult with, the appropriate regulators before commencing an examination of a bank holding company subsidiary; and, to the fullest extent possible, must avoid duplication of examination activities, reporting requirements, and requests for information.

Investments, Control, and Activities. With certain limited exceptions, the BHCA requires every bank holding company to obtain the prior approval of the Federal Reserve before (i) acquiring substantially all the assets of any bank, (ii) acquiring direct or indirect ownership or control of any voting shares of any bank if after such acquisition it would own or control more than 5% of the voting shares of such bank (unless it already owns or controls the majority of such shares), or (iii) merging or consolidating with another bank holding company.

In addition, and subject to certain exceptions, the BHCA and the Change in Bank Control Act, together with regulations thereunder, require Federal Reserve approval (or, depending on the circumstances, no notice of disapproval) prior to any person or company acquiring "control" of a bank holding company, such as the Company. Control is conclusively presumed to exist if an individual or company acquires 25% or more of any class of voting securities of the bank holding company. Control is rebuttably presumed to exist if a person acquires 10% or more but less than 25% of any class of voting securities and either the Company has registered securities under Section 12 of the Exchange Act (which the Company has done) or no other person owns a greater percentage of that class of voting securities immediately after the transaction. The regulations provide a procedure for challenge of the rebuttable control presumption.

Under the BHCA, a bank holding company is generally prohibited from engaging in, or acquiring direct or indirect control of more than 5% of the voting shares of any company engaged in nonbanking activities, unless the Federal Reserve Board, by order or regulation, has found those activities to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. Some of the activities that the Federal Reserve Board has determined by regulation to be proper incidents to the business of a bank holding company include making or servicing loans and certain types of leases, engaging in certain insurance and discount brokerage activities, performing certain data processing services, acting in certain circumstances as a fiduciary or investment or financial adviser, owning savings associations, and making investments in certain corporations or projects designed primarily to promote community welfare.

The Federal Reserve Board has imposed certain capital requirements on the Company under the BHCA, including a minimum leverage ratio and a minimum ratio of "qualifying" capital to risk-weighted assets. These requirements are described below under "Capital Regulations." Subject to its capital requirements and certain other restrictions, the Company may borrow money to make a capital contribution to the Bank, and such loans may be repaid from dividends paid from the Bank to the Company (although the ability of the Bank to pay dividends is subject to regulatory restrictions as described below in "The Bank - Dividends"). The Company is also able to raise capital for contribution to the Bank by issuing securities without having to receive regulatory approval, subject to compliance with federal and state securities laws.

Source of Strength; Cross-Guarantee. In accordance with Federal Reserve Board policy, the Company is expected to act as a source of financial strength to the Bank and to commit resources to support the Bank in circumstances in which the Company might not otherwise do so. Under the BHCA, the Federal Reserve Board may require a bank holding company to terminate any activity or relinquish control of a nonbank subsidiary (other than a nonbank subsidiary of a bank) upon the Federal Reserve Board's determination that such activity or control constitutes a serious risk to the financial soundness or stability of any subsidiary depository institution of the bank holding company. Further, federal bank regulatory authorities have additional discretion to require a bank holding company to divest itself of any bank or nonbank subsidiary if the agency determines that divestiture may aid the depository institution's financial condition.

The Bank

The Bank operates as a national banking association incorporated under the laws of the United States and subject to examination by the Office of Comptroller of the Currency ("OCC"). Deposits in the Bank are insured by the FDIC up to a maximum amount (generally $250,000 per depositor, subject to aggregation rules). The OCC and the FDIC regulate or monitor virtually all areas of the Bank’s operations, including security devices and procedures, adequacy of capitalization and loan loss reserves, loans, investments, borrowings, deposits, mergers, issuances of securities, payment of dividends, interest rates payable on deposits, interest rates or fees chargeable on loans, establishment of branches, corporate reorganizations, maintenance of books and records, and adequacy of staff training to carry on safe lending and deposit gathering practices. The OCC requires the Bank to maintain certain capital ratios and imposes limitations on the Bank’s aggregate investment in real estate, bank premises, and furniture and fixtures. The Bank is

required by the OCC to prepare quarterly reports on their financial condition and to conduct an annual audit of their financial affairs in compliance with minimum standards and procedures prescribed by the OCC.

Under FDICIA, all insured institutions must undergo regular on-site examinations by their appropriate banking agency. The cost of examinations of insured depository institutions and any affiliates may be assessed by the appropriate agency against each institution or affiliate as it deems necessary or appropriate. Insured institutions are required to submit annual reports to the FDIC and the appropriate agency (and state supervisor when applicable). FDICIA also directs the FDIC to develop with other appropriate agencies a method for insured depository institutions to provide supplemental disclosure of the estimated fair market value of assets and liabilities, to the extent feasible and practicable, in any balance sheet, financial statement, report of condition, or any other report of any insured depository institution. FDICIA also requires the federal banking regulatory agencies to prescribe, by regulation, standards for all insured depository institutions and depository institution holding companies relating, among other things, to: (i) internal controls, information systems, and audit systems; (ii) loan documentation; (iii) credit underwriting; (iv) interest rate risk exposure; and (v) asset quality.

National banks and their holding companies which have been chartered or registered or undergone a change in control within the past two years or which have been deemed by the OCC or the Federal Reserve Board, respectively, to be troubled institutions must give the OCC or the Federal Reserve Board, respectively, thirty days prior notice of the appointment of any senior executive officer or director. Within the thirty day period, the OCC or the Federal Reserve Board, as the case may be, may approve or disapprove any such appointment.

Deposit Insurance. The FDIC establishes rates for the payment of premiums by federally insured banks and thrifts for deposit insurance. A Deposit Insurance Fund ("DIF") is maintained for commercial banks and thrifts, with insurance premiums from the industry used to offset losses from insurance payouts when banks and thrifts fail. Since 1993, insured depository institutions like the Bank have paid for deposit insurance under a risk-based premium system.

The Dodd-Frank Act has changed the method of calculation for FDIC insurance assessments. Under the current system, the assessment base is domestic deposits minus a few allowable exclusions, such as pass-through reserve balances. Under the Dodd-Frank Act, assessments are to be calculated based on the depository institution's average consolidated total assets, less its average amount of tangible equity. On February 9, 2011, the FDIC published final regulations implementing these changes. In addition to providing for the required change in assessment base, the FDIC has modified or eliminated the assessment adjustments based on unsecured debt, secured liabilities, and brokered deposits; added a new adjustment for holding unsecured debt issued by another insured depository institution; and lowered the initial base assessment rate schedule in order to collect approximately the same amount of revenue under the new base as under the old base, among other changes. Due to the expanded assessment base the new initial base assessment rates have been lowered from prior levels.

Transactions With Affiliates and Insiders. The Bank is subject to Section 23A of the Federal Reserve Act, which places limits on the amount of loans to, and certain other transactions with, affiliates, as well as on the amount of advances to third parties collateralized by the securities or obligations of affiliates. The aggregate of all covered transactions is limited in amount, as to any one affiliate, to 10% of the Bank's capital and surplus and, as to all affiliates combined, to 20% of the Bank's capital and surplus. Furthermore, within the foregoing limitations as to amount, each covered transaction must meet specified collateral requirements.

The Bank is also subject to Section 23B of the Federal Reserve Act, which prohibits an institution from engaging in certain transactions with affiliates unless the transactions are on terms substantially the same, or at least as favorable to such institution, as those prevailing at the time for comparable transactions with nonaffiliated companies. The Bank is subject to certain restrictions on extensions of credit to executive officers, directors, certain principal shareholders, and their related interests. Such extensions of credit (i) must be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with third parties and (ii) must not involve more than the normal risk of repayment or present other unfavorable features.

Dividends. A national bank may not pay dividends from its capital. All dividends must be paid out of undivided profits then on hand, after deducting expenses, including reserves for losses and bad debts. In addition, a national bank is prohibited from declaring a dividend on its shares of common stock until its surplus equals its stated capital, unless the bank has transferred to surplus no less than one-tenth of its net profits of the preceding two consecutive half-year periods (in the case of an annual dividend). The approval of the OCC is required if the total of all dividends declared by a national bank in any calendar year exceeds the total of its net profits for that year combined with its retained net profits for the preceding two years, less any required transfers to surplus. In addition, under FDICIA, the banks may not pay a dividend if, after paying the dividend, the bank would be undercapitalized. See "Capital Regulations" below.

Branching. National banks are required by the National Bank Act to adhere to branch office banking laws applicable to state banks in the states in which they are located. Under current Mississippi law, banks may open branches throughout Mississippi with the prior approval of the OCC. In addition, with prior regulatory approval, banks are able to acquire existing banking operations in Mississippi. Furthermore, federal legislation has recently been passed which permits interstate branching. The new law permits out of state acquisitions by bank holding companies (subject to veto by new state law), interstate branching by banks if allowed by state law, interstate merging by banks, and de novo branching by national banks if allowed by state law. See "Recent Legislative Developments."

Community Reinvestment Act. The Community Reinvestment Act requires that, in connection with examinations of financial institutions within their respective jurisdictions, the Federal Reserve, the FDIC, the OCC, or the Office of Thrift Supervision shall evaluate the record of the financial institutions in meeting the credit needs of their local communities, including low and moderate income neighborhoods, consistent with the safe and sound operation of those institutions. These factors are also considered in evaluating mergers, acquisitions, and applications to open a branch or facility.

Other Regulations. Interest and certain other charges collected or contracted for by the Bank are subject to state usury laws and certain federal laws concerning interest rates. The Bank’s loan operations are subject to certain federal laws applicable to credit transactions, such as the federal Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers; the Home Mortgage Disclosure Act of 1975, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs community it serves; the Equal Credit Opportunity Act, prohibiting discrimination on the basis of creed or other prohibited factors in extending credit; the Fair Credit Reporting Act of 1978, governing the use and provision of information to credit reporting agencies; the Fair Debt Collection Act, concerning the manner in which consumer debts may be collected by collection agencies; and the rules and regulations of the various federal agencies charged with the responsibility of implementing such federal laws. The deposit operations of the Bank also are subject to the Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records, and the Electronic Funds Transfer Act and Regulation E issued by the Federal Reserve Board to implement that Act, which governs automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services.

Capital Regulations. The federal bank regulatory authorities have adopted risk-based capital guidelines for banks and bank holding companies that are designed to make regulatory capital requirements more sensitive to differences in risk profile among banks and bank holding companies, account for off-balance sheet exposure, and minimize disincentives for holding liquid assets. The resulting capital ratios represent qualifying capital as a percentage of total risk-weighted assets and off-balance sheet items. The guidelines are minimums, and the federal regulators have noted that banks and bank holding companies contemplating significant expansion programs should not allow expansion to diminish their capital ratios and should maintain ratios well in excess of the minimums. The current guidelines require all bank holding companies and federally-regulated banks to maintain a minimum risk-based total capital ratio equal to 8%, of which at least 4% must be Tier 1 capital. Tier 1 capital includes common shareholders' equity, qualifying perpetual preferred stock, and minority interests in equity accounts of consolidated subsidiaries, but excludes goodwill

and most other intangibles and excludes the allowance for loan and lease losses. Tier 2 capital includes the excess of any preferred stock not included in Tier 1 capital, mandatory convertible securities, hybrid capital instruments, subordinated debt and intermediate term-preferred stock, and general reserves for loan and lease losses up to 1.25% of risk-weighted assets.

Under the guidelines, banks' and bank holding companies' assets are given risk-weights of 0%, 20%, 50% and 100%. In addition, certain off-balance sheet items are given credit conversion factors to convert them to asset equivalent amounts to which an appropriate risk-weight will apply. These computations result in the total risk-weighted assets. Most loans are assigned to the 100% risk category, except for first mortgage loans fully secured by residential property and, under certain circumstances, residential construction loans, both of which carry a 50% rating. Most investment securities are assigned to the 20% category, except for municipal or state revenue bonds, which have a 50% rating, and direct obligations of or obligations guaranteed by the United States Treasury or United States Government agencies, which have a 0% rating.

The federal bank regulatory authorities have also implemented a leverage ratio, which is Tier 1 capital as a percentage of average total assets less intangibles, to be used as a supplement to the risk-based guidelines. The principal objective of the leverage ratio is to place a constraint on the maximum degree to which a bank holding company may leverage its equity capital base. The minimum required leverage ratio for top-rated institutions is 3%, but most institutions are required to maintain an additional cushion of at least 100 to 200 basis points.

FDICIA established a capital-based regulatory scheme designed to promote early intervention for troubled banks and requires the FDIC to choose the least expensive resolution of bank failures. The capital-based regulatory framework contains five categories of compliance with regulatory capital requirements, including "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized," and "critically undercapitalized." To qualify as a "well capitalized" institution, a bank must have a leverage ratio of no less than 5%, a Tier 1 risk-based ratio of no less than 6%, and a total risk-based capital ratio of no less than 10%, and the Bank must not be under any order or directive from the appropriate regulatory agency to meet and maintain a specific capital level. As of December 31, 2012, the Company and The First, were qualified as "well capitalized."

Under the FDICIA regulations, the applicable agency can treat an institution as if it were in the next lower category if the agency determines (after notice and an opportunity for hearing) that the institution is in an unsafe or unsound condition or is engaging in an unsafe or unsound practice. The degree of regulatory scrutiny of a financial institution will increase, and the permissible activities of the institution will decrease, as it moves downward through the capital categories. Institutions that fall into one of the three undercapitalized categories may be required to (i) submit a capital restoration plan; (ii) raise additional capital; (iii) restrict their growth, deposit interest rates, and other activities; (iv) improve their management; (v) eliminate management fees; or (vi) divest themselves of all or part of their operations. Bank holding companies controlling financial institutions can be called upon to boost the institutions' capital and to partially guarantee the institutions' performance under their capital restoration plans.

These capital guidelines can affect the Company in several ways. If the Company continues to grow at a rapid pace, a premature "squeeze" on capital could occur making a capital infusion necessary. The requirements could impact the Company's ability to pay dividends. The Company's present capital levels are more than adequate; however, rapid growth, poor loan portfolio performance, or poor earnings performance could change the Company's capital position in a relatively short period of time.

Failure to meet these capital requirements would mean that a bank would be required to develop and file a plan with its primary federal banking regulator describing the means and a schedule for achieving the minimum capital requirements. In addition, such a bank would generally not receive regulatory approval of any application that requires the consideration of capital adequacy, such as a branch or merger application, unless the Bank could demonstrate a reasonable plan to meet the capital requirement within a reasonable period of time.

Enforcement Powers. FIRREA expanded and increased civil and criminal penalties available for use by the federal regulatory agencies against depository institutions and certain "institution-affiliated parties" (primarily including management, employees, and agents of a financial institution, independent contractors such as attorneys and accountants, and others who participate in the conduct of the financial institution's affairs). These practices can include the failure of an institution to timely file required reports; the filing of false or misleading information; or the submission of inaccurate reports. Civil penalties may be as high as $1,000,000 a day for such violations. Criminal penalties for some financial institution crimes have been increased to twenty years. In addition, regulators are provided with greater flexibility to commence enforcement actions against institutions and institution-affiliated parties. Possible enforcement actions include the termination of deposit insurance. Furthermore, FIRREA expanded the appropriate banking agencies' power to issue cease and desist orders that may, among other things, require affirmative action to correct any harm resulting from a violation or practice, including restitution, reimbursement, indemnifications, or guarantees against loss. A financial institution may also be ordered to restrict its growth, dispose of certain assets, rescind agreements or contracts, or take other actions as determined by the ordering agency to be appropriate.

Effect of Governmental Monetary Policies. The earnings of the Bank are affected by domestic economic conditions and the monetary and fiscal policies of the United States government and its agencies. The Federal Reserve Board's monetary policies have had, and are likely to continue to have, an important impact on the operating results of commercial banks through its power to implement national monetary policy in order, among other things, to curb inflation or combat a recession. The monetary policies of the Federal Reserve Board have major effects upon the levels of bank loans, investments, and deposits through its open market operations in United States government securities and through its regulation of the discount rate on borrowings of member banks and the reserve requirements against member bank deposits. It is not possible to predict the nature or impact of future changes in monetary and fiscal policies.

Significant Legislative Developments. On September 29, 1994, the federal government enacted the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the "Interstate Banking Act"). This Act became effective on September 29, 1995, and permits eligible bank holding companies in any state, with regulatory approval, to acquire banking organizations in any other state. Since June 1, 1997, the Interstate Banking Act has allowed banks with different home states to merge, unless a particular state opts out of the statute. In addition, beginning June 1, 1997, the Interstate Banking Act has permitted national and state banks to establish de novo branches in another state if there is a law in that state which applies equally to all banks and expressly permits all out-of-state banks to establish de novo branches.

On November 12, 1999, the Gramm- Leach-Bliley Act of 1999 (the "Financial Services Modernization Act") was signed into law. The Financial Services Modernization Act repeals the two affiliation provisions of the Glass-Steagall Act: Section 20, which restricted the affiliation of Federal Reserve Member Banks with firms "engaged principally" in specified securities activities; and Section 32, which restricts officer, director, or employee interlocks between a member bank and any company or person "primarily engaged" in specified securities activities. In addition, the Financial Services Modernization Act also contains provisions that expressly preempt any state law restricting the establishment of financial affiliations, primarily related to insurance. The general effect of the law is to establish a comprehensive framework to permit affiliations among commercial banks, insurance companies, securities firms, and other financial service providers by revising and expanding the BHCA framework to permit a holding company system to engage in a full range of financial activities through a new entity known as a Financial Holding Company. "Financial activities" is broadly defined to include not only banking, insurance, and securities activities, but also merchant banking and additional activities that the Federal Reserve, in consultation with the Secretary of the Treasury, determines to be financial in nature, incidental to such financial activities, or complementary activities that do not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally.

Generally, the Financial Services Modernization Act:

! Repeals historical restrictions on, and eliminates many federal and state law barriers to, affiliations among banks, securities firms, insurance companies, and other financial service providers;

! Provides a uniform framework for the functional regulation of the activities of banks, savings institutions, and their holding companies;

! Broadens the activities that may be conducted by national banks, banking subsidiaries of bank holding companies, and their financial subsidiaries;

! Provides an enhanced framework for protecting the privacy of consumer information;

! Adopts a number of provisions related to the capitalization, membership, corporate governance, and other measures designed to modernize the Federal Home Loan Bank system;

! Modifies the laws governing the implementation of the Community Reinvestment Act ("CRA"); and

! Addresses a variety of other legal and regulatory issues affecting both day-to-day operations and long-term activities of financial institutions.

In order for a bank holding company to take advantage of the ability to affiliate with other financial services providers, that company must become a "Financial Holding Company" as permitted under an amendment to the BHCA. To become a Financial Holding Company, a company would file a declaration with the Federal Reserve, electing to engage in activities permissible for Financial Holding Companies and certifying that it is eligible to do so because all of its insured depository institution subsidiaries are well-capitalized and well-managed. In addition, the Federal Reserve must also determine that each insured depository institution subsidiary of a company has at least a "satisfactory" CRA rating.

The Financial Services Modernization Act also permits national banks to engage in expanded activities through the formation of financial subsidiaries. A national bank may have a subsidiary engaged in any activity authorized for national banks directly or any financial activity, except for insurance underwriting, insurance investments, real estate investment or development, or merchant banking, which may only be conducted through a subsidiary of a Financial Holding Company. Financial activities include all activities permitted under new sections of the BHCA or permitted by regulation.

A national bank seeking to have a financial subsidiary, and each of its depository institution affiliates, must be "well-capitalized" and "well-managed." The total assets of all financial subsidiaries may not exceed the lesser of 45% of a bank's total assets, or $50 billion. A national bank must exclude from its assets and equity all equity investments, including retained earnings, in a financial subsidiary. The assets of the subsidiary may not be consolidated with the bank's assets. The bank must also have policies and procedures to assess financial subsidiary risk and protect the bank from such risks and potential liabilities.

The Financial Services Modernization Act also includes a new section of the Federal Deposit Insurance Act governing subsidiaries of state banks that engage in "activities as principal that would only be permissible" for a national bank to conduct in a financial subsidiary. It expressly preserves the ability of a state bank to retain all existing subsidiaries. Because Mississippi permits commercial banks chartered by the state to engage in any activity permissible for national banks, the state bank competitors of The First will be permitted to form subsidiaries to engage in the activities authorized by the Financial Services Modernization Act, to the same extent as The First. In order to form a financial subsidiary, a state bank must be well-capitalized, and the state bank would be subject to the same capital deduction, risk management and affiliate transaction rules as applicable to national banks.

The Company and the Bank do not believe that the Financial Services Modernization Act will have a material adverse effect on operations in the near-term. However, to the extent that it permits banks, securities firms, and insurance companies to affiliate, the financial services industry may experience further consolidation. The Financial Services Modernization Act is intended to grant to community banks certain powers as a matter of right that larger institutions have accumulated on an ad hoc basis. Nevertheless, this act may have the result of increasing the amount of competition that the Company and the Bank face from larger institutions and other types of companies offering financial products, many of which may have substantially more financial resources than the Company and the Bank.

In 2001, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (USA Patriot Act) was signed into law. The USA Patriot Act broadened the application of anti-money laundering regulations to apply to additional types of financial institutions, such as broker-dealers, and strengthened the ability of the U.S. Government to detect and prosecute international money laundering and the financing of terrorism. The principal provisions of Title III of the USA Patriot Act require that regulated financial institutions, including state member banks: (i) establish an anti-money laundering program that includes training and audit components; (ii) comply with regulations regarding the verification of the identity of any person seeking to open an account; (iii) take additional required precautions with non-U.S. owned accounts; and (iv) perform certain verification and certification of money laundering risk for their foreign correspondent banking relationships. The USA Patriot Act also expanded the conditions under which funds in a U.S. interbank account may be subject to forfeiture and increased the penalties for violation of anti-money laundering regulations. Failure of a financial institution to comply with the USA Patriot Act's requirements could have serious legal and reputational consequences for the institution. The Bank has adopted policies, procedures and controls to address compliance with the requirements of the USA Patriot Act under the existing regulations and will continue to revise and update its policies, procedures and controls to reflect changes required by the USA Patriot Act and implementing regulations.

In July 2002, Congress enacted the Sarbanes-Oxley Act of 2002, which addresses, among other issues, corporate governance, auditing and accounting, executive compensation, and enhanced and timely disclosure of corporate information. Section 404 of the Sarbanes-Oxley Act, and regulations adopted by the SEC require the Company to include in its Annual Report, a report stating management's responsibility to establish and maintain adequate internal controls over financial reporting and management's conclusion on the effectiveness of the internal controls at year end. Additionally, the Company's independent registered public accounting firm is required to attest to and report on management's evaluation of internal control over financial reporting.

From time to time, various bills are introduced in the United States Congress with respect to the regulation of financial institutions. Certain of these proposals, if adopted, could significantly change the regulation of banks

and the financial services industry. The Company cannot predict whether any of these proposals will be adopted or, if adopted, how these proposals would affect the Company.

Recent Legislative and Regulatory Initiatives to Address Financial and Economic Crises. The Congress, Treasury Department and the federal banking regulators have taken broad action since early September, 2008 to address volatility in the U.S. banking system, including the passage of legislation, the provision of other direct and indirect assistance to financial institutions, assistance by the banking authorities in arranging acquisitions of weakened banks and broker-dealers, implementation of programs by the Federal Reserve Board to provide liquidity to the commercial paper markets and expansion of deposit insurance coverage. See "Legislative and Regulatory Initiatives to Address Financial and Economic Crises" above.

ITEM 1A. RISK FACTORS

Making or continuing an investment in securities, including the Company's Common Stock, involves certain risks that you should carefully consider. The risks and uncertainties described below are not the only risks that may have a material adverse effect on the Company. Additional risks and uncertainties also could adversely affect the Company's business and results of operations. If any of the following risks actually occur, our business, financial condition or results of operations could be affected, the market price for your securities could decline, and you could lose all or a part of your investment. Further, to the extent that any of the information contained in this Annual Report on Form 10-K constitutes forward-looking statements, the risk factors set forth below also are cautionary statements identifying important factors that could cause the Company's actual results to differ materially from those expressed in any forward-looking statements made by or on behalf of the Company.

We may be vulnerable to certain sectors of the economy

A portion of the loan portfolio is secured by real estate. If the economy deteriorates further and real estate values depress beyond a certain point, the collateral value of the portfolio and the revenue stream from those loans could come under stress and possibly require additional loan loss accruals. Our ability to dispose of foreclosed real estate at prices above the respective carrying values could also be impinged, causing additional losses.

Difficult market conditions have adversely affected the industry in which we operate

The capital and credit markets have been experiencing volatility and disruption for more than two years, causing volatility and disruption to reach unprecedented levels. Dramatic declines in the housing market over the past year, with falling home prices and increasing foreclosures, unemployment and under-employment, have negatively impacted the credit performance of mortgage loans and resulted in significant write-downs of asset values by financial institutions, including government-sponsored entities as well as major commercial and investment banks. Reflecting concern about the stability of the financial markets generally and the strength of counterparties, many lenders have reduced or ceased providing funding to borrowers, including to other financial institutions. This market turmoil and tightening of credit have led to an increased level of commercial and consumer delinquencies, lack of consumer confidence and widespread reduction of business activity generally. A worsening of these conditions would likely exacerbate the adverse effects of these difficult market conditions on us and others in the financial institution industry. Also, the economic downturn could exacerbate our exposure to credit risk, particularly in our real estate markets, as lower home prices and increased foreclosures may result in higher charge-offs and delinquencies.

General economic conditions in the areas where our operations or loans are concentrated may adversely affect our customers' ability to meet their obligations

A sudden or severe downturn in the economy in the geographic markets we serve in the state of Mississippi may affect the ability of our customers to meet loan payments obligations on a timely basis. The local economic conditions in these areas have a significant impact on our commercial, real estate, and construction loans, the ability of borrowers to repay these loans and the value of the collateral securing such loans. Changes resulting in adverse economic conditions of our market areas could negatively impact the financial results of the Company's banking operations and its profitability.

Additionally, adverse economic changes may cause customers to withdraw deposit balances, thereby causing a strain on our liquidity.

We are subject to a risk of rapid and significant changes in market interest rates

Our assets and liabilities are primarily monetary in nature, and as a result we are subject to significant risks tied to changes in interest rates. Our ability to operate profitably is largely dependent upon net interest income. Unexpected movement in interest rates markedly changing the slope of the current yield curve could cause net interest margins to decrease, subsequently decreasing net interest income. In addition, such changes could adversely affect the valuation of our assets and liabilities.

At present the Company's one-year interest rate sensitivity position is slightly asset sensitive, but a gradual increase in interest rates during the next twelve months should not have a significant impact on net interest income during that period. However, as with most financial institutions, the Company's results of operations are affected by changes in interest rates and the Company's ability to manage this risk. The difference between interest rates charged on interest-earning assets and interest rates paid on interest-bearing liabilities may be affected by changes in market interest rates, changes in relationships between interest rate indices, and/or changes in the relationships between long-term and short-term market interest rates. A change in this difference might result in an increase in interest expense relative to interest income, or a decrease in the Company's interest rate spread.

Certain changes in interest rates, inflation, or the financial markets could affect demand for our products and our ability to deliver products efficiently

Loan originations, and potentially loan revenues, could be adversely impacted by sharply rising interest rates. Conversely, sharply falling rates could increase prepayments within our securities portfolio lowering interest earnings from those investments. An unanticipated increase in inflation could cause operating costs related to salaries and benefits, technology, and supplies to increase at a faster pace than revenues.

The fair market value of the securities portfolio and the investment income from these securities also fluctuate depending on general economic and market conditions. In addition, actual net investment income and/or cash flows from investments that carry prepayment risk, such as mortgage-backed and other asset-backed securities, may differ from those anticipated at the time of investment as a result of interest rate fluctuations.

Changes in the policies of monetary authorities and other government action could adversely affect profitability

The results of operations of the Company are affected by credit policies of monetary authorities, particularly the Federal Reserve Board. The instruments of monetary policy employed by the Federal Reserve Board include open market operations in U.S. government securities, changes in the discount rate or the federal funds rate on bank borrowings and changes in reserve requirements against bank deposits. In view of changing conditions in the national economy and in the money markets, particularly in light of the continuing threat of terrorist attacks and the current military operations in the Middle East, we cannot predict possible future changes in interest rates, deposit levels, loan demand or the Company's business and earnings. Furthermore, the actions of the United States government and other governments in responding to such terrorist attacks or the military operations in the Middle East may result in currency fluctuations, exchange controls, market disruption and other adverse effects.

Natural disasters could affect our ability to operate

Our market areas are susceptible to natural disasters such as hurricanes. Natural disasters can disrupt operations, result in damage to properties and negatively affect the local economies in which we operate. The Company cannot predict whether or to what extent damage caused by future hurricanes or other natural disasters will affect operations or the economies in our market areas, but such weather events could cause a decline in loan originations, a decline in the value or destruction of properties securing the loans and an increase in the risk of delinquencies, foreclosures or loan losses.

Greater loan losses than expected may adversely affect our earnings

The Bank as lender is exposed to the risk that its customers will be unable to repay their loans in accordance with their terms and that any collateral securing the payment of their loans may not be sufficient to assure repayment. Credit losses are inherent in the business of making loans and could have a material adverse effect on operating results. Credit risk with respect to its real estate and construction loan portfolio will relate principally to the creditworthiness of corporations and the value of the real estate serving as security for the repayment of loans. Credit risk with respect to its commercial and consumer loan portfolio will relate principally to the general creditworthiness of businesses and individuals within our local markets.

The Bank makes various assumptions and judgments about the collectability of its loan portfolio and provides an allowance for estimated loan losses based on a number of factors. The Bank believes that its current allowance for loan losses is adequate. However, if our assumptions or judgments prove to be incorrect, the allowance for loan losses may not be sufficient to cover actual loan losses. We may have to increase the allowance in the future in response to the request of one of its primary banking regulators, to adjust for changing conditions and assumptions, or as a result of any deterioration in the quality of the loan portfolio. The actual amount of future provisions for loan losses cannot be determined at this time and may vary from the amounts of past provisions.

The Company may need to rely on the financial markets to provide needed capital

The Company’s Common Stock is listed and traded on the NASDAQ stock market. Although the Company anticipates that its capital resources will be adequate for the foreseeable future to meet its capital requirements, at times we may depend on the liquidity of the NASDAQ stock market to raise equity capital. If the market should fail to operate, or if conditions in the capital markets are adverse, the Company may be constrained in raising capital. Should these risks materialize, the ability to further expand its operations through internal growth may be limited.

We are subject to regulation by various Federal and State entities

The Company is subject to the regulations of the Securities and Exchange Commission (“SEC”), the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the OCC. New regulations issued by these agencies may adversely affect the Company’s ability to carry on its business activities. The Company is subject to various Federal and state laws and certain changes in these laws and regulations may adversely affect operations.

The Company is also subject to the accounting rules and regulations of the SEC and the Financial Accounting Standards Board. Changes in accounting rules could adversely affect the reported financial statements or results of operations of First Bancshares and may also require extraordinary efforts or additional costs to implement. Any of these laws or regulations may be modified or changed from time to time, and we cannot be assured that such modifications or changes will not adversely affect the Company.

We engage in acquisitions of other businesses from time to time

On occasion, the Company will engage in acquisitions of other businesses. Acquisitions may result in customer and employee turnover, thus increasing the cost of operating the new businesses. The acquired companies may also have legal contingencies, beyond those that the Company is aware of, that could result in unexpected costs.

We are subject to industry competition which may have an impact upon its success

The profitability of the Company depends on its ability to compete successfully. We operate in a highly competitive financial services environment. Certain competitors are larger and may have more resources than we do. We face competition in our regional market areas from other commercial banks, savings and loan associations, credit unions, internet banks, finance companies, mutual funds, insurance companies, brokerage and investment banking firms, and other financial intermediaries that offer similar services. Some of the nonbank competitors are not subject to the same extensive regulations that govern the Company or the Bank and may have greater flexibility in competing for business.

Another competitive factor is that the financial services market, including banking services, is undergoing rapid changes with frequent introductions of new technology-driven products and services. Our future success may depend, in part, on our ability to use technology competitively to provide products and services that provide convenience to customers and create additional efficiencies in operations.

Future issuances of additional securities could result in dilution of shareholders' ownership

The Company may determine from time to time to issue additional securities to raise additional capital, support growth, or to make acquisitions. Further, the Company may issue stock options or other stock grants to retain and motivate our employees. Such issuances of Company securities will dilute the ownership interests of the Company's shareholders.

Anti-takeover laws and certain agreements and charter provisions may adversely affect share value

Certain provisions of state and federal law and the Company's articles of incorporation may make it more difficult for someone to acquire control of the Company. Under federal law, subject to certain exemptions, a person, entity, or group must notify the federal banking agencies before acquiring 10% or more of the outstanding voting stock of a bank holding company, including the Company's shares. Banking agencies review the acquisition to determine if it will result in a change of control. The banking agencies have 60 days to act on the notice, and take into account several factors, including the resources of the acquiror and the antitrust effects of the acquisition. There also are Mississippi statutory provisions and provisions in the Company's articles of incorporation that may be used to delay or block a takeover attempt. As a result, these statutory provisions and provisions in the Company's articles of incorporation could result in the Company being less attractive to a potential acquiror.

Securities issued by the Company, including the Company's Common Stock, are not FDIC insured

Securities issued by the Company, including the Company's Common Stock, are not savings or deposit accounts or other obligations of any bank and are not insured by the FDIC, the Deposit Insurance Fund, or any other governmental agency or instrumentality, or any private insurer, and are subject to investment risk, including the possible loss of principal.

There can be no assurance that recently enacted legislation will stabilize the U.S. financial system

On October 3, 2008, President Bush signed into law the EESA. The legislation was the result of a proposal by the Treasury in response to the financial crises affecting the banking system and financial markets and threats to investment banks and other financial institutions. Pursuant to the EESA, the Treasury was given the authority to, among other things, purchase up to $700 billion of mortgages, mortgage-backed securities and certain other financial instruments from financial institutions for the purpose of stabilizing and providing liquidity to the U.S. financial markets. In 2008, the Treasury announced the Capital Purchase Program, which was followed by the Community Development Capital Initiative in 2010. In 2008, the FDIC adopted a Final rule with respect to its Temporary Liquidity Guarantee Program pursuant to which the FDIC guaranteed certain "newly-issued unsecured debt" of banks and certain holding companies and also temporarily guaranteed, on an unlimited basis, noninterest-bearing bank transaction accounts; the unlimited guarantee of noninterest-bearing transaction accounts has now been extended through 2012 by the Dodd-Frank Act. On February 17, 2009, President Obama signed into law the ARRA. The purposes of the legislation are to preserve and create jobs, to assist those most impacted by the recession, to provide investments to increase economic efficiency in health services, to invest in transportation, environmental protection and other infrastructure, and to stabilize local and state governments.

Each of these programs was implemented to help stabilize our economy and financial system. There can be no assurance, however, as to the actual impact that the EESA and its implementing regulations, the Capital Purchase Program, the FDIC programs, or any other governmental program will have on the financial markets. The failure of the EESA, the ARRA or the U.S. government to stabilize the financial markets and a continuation or worsening of current financial market conditions could materially and adversely affect the Company's business, financial condition, and results of operations, access to credit or the trading price of the Company's common stock.

The failure of other financial institutions could adversely affect the Company

The Company's ability to engage in routine funding transactions could be adversely affected by the actions and potential failures of other financial institutions. Financial institutions are interrelated as a result of trading, clearing, counterparty and other relationships. As a result, defaults by, or even rumors or concerns about, one or more financial institutions or the financial services industry generally have led to market-wide liquidity problems and could lead to losses or defaults by the Company or by other institutions.

*Concern by customers over deposit insurance may cause a decrease in deposits and changes in the mix of funding sources available to the Compan*y

With recent increased concerns about bank failures, customers increasingly are concerned about the extent to which their deposits are insured by the FDIC. Customers may withdraw deposits in an effort to ensure that the amount they have on deposit with their bank is fully insured and some may seek deposit products or other bank savings and investment products that are collateralized. Decreases in deposits and changes in the mix of funding sources may adversely affect the Company's funding costs and net income.

Evaluation of investment securities for other-than-temporary impairment involves subjective determinations and could materially impact the Company's results of operations and financial condition

The evaluation of impairments is a quantitative and qualitative process, which is subject to risks and uncertainties, and is intended to determine whether declines in the fair value of investment should be recognized in current period earnings. The risks and uncertainties include changes in general economic conditions, the issuers' financial condition or future recovery prospects, the effects of changes in interest rates or credit spreads and the expected recovery period. Estimating future cash flows involves incorporating information received from third-party sources and making internal assumptions and judgments regarding the future performance of the underlying collateral and assessing the probability that an adverse change in future cash flows has occurred. The determination of the amount of other-than-temporary impairments is based upon the Company's quarterly evaluation and assessment of known and inherent risks associated with the respective asset class. Such evaluations and assessments are revised as conditions

change and new information becomes available.

Additionally, the Company's management considers a wide range of factors about the security issuer and uses its reasonable judgment in evaluating the cause of the decline in the estimated fair value of the security and in assessing the prospects for recovery. Inherent in management's evaluation of the security are assumptions and estimates about the operations of the issuer and its future earnings potential. Impairments to the carrying value of our investment securities may need to be taken in the future, which would have a material adverse effect on our results of operations and financial condition.

The Company may be required to pay additional insurance premiums to the FDIC, which could negatively impact earnings

Recent insured institution failures, as well as deterioration in banking and economic conditions generally, have significantly increased FDIC loss provisions, resulting in a decline in the designated reserve ratio to historical lows. The FDIC expects a higher rate of insured institution failures in the next few years compared to recent years; thus, the reserve ratio may continue to decline. In addition, pursuant to the Dodd-Frank Act, the limit on FDIC coverage has been permanently increased to $250,000. These developments have caused the premiums assessed to the Bank by the FDIC to increase.

Further, depending upon any future losses that the FDIC insurance fund may suffer, there can be no assurance that there will not be additional premium increases in order to replenish the fund. The FDIC may need to set a higher base rate schedule or impose special assessments due to future financial institution failures and updated failure and loss projections. Potentially higher FDIC assessment rates than those currently projected could have an adverse impact on the Company's results of operations.

The Company participates in the U.S. Treasury's Troubled Asset Relief Program

- The Company received $5,000,000 in funding under the Capital Purchase Program ("CPP") in exchange for preferred stock and common stock warrants during 2009, which funding was refinanced into lower-cost Community Development Capital Initiative ("CDCI") funding on September 29, 2010. In addition, on September 29, 2010, the Company also accepted $12,123,000 in additional CDCI funding, for a total of $17,123,000 in CDCI funding. Participation in this program constrains the Company's ability to raise dividends and also places certain constraints on executive compensation arrangements. The increased funding provides assurance that the Company can maintain its minimum regulatory capital ratios in the face of future large real estate-related losses. The Company will have to repay these funds, possibly by raising capital within the next seven to eight years to keep its dividend costs from increasing to 9% per annum.

- Both the CPP and the CDCI are part of the Troubled Asset Relief Program ("TARP"). The rules that govern the TARP include restrictions on certain compensation to executive officers and a number of others in the Company. Among other things, these rules include a prohibition on golden parachute payments, a prohibition on providing tax gross-ups, a bonus claw-back provision, and a prohibition on paying any bonus payment to the Company's most highly compensated employees. It is possible that compensation restrictions imposed on TARP participants could impede our ability to attract and retain qualified executive officers.

- Our participation in the TARP limits our annual dividend payments to no more than $0.15 per share. Our ability to repurchase our common stock would also be restricted in the event that we failed to make our dividend payments.

- Since the TARP was part of legislation that has the reputation of being passed as a bailout of the financial industry, participation in the program could also create some reputational risk. This reputation of the program could impede the Company's ability to attract business in competition with other financial institutions that did not participate. This reputational risk could also impede the Company's ability to attract and retain qualified executive officers.

The Company recently executed an Acquisition Agreement to purchase First National Bank of Baldwin County

On January 31, 2013, the Company entered into an Acquisition Agreement (the "Agreement") with First Baldwin Bancshares, Inc., an Alabama corporation ("Baldwin"). The Agreement provides that, upon the terms and subject to the conditions set forth in the Agreement, the Company will acquire all of the outstanding shares (the "Acquisition") of

Baldwin's wholly-owned subsidiary, First National Bank of Baldwin County, a national banking association ("FNB"). Subject to the terms and conditions of the Agreement, which has been approved by the Boards of Directors of the Company and Baldwin, Baldwin intends to file a voluntary bankruptcy petition under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court ("Bankruptcy Court") and to seek Bankruptcy Court approval of the Agreement and the Acquisition through a Chapter 11 plan. Upon approval by the Bankruptcy Court and consummation of the Acquisition, all outstanding FNB common stock will be sold to the Company for cash consideration not to exceed $3,300,000 (the "Purchase Price"). Each outstanding share of FNB common stock will remain outstanding and be unaffected by the Acquisition.

The Agreement contains customary representations and warranties from both the Company and Baldwin and each have agreed to customary covenants, including, among others, covenants relating to (1) the conduct of the Company and Baldwin's businesses during the interim period between the execution of the Agreement and the completion of the Acquisition, (2) certificates of approval from the respective officers of the parties regarding approval by the Boards of Directors of the Company, Baldwin and FNB of the Acquisition, the Agreement and the transactions contemplated thereby. Baldwin has also agreed, subject to certain exceptions, not to (1) solicit proposals relating to alternative business combination transactions or (2) enter into any discussions, or enter into any agreement, concerning, or provide confidential information in connection with, any proposals for alternative business combination transactions.

Completion of the Acquisition is subject to certain customary conditions, including, among others, (1) receipt of all required regulatory and bankruptcy court approvals and (2) the absence of any law or order prohibiting the completion of the Acquisition. Each party's obligation to complete the Acquisition is also subject to certain additional customary conditions, including (1) subject to certain exceptions, the accuracy of the representations and warranties of the other party, (2) performance in all material respects by the other party of its obligations under the Agreement, and (3) certain elections under applicable provisions of the Internal Revenue Service code and Treasury regulations.

If any of the representation or warranties are breached, or if any of the conditions or covenants are not fulfilled, the Acquisition could be delayed or not completed, which could have a material adverse effect on our results of operations and financial condition.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None

ITEM 2. PROPERTIES

The Company's main office, which is the holding company headquarters, is located at 6480 U.S. Hwy 98 West in Hattiesburg, Mississippi. The Company operates 17 full service banking and financial services offices and one motor bank facility. Management ensures that all properties, whether owned or leased, are maintained in suitable condition.

ITEM 3. LEGAL PROCEEDINGS

From time to time the Company and/or the Bank may be named as defendants in various lawsuits arising out of the normal course of business. At present, the Company is not aware of any legal proceedings that it anticipates may materially adversely affect its business.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

In response to this Item, the information contained on page 70 of the Company's Annual Report to Shareholders for the year ended December 31, 2012, is incorporated herein by reference.

ITEM 6. SELECTED FINANCIAL DATA

In response to this Item, the information contained on pages 7 and 8 of the Company’s Annual Report to Shareholders for the year ended December 31, 2012, is incorporated herein by reference.

ITEM 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

In response to this Item, the information contained on pages 6 through 27 of the Company's Annual Report to Shareholders for the year ended December 31, 2012, is incorporated herein by reference.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

In response to this Item, the information contained on pages 29 through 69 of the Company's Annual Report to Shareholders for the year ended December 31, 2012 is incorporated herein by reference.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

ITEM 9A. CONTROLS AND PROCEDURES

The Company's principal executive officer and principal financial officer have concluded, based upon their evaluation of the Company's disclosure controls and procedures as of December 31, 2012 that the Company's disclosure controls and procedures were effective. During the quarter ended December 31, 2012, no changes have occurred in the Company's internal control over financial reporting that have materially affected or are reasonably likely to materially affect the Company's internal control over financial reporting.

The First Bancshares, Inc.

Management's Report on Internal Control Over Financial Reporting

Management of the "Company is responsible for establishing and maintaining effective internal control over financial reporting. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles.

Under the supervision and with the participation of management, including the principal executive officer and principal financial officer, the Company conducted an evaluation of the effectiveness of internal control over financial reporting based on the framework in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management of the Company has concluded the Company maintained effective internal control over financial reporting, as such term is defined in Securities Exchange Act of 1934 Rules 12a-15(f), as of December 31, 2012.

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting can also be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. These inherent limitations, however, are known features of the financial reporting process. It is possible, therefore, to design into the process safeguards to reduce, though not eliminate, this risk.

This annual report does not include an attestation report of the Company's independent registered public accounting firm regarding internal control over financial reporting. The Company's registered public accounting firm was not required to issue an attestation report on internal controls over financial reporting pursuant to temporary rules of the Securities and Exchange Commission.

/s/ M. Ray (Hoppy) Cole, Jr.	/s/ Dee Dee Lowery
CEO and President	Executive VP and Chief Financial Officer
March 21, 2013	March 21, 2013

ITEM 9B. OTHER INFORMATION

Not applicable.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICER, AND CORPORATE GOVERNANCE

In response to this Item, the information contained under the captions, "Election of Directors" and "Additional Information Concerning Directors and Officers" of the Company's Proxy Statement for the Annual Meeting of Shareholders to be held on May 23, 2013, is incorporated herein by reference.

Code of Ethics

The Company's Board of Directors has adopted a Code of Ethics that applies to the Company's principal executive officer, principal financial officer, principal accounting officer, or persons performing similar functions. A copy of

this Code of Ethics can be found at the Company's internet website at www.thefirstbank.com. The Company intends to disclose any amendments to its Code of Ethics, and any waiver from a provision of the Code of Ethics granted to the Company's principal executive officer, principal financial officer, principal accounting officer, or persons performing similar functions, on the Company's internet website within five business days following such amendment or waiver. The information contained on or connected to the Company's internet website is not incorporated by reference into this Form 10-K and should not be considered part of this or any other report that we file with or furnish to the SEC.

Audit Committee

The information contained under the caption “Committees of the Board of Directors” of the Company's Proxy Statement for the Annual Meeting of Shareholders to be held on May 23, 2013, is incorporated herein by reference. The Board of Directors has determined that there is at least one independent audit committee financial expert, J. Douglas Seidenburg, serving on the Audit Committee, as the terms independent and audit committee financial expert are used in pertinent NASDAQ listing standards and Securities and Exchange Commission

regulations.

Corporate Governance

The information contained under the caption "Additional Information Concerning Directors and Officers" of the Company's Proxy Statement for the Annual Meeting of Shareholders to be held on May 23, 2013, is incorporated herein by reference.

As a TARP recipient the Company is required to have an Excessive Expenditure Policy. Such a policy was adopted by the Company's Board of Directors on July 23, 2009, and is posted on the Bank's website at www.thefirstbank.com.

ITEM 11. EXECUTIVE COMPENSATION

In response to this Item, the information contained under the caption "Compensation Discussion and Analysis" of the Company's Proxy Statement for the Annual Meeting of Shareholders to be held on May 23, 2013, is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENTAND RELATED STOCKHOLDER MATTERS

In response to this Item, the information contained under the caption "Security Ownership of Certain Beneficial Owners and Management" of the Company's Proxy Statement for the Annual Meeting of Shareholders to be held on May 23, 2013, is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

In response to this Item, the information contained under the caption "Certain Relationships and Related Transactions" of the Company's Proxy Statement for the Annual Meeting of Shareholders to be held on May 23, 2013, is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

In response to this Item, the information contained under the caption "Principal Accountant Fees and Services" of the Company's Proxy Statement for the Annual meeting of Shareholders to be held on May 23, 2013, is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

The following exhibits are furnished (or incorporated by reference):

Exhibit Number	Description
3.1	Restated Articles of Incorporation (incorporated by reference to Exhibit 3.2 filed with Form 8-K with the Commission on March 21, 2013).
3.2	Bylaws (incorporated by reference to Exhibit 3.2 to the Company's Registration Statement No. 33-94288 on Form S-1).
3.3	Articles of Amendment Containing Certificate of Designations for the Fixed Rate Cumulative Perpetual Preferred Stock, Series CD (incorporated by reference to Exhibit 3.1 filed with Form 8-K with the Commission on October 4, 2010).

4.1	Provisions in the Company's Articles of Incorporation and Bylaws defining the rights of holders of the Company's Common Stock (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement No. 33-94288 on Form S-1).
4.2	Form of Certificate of Common Stock (incorporated by reference to Exhibit 4.2 to the Company's Registration Statement No. 33-94288 on Form S-1).
10.1	Purchase Letter Agreement dated February 6, 2009 between The First Bancshares and the United States Department of the Treasury, including the Standard Terms, with respect to the issuance of the CPP Preferred Stock. (incorporated by reference to Exhibit 10.1 filed with Form 8-K with the Commission on October 4, 2010).
10.2	Exchange Letter Agreement dated September 29, 2010 between The First Bancshares and the United States Department of the Treasury, including the Standard Terms, with respect to the exchange of the CDCI Preferred Stock. (incorporated by reference to Exhibit 10.2 filed with Form 8-K with the Commission on October 4, 2010).
10.5	Employment Agreement dated May 31, 2011, between The First, A National Banking Association and M. Ray Cole, Jr. (incorporated by reference to Exhibit 10.5 of the Company's Form 10-K for the fiscal year ended December 31, 2011, filed on March 29, 2012, File No. 000-22507).
10.6	First Bancshares, Inc. 1997 Stock Option Plan as of March 18, 1997 (incorporated by reference to Exhibit 10.7 of the Company's Form 10-KSB for the fiscal year ended December 31, 1996, File No. 33-94288).
10.7	Agreement to Repurchase Stock by and among The First Bancshares, Inc., Nick Welch and David Johnson (incorporated by reference to Exhibit 10.9 to the Company's Registration Statement No. 333-102908 on Form S-2).
10.8	The First Bancshares, Inc. 2007 Stock Incentive Plan (incorporated by reference to Exhibit 4.3 to the Company's Registration Statement No. 171996 on Form S-8)
13	The Company's 2012 Annual Report
21	Subsidiaries of the Company
23	Consent of Independent Registered Public Accounting Firm
31	Rule 13a-14(a)/15d-14(a) Certifications
32	Section 1350 Certifications
99.1	EESA Certification of CEO
99.2	EESA Certification of CFO

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

THE FIRST BANCSHARES, INC.

Date: March 21, 2013	By: /s/ M. Ray (Hoppy) Cole, Jr. M. Ray (Hoppy) Cole, Jr. Chief Executive Officer and President (Principal Executive Officer)
Date: March 21, 2013	By: /s/ Dee Dee Lowery Dee Dee Lowery Executive VP and Chief Financial Officer (Principal Financial and Principal Accounting Officer)

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

SIGNATURES	**CAPACITIES**	**DATE**
/s/ E. Ricky Gibson	Director and Chairman of the Board	March 21 2013
/s/ Charles R. Lightsey	Director	March 21, 2013
/s/ J. Douglas Seidenburg	Director	March 21, 2013
/s/ Andy Stetelman	Director	March 21, 2013
/s/ David W. Bomboy	Director	March 21, 2013
/s/ Ted E. Parker	Director	March 21, 2013
/s/ Michael W. Chancellor	Director	March 21, 2013
/s/ Fred McMurry	Director	March 21, 2013
/s/ Gregory Mitchell	Director	March 21, 2013
/s/ M. Ray (Hoppy) Cole, Jr.	CEO, President and Director (Principal Executive Officer)	March 21, 2013
/s/ Dee Dee Lowery	Executive VP & Chief Financial Officer (Principal Financial and Accounting Officer)	March 21, 2013

25

;width:8.88%;">

WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING:

Basic	
	12,463,060
	12,094,181
	12,426,369
	12,039,593

Diluted	12,567,912
	12,301,772
	12,572,226
	12,245,212

ANNUAL DIVIDENDS DECLARED PER COMMON SHARE

$

$

$ 0.15

$ 0.15

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

6

Table of Contents

DYNAMIC MATERIALS CORPORATION & SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2008

(Amounts in Thousands)

(unaudited)

	Common Stock		Additional Paid-In	Retained	Other Cumulative Comprehensive		Comprehensive Income
	Shares	Amount	Capital	Earnings	Income	Total	for the Period
Balances, December 31, 2007	12,434	$ 622	$ 38,246	$ 55,868	$ 3,543	$ 98,279	
Shares issued for stock option exercises	74	4	224			228	
Restricted stock awards	153	8	(8)				
Shares issued in connection with the employee stock purchase plan	4		105			105	
Excess tax benefit related to stock options			9			9	
Stock-based compensation			2,363			2,363	
Dividends declared				(1,894)		(1,894)	
Net income				18,683		18,683	18,683
Derivative valuation adjustment, net of tax of $48					77	77	77
Change in cumulative foreign currency translation adjustment					(2,010)	(2,010)	(2,010)
Balances, September 30, 2008	12,665	$ 634	$ 40,939	$ 72,657	$ 1,610	$ 115,840	$ 16,750

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

7

Table of Contents

DYNAMIC MATERIALS CORPORATION & SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007

(Dollars in Thousands)

(unaudited)

	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 18,683	$ 17,659
Adjustments to reconcile net income to net cash provided by operating activities -		
Depreciation (including capital lease amortization)	3,621	1,394
Amortization of purchased intangible assets	6,188	
Amortization of capitalized debt issuance costs	210	
Stock-based compensation	2,363	912
Deferred income tax benefit	(2,735)	(239)
Equity in earnings of joint ventures	(270)	
Change in -		
Restricted cash		3,059
Accounts receivable, net	7,631	2,001
Inventories	262	(13,541)
Prepaid expenses and other	(2,549)	(636)
Accounts payable	(3,771)	3,125
Customer advances	218	132
Accrued expenses and other liabilities	(5,046)	(1,065)
Net cash provided by operating activities	24,805	12,801
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisition of property, plant and equipment	(7,325)	(7,347)
Change in other non-current assets	50	(11)
Net cash used in investing activities	(7,275)	(7,358)

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

Table of Contents

DYNAMIC MATERIALS CORPORATION & SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007

(Dollars in Thousands)

(unaudited)

	2008	2007
CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowings on bank lines of credit, net	7,247	
Payment on term loan with French bank	(441)	(389)
Payment on Nord LB term loans	(810)	
Payment of capital lease obligations	(308)	
Payment of dividends	(1,894)	(1,821)
Payment of deferred debt issuance costs	(167)	
Net proceeds from issuance of common stock to employees and directors	333	563
Excess tax benefit related to exercise of stock options	9	5
Net cash provided by (used in) financing activities	3,969	(1,642)
EFFECTS OF EXCHANGE RATES ON CASH	(36)	357
NET INCREASE IN CASH AND CASH EQUIVALENTS	21,463	4,158
CASH AND CASH EQUIVALENTS, beginning of the period	9,045	17,886
CASH AND CASH EQUIVALENTS, end of the period	$ 30,508	$ 22,044

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

Table of Contents

DYNAMIC MATERIALS CORPORATION & SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in Thousands, Except Share and Per Share Data)

(unaudited)

1. BASIS OF PRESENTATION

The information included in the Condensed Consolidated Financial Statements is unaudited but includes all normal and recurring adjustments which, in the opinion of management, are necessary for a fair presentation of the interim periods presented. These Condensed Consolidated Financial Statements should be read in conjunction with the financial statements that are included in the Company s Annual Report filed on Form 10-K for the year ended December 31, 2007.

2. SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The Condensed Consolidated Financial Statements include the accounts of the Company and its subsidiaries. Only subsidiaries in which controlling interests are maintained are consolidated. The equity method is used to account for our ownership in subsidiaries where we do not have controlling interest. All significant intercompany accounts, profits, and transactions have been eliminated in consolidation.

Foreign Operations and Foreign Exchange Rate Risk

The functional currency for the Company s foreign operations is the applicable local currency for each affiliate company. Assets and liabilities of foreign subsidiaries for which the functional currency is the local currency are translated at exchange rates in effect at period-end, and the statements of operations are translated at the average exchange rates during the period. Exchange rate fluctuations on translating foreign currency financial statements into U.S. dollars that result in unrealized gains or losses are referred to as translation adjustments. Cumulative translation adjustments are recorded as a separate component of stockholders equity and are included in other cumulative comprehensive income. Transactions denominated in currencies other than the local currency are recorded based on exchange rates at the time such transactions arise. Subsequent changes in exchange rates result in transaction gains and losses which are reflected in income as unrealized (based on period-end translations) or realized upon settlement of the transactions. Cash flows from the Company s operations in foreign countries are translated at actual exchange rates when known or at the average rate for the period. As a result, amounts related to assets and liabilities reported in the consolidated statements of cash flows will not conform with changes in the corresponding balances in the

Consolidated Balance Sheets. The effects of exchange rate changes on cash balances held in foreign currencies are reported as a separate line item below cash flows from financing activities.

Table of Contents

Revenue Recognition

Sales of clad metal products and welding services are generally based upon customer specifications set forth in customer purchase orders and require the Company to provide certifications relative to metals used, services performed and the results of any non-destructive testing that the customer has requested be performed. All issues of conformity of the product to specifications are resolved before the product is shipped and billed. Products related to the oilfield products segment, which include detonating cords, detonators, bi-directional boosters and shaped charges, as well as seismic related explosives and accessories, are standard in nature. In all cases, revenue is recognized only when all four of the following criteria have been satisfied: persuasive evidence of an arrangement exists; the price is fixed or determinable; delivery has occurred; and collection is reasonably assured. For contracts that require multiple shipments, revenue is recorded only for the units included in each individual shipment. If, as a contract proceeds toward completion, projected total cost on an individual contract indicates a potential loss, the Company will account for such anticipated loss.

Related Party Transactions

The Company has related party transactions with its unconsolidated joint ventures, as well as with the minority partner of one of its consolidated joint ventures. A summary of those transactions for the three and nine months ended September 30, 2008 is presented below:

	3 months ended September 30, 2008		9 months ended September 30, 2008	
	Sales to	Interest income from	Sales to	Interest income from
Perfoline	$ 115	$ 11	$ 162	$ 37
DYNAenergetics RUS	1,008		2,145	
Minority Interest Partner	547		1,531	
Total	$ 1,669	$ 11	$ 3,838	$ 37

A summary of related party balances as of September 30, 2008 and December 31, 2007 is presented below:

	As of September 30, 2008		As of December 31, 2007	
	Accounts receivable and loan to	Accounts payable and loan from	Accounts receivable and loan to	Accounts payable and loan from
Perfoline	$ 451	$ 137	$ 523	$ 120
DYNAenergetics RUS	660		449	
KazDYNAenergetics			131	
Minority Interest Partner	854	383		205
Total	$ 1,965	$ 520	$ 1,103	$ 325

11

Table of Contents

Earnings Per Share

Basic earnings per share (EPS) is computed by dividing net income by the weighted average number of shares of common stock outstanding during the period. Diluted EPS recognizes the potential dilutive effects of dilutive securities. The following represents a reconciliation of the numerator and denominator used in the calculation of basic and diluted EPS:

	For the three months ended September 30, 2008		
	Income	**Shares**	**Per share Amount**
Basic earnings per share:			
Net income	$ 7,223	12,463,060	$ 0.58
Dilutive effect of options to purchase common stock		93,260	
Dilutive effect of restricted stock awards		11,592	
Diluted earnings per share:			
Net income	$ 7,223	12,567,912	$ 0.57

	For the three months ended September 30, 2007		
	Income	**Shares**	**Per share Amount**
Basic earnings per share:			
Net income	$ 7,117	12,094,181	$ 0.59
Dilutive effect of options to purchase common stock		182,455	
Dilutive effect of restricted stock awards		25,136	
Diluted earnings per share:			
Net income	$ 7,117	12,301,772	$ 0.58

	For the nine months ended September 30, 2008		
	Income	**Shares**	**Per share Amount**
Basic earnings per share:			
Net income	$ 18,683	12,426,369	$ 1.50
Dilutive effect of options to purchase common stock		120,374	
Dilutive effect of restricted stock awards		25,483	
Diluted earnings per share:			
Net income	$ 18,683	12,572,226	$ 1.49

Table of Contents

	For the nine months ended September 30, 2007		
	Income	Shares	Per share Amount
Basic earnings per share:			
Net income	$ 17,659	12,039,593	$ 1.47
Dilutive effect of options to purchase common stock		191,652	
Dilutive effect of restricted stock awards		13,967	
Diluted earnings per share:			
Net income	$ 17,659	12,245,212	$ 1.44

Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with accounting principles generally accepted in the United States, and expands disclosures about fair value measurements. SFAS No. 157 was initially effective for financial statements issued for fiscal years beginning after November 15, 2007. The FASB issued a staff position statement (FSP) in February 2008 that deferred the required implementation date of SFAS 157 for certain assets and liabilities. The adoption of SFAS 157 in the nine months ended September 30, 2008 did not have a material impact on the Company s results of operations or financial position.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115*. This Statement permits entities to measure many financial instruments and certain other items at fair value. This election is made on an instrument-by-instrument basis and is irrevocable. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. This statement is effective for fiscal years beginning after November 15, 2007. The Company did not elect the fair value option for any of its existing financial assets and liabilities during the nine months ended September 30, 2008.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations* and SFAS No. 160, *Accounting and Reporting of Noncontrolling Interest in Consolidated Financial Statements*, an amendment of ARB No. 51. These new standards will significantly change the accounting for and reporting of business combination transactions and noncontrolling (minority) interests in consolidated financial statements. SFAS Nos. 141(R) and 160 are required to be adopted simultaneously and are effective for the first annual reporting period beginning on or after December 15, 2008. Thus, we are required to adopt these Standards on January 1, 2009. Earlier adoption is prohibited. The Company is in the process of determining the effect, if any, the adoption of SFAS Nos. 141(R) and 160 will have on its results of operations or financial position.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities*. SFAS 161 requires additional disclosures related to the use of derivative instruments, the accounting for derivatives and how derivatives impact financial statements. SFAS No. 161 is effective for fiscal years and interim periods beginning after November 15, 2008. The Company is currently evaluating the impact of adopting SFAS No. 161 on our consolidated financial statements.

Table of Contents

3. ACQUISITION

On November 15, 2007, the Company and a newly-formed subsidiary, DYNAenergetics Holding GmbH (the Purchaser), entered into a Purchase, Sale and Assignment Agreement (the Purchase Agreement) with Rolf Rospek, Patrick Xylander, Uwe Gessel, and Oag Beteiligungs-GmbH, a German limited liability company (collectively the Sellers). Pursuant to the terms of the Purchase Agreement, on November 15, 2007, the Purchaser acquired 100% of the issued and outstanding shares of DYNAenergetics Beteiligungs-GmbH and all of the interests in DYNAenergetics GmbH and Co. KG (collectively, DYNAenergetics) from the Sellers.

DYNAenergetics manufactures clad metal plates and various explosives-related oilfield products and operates under two business segments: Explosive Metalworking and Oilfield Products. The acquisition enhances the Company s ability to address growing worldwide demand for clad metal plates and expands the Company s position in the global explosion welding market. The addition of the Oilfield Products business segment will augment the Company s involvement in specialized explosive manufacturing processes and position the Company within the growing international oil and gas services industry.

As part of the Oilfield Products business segment, the Company has several joint ventures, some of which are unconsolidated and accounted for under the equity method (see Note 4).

The acquisition was valued at $112,701 and was financed by (i) the payment of $81,781 in cash, net of cash acquired of $1,870 and transaction related taxes of $3,708 (2,530 Euros) due from one of the Sellers and withheld by the Purchaser, (ii) the issuance of 251,041 shares of common stock of the Company (valued at $13,509), and (iii) the assumption of approximately $11,833 (8,074 Euros) of DYNAenergetics debt. The cash portion of the purchase price was financed using proceeds from the new syndicated credit agreement and existing available cash.

The purchase price of the acquisition was allocated to the Company s tangible and identifiable intangible assets based on their fair values as determined by appraisals performed as of the acquisition date. The excess of the purchase price over the tangible and identifiable intangible assets was recorded as goodwill.

Table of Contents

The allocation of the purchase price to the assets and liabilities of DYNAenergetics was as follows:

Current assets	$	30,222
Property, plant and equipment		7,845
Intangible assets		62,794
Goodwill		45,985
Investment in joint ventures		1,324
Other assets		11
Total assets acquired		148,181
Current liabilities		14,524
Long term debt		11,833
Deferred tax liabilities		19,850
Other long term liabilities		1,096
Minority interest		10
Total liabilities acquired		47,313
Net assets acquired	$	100,868

The Company acquired identifiable finite-lived intangible assets as a result of the acquisition of DYNAenergetics. The finite-lived intangible assets acquired are preliminarily classified and valued as follows:

		Value	Weighted Average Amortization Period
Core technology	$	24,531	20 years
Customer relationships		33,099	9 years
Trademarks / Trade names		2,672	9 years
Order backlog DYNAplat		2,492	Within 1 year
Total intangible assets	$	62,794	

The Company acquired goodwill in the amount of $45,985 as a result of the acquisition of DYNAenergetics. The amount of goodwill assigned to each reportable segment is as follows:

		Value
Explosive Metalworking	$	25,258
Oilfield Products		20,727
Total goodwill	$	45,985

Goodwill as of September 30, 2008 amounts to $44,797 and the change from December 31, 2007 reflects the impact of foreign currency translation and subsequent purchase price adjustments resulting from the compilation of additional acquisition related expenses.

Table of Contents

The following table presents the unaudited, pro-forma combined results of operations for the three and nine months ended September 30, 2007 assuming (i) the acquisition had occurred on January 1, 2007; (ii) pro-forma amortization expense of the purchased intangible assets and (iii) pro-forma interest expense assuming the Company utilized its syndicated credit agreement to finance the acquisition:

	Three months ended September 30, 2007	Nine months ended September 30, 2007
Net sales	$ 60,180	$ 154,195
Income from operations	$ 12,483	$ 28,315
Net income	$ 7,346	$ 15,793
Net income per share:		
Basic	$ 0.60	$ 1.28
Diluted	$ 0.59	$ 1.26

The pro-forma results above are not necessarily indicative of the operating results that would have actually occurred if the acquisition had been in effect on the dates indicated, nor are they necessarily indicative of future results of the combined companies.

4. INVESTMENT IN JOINT VENTURES

Operating results include the Company s proportionate share of income from joint ventures, which consist of unconsolidated joint ventures accounted for under the equity method. These investments (all of which resulted from the acquisition of DYNAenergetics and pertain to the Company s Oilfield Products business segment) include the following: (1) 65.19% interest in Perfoline, which is a Russian manufacturer of perforating gun systems and (2) 55% interest in DYNAenergetics RUS which is a Russian trading company that sells the Company s oilfield products. Due to certain minority interest veto rights that effectively require the minority interest shareholders to participate in ordinary course of business decisions, these joint ventures have been accounted for under the equity method instead of being consolidated in these financial statements. Investments in these joint ventures totaled $1,325 and $1,361 as of September 30, 2008 and December 31, 2007, respectively.

Table of Contents

Summarized unaudited financial information for the joint ventures accounted for under the equity method as of September 30, 2008 and December 31, 2007 and for the three and nine months ended September 30, 2008 is as follows:

	September 30, 2008	December 31, 2007
Current assets	$ 4,099	$ 4,148
Noncurrent assets	848	666
Total assets	$ 4,947	$ 4,814
Current liabilities	$ 1,151	$ 1,400
Noncurrent liabilities	917	1,048
Equity	2,879	2,366
Total liabilities and equity	$ 4,947	$ 4,814

	Three months ended September 30, 2008	Nine months ended September 30, 2008
Net sales	$ 1,875	$ 6,600
Gross profit	$ 347	$ 1,580
Operating income	$ 120	$ 908
Net income	$ 60	$ 595
Equity in earnings (losses) of joint ventures	$ (19)	$ 270

5. INVENTORY

The components of inventory are as follows at September 30, 2008 and December 31, 2007:

	September 30, 2008 (unaudited)	December 31, 2007
Raw materials	$ 12,628	$ 13,744
Work-in-process	21,992	23,699
Finished goods	5,293	3,564
Supplies	987	621
	$ 40,900	$ 41,628

Table of Contents

6. PURCHASED INTANGIBLE ASSETS

The following table presents details of our purchased intangible assets, other than goodwill, as of September 30, 2008:

	Gross	Accumulated Amortization	Net
Core technology	$ 24,185	$ (1,058)	$ 23,127
Customer relationships	32,633	(3,173)	29,460
Trademarks / Trade names	2,634	(345)	2,289
Order backlog DYNAplat	2,456	(2,456)	
Total intangible assets	$ 61,908	$ (7,032)	$ 54,876

The following table presents details of our purchased intangible assets, other than goodwill, as of December 31, 2007:

	Gross	Accumulated Amortization	Net
Core technology	$ 24,653	$ (154)	$ 24,499
Customer relationships	33,263	(461)	32,802
Trademarks / Trade names	2,685	(50)	2,635
Order backlog DYNAplat	2,504	(526)	1,978
Total intangible assets	$ 63,105	$ (1,191)	$ 61,914

The decrease in the gross value of our purchased intangible assets from December 31, 2007 to September 30, 2008 is due to the impact of foreign currency translation.

7. DEBT

Lines of credit consist of the following at September 30, 2008 and December 31, 2007:

	September 30, 2008 (unaudited)	December 31, 2007
Syndicated credit agreement revolving loan	$ 9,536	$
Commerzbank revolving line of credit	1,173	3,225
Commerzbank line of credit	3,612	1,473
Deutsche Bank revolving line of credit		680
Nord LB line of credit		2,209

		14,321		7,587
Less current portion		(4,785)		(7,587)
Long-term lines of credit	$	9,536	$	

18

Table of Contents

Long-term debt consists of the following at September 30, 2008 and December 31, 2007:

	September 30, 2008 (unaudited)	December 31, 2007
Syndicated credit agreement term loan	$ 45,000	$ 45,000
Syndicated credit agreement Euro term loan	20,229	20,621
Euro term loan - French bank		427
Nord LB 3,000 Euro term loan	2,601	3,314
Nord LB 500 Euro term loan	81	203
	67,911	69,565
Less current maturities	(7,471)	(8,035)
Long-term debt	$ 60,440	$ 61,530

Loan Covenants and Restrictions

The Company s existing loan agreements include various covenants and restrictions, certain of which relate to the incurrence of additional indebtedness, mortgaging, pledging or disposition of major assets, limits on capital expenditures and maintenance of specified financial ratios. As of September 30, 2008, the Company was in compliance with all financial covenants and other provisions of its debt agreements.

Swap Agreement

On November 15, 2007, the Company entered into an interest swap agreement that effectively converted the LIBOR based variable rate borrowings under the $45,000 term loan to a fixed rate of 6.34%. The company has designated the swap agreement as an effective cash flow hedge with matched terms in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities,* and as a result, changes in the fair value of the swap agreement are recorded in other comprehensive income with the offset as a swap asset or liability. As of September 30, 2008, the fair value of the swap agreement was a liability of $70, net of tax. The swap agreement expires on November 16, 2008.

On October 15, 2008, the Company entered into a new two-year interest rate swap agreement which becomes effective on November 17, 2008. Similar to the interest rate swap agreement described above, this new agreement will effectively convert the LIBOR based variable rate US borrowings to a fixed rate of 4.87% and the Company has designated this new swap agreement as an effective cash flow hedge with matched terms in accordance with SFAS No. 133.

8. BUSINESS SEGMENTS

The Company is organized in the following three segments: Explosive Metalworking, Oilfield Products and AMK Welding. The Explosive Metalworking segment uses explosives to perform metal cladding and shock synthesis of industrial diamonds. The most significant product of this group is clad metal which is used in the fabrication of pressure vessels, heat exchangers and transition joints for various industries, including upstream oil and gas, oil refinery, petrochemicals, hydrometallurgy, aluminum production, shipbuilding, power generation, industrial refrigeration, and similar industries. The Oilfield Products segment manufactures, markets and sells oilfield perforating equipment and explosives, including detonating cords, detonators, bi-directional

Table of Contents

boosters and shaped charges, and seismic related explosives and accessories. AMK Welding utilizes a number of welding technologies to weld components for manufacturers of jet engines and ground-based turbines.

The accounting policies of all the segments are the same as those described in the summary of significant accounting policies. The Company s reportable segments are separately managed strategic business units that offer different products and services. Each segment s products are marketed to different customer types and require different manufacturing processes and technologies. Segment information is presented for the three and nine months ended September 30, 2008 and 2007 as follows:

	Explosive Metalworking Group	Oilfield Products	AMK Welding	Total
For the three months ended September 30, 2008:				
Net sales	$ 42,703	$ 6,756	$ 2,921	$ 52,380
Depreciation and amortization	$ 1,574	$ 947	$ 109	$ 2,630
Income from operations	$ 8,593	$ 725	$ 874	$ 10,192
Equity in earnings (losses) of joint ventures	$	$ (19)	$	(19)
Unallocated amounts:				
Stock-based compensation				(820)
Other expense				(268)
Interest expense				(1,469)
Interest income				153
Consolidated income before income taxes				$ 7,769

	Explosive Metalworking Group	AMK Welding	Total
For the three months ended September 30, 2007:			
Net sales	$ 40,326	$ 1,773	$ 42,099
Depreciation	$ 402	$ 82	$ 484
Income from operations	$ 10,646	$ 325	$ 10,971
Unallocated amounts:			
Stock-based compensation			(393)
Other income			23
Interest expense			(20)
Interest income			233
Consolidated income before income taxes			$ 10,814

Table of Contents

	Explosive Metalworking Group		Oilfield Products		AMK Welding		Total	
For the nine months ended September 30, 2008:								
Net sales	$	147,344	$	19,128	$	7,485	$	173,957
Depreciation and amortization	$	6,619	$	2,866	$	324	$	9,809
Income from operations	$	28,393	$	775	$	2,096	$	31,264
Equity in earnings of joint ventures	$		$	270	$			270
Unallocated amounts:								
Stock-based compensation								(2,363)
Other expense								(227)
Interest expense								(4,203)
Interest income								477
Consolidated income before income taxes							$	25,218

	Explosive Metalworking Group		AMK Welding		Total	
For the nine months ended September 30, 2007:						
Net sales	$	105,257	$	4,707	$	109,964
Depreciation	$	1,190	$	204	$	1,394
Income from operations	$	27,197	$	606	$	27,803
Unallocated amounts:						
Stock-based compensation						(912)
Other income						3
Interest expense						(20)
Interest income						598
Consolidated income before income taxes					$	27,472

During the three and nine months ended September 30, 2008 no sales to any one customer accounted for more than 10% of total net sales. During the three months ended September 30, 2007, sales to one customer represented approximately $7,333 (17%) of total net sales. During the nine months ended September 30, 2007, no sales to any one customer accounted for more than 10% of total net sales.

9. COMPREHENSIVE INCOME

The Company s comprehensive income for the three and nine months ended September 30, 2008 and 2007 was as follows:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2008		2007		2008		2007	
Net income for the period	$	7,223	$	7,117	$	18,683	$	17,659
Interest rate swap valuation adjustment, net of tax		167				77		
Foreign currency translation adjustment		(9,117)		898		(2,010)		1,158

Comprehensive income (loss)	$ (1,727)	$ 8,015	$ 16,750	$ 18,817

Table of Contents

Accumulated other cumulative comprehensive income as of September 30, 2008 and December 31, 2007 consisted of the following:

	September 30, 2008 (unaudited)	December 31, 2007
Currency translation adjustment	$ 1,680	$ 3,690
Interest rate swap valuation adjustment, net of tax of $42 and $90, respectively	(70)	(147)
	$ 1,610	$ 3,543

22

Table of Contents

ITEM 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with our historical consolidated financial statements and notes, as well as the selected historical consolidated financial data that are included in the Company s Annual Report filed on Form 10-K for the year ended December 31, 2007.

Unless stated otherwise, all dollar figures in this discussion are presented in thousands (000 s).

Executive Overview

Historically, our business has been organized into two segments: Explosive Metalworking (which we also refer to as DMC Clad) and AMK Welding. On November 15, 2007, we acquired 100% ownership of a German company, DYNAenergetics. DYNAenergetics operates two distinct businesses which have historically been known as DYNAplat and DYNAwell. DYNAplat is a manufacturer of explosion clad products similar to those manufactured by DMC Clad, and its operating results from the date of acquisition are included in our Explosive Metalworking segment. DYNAwell manufactures a number of products for the perforation of oil and gas wells and also distributes a line of seismic products for oil and gas exploration activities. DYNAwell s operating results from the date of acquisition are reported under a new segment that we have named Oilfield Products.

For the nine months ended September 30, 2008, Explosive Metalworking accounted for 85% of our net sales and 91% of our income from operations before consideration of stock-based compensation expense, which is not allocated to our business segments. Our AMK Welding and Oilfield Products segments accounted for 4% and 11%, respectively, of our year-to-date 2008 net sales.

Our net sales for the nine months ended September 30, 2008, which include $44,099 of sales from our recently acquired DYNAenergetics businesses, increased by $63,993 (58.2%) compared to the first nine months of 2007, reflecting year-to-year net sales increases of $42,087 (40.0%) and $2,778 (59.0%) for our Explosive Metalworking and AMK Welding segments, respectively, and a sales contribution of $19,128 from our new Oilfield Products segment. Income from operations increased by 7.5% to $28,901 in the first nine months of 2008 from $26,891 in the first nine months of 2007, reflecting improvements in Explosive Metalworking s and AMK Welding s operating income of $1,196 and $1,490, respectively, that were partially offset by a $1,451 increase in stock-based compensation expense. Our Oilfield Products segment reported operating income of $775 in the first nine months of 2008. Our net income increased by 5.8% to $18,683 for the nine months ended September 30, 2008 from $17,659 in the same period of 2007.

Net sales

Explosive Metalworking s revenues are generated principally from sales of clad metal plates and sales of transition joints, which are made from clad plates, to customers that fabricate industrial equipment for various industries, including oil and gas, petrochemicals, alternative energy, hydrometallurgy, aluminum production, shipbuilding, power generation, industrial refrigeration and similar industries. While demand for our clad metal products in the United States is largely driven by new plant construction and large plant expansion projects, maintenance and retrofit

projects at existing chemical processing, petrochemical processing and oil refining facilities also account for a significant portion of total demand. In contrast to the U.S. market,

Table of Contents

demand for our clad products in Europe and Asia is more dependent on new construction projects, such as the building of new Purified Terephthalic Acid (PTA) plants in different parts of the world, including China, and on sales of electrical transition joints that are used in the aluminum production industry.

Oilfield Products revenues are generated principally from sales of shaped charges, detonators and detonating cord, boosters, and perforating guns to customers who perform the perforation of oil and gas wells and from sales of seismic products to customers involved in oil and gas exploration activities.

AMK Welding s revenues are generated from welding, heat treatment, and inspection services that are provided with respect to customer-supplied parts for customers primarily involved in the power generation industry and aircraft engine markets.

A significant portion of our revenue is derived from a relatively small number of customers; therefore, the failure to complete existing contracts on a timely basis, to receive payment for such services in a timely manner, or to enter into future contracts at projected volumes and profitability levels could adversely affect our ability to meet cash requirements exclusively through operating activities. We attempt to minimize the risk of losing customers or specific contracts by continually improving product quality, delivering products on time, and competing favorably on the basis of price.

DMC Clad s business is cyclical since it is linked to its customers end-market activity. For example, the construction cycle for new manufacturing capacity in the chemical industry has historically been one characterized by significant amplitude. It is driven both by global economic demand growth and capacity utilization. As capacity starts to become tight for various chemicals and prices begin to rise, new manufacturing capacity is added in relatively large incremental amounts.

Gross profit and cost of products sold

Cost of products sold for Explosive Metalworking include the cost of metals and alloys used to manufacture clad metal plates, the cost of explosives, employee compensation and benefits, freight, outside processing costs, depreciation of manufacturing facilities and equipment, manufacturing supplies, and other manufacturing overhead expenses.

Cost of products sold for Oilfield Products include the cost of metals, explosives and other raw materials used to manufacture shaped charges, detonating products, and perforating guns as well as employee compensation and benefits, depreciation of manufacturing facilities and equipment, manufacturing supplies, and other manufacturing overhead expenses.

AMK Welding s cost of products sold consists principally of employee compensation and benefits, welding supplies (wire and gas), depreciation of manufacturing facilities and equipment, outside services, and other manufacturing overhead expenses.

Income taxes

Our effective income tax rate decreased to 25.9% for the first nine months of 2008 from 35.7% for the same period of 2007. Income tax provisions on the earnings of Nobelclad, Nitro Metall, DYNAenergetics and our German and Luxembourg holding companies have been provided based upon the respective French, Swedish, German and Luxembourg statutory tax rates. Based upon existing tax regulations and current federal, state and foreign statutory tax rates, we expect our full year 2008 blended effective tax rate on our consolidated pre-tax income to

Table of Contents

approximate 27%. We currently expect our blended effective tax rate for 2009 to increase to a range from 31% to 32%.

Backlog

We use backlog as a primary means of measuring the immediate outlook for our business. We define backlog at any given point in time to consist of all firm, unfulfilled purchase orders and commitments at that time. Generally speaking, we expect to fill most backlog orders within the following 12 months. From experience, most firm purchase orders and commitments are realized. However, since orders may be rescheduled or canceled, and a significant portion of our net sales is derived from a small number of customers, backlog is not necessarily indicative of future sales levels. Moreover, we cannot be sure of when during the future 12-month period we will be able to recognize revenue corresponding to our backlog nor can we be sure that revenues corresponding to our backlog will not fall into periods beyond the 12-month horizon.

Our backlog with respect to the Explosive Metalworking segment, which totaled approximately $100,000 at the beginning of 2008, decreased during the current quarter to approximately $98,610 at September 30, 2008 from approximately $104,871 at June 30, 2008. Approximately $4 million of the backlog reduction from June 30 to September 30 relates to the change in the Euro to U.S. dollar exchange rate as of the respective quarter-end dates.

Three and Nine Months Ended September 30, 2008 Compared to Three and Nine Months Ended September 30, 2007

Net sales

	Three Months Ended September 30,			
	2008	**2007**	**Change**	**Percentage Change**
Net sales	$ 52,380	$ 42,099	$ 10,281	24.4%

	Nine Months Ended September 30,			
	2008	**2007**	**Change**	**Percentage Change**
Net sales	$ 173,957	$ 109,964	$ 63,993	58.2%

Net sales for the third quarter of 2008 increased 24.4% to $52,380 from $42,099 in the third quarter of 2007. Explosive Metalworking sales increased 5.9% to $42,703 in the three months ended September 30, 2008 (81% of total sales) from $40,326 in the same period of 2007 (96% of total sales). The increase in Explosive Metalworking sales reflects a sales contribution of $5,622 from the DYNAplat division of DYNAenergetics that offset the decreased sales of $3,245 from our other DMC Clad divisions.

Oilfield Products contributed $6,756 to third quarter 2008 sales (13% of total sales).

AMK Welding contributed $2,921 to third quarter 2008 sales (6% of total sales), which represents a 64.7% increase from sales of $1,773 in the third quarter of 2007 (4% of total sales). The increase in AMK s sales relates principally to increased revenues from ground-based gas turbine work.

Net sales for the first nine months of 2008 increased 58.2% to $173,957 from $109,964 in the first nine months of 2007. Explosive Metalworking sales increased 40.0% to $147,344 in the

Table of Contents

nine months ended September 30, 2008 (85% of total sales) from $105,257 in the same period of 2007 (96% of total sales). The significant increase in Explosive Metalworking sales reflects a sales contribution of $24,971 from the DYNAplat division of DYNAenergetics and increased sales of $17,116 from our other DMC Clad divisions which reflect the continued strong economic condition of the industries this business segment serves. At the end of this year s second quarter, we disclosed that third quarter 2008 sales were expected to be up to 20% less than the $52,996 in sales that we reported in the second quarter due to longer lead times on carbon steel supply in the United States. Actual third quarter sales of $42,703 were 19.4% below those of the second quarter. We have seen some improvement in carbon steel deliveries and expect our fourth quarter sales to return to the level that we enjoyed in the second quarter.

Oilfield Products contributed $19,128 to first nine months 2008 sales (11% of total sales). Fourth quarter sales are expected to be 20% to 25% higher than the $6,756 in sales that Oilfield Products reported in the third quarter.

AMK Welding contributed $7,485 to sales for the first nine months 2008 (4% of total sales), which represented a 59.0% increase from sales of $4,707 in the first nine months of 2007 (4% of total sales). As indicated above, AMK s 2008 sales relate principally to increased revenues from ground-based gas turbine work. Third quarter sales at AMK were stronger than expected as a result of earlier than planned shipments of certain orders. We expect AMK s fourth quarter sales to decline to a level that is more consistent with amounts that we reported in the first and second quarter of this year ($2,299 and $2,265, respectively).

Gross profit

	Three Months Ended September 30,			
	2008	**2007**	**Change**	**Percentage Change**
Gross profit	$ 17,025	$ 14,292	$ 2,733	19.1%
Consolidated gross profit margin rate	32.5%	33.9%		

	Nine Months Ended September 30,			
	2008	**2007**	**Change**	**Percentage Change**
Gross profit	$ 53,786	$ 37,223	$ 16,563	44.5%
Consolidated gross profit margin rate	30.9%	33.9%		

Gross profit increased by 19.1% to $17,025 for the three months ended September 30, 2008 from $14,292 for the three months ended September 30, 2007. Our third quarter 2008 consolidated gross profit margin rate decreased to 32.5% from 33.9% in the third quarter of 2007. The gross profit margin rate for Explosive Metalworking decreased from 34.3% in the third quarter of 2007 to 31.9% in the third quarter of 2008, for the reasons discussed below. The gross profit margin rate for AMK Welding increased to 37.9% in the third quarter of 2008 from 27.7% in the third quarter of 2007, with this improvement being largely attributable to the 64.7% increase in AMK s sales volume as discussed above. Oilfield Products reported a gross profit margin rate of 35.6% on its third quarter 2008 sales of $6,756, which was higher than the normal gross margin level for this business due to a favorable third quarter product and customer mix.

Table of Contents

For the nine months ended September 30, 2008, gross profit increased to $53,786 from $37,223 for the same period of 2007, a 44.5% increase. Our year to date consolidated gross profit margin grate decreased to 30.9% from 33.9% for the first nine months of 2007. The gross profit margin rate for Explosive Metalworking decreased to 30.6% from 34.3%. For the nine months ended September 30, 2007, the gross profit margin rate for AMK Welding increased to 36.3% from 26.5% for the same period of 2007. Oilfield Products reported a gross profit margin rate of 32.4% for the first nine months of 2008, which is considered somewhat higher than the normal gross margin range for this business.

The decreased third quarter and year-to-date 2008 gross profit margin rates for Explosive Metalworking relates primarily to a higher proportion of sales by our European divisions in the first nine months of 2008 than in the first nine months of 2007 as a result of the DYNAenergetics acquisition. As mentioned above, the DYNAplat division of DYNAenergetics reported year-to-date 2008 sales of $24,971. Historically, gross margins for our European explosion welding divisions, including those of the DYNAplat division, have generally been lower than those reported by our U.S. division.

Our third quarter consolidated gross margin of 32.5% was higher than expected as a result of the strong gross margins reported in the third quarter by both our Oilfield Products and AMK Welding segments as discussed above and higher than expected proportionate Explosive Metalworking sales by our U.S. division, which generally enjoys higher gross margins than our European Explosive Metalworking divisions. Based upon expected fourth quarter sales volume and normal quarter to quarter fluctuations in product mix, we expect our fourth quarter consolidated gross margin to be comparable to the gross margin rates that we reported in the first and second quarter of this year (30.3% and 30.1%, respectively).

General and administrative expenses

	Three Months Ended September 30, 2008	2007	Change	Percentage Change
General & administrative expenses	$ 3,679	$ 1,903	$ 1,776	93.3%
Percentage of net sales	7.0%	4.5%		

	Nine Months Ended September 30, 2008	2007	Change	Percentage Change
General & administrative expenses	$ 10,612	$ 5,419	$ 5,193	95.8%
Percentage of net sales	6.1%	4.9%		

General and administrative expenses increased by $1,776, or 93.3%, to $3,679 in the third quarter of 2008 from $1,903 in the third quarter of 2007. Excluding $1,050 of incremental general and administrative expenses that resulted from the DYNAenergetics acquisition, our general and administrative expenses increased by $726 or 38.1%. This increase included a $258 increase in stock-based compensation and an impact of $172 from annual salary adjustments and staffing changes. As a percentage of net sales, general and administrative expenses increased to 7.0% in the third quarter of 2008 from 4.5% in the third quarter of 2007.

General and administrative expenses for the nine months ended September 30, 2008 totaled $10,612 compared to $5,419 for the same period of 2007. This reflects an increase of 95.8%.

Table of Contents

Excluding $3,388 of incremental general and administrative expenses for DYNAenergetics, our general and administrative expenses increased by $1,805 or 33.3%. This increase reflects a $909 increase in stock-based compensation and an impact of $294 from annual salary adjustments and staffing changes. As a percentage of net sales, general and administrative expenses increased to 6.1% in the first nine months of 2008 from 4.9% in the first nine months of 2007.

Selling expenses

	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007	Change	Percentage Change
Selling expenses	$ 2,611	$ 1,811	$ 800	44.2%
Percentage of net sales	5.0%	4.3%		

	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007	Change	Percentage Change
Selling expenses	$ 8,085	$ 4,913	$ 3,172	64.6%
Percentage of net sales	4.6%	4.5%		

Selling expenses, which include sales commissions of $270 in 2008 and $663 in 2007, increased by 44.2% to $2,611 in the third quarter of 2008 from $1,811 in the third quarter of 2007. Excluding $1,083 of incremental selling expenses that resulted from the DYNAenergetics acquisition, our selling expenses decreased by $283 or 15.6%. This decrease reflects a $393 decrease in sales commissions and a net decrease of $113 in other expense categories that were partially offset by increases of $119 in stock-based compensation expense and $104 resulting from annual salary adjustments/staffing changes. As a percentage of net sales, selling expenses increased to 5.0% in the third quarter of 2008 from 4.3% in the third quarter of 2007.

Selling expenses increased by 64.6% to $8,085 in the first nine months of 2008 from $4,913 in the same period of 2007. These expenses include sales commission of $892 and $1,378 for 2008 and 2007, respectively. Excluding $2,747 of incremental selling expenses from DYNAenergetics, our selling expenses increased by $425 or 8.6%. This increase reflects an increase in stock-based compensation expense of $385, an impact of $289 from annual salary adjustments and staffing changes, and a $229 increase in travel expenses that were partially offset by a $486 decrease in sales commissions. As a percentage of net sales, selling expenses increased to 4.6% in the first nine months of 2008 from 4.5% in the first nine months of 2007.

Amortization expenses

	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007	Change	Percentage Change
Amortization expense of purchased intangible assets	$ 1,363	$	$ 1,363	NA
Percentage of net sales	2.6%	0.0%		

Table of Contents

	Nine Months Ended September 30,			
	2008	2007	Change	Percentage Change
Amortization expense of purchased intangible assets	$ 6,188	$	$ 6,188	NA
Percentage of net sales	3.6%	0.0%		

Amortization expense relates entirely to the amortization of values assigned to intangible assets in connection with the November 15, 2007 acquisition of DYNAenergetics. Amortization expense for the three months ended September 30, 2008 includes $945, $315 and $103 relating to values assigned to customer relationships, core technology and trademarks/trade names, respectively. Amortization expense for the nine months ended September 30, 2008 includes $2,055, $2,866, $956 and $311 relating to values assigned to order backlog, customer relationships, core technology and trademarks/trade names, respectively. Based upon the current foreign exchange rates, we expect amortization expense for 2008 to approximate $7,500.

Income from operations

	Three Months Ended September 30,			
	2008	2007	Change	Percentage Change
Income from operations	$ 9,372	$ 10,578	$ (1,206)	(11.4)%

	Nine Months Ended September 30,			
	2008	2007	Change	Percentage Change
Income from operations	$ 28,901	$ 26,891	$ 2,010	7.5%

Income from operations decreased by 11.4% to $9,372 in the third quarter of 2008 from $10,578 in the third quarter of 2007. Explosive Metalworking reported income from operations of $8,593 in the third quarter of 2008 as compared to $10,646 in the third quarter of 2007. This 19.3% decrease in Explosive Metalworking operating income is largely attributable to a decline in the gross margin rate from 34.3% in 2007 to 31.9% in 2008 and increased operating expenses from the acquired DYNAplat business. Oilfield Products reported income from operations of $725 for the third quarter of 2008. AMK Welding reported income from operations of $874 for the three months ended September 30, 2008 as compared to $325 for the same period of 2007. This significant increase is attributable to the $1,148, or 64.7%, increase in sales as discussed above.

Income from operations increased by 7.5% to $28,901 in the first nine months of 2008 from $26,891 in the first nine months of 2007. Explosive Metalworking reported income from operations of $28,393 in the first nine months of 2008 as compared to $27,197 in the first nine months of 2007. This modest 4.4% increase reflects a favorable impact from the 40.0% sales increase discussed above that was offset by a decline in the gross margins rate from 34.3% in 2007 to 30.6% in 2008 and increased operating expenses from the acquired DYNAplat business. Oilfield Products reported income from operations of $775 for the first nine months of 2008. AMK Welding reported income from operations of $2,096 for the first nine months of 2008 as compared to $606 for the first nine months of 2007, with this increase of $1,490 reflecting a $2,778, or 59.0%, increase in sales as discussed above.

Table of Contents

Income from operations for the three and nine months ended September 30, 2008 includes $820 and $2,363, respectively, of stock-based compensation expense compared to stock-based compensation expense for the three and nine months ended September 30, 2007 of $393 and $912, respectively. This expense is not allocated to our business segments and thus is not included in the above third quarter and year to date operating income totals for Explosive Metalworking, Oilfield Products and AMK Welding.

Interest income (expense), net

	Three Months Ended September 30,			
	2008	2007	Change	Percentage Change
Interest income (expense), net	$ (1,316)	$ 213	$ (1,529)	NM

	Nine Months Ended September 30,			
	2008	2007	Change	Percentage Change
Interest income (expense), net	$ (3,726)	$ 578	$ (4,304)	NM

We recorded net interest expense of $1,316 in the three months ended September 30, 2008 compared to net interest income of $213 in the same time period of 2007. We recorded net interest expense of $3,726 in the first nine months of 2008 compared to net interest income of $578 in the first nine months of 2007. During the first nine months of 2007, we were in a positive net cash position and earned interest on investment of excess cash balances. In connection with the acquisition of DYNAenergetics, we borrowed approximately $65,000 under our new $100,000 five-year credit facility, assumed approximately $12,000 of DYNAenergetics debt outstanding as of the acquisition date, and used approximately $16,000 of our existing cash balances to finance the acquisition. As a result of this new indebtedness and a decrease in our cash position, we reported a significant amount of interest expense during the third quarter and first nine months of 2008.

Income tax provision

	Three Months Ended September 30,			
	2008	2007	Change	Percentage Change
Income tax provision	$ 546	$ 3,697	$ (3,151)	(85.2)%
Effective tax rate	7.0%	34.2%		

	Nine Months Ended September 30,			
	2008	2007	Change	Percentage Change
Income tax provision	$ 6,535	$ 9,813	$ (3,278)	(33.4)%
Effective tax rate	25.9%	35.7%		

We recorded an income tax provision of $546 in the third quarter of 2008 compared to $3,697 in the third quarter of 2007. The effective tax rate decreased to 7.0% in the third quarter of 2008 from 34.2% in the third quarter of 2007. The income tax provisions for the three months ended

September 30, 2008 and 2007 include $83 and $3,274, respectively, related to U.S. taxes,

Table of Contents

with the remainder relating to foreign taxes and foreign tax benefits associated with the operations of Nobelclad and its Swedish subsidiary, Nitro Metall, as well as the newly acquired DYNAenergetics division and related holding companies in Germany and Luxembourg. The third quarter 2008 effective tax rate of 7.0% represents a significant deviation from the expected full year 2008 effective tax rate of 32% to 33% that was disclosed at the end of the second quarter. The deviation arose primarily from the completion during the third quarter of an Internal Revenue Service examination and from adjustments that were identified during the third quarter 2008 preparation and filing of our 2007 federal and state tax returns. The closure of the Internal Revenue Service examination enabled the Company to record previously unrecognized tax benefits of approximately $300. The book-to-return adjustments favorably impacted the third quarter tax provision by approximately $1,100 and related primarily to apportionment factors utilized to compute state income taxes. As a result of these third quarter tax provision adjustments, we now expect our full year 2008 blended effective tax rate on our consolidated pre-tax income to approximate 27%. Our blended effective tax rate for 2009 is expected to increase to a range from 31% to 32%.

For the nine months ended September 30, 2008, we recorded an income tax provision of $6,535 compared to $9,813 for the same period of 2007. The effective tax rate decreased to 25.9% for the first nine months of 2008 from 35.7% for the first nine months of 2007. The income tax provisions for the nine months ended September 30, 2008 and 2007 include $5,643 and $8,317, respectively, related to U.S. taxes, with the remainder relating to foreign taxes and foreign tax benefits associated with the operations of Nobelclad, Nitro Metall, DYNAenergetics and our holding companies in Germany and Luxembourg. The effective tax rate for the nine months ended September 30, 2008 was favorably impacted by the items noted above in the preceding paragraph.

Liquidity and Capital Resources

We have historically financed our operations from a combination of internally generated cash flow, revolving credit borrowings, various long-term debt arrangements and the issuance of common stock. Prior to the November 15, 2007 acquisition of DYNAenergetics, we had no outstanding borrowings under our $10,000 revolving credit facility with a U.S. bank and term debt outstanding of 290 Euros (approximately $458) under a term loan with a French bank. In connection with the acquisition of DYNAenergetics, we terminated our $10,000 revolving credit facility and entered into a five-year syndicated credit agreement. The credit agreement, which provides for term loans of $45,000 and 14,000 Euros and revolving loans of $25,000 and 7,000 Euros, is through a syndicate of seven banks. The credit facility in the approximate amount of $100,000 expires on November 16, 2012. As of September 30, 2008, term loans of $45,000 and 14,000 Euros ($20,229) and revolving loans of 6,600 Euros ($9,536) were outstanding under the new credit facility. Additionally, we have assumed outstanding debt obligations of DYNAenergetics, including lines of credit loans and term loans with outstanding amounts of $4,785 and $2,682, respectively, as of September 30, 2008.

We believe that cash flow from operations and funds available under our current credit facilities and any future replacement thereof will be sufficient to fund the working capital, debt service and capital expenditure requirements of our current business operations for the foreseeable future. Nevertheless, our ability to generate sufficient cash flows from operations will depend upon our success in executing our strategies. If we are unable to (i) realize sales from our backlog; (ii) secure new customer orders at attractive prices; (iii) successfully integrate the recently-acquired DYNAenergetics businesses; or (iv) continue to implement cost-effective internal processes, our ability to meet cash requirements through operating activities could be impacted. Furthermore, any restriction on the availability of borrowings under our credit facilities could negatively affect our ability to meet future cash requirements.

Table of Contents

Debt and other contractual obligations and commitments

Our existing loan agreements include various covenants and restrictions, certain of which relate to the payment of dividends or other distributions to stockholders, redemption of capital stock, incurrence of additional indebtedness, mortgaging, pledging or disposition of major assets and maintenance of specified financial ratios. As of September 30, 2008, we were in compliance with all financial covenants and other provisions of our debt agreements.

The Company s principal cash flows related to debt obligations and other contractual obligations and commitments have not materially changed since December 31, 2007.

Cash flows from operating activities

Net cash flows provided by operating activities for the first nine months of 2008 totaled $24,805. Significant sources of operating cash flow included net income of $18,683, non-cash depreciation and amortization expense of $10,019 and stock-based compensation of $2,363. These sources of operating cash flow were partially offset by a deferred income tax benefit of $2,735, $270 in equity in losses of joint ventures and net negative changes in various components of working capital in the amount of $3,255. Net negative changes in working capital included increases in prepaid expenses of $2,549 and decreases in accounts payable and accrued expenses and other liabilities of $3,771 and $5,046, respectively. These negative changes in working capital were partially offset by decreases in accounts receivable and inventories of $7,631 and $262, respectively, and increases in customer advances of $218.

Net cash flows provided by operating activities for the nine months ended September 30, 2007 totaled $12,801. Significant sources of operating cash flow included net income of $17,659, non-cash depreciation expense of $1,394 and stock-based compensation of $912. These sources of operating cash flow were offset by net negative changes in various components of working capital in the amount of $6,925. Net negative changes in working capital included increases in inventories and prepaid expenses of $13,541 and $636, respectively, and decreases in accrued expenses and other liabilities of $1,065. These negative changes in working capital were partially offset by decreases in restricted cash and accounts receivable of $3,059 and $2,001, respectively, and increases in accounts payable and customer advances of $3,125 and $132, respectively.

Cash flows from investing activities

Net cash flows used by investing activities for the first nine months of 2008 totaled $7,275 and consisted almost entirely of capital expenditures.

Net cash flows used in investing activities for the first nine months of 2007 totaled $7,358 and consisted primarily of capital expenditures.

Cash flows from financing activities

Net cash flows provided by financing activities for the first nine months of 2008 were $3,969, which consisted primarily of net borrowings on bank lines of credit of $7,247 and $333 in net proceeds from the issuance of common stock relating to the exercise of stock options. These sources of cash flow were partially offset by payment of annual dividends of $1,894, a final principal payment on a term loan with French bank of $441, an $810 principal payment on a Nord LB term loan, payments of deferred debt issuance costs of $167 and payment on capital lease obligations of $308.

Table of Contents

Net cash flows used in financing activities for the first nine months of 2007 were $1,627. Significant uses of cash for financial activities included a $1,821 payment of annual dividends and $389 principal payment on a term loan with French bank. Sources of cash flow from financial activities include $563 in net proceeds from the issuance of common stock relating to the exercise of stock options.

Payment of Dividends

We paid annual dividends in 2008 and 2007 and may continue to pay annual dividends in the future subject to capital availability and periodic determinations that cash dividends are in compliance with our debt covenants and are in the best interests of our stockholders, but we cannot assure you that such payments will continue. Future dividends may be affected by, among other items, our views on potential future capital requirements, future business prospects, changes in federal income tax laws, or any other factors that our board of directors deems relevant. Any decision to pay cash dividends is and will continue to be at the discretion of board of directors.

Critical Accounting Policies

Our historical consolidated financial statements and notes to our historical consolidated financial statements contain information that is pertinent to our management s discussion and analysis of financial condition and results of operations. Preparation of financial statements in conformity with accounting principles generally accepted in the United States requires that our management make estimates, judgments, and assumptions that affect the reported amounts of assets, liabilities, revenues, and expenses, and requires the disclosure of contingent assets and liabilities. However, the accounting principles used by us generally do not change our reported cash flows or liquidity. Interpretation of the existing rules must be performed and judgments made on how the specifics of a given rule apply to us.

In management s opinion, the more significant reporting areas impacted by management s judgments and estimates are revenue recognition, asset impairments, business combinations, goodwill, intangible assets subject to amortization, impact of foreign currency exchange rate risks, income taxes and stock-based compensation expense. Management s judgments and estimates in these areas are based on information available from both internal and external sources, and actual results could differ from the estimates, as additional information becomes known. We believe the following to be our most critical accounting policies.

Revenue recognition

Sales of clad metal products and welding services are generally based upon customer specifications set forth in customer purchase orders and require us to provide certifications relative to metals used, services performed, and the results of any non-destructive testing that the customer has requested be performed. All issues of conformity of the product to specifications are resolved before the product is shipped and billed. Products related to the oilfield products segment, which include detonating cords, detonators, bi-directional boosters, and shaped charges, as well as, seismic related explosives and accessories, are standard in nature. In all cases, revenue is recognized only when all four of the following criteria have been satisfied: persuasive evidence of an arrangement exists; the price is fixed or determinable; delivery has occurred; and collection is reasonably assured. For contracts that require multiple shipments, revenue is recorded only for the units included in each individual shipment. If, as a contract proceeds toward completion, projected total cost on an individual contract indicates a potential loss, the Company will account for such anticipated loss.

33

Table of Contents

Asset impairments

We review our long-lived assets held and used by us for impairment whenever events or changes in circumstances indicate their carrying amount may not be recoverable. In so doing, we estimate the future net cash flows expected to result from the use of the asset and its eventual disposition. If the sum of the expected future net cash flows (undiscounted and without interest charges) is less than the carrying amount of the asset, an impairment loss is recognized to reduce the asset to its estimated fair value. Otherwise, an impairment loss is not recognized. Long-lived assets to be disposed of, if any, are reported at the lower of carrying amount or fair value less cost to sell.

Business Combinations

We accounted for our business acquisition in accordance with the provisions of SFAS No. 141, Business Combinations, using the purchase method of accounting. We allocated the total cost of the acquisition to the underlying net assets based on their respective estimated fair values. As part of this allocation process, we identified and attributed values and estimated lives to the intangible assets acquired. These determinations involved significant estimates and assumptions regarding multiple, highly subjective variables, including those with respect to future cash flows, discount rates, asset lives, and the use of different valuation models and therefore require considerable judgment. Our estimates and assumptions were based, in part, on the availability of listed market prices or other transparent market data. These determinations affect the amount of amortization expense recognized in future periods. We based our fair value estimates on assumptions we believe to be reasonable but are inherently uncertain.

Goodwill

In accordance with SFAS No. 142, we test goodwill for impairment on a reporting unit level as defined by reference to SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information* on at least an annual basis. A reporting unit is a group of businesses (i) for which discrete financial information is available and (ii) that have similar economic characteristics. We test goodwill for impairment using the following two-step approach:

We first determine the fair value of each reporting unit. If the fair value of a reporting unit is less than its carrying value, this is an indicator that the goodwill assigned to that reporting unit might be impaired, which requires performance of the second step. We determine the fair value of our reporting units based on projected future discounted cash flows, which, in turn, are based on our views of uncertain variables such as growth rates, anticipated future economic conditions, and the appropriate discount rates relative to risk and estimates of residual values.

In the second step, if required, we allocate the fair value of the reporting unit to the assets and liabilities of the reporting unit as if it had just been acquired in a business combination and as if the purchase price was equivalent to the fair value of the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to its assets and liabilities is referred to as the implied fair value of goodwill. We then compare that implied fair value of the reporting unit s goodwill to the carrying value of that goodwill. If the implied fair value is less than the carrying value, we recognize an impairment loss for the excess.

The use of different estimates or assumptions within our discounted cash flow model when determining the fair value of our reporting units or using a methodology other than a discounted cash flow model could result in different values for reporting units and could result in an impairment charge.

Table of Contents

Intangible assets subject to amortization

An intangible asset that is subject to amortization is reviewed when impairment indicators are present in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. We compare the expected undiscounted future operating cash flows associated with finite-lived assets to their respective carrying values to determine if the asset is fully recoverable. If the expected future operating cash flows are not sufficient to recover the carrying value, we estimate the fair value of the asset. Impairment is recognized when the carrying amount of the asset is not recoverable and when the carrying value exceeds fair value. The projected cash flows require several assumptions related to, among other things, relevant market factors, revenue growth, if any, and operating margins. While we believe our assumptions are reasonable, changes in these assumptions may have a material impact on our financial results.

Impact of foreign currency exchange rate risks

The functional currency for our foreign operations is the applicable local currency for each affiliate company. Assets and liabilities of foreign subsidiaries for which the functional currency is the local currency are translated at exchange rates in effect at period-end, and the statements of operations are translated at the average exchange rates during the period. Exchange rate fluctuations on translating foreign currency financial statements into U.S. dollars that result in unrealized gains or losses are referred to as translation adjustments. Cumulative translation adjustments are recorded as a separate component of stockholders equity and are included in other cumulative comprehensive income (loss). Transactions denominated in currencies other than the local currency are recorded based on exchange rates at the time such transactions arise. Subsequent changes in exchange rates result in transaction gains and losses, which are reflected in income as unrealized (based on period-end translations) or realized (based upon settlement of the transactions). Cash flows from our operations in foreign countries are translated at actual exchange rates when known, or at the average rate for the period. As a result, amounts related to assets and liabilities reported in the consolidated statements of cash flows will not agree to changes in the corresponding balances in the consolidated balance sheets. The effects of exchange rate changes on cash balances held in foreign currencies are reported as a separate line item below cash flows from financing activities.

Income taxes

We account for income taxes in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes (SFAS 109), which requires the recognition of deferred tax assets and deferred tax liabilities for the expected future income tax consequences of transactions that have been included in our financial statements but not our tax returns. Deferred tax assets and liabilities are determined based on income tax credits and on the temporary differences between the Consolidated Financial Statement basis and the tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. We routinely evaluate deferred tax assets to determine if they will, more likely than not, be recovered from future projected taxable income; if not, we record an appropriate valuation allowance.

We continue to maintain a full valuation allowance of $111 against the carryforward tax attributes of a state in which we are no longer considered to be doing business.

Table of Contents

Stock-Based Compensation Expense

We account for stock-based compensation in accordance with the provisions of Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R). Under the fair value recognition provisions of SFAS 123R, stock-based compensation cost is estimated at the grant date based on the value of the award and is recognized as expense ratably over the requisite service period of the award. The fair value of restricted stock awards is based on the fair value of the Company s stock on the date of grant. Determining the appropriate fair value model and calculating the fair value of stock options at the grant date requires judgment, including estimating stock price volatility, forfeiture rates, and expected option life.

Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with accounting principles generally accepted in the United States, and expands disclosures about fair value measurements. SFAS No. 157 was initially effective for financial statements issued for fiscal years beginning after November 15, 2007. The FASB issued a staff position statement (FSP) in February 2008 that deferred the required implementation date of SFAS 157 for certain assets and liabilities. The adoption of SFAS 157 in the nine months ended September 30, 2008 did not have a material impact on the Company s results of operations or financial position.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115*. This Statement permits entities to measure many financial instruments and certain other items at fair value. This election is made on an instrument-by-instrument basis and is irrevocable. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. This statement is effective for fiscal years beginning after November 15, 2007. The Company did not elect the fair value option for any of its existing financial assets and liabilities during the nine months ended September 30, 2008.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations* and SFAS No. 160, *Accounting and Reporting of Noncontrolling Interest in Consolidated Financial Statements*, an amendment of ARB No. 51. These new standards will significantly change the accounting for and reporting of business combination transactions and noncontrolling (minority) interests in consolidated financial statements. SFAS Nos. 141(R) and 160 are required to be adopted simultaneously and are effective for the first annual reporting period beginning on or after December 15, 2008. Thus, we are required to adopt these Standards on January 1, 2009. Earlier adoption is prohibited. The Company is in the process of determining the effect, if any, the adoption SFAS Nos. 141(R) and 160 will have on its results of operations or financial position.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities*. SFAS 161 requires additional disclosures related to the use of derivative instruments, the accounting for derivatives and how derivatives impact financial statements. SFAS No. 161 is effective for fiscal years and interim periods beginning after November 15, 2008. The Company is currently evaluating the impact of adopting SFAS No. 161 on our consolidated financial statements.

Table of Contents

ITEM 3. Quantitative and Qualitative Disclosure about Market Risk

There have been no events that materially affect our quantitative and qualitative disclosure about market risk from that reported in our Annual Report on Form 10-K for the year ended December 31, 2007.

ITEM 4. **Controls and Procedures**

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company s Exchange Act reports is accurately recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms, and that such information is accumulated and communicated to the Company s management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily applied its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As of September 30, 2008, the Company carried out an evaluation, under the supervision and with the participation of the Company s management, including the Company s Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company s disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)). Based on that evaluation, the Company s Chief Executive Officer and Chief Financial Officer concluded that the Company s disclosure controls and procedures were effective. There have been no changes in the Company s internal controls during the quarter ended September 30, 2008 or in other factors that could materially affect the Company s internal controls over financial reporting.

The Company s management, including the Company s Chief Executive Officer and Chief Financial Officer, does not expect that the Company s disclosure controls or its internal controls will prevent all errors and all fraud. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. As a result of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple errors or mistakes. As a result of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. Accordingly, the Company s disclosure controls and procedures are designed to provide reasonable, not absolute, assurance that the disclosure controls and procedures are met.

Table of Contents

Part II - OTHER INFORMATION

Item 1. Legal Proceedings

None.

Item 1A. Risk Factors

Our 2007 Annual Report on Form 10-K includes a detailed discussion of our risk factors. The information presented below updates and should be read in conjunction with the risk factors and information disclosed in our Form 10-K.

Our backlog figures may not accurately predict future sales.

We define backlog at any given point in time to consist of all firm, unfulfilled purchase orders and commitments at that time. Generally speaking, we expect to fill most items of backlog within the following 12 months. However, since orders may be rescheduled or canceled, and a significant portion of our net sales is derived from a small number of customers, backlog is not necessarily indicative of future sales levels. Moreover, we cannot be sure of when during the future 12-month period we will be able to recognize revenue corresponding to our backlog; nor can we be certain that revenues corresponding to our backlog will not fall into periods beyond the 12-month horizon.

Weakness in the general global economy may adversely affect certain segments of our end market customers and reduce our sales and results of operations.

We supply products to customers that fabricate industrial equipment for various capital-intensive industries. The current weakness in the general global economy may adversely affect our end market customers, causing them to cancel or postpone new plant or infrastructure construction, expansion or maintenance and retrofitting projects that use our products. While to date we have not seen material signs of postponements or cancellations of projects important to us, there can be no assurances that general economic conditions will not lessen demand for our products and reduce our sales and results of operations.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

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

None.

Item 5. Other Information

None.

Table of Contents

Item 6.

Exhibits

31.1 Certification of the President and Chief Executive Officer pursuant to 17 CFR 240.13a-14(a) or 17 CFR 240.15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of the Vice President and Chief Financial Officer pursuant to 17 CFR 240.13a-14(a) or 17 CFR 240.15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of the President and Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of the Vice President and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Table of Contents

SIGNATURES

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

DYNAMIC MATERIALS CORPORATION
(Registrant)

Date: October 31, 2008

/s/ Richard A. Santa
Richard A. Santa, Senior Vice President and Chief Financial Officer (Duly Authorized Officer and Principal Financial and Accounting Officer)