SOUTHSIDE BANCSHARES INC
Form 10-Q
August 06, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2007

OR

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

For the transition period from ____________ to ____________

Commission file number 0-12247

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

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

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

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

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

Large accelerated filer o Accelerated filer x Non-accelerated filer o

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

The number of shares of the issuer's common stock, par value $1.25, outstanding as of July 26, 2007 was 13,081,616 shares.

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

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

ASSETS	June 30, 2007	December 31, 2006
Cash and due from banks	$ 43,762	$ 52,537
Interest earning deposits	544	550
Federal funds sold	11,850	1,925
Total cash and cash equivalents	56,156	55,012
Investment securities:		
Available for sale, at estimated fair value	88,566	98,952
Held to maturity, at cost	1,353	1,351
Mortgage-backed and related securities:		
Available for sale, at estimated fair value	599,326	643,164
Held to maturity, at cost	207,262	226,162
Federal Home Loan Bank stock, at cost	15,540	25,614
Other investments, at cost	881	882
Loans held for sale	5,042	3,909
Loans:		
Loans	768,739	759,147
Less: allowance for loan losses	(7,367)	(7,193)
Net Loans	761,372	751,954
Premises and equipment, net	35,268	32,641
Interest receivable	9,921	10,110
Deferred tax asset	10,456	8,678
Other assets	30,633	32,547
TOTAL ASSETS	$ 1,821,776	$ 1,890,976
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Noninterest bearing	$ 328,361	$ 325,771
Interest bearing	1,007,989	956,704
Total Deposits	1,336,350	1,282,475
Short-term obligations:		
Federal funds purchased	–	5,675
FHLB Dallas advances	239,826	322,241
Other obligations	1,511	1,605
Total Short-term obligations	241,337	329,521
Long-term obligations:		
FHLB Dallas advances	89,393	129,379
Long-term debt	20,619	20,619
Total Long-term obligations	110,012	149,998
Other liabilities	18,583	18,378
TOTAL LIABILITIES	1,706,282	1,780,372

Off-Balance-Sheet Arrangements, Commitments and Contingencies (Note 9)

Shareholders' equity:		
Common stock: ($1.25 par, 20,000,000 shares authorized,		
14,805,225 and 14,075,653 shares issued)	18,507	17,594
Paid-in capital	114,462	100,736
Retained earnings	21,392	29,648
Treasury stock (1,724,857 and 1,718,737 shares at cost)	(22,983)	(22,850)
Accumulated other comprehensive loss	(15,884)	(14,524)
TOTAL SHAREHOLDERS' EQUITY	115,494	110,604
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 1,821,776	$ 1,890,976

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Interest income				
Loans	$ 12,733	$ 11,328	$ 25,247	$ 21,956
Investment securities – taxable	616	594	1,452	1,337
Investment securities – tax-exempt	505	490	1,012	1,089
Mortgage-backed and related securities	10,163	11,149	21,097	21,386
Federal Home Loan Bank stock and other investments	330	350	700	694
Other interest earning assets	33	14	69	32
Total interest income	24,380	23,925	49,577	46,494
Interest expense				
Deposits	10,025	7,404	19,590	13,658
Short-term obligations	2,776	4,037	6,722	7,587
Long-term obligations	1,518	1,947	3,178	4,143
Total interest expense	14,319	13,388	29,490	25,388
Net interest income	10,061	10,537	20,087	21,106
Provision for loan losses	217	448	334	729
Net interest income after provision for loan losses	9,844	10,089	19,753	20,377
Non interest income				
Deposit services	4,270	3,947	8,198	7,416
Gain on sale of securities available for sale	6	101	435	224
Gain on sale of loans	724	469	1,069	842
Trust income	576	403	1,040	807
Bank owned life insurance income	268	265	532	509
Other	818	782	1,526	1,267
Total non interest income	6,662	5,967	12,800	11,065
Non interest expense				
Salaries and employee benefits	7,298	7,310	14,402	14,730
Occupancy expense	1,190	1,201	2,358	2,374
Equipment expense	242	225	470	428
Advertising, travel & entertainment	449	472	870	924
ATM and debit card expense	242	275	496	445
Director fees	141	167	268	312
Supplies	188	168	336	352
Professional fees	240	318	551	633
Postage	155	155	303	305
Telephone and communications	193	191	384	354
Other	1,118	1,081	2,254	2,140
Total non interest expense	11,456	11,563	22,692	22,997
Income before income tax expense	5,050	4,493	9,861	8,445
Provision for income tax expense	463	950	1,511	1,674
Net Income	$ 4,587	$ 3,543	$ 8,350	$ 6,771
Earnings per common share –basic	$ 0.35	$ 0.28	$ 0.64	$ 0.53
Earnings per common share –diluted	$ 0.34	$ 0.27	$ 0.62	$ 0.51

Dividends declared per common share	$	0.12	$	0.11	$	0.23	$	0.22

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

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

	Compre-hensive Income	Common Stock	Paid-in Capital	Retained Earnings	Treasury Stock	Accumulated Other Compre-hensive Income (Loss)	Total Share-holders Equity
Balance at December 31, 2005		$ 16,633	$ 87,962	$ 32,054	$ (22,850)	$ (4,509)	$ 109,290
Net Income	$ 6,771			6,771			6,771
Other comprehensive loss, net of tax							
Unrealized losses on securities, net of reclassification adjustment (see Note 3)	(9,167)					(9,167)	(9,167)
Comprehensive loss	$ (2,396)						
Common stock issued (94,803 shares)		119	714				833
Stock compensation expense			14				14
Tax benefit of incentive stock options			41				41
Dividends paid on common stock				(2,626)			(2,626)
Stock dividend		728	10,978	(11,706)			–
Balance at June 30, 2006		$ 17,480	$ 99,709	$ 24,493	$ (22,850)	$ (13,676)	$ 105,156
Balance at December 31, 2006		$ 17,594	$ 100,736	$ 29,648	$ (22,850)	$ (14,524)	$ 110,604
Net Income	$ 8,350			8,350			8,350
Other comprehensive income, net of tax							
Unrealized losses on securities, net of reclassification adjustment	(1,533)					(1,533)	(1,533)

(see Note 3)							
Adjustment to net periodic benefit cost (see Note 3)	173					173	173
Comprehensive Income	$ 6,990						
Common stock issued (108,634 shares)		137	788				925
Stock compensation expense			14				14
Tax benefit of incentive stock options			21				21
Dividends paid on common stock				(2,927)			(2,927)
Purchase of 6,120 shares of common stock					(133)		(133)
Stock dividend		776	12,903	(13,679)			–
Balance at June 30, 2007		$ 18,507	$ 114,462	$ 21,392	$ (22,983)	$ (15,884)	$ 115,494

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

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

	Six Months Ended June 30, 2007	Six Months Ended June 30, 2006
OPERATING ACTIVITIES:		
Net income	$ 8,350	$ 6,771
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation	1,085	1,132
Amortization of premium	2,445	3,066
Accretion of discount and loan fees	(1,314)	(929)
Provision for loan losses	334	729
Stock compensation expense	14	14
Decrease (increase) in interest receivable	189	(659)
Decrease in other assets	1,585	208
Net change in deferred taxes	(1,077)	(176)
(Decrease) increase in interest payable	(134)	338
Decrease in other liabilities	(434)	(4,378)
Increase in loans held for sale	(1,133)	(2,839)
Gain on sale of available for sale securities	(435)	(224)
Gain on sale of assets	–	(1)
Loss on sale of other real estate owned	1	–
Net cash provided by operating activities	9,476	3,052
INVESTING ACTIVITIES:		
Proceeds from sales of investment securities available for sale	4,953	39,197
Proceeds from sales of mortgage-backed securities available for sale	51,430	30,651
Proceeds from maturities of investment securities available for sale	57,891	14,175
Proceeds from maturities of mortgage-backed securities available for sale	50,874	53,060
Proceeds from maturities of mortgage-backed securities held to maturity	20,596	16,683
Proceeds from redemption of Federal Home Loan Bank stock	10,729	2,019
Purchases of investment securities available for sale	(51,789)	(23,027)
Purchases of investment securities held to maturity	–	(1,348)
Purchases of mortgage-backed securities available for sale	(60,474)	(157,067)
Purchases of mortgage-backed securities held to maturity	(2,180)	(33,749)
Purchases of Federal Home Loan Bank stock and other investments	(654)	(657)
Net increase in loans	(10,048)	(45,119)
Purchases of premises and equipment	(3,712)	(933)
Proceeds from sales of premises and equipment	–	1
Proceeds from sales of other real estate owned	334	45
Proceeds from sales of repossessed assets	191	185
Net cash provided by (used in) investing activities	68,141	(105,884)

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

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

	Six Months Ended June 30,	
	2007	2006
FINANCING ACTIVITIES:		
Net increase in demand and savings accounts	21,773	5,388
Net increase in certificates of deposit	31,944	78,801
Net (decrease) increase in federal funds purchased	(5,675)	10,600
Proceeds from FHLB Advances	2,786,999	3,608,804
Repayment of FHLB Advances	(2,909,400)	(3,603,261)
Tax benefit of incentive stock options	21	41
Purchases of common stock	(133)	–
Proceeds from the issuance of common stock	925	833
Dividends paid	(2,927)	(2,626)
Net cash (used in) provided by financing activities	(76,473)	98,580
Net increase (decrease) in cash and cash equivalents	1,144	(4,252)
Cash and cash equivalents at beginning of period	55,012	51,829
Cash and cash equivalents at end of period	$ 56,156	$ 47,577
SUPPLEMENTAL DISCLOSURES FOR CASH FLOW INFORMATION:		
Interest paid	$ 29,624	$ 25,050
Income taxes paid	2,000	1,150
SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Acquisition of other repossessed assets and real estate through foreclosure	$ 197	$ 957
Payment of 5% stock dividend	13,679	11,706
Adjustment to pension liability	(262)	–
Unsettled trades to purchase securities	941	–

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

SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO FINANCIAL STATEMENTS

1. Basis of Presentation

The term "Company" is used throughout this report to refer to Southside Bancshares, Inc. and its subsidiaries. The term "Bank" is used to refer to Southside Bank wherever a distinction between Southside Bancshares, Inc. and Southside Bank aids in the understanding of this report.

The consolidated balance sheet as of June 30, 2007, and the related consolidated statements of income, shareholders' equity and cash flows and notes to the financial statements for the three and six month periods ended June 30, 2007 and 2006 are unaudited; in the opinion of management, all adjustments necessary for a fair presentation of such financial statements have been included. Such adjustments consisted only of normal recurring items. All significant intercompany accounts and transactions are eliminated in consolidation. The preparation of these consolidated financial statements in conformity with U.S. generally accepted accounting principles ("GAAP") requires the use of management's estimates. These estimates are subjective in nature and involve matters of judgment. Actual amounts could differ from these estimates.

Interim results are not necessarily indicative of results for a full year. These financial statements should be read in conjunction with the financial statements and notes thereto in our Annual Report on Form 10-K for the year ended December 31, 2006. All share data has been adjusted to give retroactive recognition to stock splits and stock dividends. For a description of our significant accounting and reporting policies, refer to Note 1 of the Notes to Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2006.

2. Earnings Per Share

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Basic Earnings and Shares:				
Net Income	$ 4,587	$ 3,543	$ 8,350	$ 6,771
Weighted-average basic shares outstanding	13,035	12,853	13,008	12,830
Basic Earnings Per Share:				
Net Income	$ 0.35	$ 0.28	$ 0.64	$ 0.53
Diluted Earnings and Shares:				
Net Income	$ 4,587	$ 3,543	$ 8,350	$ 6,771
Weighted-average basic shares outstanding	13,035	12,853	13,008	12,830
Add: Stock options	401	484	421	496

Weighted-average diluted shares outstanding	13,436	13,337	13,429	13,326
Diluted Earnings Per Share:				
Net Income	$ 0.34	$ 0.27	$ 0.62	$ 0.51

For the three and six month periods ended June 30, 2007 and 2006, there were no antidilutive options.

3. Comprehensive Income (Loss)

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

	Six Months Ended June 30, 2007		
	Before-Tax Amount	Tax (Expense) Benefit	Net-of-Tax Amount
Unrealized losses on securities:			
Unrealized holding losses arising during period	$ (1,888)	$ 642	$ (1,246)
Less: reclassification adjustment for gains included in net income	435	(148)	287
Net unrealized losses on securities	(2,323)	790	(1,533)
Adjustment to net periodic benefit cost	262	(89)	173
Other comprehensive loss	$ (2,061)	$ 701	$ (1,360)

	Three Months Ended June 30, 2007		
	Before-Tax Amount	Tax (Expense) Benefit	Net-of-Tax Amount
Unrealized losses on securities:			
Unrealized holding losses arising during period	$ (5,556)	$ 1,889	$ (3,667)
Less: reclassification adjustment for gains included in net income	6	(2)	4
Net unrealized losses on securities	(5,562)	1,891	(3,671)
Adjustment to net periodic benefit cost	104	(35)	69
Other comprehensive loss	$ (5,458)	$ 1,856	$ (3,602)

	Six Months Ended June 30, 2006		
	Before-Tax Amount	Tax (Expense) Benefit	Net-of-Tax Amount
Unrealized losses on securities:			
Unrealized holding losses arising during period	$ (13,665)	$ 4,646	$ (9,019)
Less: reclassification adjustment for gains included in net income	224	(76)	148
Net unrealized losses on securities	(13,889)	4,722	(9,167)
Other comprehensive loss	$ (13,889)	$ 4,722	$ (9,167)

	Three Months Ended June 30, 2006		
	Before-Tax Amount	Tax (Expense) Benefit	Net-of-Tax Amount
Unrealized losses on securities:			
Unrealized holding losses arising during period	$ (5,982)	$ 2,034	$ (3,948)

Less: reclassification adjustment for gains			
included in net income	101	(34)	67
Net unrealized losses on securities	(6,083)	2,068	(4,015)
Other comprehensive loss	$ (6,083)	$ 2,068	$ (4,015)

4. Securities

The amortized cost and estimated market value of investment and mortgage-backed securities as of June 30, 2007 and December 31, 2006, are reflected in the tables below (in thousands):

	June 30, 2007			
AVAILABLE FOR SALE:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
Investment Securities:				
U.S. Treasury	$ 18,157	$ –	$ 1,051	$ 17,106
Government Sponsored Enterprise Debentures	8,999	–	2	8,997
State and Political Subdivisions	54,361	1,077	480	54,958
Other Stocks and Bonds	7,591	9	95	7,505
Mortgage-backed Securities:				
U.S. Government Agencies	73,596	274	1,669	72,201
Government Sponsored Enterprises	527,797	896	8,196	520,497
Other Private Issues	6,711	39	122	6,628
Total	$ 697,212	$ 2,295	$ 11,615	$ 687,892
HELD TO MATURITY:				
Investment Securities:				
Other Stocks and Bonds	$ 1,353	$ 14	$ –	$ 1,367
Mortgage-backed Securities:				
U.S. Government Agencies	28,228	–	621	27,607
Government Sponsored Enterprises	179,034	44	3,485	175,593
Total	$ 208,615	$ 58	$ 4,106	$ 204,567

	December 31, 2006			
AVAILABLE FOR SALE:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
Investment Securities:				
U.S. Treasury	$ 27,104	$ –	$ 721	$ 26,383
Government Sponsored Enterprise Debentures	9,923	–	–	9,923
State and Political Subdivisions	54,037	1,488	390	55,135
Other Stocks and Bonds	7,611	12	112	7,511
Mortgage-backed Securities:				
U.S. Government Agencies	72,183	425	1,209	71,399
Government Sponsored Enterprises	570,777	1,250	7,377	564,650
Other Private Issues	7,190	20	95	7,115
Total	$ 748,825	$ 3,195	$ 9,904	$ 742,116
HELD TO MATURITY:				
Investment Securities:				
Other Stocks and Bonds	$ 1,351	$ 7	$ 16	$ 1,342
Mortgage-backed Securities:				
U.S. Government Agencies	30,788	–	407	30,381

Government Sponsored Enterprises	195,374	97	3,104	192,367
Total	$ 227,513	$ 104	$ 3,527	$ 224,090

The Bank concluded that, based on the creditworthiness of the issuer, the unrealized loss on each security in the above table represents a temporary impairment and does not require adjustment to the carrying amount of any of the individual securities. Additionally, the Bank has the ability and the intent to hold such securities through recovery of the unrealized losses.

Investment and mortgage-backed securities with book values of $322.9 million at June 30, 2007 and $454.6 million at December 31, 2006 were pledged to collateralize FHLB advances, public funds, trust deposits, repurchase agreements and for other purposes, as required or permitted by law.

5. Loans and Allowance for Probable Loan Losses

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

	At June 30, 2007	At December 31, 2006
Real Estate Loans:		
Construction	$ 46,876	$ 39,588
1-4 Family Residential	223,996	227,354
Other	177,918	181,047
Commercial Loans	125,609	118,962
Municipal Loans	110,416	106,155
Loans to Individuals	83,924	86,041
Total Loans	$ 768,739	$ 759,147

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Balance at beginning of period	$ 7,261	$ 7,193	$ 7,193	$ 7,090
Provision for loan losses	217	448	334	729
Loans charged off	(616)	(744)	(1,209)	(1,447)
Recoveries of loans charged off	505	449	1,049	974
Balance at end of period	$ 7,367	$ 7,346	$ 7,367	$ 7,346

6. Employee Benefit Plans

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

	Six Months Ended June 30,			
	Defined Benefit Pension Plan		Restoration Plan	
	2007	2006	2007	2006
Service cost	$ 665	$ 669	$ 31	$ 34
Interest cost	1,156	1,095	84	92
Expected return on assets	(1,264)	(1,162)	–	–
Transition obligation recognition	–	–	1	1
Net loss recognition	241	392	42	90
Prior service credit amortization	(21)	(21)	(1)	(1)
Net periodic benefit cost	$ 777	$ 973	$ 157	$ 216

	Three Months Ended June 30,			
	Defined Benefit Pension Plan		Restoration Plan	
	2007	2006	2007	2006
Service cost	$ 356	$ 347	$ 16	$ 16
Interest cost	566	548	39	43
Expected return on assets	(631)	(581)	–	–
Transition obligation recognition	–	–	–	–
Net loss recognition	105	203	10	40
Prior service credit amortization	(11)	(21)	–	(1)
Net periodic benefit cost	$ 385	$ 496	$ 65	$ 98

Employer Contributions

We previously disclosed in our financial statements for the year ended December 31, 2006, that we expected to contribute $3.0 million to our defined benefit pension plan and $88,000 to our post retirement benefit plan in 2007. As of June 30, 2007, we had contributed $3.0 million to the defined benefit pension plan, and $40,000 of contributions had been made to the post retirement benefit plan.

7. Incentive Stock Options

In April 1993, we adopted the Southside Bancshares, Inc. 1993 Incentive Stock Option Plan ("the ISO Plan"), a stock-based incentive compensation plan. The ISO Plan expired March 31, 2003. Prior to January 1, 2006, we applied APB Opinion 25 and related Interpretations in accounting for the ISO Plan and disclosed the pro forma information required by SFAS 123 and SFAS 148. There was no compensation expense recognized for the stock options prior to January 1, 2006.

A summary of the status of our nonvested shares as of June 30, 2007 is as follows:

	Six Months Ended June 30, 2007	
	Number of Options	**Weighted Average Grant-Date Fair Value**
Nonvested at beginning of the period	12,257	$ 4.91
Vested	(6,127)	$ 4.91
Cancelled	(383)	$ 4.91
Nonvested at end of period	5,747	$ 4.91

For the three and six months ended June 30, 2007 and 2006, we recorded approximately $7,000 and $14,000, respectively, of stock-based compensation expense. As of June 30, 2007 and 2006, there was $20,000 and $47,000, respectively, of total unrecognized compensation cost related to the ISO Plan for nonvested options granted in March 2003. The cost is expected to be recognized over a weighted-average period of 9 months.

The fair value of each stock option granted is estimated on the date of grant using the Black-Scholes method of option pricing with the following weighted-average assumptions for grants in 2003: dividend yield of 1.93%; risk-free interest rate of 4.93%; expected life of 6 years; and expected volatility of 28.90%.

Under the ISO Plan, we were authorized to issue shares of common stock pursuant to "Awards" granted in the form of incentive stock options (intended to qualify under Section 422 of the Internal Revenue Code of 1986, as amended). Before the ISO Plan expired, awards were granted to selected employees and directors. No stock options have been available for grant under the ISO Plan since its expiration in March 2003. Currently, we do not offer share-based payment programs to our employees.

The ISO Plan provided that the exercise price of any stock option not be less than the fair market value of the common stock on the date of grant. The outstanding stock options have contractual terms of 10 years. All options vest on a graded schedule, 20% per year for 5 years, beginning on the first anniversary date of the grant date.

A summary of the status of our stock options as of June 30, 2007 and the changes during the six months ended on those dates is presented below:

	Number of Options	Weighted Average Exercise Prices	Weighted Average Remaining Contract Life (Years)	Aggregate Intrinsic Value (in thousands)

Outstanding at December 31, 2006	604,281	$	5.76			
Exercised	(90,601)	$	5.43			
Cancelled	(383)	$	12.61			
Outstanding at June 30, 2007	513,297	$	5.82	2.60	$	8,278
Exercisable at June 30, 2007	507,550	$	5.74	2.56	$	8,226

The total intrinsic value (i.e., the amount by which the fair value of the underlying common stock exceeds the exercise price of a stock option on exercise date) of stock options exercised during the six months ended June 30, 2007 and 2006 were $1.5 million and $1.1 million, respectively.

Cash received from stock option exercises for the six months ended June 30, 2007 and 2006 was $360,000 and $396,000, respectively. The tax benefit realized for the deductions related to the stock option exercises were $21,000 and $41,000 for the six months ended June 30, 2007 and 2006, respectively.

8. Accounting Pronouncements

Statements of Financial Accounting Standards

SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115." SFAS 159, issued by the Financial Accounting Standards Board ("FASB") in February 2007, allows entities to irrevocably elect fair value as the initial and subsequent measurement attribute for certain financial assets and financial liabilities that are not otherwise required to be measured at fair value, with changes in fair value recognized in earnings as they occur. SFAS 159 also requires entities to report those financial assets and financial liabilities measured at fair value in a manner that separates those reported fair values from the carrying amounts of similar assets and liabilities measured using another measurement attribute on the face of the statement of financial position. Lastly, SFAS 159 establishes presentation and disclosure requirements designed to improve comparability between entities that elect different measurement attributes for similar assets and liabilities. SFAS 159 is effective for fiscal years beginning after November 15, 2007, with early adoption permitted if an entity also early adopts the provisions of SFAS 157. We intend to adopt SFAS 159 on January 1, 2008. We have not yet determined if, or to what extent, we will elect to use the fair value option to value our financial assets and liabilities or the impact that the implementation of SFAS 159 will have on our consolidated financial statements.

SFAS No. 157, "Fair Value Measurements." SFAS 157 defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. SFAS 157 is effective for us on January 1, 2008 and is not expected to have a material impact on our consolidated financial statements.

SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments — an amendment of FASB Statements No. 133 and 140." SFAS 155 amends SFAS 133, "Accounting for Derivative Instruments and Hedging Activities" and SFAS 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." SFAS 155 permits, but does not require, fair value accounting for hybrid financial instruments that contain an embedded derivative that would otherwise require bifurcation in accordance with SFAS 133. SFAS 155 also eliminated the temporary exemption for interests in securitized financial assets provided for by SFAS 133, Derivatives Implementation Group ("DIG") Issue D1, "Application of Statement 133 to Beneficial Interests in Securitized Financial Assets." However, in January 2007, the FASB issued interpretive guidance in SFAS 133, DIG Issue B40, "Application of Paragraph 13(b) to Securitized Interests in Prepayable Financial Assets." In DIG Issue B40, the FASB concluded that a securitized interest in prepayable financial assets was not subject to the bifurcation requirements of SFAS 155 provided that the interest met both the following criteria: (1) the right to accelerate the settlement of the securitized interest cannot be controlled by the investor; and (2) the securitized interest itself does not contain an embedded derivative for which bifurcation would be required other than an embedded derivative that results solely from the embedded call options in the underlying financial assets. The guidance in DIG Issue B40 is effective upon the adoption of SFAS 155. SFAS 155 was effective for all financial instruments acquired or issued after December 31, 2006 as well as to those hybrid financial instruments that had been previously bifurcated under SFAS 133. The adoption of SFAS 155 did not have a material impact on our consolidated financial statements.

Emerging Issues Task Force Consensuses

In September 2006, the Emerging Issues Task Force ("EITF") reached a final consensus on Issue 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements." EITF 06-4 requires that for a split-dollar life insurance arrangement, an employer should recognize a liability for future benefits in accordance with SFAS 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions." Under the guidance, the purchase of an endorsement type policy does not constitute a settlement since the policy does not qualify as nonparticipating because the policyholders are subject to the favorable and unfavorable experience of the insurance company. EITF 06-4 is effective for fiscal years beginning after December 15, 2007. We are currently assessing the impact of the adoption of EITF 06-4 on our consolidated financial statements.

In September 2006, the EITF reached a final consensus on Issue 06-5, “Accounting for Purchases of Life Insurance.” EITF 06-5 provides guidance on FASB Technical Bulletin No. 85-4, “Accounting for Purchases of Life Insurance.” Under the guidance, the policyholder should consider any additional amounts included in the contractual terms of the policy in determining the amount that could be realized under the insurance contract. In addition, the policyholder should also determine the amount that could be realized under the life insurance contract assuming the surrender of an individual-life by individual-life policy. EITF 06-5 was effective for fiscal years beginning after December 15, 2006. The adoption of EITF 06-5 did not have a material impact on our consolidated financial statements.

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Financial Accounting Standards Board Staff Positions and Interpretations

FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement 109.” FASB Interpretation No. 48 (“FIN 48”) prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Benefits from tax positions should be recognized in the financial statements only when it is more likely than not that the tax position will be sustained upon examination by the appropriate taxing authority that would have full knowledge of all relevant information. A tax position that meets the more-likely-than-not recognition threshold is measured at the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. Tax positions that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first subsequent financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not recognition threshold should be derecognized in the first subsequent financial reporting period in which that threshold is no longer met. Interpretation 48 also provides guidance on the accounting for and disclosure of unrecognized tax benefits, interest and penalties.

We adopted the provisions of FIN 48 on January 1, 2007. As of the date of adoption, we had no unrecognized tax benefits and thus had accrued no interest or penalties on such benefits. At adoption, we did not anticipate a significant increase in unrecognized tax benefits during the subsequent 12 months. As of January 1, 2007, our 2003 through 2006 tax years were open to examination by the Internal Revenue Service and state taxing jurisdictions. There were no material changes in these items during the current quarter. While we typically do not incur significant interest or penalties on income tax liabilities, it is our policy to classify such amounts as interest expense and miscellaneous expense, respectively. We did not change our policy on classification of interest and penalties upon adoption of FIN 48.

9. Off-Balance-Sheet Arrangements, Commitments and Contingencies

Financial Instruments with Off-Balance-Sheet-Risk. In the normal course of business, we are a party to certain financial instruments, with off-balance-sheet risk, to meet the financing needs of our customers. These off-balance-sheet instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount reflected in the financial statements. The contract or notional amounts of these instruments reflect the extent of involvement and exposure to credit loss we have in these particular classes of financial instruments.

Commitments to extend credit are agreements to lend to a customer provided that the terms established in the contract are met. Commitments generally have fixed expiration dates and may require payment of fees. Since some commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. These guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan commitments to customers.

We had outstanding unused commitments to extend credit of $118.0 million and $99.5 million at June 30, 2007 and 2006, respectively. Each commitment has a maturity date and the commitment expires on that date with the exception of credit card and ready reserve commitments, which have no stated maturity date. Unused commitments for credit card and ready reserve at June 30, 2007 and 2006 were $9.3 million and $7.9 million, respectively, and are reflected in the due after one year category. We had outstanding standby letters of credit of $3.9 million and $3.6 million at June 30, 2007 and 2006, respectively.

The scheduled maturities of unused commitments as of June 30, 2007 and 2006 were as follows (in thousands):

	June 30,	
	2007	2006
Unused commitments:		
Due in one year or less	$ 87,271	$ 57,812
Due after one year	30,691	41,697
Total	$ 117,962	$ 99,509

We apply the same credit policies in making commitments and standby letters of credit as we do for on-balance-sheet instruments. We evaluate each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary, upon extension of credit is based on management's credit evaluation of the borrower. Collateral held varies but may include cash or cash equivalents, negotiable instruments, real estate, accounts receivable, inventory and property, plant, and equipment.

Lease Commitments. We lease certain branch facilities and office equipment under operating leases. It is expected that certain leases will be renewed or equipment replaced with new leased equipment as these leases expire.

Securities. In the normal course of business we buy and sell securities. There were $941,000 of unsettled trades to purchase and no unsettled trades to sell securities at June 30, 2007. At December 31, 2006, there were no unsettled trades to purchase or sell securities.

Litigation. We are subject to litigation in the normal course of business. Management, after consulting with our legal counsel, believes that any liability resulting from litigation will not have a material effect on our financial position and results of operations or our liquidity.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is a discussion of the consolidated financial condition, changes in financial condition, and results of our operations, and should be read and reviewed in conjunction with the financial statements, and the notes thereto, in this presentation and in our Annual Report on Form 10-K for the year ended December 31, 2006.

We reported an increase in net income for the three months and six months ended June 30, 2007 compared to the same periods in 2006. Net income for the three and six months ended June 30, 2007 was $4.6 million and $8.4 million, respectively, compared to $3.5 million and $6.8 million, respectively, for the same periods in 2006.

All share data has been adjusted to give retroactive recognition to stock splits and stock dividends.

Forward Looking Statements

Certain statements of other than historical fact that are contained in this document and in written material, press releases and oral statements issued by or on behalf of Southside Bancshares, Inc., a bank holding company, may be considered to be “forward-looking statements” within the meaning of and subject to the protections of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are not guarantees of future performance, nor should they be relied upon as representing management’s views as of any subsequent date. These statements may include words such as "expect," "estimate," "project," "anticipate," “appear,” "believe," "could," "should," "may," "intend," "probability," "risk," "target," "objective," “plans,” “potential,” and similar expressions. Forward-looking statements are statements with respect to our beliefs, plans, expectations, objectives, goals, anticipations, assumptions, estimates, intentions and future performance, and are subject to significant known and unknown risks and uncertainties, which could cause our actual results to differ materially from the results discussed in the forward-looking statements. For example, discussions of the effect of our expansion, trends in asset quality and earnings from growth, and certain market risk disclosures are based upon information presently available to management and are dependent on choices about key model characteristics and assumptions and are subject to various limitations. By their nature, certain of the market risk disclosures are only estimates and could be materially different from what actually occurs in the future. As a result, actual income gains and losses could materially differ from those that have been estimated. Other factors that could cause actual results to differ materially from forward-looking statements include, but are not limited to, the following:

- general economic conditions, either globally, nationally, in the State of Texas, or in the specific markets in which we operate;
- legislation, regulatory changes or changes in monetary or fiscal policy that adversely affect the businesses in which we are engaged;
- adverse changes in the status or financial condition of the Government Sponsored Enterprises (the “GSEs”) impacting the GSEs’ guarantees or ability to pay or issue debt;
- economic or other disruptions caused by acts of terrorism in the United States, Europe or other areas;
- changes in the interest rate yield curve such as flat, inverted or steep yield curves, or changes in the interest rate environment that impact interest margins and may impact prepayments on the mortgage-backed securities portfolio;
- unexpected outcomes of existing or new litigation involving us;
- changes impacting the leverage strategy;
- significant increases in competition in the banking and financial services industry;
- changes in consumer spending, borrowing and saving habits;
- technological changes;
- our ability to increase market share and control expenses;
- the effect of changes in federal or state tax laws;

- the effect of compliance with legislation or regulatory changes;
- the effect of changes in accounting policies and practices;
- the costs and effects of unanticipated litigation;
- risks of mergers and acquisitions including the related time and cost of implementing transactions and the potential failure to achieve expected gains, revenue growth or expense savings; and
- failure of assumptions underlying allowance for loan losses and other estimates.

Additional information concerning us and our business, including additional factors that could materially affect our financial results, is included in our filings with the Securities and Exchange Commission. All written or oral forward-looking statements made by us or attributable to us are expressly qualified by this cautionary notice. We disclaim any obligation to update any factors or to announce publicly the result of revisions to any of the forward-looking statements included herein to reflect future events or developments.

Critical Accounting Estimates

Our accounting and reporting estimates conform with accounting principles generally accepted in the United States and general practices within the financial services industry. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. We consider our critical accounting policies to include the following:

Allowance for Losses on Loans. The