TRUSTMARK CORP
Form 10-Q
November 08, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended September 30, 2006

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 0-3683

Trustmark Corporation
(Exact name of registrant as specified in its charter)

Mississippi	**64-0471500**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
248 East Capitol Street, Jackson, Mississippi	**39201**
(Address of principal executive offices)	*(Zip Code)*

(601) 208-5111
(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 þ 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 þ Accelerated filer o Non-accelerated filer o

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

As of October 23, 2006, there were 58,633,782 shares outstanding of the registrant's common stock (no par value).

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

Trustmark Corporation and Subsidiaries
Consolidated Balance Sheets
($ in thousands)

	(Unaudited) September 30, 2006	December 31, 2005
Assets		
Cash and due from banks (noninterest-bearing)	$ 348,397	$ 387,930
Federal funds sold and securities purchased under reverse repurchase agreements	6,907	130,115
Securities available for sale (at fair value)	862,482	1,041,754
Securities held to maturity (fair value: $288,314-2006; $295,521-2005)	289,125	294,902
Loans held for sale	125,988	146,936
Loans	6,538,872	5,893,439
Less allowance for loan losses	75,539	76,691
Net loans	6,463,333	5,816,748
Premises and equipment	132,055	115,115
Mortgage servicing rights	66,526	58,424
Goodwill	290,753	137,368
Identifiable intangible assets	45,704	28,703
Other assets	238,284	231,755
Total Assets	$ 8,869,554	$ 8,389,750
Liabilities		
Deposits:		
Noninterest-bearing	$ 1,580,533	$ 1,556,142
Interest-bearing	5,541,680	4,726,672
Total deposits	7,122,213	6,282,814
Federal funds purchased	77,927	178,789
Securities sold under repurchase agreements	180,536	314,064
Short-term borrowings	430,210	775,402
Long-term FHLB advances	-	5,726
Junior subordinated debt securities	70,104	-
Other liabilities	98,634	91,492
Total Liabilities	7,979,624	7,648,287
Commitments and Contingencies		
Shareholders' Equity		
Common stock, no par value:		
Authorized: 250,000,000 shares		
Issued and outstanding: 58,611,242 shares - 2006; 55,771,459 shares - 2005	12,212	11,620
Capital surplus	156,625	65,374
Retained earnings	732,781	677,781
Accumulated other comprehensive loss, net of tax	(11,688)	(13,312)

Total Shareholders' Equity		889,930		741,463
Total Liabilities and Shareholders' Equity	$	8,869,554	$	8,389,750

See notes to consolidated financial statements.

Trustmark Corporation and Subsidiaries
Consolidated Statements of Income
($ in thousands except per share data)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Interest Income				
Interest and fees on loans	$ 112,282	$ 91,533	$ 311,834	$ 254,156
Interest on securities:				
Taxable	10,710	13,358	33,589	43,085
Tax exempt	1,803	1,850	5,418	5,607
Interest on federal funds sold and securities purchased under reverse repurchase agreements	346	287	1,018	703
Other interest income	56	15	107	57
Total Interest Income	125,197	107,043	351,966	303,608
Interest Expense				
Interest on deposits	41,781	21,415	105,225	56,109
Interest on federal funds purchased and securities sold under repurchase agreements	4,896	5,050	15,700	13,693
Other interest expense	7,890	11,591	22,552	28,501
Total Interest Expense	54,567	38,056	143,477	98,303
Net Interest Income	70,630	68,987	208,489	205,305
Provision for loan losses	(81)	12,127	(5,029)	16,352
Net Interest Income After Provision for Loan Losses	70,711	56,860	213,518	188,953
Noninterest Income				
Service charges on deposit accounts	14,360	13,025	39,357	38,950
Insurance commissions	8,935	9,294	26,002	25,526
Wealth management	5,770	5,293	17,246	15,950
General banking - other	5,668	5,226	16,333	15,262
Mortgage banking, net	1,131	3,290	7,481	3,895
Other, net	3,559	8,028	7,827	13,125
Securities gains (losses)	645	45	1,895	(4,009)
Total Noninterest Income	40,068	44,201	116,141	108,699
Noninterest Expense				
Salaries and employee benefits	40,231	37,808	119,175	112,412
Services and fees	9,240	8,269	26,983	25,331
Net occupancy - premises	4,479	3,956	12,433	11,308
Equipment expense	3,731	3,653	10,963	11,461
Other expense	8,144	7,293	23,535	21,870
Total Noninterest Expense	65,825	60,979	193,089	182,382
Income Before Income Taxes	44,954	40,082	136,570	115,270

Income taxes		15,193		13,861		46,716		40,062
Net Income	$	29,761	$	26,221	$	89,854	$	75,208
Earnings Per Share								
Basic	$	0.53	$	0.46	$	1.61	$	1.32
Diluted	$	0.52	$	0.46	$	1.60	$	1.32
Dividends Per Share	$	0.21	$	0.20	$	0.63	$	0.60

See notes to consolidated financial statements.

Trustmark Corporation and Subsidiaries
Consolidated Statements of Changes in Shareholders' Equity
($ in thousands)
(Unaudited)

	2006	2005
Balance, January 1,	$ 741,463	$ 750,396
Cumulative effect adjustment due to change in accounting for mortgage servicing rights	848	-
Comprehensive income:		
Net income per consolidated statements of income	89,854	75,208
Net change in fair value of securities available for sale, net of tax	1,624	(6,275)
Comprehensive income	91,478	68,933
Cash dividends paid	(35,701)	(34,032)
Common stock issued, long-term incentive plan	4,407	2,024
Compensation expense, long-term incentive plan	2,432	1,163
Common stock issued in business combination	103,812	-
Repurchase and retirement of common stock	(18,809)	(55,930)
Balance, September 30,	$ 889,930	$ 732,554

See notes to consolidated financial statements.

Trustmark Corporation and Subsidiaries
Consolidated Statements of Cash Flows
($ in thousands)
(Unaudited)

	Nine Months Ended September 30, 2006	2005
Operating Activities		
Net income	$ 89,854	$ 75,208
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	(5,029)	16,352
Depreciation and amortization/impairment	19,672	18,143
Net amortization of securities	3,549	5,990
Securities (gains) losses	(1,895)	4,009
Gains on sales of loans	(4,907)	(1,929)
Deferred income tax provision (benefit)	5,255	(4,374)
Excess tax benefit from exercise of stock options	(480)	(200)
Proceeds from sales of loans held for sale	874,221	693,233
Purchases and originations of loans held for sale	(849,562)	(699,976)
Net increase in mortgage servicing rights	(12,736)	(11,234)
Net increase in other assets	(4,218)	(7,465)
Net increase in other liabilities	2,835	25,817
Other operating activities, net	969	1,294
Net cash provided by operating activities	117,528	114,868
Investing Activities		
Proceeds from calls and maturities of securities held to maturity	9,622	12,931
Proceeds from calls and maturities of securities available for sale	238,934	199,723
Proceeds from sales of securities available for sale	105,268	286,551
Purchases of securities held to maturity	(6,707)	(177,637)
Purchases of securities available for sale	(85,060)	(65,292)
Net decrease in federal funds sold and securities purchased under reverse repurchase agreements	123,208	70,506
Net increase in loans	(165,502)	(547,276)
Purchases of premises and equipment	(16,001)	(7,462)
Proceeds from sales of premises and equipment	1,788	1,702
Proceeds from sales of other real estate	2,135	4,678
Net cash paid in business combination	(78,920)	-
Net cash provided by (used in) investing activities	128,765	(221,576)
Financing Activities		
Net increase in deposits	245,425	395,349
Net decrease in federal funds purchased and securities sold under repurchase agreements	(169,867)	(98,373)
Net decrease in other borrowings	(373,138)	(147,428)
Proceeds from long-term FHLB advances	-	100,000
Proceeds from issuance of junior subordinated debt securities	61,856	-
Cash dividends	(35,701)	(34,032)
Proceeds from exercise of stock options	3,928	1,824

Excess tax benefit from exercise of stock options		480		200
Repurchase and retirement of common stock		(18,809)		(55,930)
Net cash (used in) provided by financing activities		(285,826)		161,610
(Decrease) increase in cash and cash equivalents		(39,533)		54,902
Cash and cash equivalents at beginning of period		387,930		343,125
Cash and cash equivalents at end of period	$	348,397	$	398,027

See notes to consolidated financial statements.

TRUSTMARK CORPORATION & SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - BASIS OF FINANCIAL STATEMENT PRESENTATION AND PRINCIPLES OF CONSOLIDATION

The consolidated financial statements in this quarterly report on Form 10-Q include the accounts of Trustmark Corporation (Trustmark) and all other entities in which Trustmark has a controlling financial interest. All significant intercompany accounts and transactions have been eliminated in consolidation. Certain reclassifications have been made to prior period amounts to conform with the current period presentation.

The accompanying unaudited condensed consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements and should be read in conjunction with the consolidated financial statements, and notes thereto, included in Trustmark’s 2005 annual report on Form 10-K. Operating results for the interim periods disclosed herein are not necessarily indicative of the results that may be expected for a full year or any future period.

Management is required to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. In the opinion of Management, all adjustments (consisting of normal recurring accruals) considered necessary for the fair presentation of these consolidated financial statements have been included.

NOTE 2 - BUSINESS COMBINATIONS

On August 25, 2006, Trustmark completed its merger with Houston-based Republic Bancshares of Texas, Inc. (Republic) in a business combination accounted for by the purchase method of accounting. Trustmark purchased all the outstanding common and preferred shares of Republic for approximately $205.3 million. The purchase price includes approximately 3.3 million in common shares of Trustmark valued at $103.8 million, $100.0 million in cash and $1.5 million in acquisition-related costs. The purchase price allocations are preliminary and are subject to final determination and valuation of the fair value of assets acquired and liabilities assumed. At August 25, 2006, Republic had assets consisting of $21.1 million in cash and due from banks, $64.5 million in federal funds sold, $76.5 million in securities, $458.0 million in loans, $9.0 million in premises and equipment and $18.8 million in other assets as well as deposits of $593.3 million and borrowings and other liabilities of $13.7 million. These assets and liabilities have been recorded at estimated fair value based on market conditions and risk characteristics at the acquisition date. Excess costs over tangible net assets acquired totaled $173.4 million, of which $19.3 million has been allocated to core deposits, $690 thousand to borrower relationships and $153.4 million to goodwill. Trustmark's financial statements include the results of operations for Republic from the date of the merger. Pro forma consolidated results of operations assuming Republic had been acquired at the beginning of the reported periods are not presented because the effect of this business combination was not considered significant.

NOTE 3 - LOANS AND ALLOWANCE FOR LOAN LOSSES

For the periods presented, loans consisted of the following ($ in thousands):

	September 30, 2006	December 31, 2005
Real estate loans:		
Construction and land development	$ 903,399	$ 715,174
Secured by 1-4 family residential properties	1,865,395	1,901,196
Secured by nonfarm, nonresidential properties	1,310,191	1,061,669
Other	127,072	166,685
Loans to finance agricultural production	31,055	40,162
Commercial and industrial	1,115,452	861,167
Consumer	926,823	886,072
Obligations of states and political subdivisions	207,369	210,310
Other loans	52,116	51,004
Loans	6,538,872	5,893,439
Less allowance for loan losses	75,539	76,691
Net loans	$ 6,463,333	$ 5,816,748

The following table summarizes the activity in the allowance for loan losses for the periods presented ($ in thousands):

	Nine Months Ended September 30, 2006	2005
Balance at beginning of year	$ 76,691	$ 64,757
Provision charged to expense	(5,029)	16,352
Loans charged off	(9,874)	(12,163)
Recoveries	8,434	6,804
Net charge-offs	(1,440)	(5,359)
Allowance of acquired bank	5,317	-
Balance at end of period	$ 75,539	$ 75,750

On August 29, 2005, Hurricane Katrina struck the Mississippi Gulf Coast and Central and Eastern Mississippi causing significant damages. Immediately following the storm, Trustmark initiated a process to assess the storm's impact on its customers and on Trustmark's consolidated financial statements. In accordance with Statement of Financial Accounting Standards (SFAS) No. 5, "Accounting for Contingencies," Trustmark determined, through reasonable estimates, that specific losses were probable and initially increased its allowance for loan losses by $9.8 million, on a pretax basis.

Trustmark continually reevaluates its estimates for probable losses resulting from Hurricane Katrina. As a result, during 2006, Trustmark has released allowance for loan losses of $6.3 million on a pretax basis. At September 30, 2006, the allowance for loan losses included specific Katrina reserves totaling $3.4 million, comprised of $2.3 million for mortgage loans and $1.1 million for consumer loans. Management's estimates, assumptions and judgments are based on information available as of the date of the consolidated financial statements; accordingly, as the information changes, actual results could differ from those estimates.

The allowance for loans losses is maintained at a level believed adequate by Management, based on estimated probable losses within the existing loan portfolio. Trustmark's allowance for loan loss methodology is based on guidance provided in SEC Staff Accounting Bulletin No. 102, "Selected Loan Loss Allowance Methodology and Documentation Issues," as well as other regulatory guidance. Accordingly, Trustmark's methodology is based on historical loss experience by type of loan and internal risk ratings, homogeneous risk pools, and specific loss allocations, with adjustments considering current economic events and conditions. The provision for loan losses reflects loan quality trends, including the levels of and trends related to nonaccrual loans, past due loans, potential problem loans, criticized loans and net charge-offs or recoveries and other factors.

At September 30, 2006 and 2005, the carrying amounts of nonaccrual loans were $27.8 million and $27.2 million, respectively. Included in these nonaccrual loans at September 30, 2006 and 2005, are loans that are considered to be impaired, which totaled $24.5 million and $22.5 million, respectively. At September 30, 2006, the total allowance for loan losses related to impaired loans was $6.7 million compared with $6.6 million at September 30, 2005. The average carrying amounts of impaired loans during the third quarter of 2006 and 2005 were $22.3 million and $23.8 million, respectively. No material amounts of interest income were recognized on impaired loans or nonaccrual loans for the three and nine months ended September 30, 2006 and 2005.

NOTE 4 - MORTGAGE BANKING

On March 17, 2006, the Financial Accounting Standard Board (FASB) released SFAS No. 156, "Accounting for Servicing Financial Assets, an amendment of SFAS No. 140." This statement amends SFAS No. 140 to require that all separately recognized servicing assets and liabilities be initially measured at fair value, if practical. The effective date of this statement is as of the beginning of the first fiscal year that begins after September 15, 2006; however, early adoption is permitted as of the beginning of any fiscal year, provided the entity has not issued financial statements for the interim period. The initial recognition and measurement of servicing assets and servicing liabilities are required to be applied prospectively to transactions occurring after the effective date.

During the first quarter of 2006, Trustmark elected to early adopt SFAS No. 156 and recorded all of its Mortgage Servicing Rights (MSR) at fair value effective January 1, 2006. Upon adoption, MSR were increased by $1.4 million while retained earnings were also increased by $0.8 million, net of taxes. During the first quarter of 2006, a strategy was implemented which utilized a portfolio of derivative instruments such as interest rate futures contracts and exchange-traded option contracts to achieve a return that would substantially offset the changes in fair value of MSR attributable to interest rates. Changes in the fair value of these derivative instruments are recorded in noninterest income in mortgage banking, net and are offset by the changes in the fair value of MSR. For the nine months ended September 30, 2006, mortgage banking, net increased by $2.1 million from the change in the fair value of MSR due to interest rates, decreased by $7.7 million from the change in fair value of MSR due to runoff and decreased by $0.9 million from the costs of derivatives used in hedging MSR. Net fees related to the servicing of MSR are also included in noninterest income in mortgage banking, net.

The MSR valuation process includes the use of highly capable and experienced third parties providing valuation expertise and valuation advisory services. The fair value of MSR is determined using discounted cash flow techniques benchmarked against third party opinions of value. Estimates of fair value involve several assumptions, including the key valuation assumptions about market expectations of future prepayment rates, interest rates and discount rates. At September 30, 2006, the valuation of MSR included an assumed average prepayment speed of 8.97 CPR and an average discount rate of 10.11%. Prepayment rates are projected using an industry standard prepayment model. The model considers other key factors, such as a wide range of standard industry assumptions tied to specific portfolio characteristics such as remittance cycles, escrow payment requirements, geographic factors, foreclosure loss exposure, VA no-bid exposure, delinquency rates and cost of servicing including base cost and cost to service delinquent mortgages. Prevailing market conditions at the time of analysis are factored into the accumulation of assumptions and determination of servicing value.

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Prior to January 1, 2006, Trustmark's purchased servicing rights were capitalized at cost. For loans originated and sold where the servicing rights had been retained, Trustmark allocated the cost of the loan and servicing right based on their relative fair values. MSR were amortized over the estimated period of the related net servicing income and were evaluated quarterly for impairment. Impairment occurred when the estimated fair value of the MSR fell below its carrying value.

The activity in mortgage servicing rights is detailed in the table below ($ in thousands):

	Nine Months Ended September 30,			
		2006		2005
Balance at beginning of period	$	58,424	$	52,463
Cumulative-effect adjustment - change in accounting for MSR		1,373		-
Additions				
Purchase of servicing assets		9,602		8,545
Servicing assets that resulted from transfers of financial assets		5,185		3,405
Disposals		(2,051)		(716)
Change in fair value:				
Due to market changes		2,113		-
Due to runoff		(7,654)		-
Due to other		(466)		-
Amortization		-		(7,990)
Impairment		-		1,638
Balance at end of period	$	66,526	$	57,345

NOTE 5 - DEPOSITS

At September 30, 2006 and December 31, 2005, deposits consisted of the following ($ in thousands):

		September 30, 2006		December 31, 2005
Noninterest-bearing demand deposits	$	1,580,533	$	1,556,142
Interest-bearing deposits				
Interest-bearing demand		1,226,771		846,754
Savings		1,748,347		1,608,334
Time		2,566,562		2,271,584
Total interest-bearing deposits		5,541,680		4,726,672
Total deposits	$	7,122,213	$	6,282,814

NOTE 6 - STOCK AND INCENTIVE COMPENSATION PLANS

Effective January 1, 2006, Trustmark adopted the provisions of SFAS No. 123r, a revision of SFAS No. 123, "Accounting for Stock-Based Compensation." This statement establishes fair value as the measurement objective in accounting for stock awards and requires the application of a fair-value-based measurement method in accounting for compensation cost, which is recognized over the requisite service period. Trustmark implemented the provisions of this statement using the modified prospective approach, which applies to new awards, as well as, any previously granted awards outstanding on January 1, 2006. Compensation cost for the portion of awards for which the requisite service had not been rendered as of the date of adoption, is being recognized over the remaining service period using the compensation cost calculated for pro forma disclosure purposes previously under SFAS No. 123. Prior period amounts have not been restated to reflect the impact of the adoption of SFAS No. 123r.

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During the fourth quarter of 2005, with the approval of Trustmark's Board of Directors and in accordance with the applicable provisions of the 1997 Long Term Incentive Plan, Trustmark accelerated the vesting of unvested stock options, which were awarded on April 9, 2002, to directors and executive officers. The decision to accelerate the vesting was made primarily to reduce non-cash compensation expense of approximately $145 thousand that would have been recorded during the first quarter of 2006 following the application of SFAS No. 123r. As a result of this action, options to purchase approximately 70 thousand shares of common stock became fully vested. No additional compensation expense was recognized as the exercise price exceeded Trustmark's market price on the acceleration date.

Prior to January 1, 2006, Trustmark accounted for stock-based compensation awards under the provisions of SFAS No. 123, as amended by SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure" prospectively for all awards granted, modified or settled after January 1, 2003. Under the provisions of this statement, compensation expense was recognized over the vesting period for stock option awards and was estimated using the Black-Scholes option-pricing model, while compensation expense for restricted performance awards was recognized over the service period based on the fair value of the underlying common stock on the date of grant based on the number of restricted shares expected to vest.

Prior to January 1, 2003, Trustmark accounted for stock-based compensation awards under the recognition and measurement provisions of Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees." Under APB No. 25, because the exercise price of Trustmark's stock options equaled the market price for the underlying stock on the date of grant, no compensation expense was recognized. The following table reflects pro forma net income and earnings per share for the three and nine months ended September 30, 2005, had Trustmark elected to adopt the fair value approach for all outstanding options prior to January 1, 2003 ($ in thousands except per share data):

	Three Months Ended Sept. 30, 2005	Nine Months Ended Sept. 30, 2005
Net income, as reported	$ 26,221	$ 75,208
Add: Total stock-based compensation expense reported in net income, net of related tax effects	298	718
Deduct: Total stock-based compensation expense determined under fair value based methods for all awards, net of related tax effects	(418)	(1,213)
Pro forma net income	$ 26,101	$ 74,713
Earnings per share:		
As reported		
Basic	$ 0.46	$ 1.32
Diluted	0.46	1.32
Pro forma		
Basic	$ 0.46	$ 1.31
Diluted	0.46	1.31

On May 10, 2005, the shareholders of Trustmark, upon the recommendation of Trustmark's Board of Directors, approved the Trustmark Corporation 2005 Stock and Incentive Compensation Plan (the 2005 Plan), which was adopted by the Board of Directors, and replaced the Trustmark Corporation 1997 Long Term Incentive Plan (the 1997 Plan). The 2005 Plan became effective May 10, 2005, and subject to earlier termination by the Board of Directors, terminates on May 9, 2015. The purpose of the 2005 Plan is to promote the success of Trustmark and its subsidiaries by providing incentives to key associates and directors that will promote the identification of their personal interest with the long term financial success of Trustmark and with growth in shareholder value. The 2005 Plan is designed to provide flexibility to Trustmark in its ability to motivate, attract, and retain the services of key associates and directors upon whose judgment, interest, and special effort the successful conduct of its operation is largely dependent. The 2005 Plan allows Trustmark to make grants of non-qualified stock options, incentive stock options, stock appreciation rights, restricted stock, restricted stock units and performance units to key associates and directors. The maximum number of shares of Trustmark's common stock available for issuance under the 2005 Plan is the sum of (1) 6,000,000 common shares plus (2) the number of outstanding options under the 1997 Plan, which expire or are otherwise terminated or forfeited after May 10, 2005.

Stock Option Grants

On May 9, 2006, Trustmark awarded 271,200 options to key executives under the 2005 Plan. Stock option awards under the 2005 Plan are granted with an exercise price equal to the market price of Trustmark's stock on the date of grant. Stock options granted under the 2005 Plan vest 20% per year and have a term of seven years. Stock option awards, which were granted under the 1997 Plan had an exercise price equal to the market price of Trustmark's stock on the date of grant, vested equally over four years with a 10-year term. The fair value of the options granted was estimated using the Black-Scholes option pricing model. The assumptions used to estimate the fair value of option grants were: dividend yield - 2.79%; expected volatility factor - 22.34%; risk-free interest rate - 5.05% and expected term - 7 years. For the three months ended September 30, 2006 and 2005, compensation expense for these plans totaled $507 thousand and $413 thousand, respectively. For the nine months ended September 30, 2006 and 2005, compensation expense for these plans totaled $1.4 million and $1.0 million, respectively. The following table presents a summary of Trustmark’s option activity for the nine months ended September 30, 2006:

Options	Shares	2006 Weighted-Average Exercise Price	Aggregate Intrinsic Value
Outstanding, beginning of period	2,016,930	$ 24.44	
Granted	271,200	31.55	
Exercised	(167,675)	23.43	
Forfeited	(43,850)	28.86	
Expired	-	-	
Outstanding, end of period	2,076,605	25.36	$ 13,589,551
Exercisable, end of period	1,307,478	23.37	$ 11,151,696

The following table presents information on stock option by ranges of exercises at September 30, 2006:

	Options Outstanding			Options Exercisable		
Range of Exercise Prices	Outstanding Sept. 30, 2006	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life	Exercisable Sept. 30, 2006	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life
$13.53 - $19.60	199,370	$ 17.78	3.4	199,370	$ 17.78	3.4
$19.61 - $25.67	954,135	23.57	4.8	871,368	23.52	4.8
$25.68 - $31.74	923,100	28.84	6.6	236,740	27.53	6.6
	2,076,605	25.36	5.5	1,307,478	23.37	5.5

For the nine months ended September 30, 2006 and 2005, cash received from the exercise of share options was $3.9 million and $1.8 million, respectively, while tax benefits realized from options exercised were $480 thousand and $200 thousand, respectively. The total intrinsic value of options exercised was $1.3 million during the first nine months of 2006 and $546 thousand during the same time period in 2005.

At September 30, 2006, unrecognized stock-based compensation expense related to nonvested stock option awards totaled $4.0 million, which is expected to be recognized over a weighted-average period of 6.5 years.

Restricted Stock Grants

On August 28, 2006, Trustmark awarded 37,916 shares of restricted stock as a result of Trustmark’s merger with Republic. These are time-vested awards and are restricted until August 27, 2009. On February 1, 2006, Trustmark awarded 67,000 shares of restricted stock to key executives. These awards are restricted until December 31, 2009, and vest based on performance goals of return on average equity and total shareholder return compared to a defined peer group. The restricted share agreement entitles the executives to vote their restricted shares and earn dividends. Compensation expense is recorded utilizing the fair value of Trustmark’s stock at the grant date based on the estimated number of shares expected to vest. For the three months ended September 30, 2006 and 2005, Trustmark recorded compensation expense for restricted stock awards of $379 thousand and $70 thousand, respectively. For the nine months ended September 30, 2006 and 2005, Trustmark recorded compensation expense for restricted stock awards of $1.0 million and $116 thousand, respectively. The following table summarizes Trustmark's restricted stock activity during the first nine months of 2006:

Nonvested Shares	Shares	Weighted-Average Grant Date Fair Value
Nonvested shares, beginning of period	26,325	$ 28.28
Granted	104,916	28.67
Vested	-	
Forfeited	(1,250)	28.25
Nonvested shares, end of period	129,991	28.42

NOTE 7 - BENEFIT PLANS

Pension Plan

Trustmark maintains a noncontributory defined benefit pension plan, which covers substantially all associates with more than one year of service. The plan provides pension benefits that are based on the length of credited service and final average compensation as defined in the plan. The acceptable range of contributions to the plan is determined each year by the plan's actuary. In 2006, Trustmark's minimum required contribution is expected to be zero. The actual amount of the contribution will be determined based on the plan's funded status and return on plan assets as of the measurement date, which is October 31st.

The following table presents information regarding the plan's net periodic pension costs for the nine months ended September 30, 2006 and 2005 ($ in thousands):

		2006		2005
Service cost - benefits earned during the period	$	1,962	$	1,635
Interest cost on projected benefit obligation		3,294		3,202
Expected return on plan assets		(3,923)		(4,056)
Amortization of prior service cost		(262)		(67)
Recognized net actuarial loss		1,841		1,438
Net periodic benefit cost	$	2,912	$	2,152

Supplemental Retirement Plan

Trustmark maintains a non-qualified supplemental retirement plan covering directors, that elect to defer fees, key executive officers and senior officers. The plan provides for defined death benefits and/or retirement benefits based on a participant's covered salary. Trustmark has acquired life insurance contracts on the participants covered under the plan, which may be used to fund future payments.

The following table presents information regarding the plan's net periodic benefit costs for the nine months ended September 30, 2006 and 2005 ($ in thousands):

		2006		2005
Service cost - benefits earned during the period	$	1,201	$	1,088
Interest cost on projected benefit obligation		1,239		1,177
Amortization of prior service cost		104		152
Recognized net actuarial loss		110		77
Net periodic benefit cost	$	2,654	$	2,494

NOTE 8 - CONTINGENCIES

Letters of Credit

Standby and commercial letters of credit are conditional commitments issued by Trustmark to insure the performance of a customer to a third party. In the normal course of business, in order to fulfill the financing needs of its customers, Trustmark issues financial and performance standby letters of credit. A financial standby letter of credit irrevocably obligates Trustmark to pay a third-party beneficiary when a customer fails to repay an outstanding loan or debt instrument. A performance standby letter of credit irrevocably obligates Trustmark to pay a third-party beneficiary when a customer fails to perform some contractual, nonfinancial obligation. When issuing letters of credit, Trustmark uses essentially the same policies regarding credit risk and collateral which are followed in the lending process.

At September 30, 2006 and 2005, Trustmark's maximum exposure to credit loss in the event of nonperformance by the other party for standby and commercial letters of credit was $119.2 million and $110.9 million, respectively. These amounts consist primarily of commitments with maturities of less than three years, which have an immaterial carrying value. Trustmark holds collateral to support standby letters of credit when deemed necessary. As of September 30, 2006, the fair value of collateral held was $22.7 million.

Legal Proceedings
Trustmark and its subsidiaries are parties to lawsuits and other claims that arise in the ordinary course of business. Some of the lawsuits assert claims related to the lending, collection, servicing, investment, trust and other business activities, and some of the lawsuits allege substantial claims for damages. The cases are being vigorously contested. In the regular course of business, Management evaluates estimated losses or costs related to litigation, and provision is made for anticipated losses whenever Management believes that such losses are probable and can be reasonably estimated. At the present time, Management believes, based on the advice of legal counsel and Management's evaluation, that the final resolution of pending legal proceedings will not have a material impact on Trustmark's consolidated financial position or results of operations; however, Management is unable to estimate a range of potential loss on these matters because of the nature of the legal environment in states where Trustmark conducts business.

NOTE 9 - ISSUANCE OF TRUST PREFERRED SECURITIES AND JUNIOR SUBORDINATED DEBT

On August 18, 2006, Trustmark completed a private placement of $60.0 million of trust preferred securities through a newly formed Delaware trust affiliate, Trustmark Preferred Capital Trust I, (the Trust). The trust preferred securities mature September 30, 2036, are redeemable at Trustmark's option beginning after five years, and bear interest at a variable rate per annum equal to the three-month LIBOR plus 1.72%. Under applicable regulatory guidelines, these trust preferred securities qualify as Tier 1 capital.

The proceeds from the sale of the trust preferred securities were used by the Trust to purchase $61.856 million in aggregate principal amount of Trustmark's junior subordinated debentures. The net proceeds to Trustmark from the sale of the notes to the Trust were used to finance its merger with Republic Bancshares of Texas, Inc.

The debentures were issued pursuant to a Junior Subordinated Indenture, dated August 18, 2006 between Trustmark, as issuer, and Wilmington Trust Company, as trustee. Like the trust preferred securities, the debentures bear interest at a variable rate per annum equal to the three-month LIBOR plus 1.72% and mature on September 30, 2036. The debentures may be redeemed at Trustmark's option at anytime on or after September 30, 2011 or at anytime upon certain events, such as a change in the regulatory capital treatment of the debentures, the Trust being deemed an investment company or the occurrence of certain adverse tax events. The interest payments by Trustmark will be used to pay the quarterly distributions payable by the Trust to the holder of the trust preferred securities. However, so long as no event of default has occurred under the debentures, Trustmark may defer interest payments on the debentures (in which case the Trust will also defer distributions otherwise due on the trust preferred securities) for up to 20 consecutive quarters.

The debentures are subordinated to the prior payment of any other indebtedness of Trustmark that, by its terms, is not similarly subordinated. The trust preferred securities are recorded as a long-term liability on Trustmark's balance sheet; however, for regulatory purposes the trust preferred securities are treated as Tier 1 capital under rulings of the Federal Reserve Board, Trustmark's primary federal regulatory agency.

Trustmark also entered into a Guarantee Agreement, dated August 18, 2006, pursuant to which it has agreed to guarantee the payment by the Trust of distributions on the trust preferred securities, and the payment of principal of the trust preferred securities when due, either at maturity or on redemption, but only if and to the extent that the Trust fails to pay distributions on or principal of the trust preferred securities after having received interest payments or principal payments on the notes from Trustmark for the purpose of paying those distributions or the principal amount of the trust preferred securities.

In addition, pursuant to the acquisition of Republic Bancshares of Texas, Inc. on August 25, 2006, Trustmark assumed the liability for $8.248 million in junior subordinated debt securities issued to Republic Bancshares Capital Trust I (Republic Trust), also a Delaware trust. Republic Trust used the proceeds from the issuance of $8.0 million in trust preferred securities to acquire the junior subordinated debt securities. Both the trust preferred securities and the junior subordinated debt securities mature on January 7, 2033, and are callable at the option of Trustmark, in whole or in part, on January 7, 2008. Both the trust preferred securities and junior subordinated debt securities bear interest at a variable rate per annum equal to the three-month LIBOR plus 3.35%.

NOTE 10 - EARNINGS PER SHARE

Basic earnings per share (EPS) is computed by dividing net income by the weighted-average shares of common stock outstanding. Diluted EPS is computed by dividing net income by the weighted-average shares of common stock outstanding, adjusted for the effect of potentially dilutive stock options outstanding during the period. The following table reflects weighted-average shares used to calculate basic and diluted EPS for the periods presented (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Basic shares	56,591	56,406	55,954	56,874
Dilutive shares (related to stock options)	240	137	154	137
Diluted shares	56,831	56,543	56,108	57,011

In December 2004, the FASB issued a revision of SFAS No. 123 (SFAS No. 123r), "Share-Based Payment." This statement revises SFAS No. 123, "Accounting for Stock-Based Compensation," and supersedes APB No. 25, "Accounting for Stock Issued to Employees." Trustmark adopted SFAS No. 123r effective January 1, 2006. Prior period dilutive shares consisted of potentially dilutive stock options outstanding accounted for under APB No. 25.

NOTE 11 - STATEMENTS OF CASH FLOWS

Trustmark paid income taxes of $39.5 million and $24.1 million during the nine months ended September 30, 2006 and 2005, respectively. Interest paid on deposit liabilities and other borrowings approximated $136.1 million in the first nine months of 2006 and $93.1 million in the first nine months of 2005. For the nine months ended September 30, 2006 and 2005, noncash transfers from loans to foreclosed properties were $1.6 million and $1.2 million, respectively. Assets acquired during the third quarter of 2006 as a result of the Republic business combination totaled $647.9 million, while liabilities assumed totaled $607.0 million. During the first nine months of 2006, no long-term FHLB advances were converted to short-term borrowings compared with conversions of $75.0 million in the first nine months of 2005.

NOTE 12 - SEGMENT INFORMATION

Trustmark's management reporting structure includes four segments: general banking, wealth management, insurance and administration. General banking is responsible for all traditional banking products and services, including loans and deposits. Wealth management provides customized solutions for affluent customers by integrating financial services with traditional banking products and services such as private banking, money management, full-service brokerage, financial planning, personal and institutional trust, and retirement services, as well as insurance and risk management services provided by TRMK Risk Management, Inc., a wholly owned subsidiary of TNB. Insurance includes two wholly-owned subsidiaries of TNB: The Bottrell Insurance Agency and Fisher-Brown, Incorporated. Through Bottrell and Fisher-Brown, Trustmark provides a full range of retail insurance products, including commercial risk management products, bonding, group benefits and personal lines coverages. Administration includes all other activities that are not directly attributable to one of the major lines of business. Administration consists of internal operations such as Human Resources, Executive Administration, Treasury (Funds Management) and Corporate Finance.

The accounting policies of each reportable segment are the same as those of Trustmark except for its internal allocations. Trustmark uses a match-funded transfer pricing process to assess operating segment performance. Noninterest expenses for back-office operations support are allocated to segments based on estimated uses of those services. In the first nine months of 2006, Trustmark updated its estimates for probable losses resulting from Hurricane Katrina and released allowance for loan losses and provision for loan losses by $6.3 million on a pretax basis. As was the case in 2005, Management has determined that this item should be included in the Administrative division due to its unusual nature.

The following tables disclose financial information by reportable segment for the periods ended September 30, 2006 and 2005.

Trustmark Corporation
Segment Information
($ in thousands)

For the three months ended September 30, 2006	General Banking Division	Wealth Management Division	Insurance Division	Administration Division	Total
Net interest income from external customers	$ 72,002	$ 1,244	$ (2)	$ (2,614)	$ 70,630
Internal funding	(2,739)	(266)	-	3,005	-
Net interest income	69,263	978	(2)	391	70,630
Provision for loan losses	1,429	-	-	(1,510)	(81)
Net interest income after provision for loan losses	67,834	978	(2)	1,901	70,711
Noninterest income	24,633	5,887	9,089	459	40,068
Noninterest expense	46,432	4,628	5,999	8,766	65,825
Income before income taxes	46,035	2,237	3,088	(6,406)	44,954
Income taxes	15,963	818	1,180	(2,768)	15,193
Segment net income	$ 30,072	$ 1,419	$ 1,908	$ (3,638)	$ 29,761
Selected Financial Information					
Average assets	$ 6,841,654	$ 91,460	$ 33,199	$ 1,505,526	$ 8,471,839
Depreciation and amortization	$ 5,739	$ 105	$ 96	$ 1,186	$ 7,126

For the three months ended September 30, 2005	General Banking Division	Wealth Management Division	Insurance Division	Administration Division	Total
Net interest income from external customers	$ 70,844	$ 1,045	$ (3)	$ (2,899)	$ 68,987
Internal funding	(7,757)	(204)	-	7,961	-
Net interest income	63,087	841	(3)	5,062	68,987
Provision for loan losses	2,485	43	-	9,599	12,127
Net interest income after provision for loan losses	60,602	798	(3)	(4,537)	56,860
Noninterest income	30,063	5,493	9,283	(638)	44,201
Noninterest expense	42,690	4,615	5,931	7,743	60,979
Income before income taxes	47,975	1,676	3,349	(12,918)	40,082
Income taxes	16,567	614	1,305	(4,625)	13,861
Segment net income	$ 31,408	$ 1,062	$ 2,044	$ (8,293)	$ 26,221
Selected Financial Information					
Average assets	$ 6,375,691	$ 96,748	$ 31,357	$ 1,713,981	$ 8,217,777
Depreciation and amortization/impairment	$ 1,785	$ 136	$ 92	$ 960	$ 2,973

Trustmark Corporation
Segment Information
($ in thousands)

For the nine months ended September 30, 2006	General Banking Division	Wealth Management Division	Insurance Division	Administration Division	Total
Net interest income from external customers	$ 205,924	$ 3,301	$ (6)	$ (730)	$ 208,489
Internal funding	(5,382)	(207)	-	5,589	-
Net interest income	200,542	3,094	(6)	4,859	208,489
Provision for loan losses	1,633	(8)	-	(6,654)	(5,029)
Net interest income after provision for loan losses	198,909	3,102	(6)	11,513	213,518
Noninterest income	70,151	17,664	26,328	1,998	116,141
Noninterest expense	136,620	14,095	17,467	24,907	193,089
Income before income taxes	132,440	6,671	8,855	(11,396)	136,570
Income taxes	45,749	2,431	3,425	(4,889)	46,716
Segment net income	$ 86,691	$ 4,240	$ 5,430	$ (6,507)	$ 89,854

Selected Financial Information