FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

Filing Date: **1999-07-27** | Period of Report: **1999-06-30**
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FILER

NEWSOUTH BANCORP INC

CIK:**1027183**| IRS No.: **561999749** | State of Incorp.:**VA** | Fiscal Year End: **0930**
Type: **10-Q** | Act: **34** | File No.: **000-22219** | Film No.: **99671112**
SIC: **6035** Savings institution, federally chartered

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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, 1999.

[ ] 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: 0-22219

NEWSOUTH BANCORP, INC.
(Exact name of registrant as specified in its charter)

VIRGINIA	56-1999749
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1311 CAROLINA AVENUE, WASHINGTON, NORTH CAROLINA 27889
(Address of principal executive offices)
(Zip Code)

(252) 946-4178
(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 [ ]

Number of shares of common stock outstanding as of July 25, 1999: 3,720,501

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NEWSOUTH BANCORP, INC.
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

<TABLE>
<CAPTION>

	JUNE 30 1999	SEPTEMBER 30 1998
Assets	(UNAUDITED)	
<S>	<C>	<C>
Cash and due from banks	$ 4,639,576	$ 5,243,853
Interest-bearing deposits in financial institutions	4,340,562	11,767,988
Investment securities - available for sale	3,039,157	3,107,545
Mortgage-backed securities - available for sale	53,085,336	27,016,679
Loans receivable, net:		
Held for sale	16,225,604	38,406,628
Held for investment	200,197,817	186,592,403
Premises and equipment, net	3,617,005	3,558,836
Deferred income taxes	1,366,021	569,604
Real estate owned	594,748	411,938
Federal Home Loan Bank of Atlanta stock, at cost	1,460,200	1,363,800
Accrued interest receivable	2,033,057	1,935,490
Prepaid expenses and other assets	1,746,885	1,504,689
Total assets	$ 292,345,968	$ 281,479,453
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits:		
Demand	$ 52,763,027	$ 42,873,230
Savings	7,014,390	6,397,856
Large denomination certificates of deposit	28,600,341	25,587,798
Other time	130,199,736	129,776,201
Total deposits	218,577,494	204,635,085
Borrowed money	15,321,296	11,932,919
Accrued interest payable	150,679	62,707
Advance payments by borrowers for property taxes and insurance	229,387	451,860
Other liabilities	7,379,597	7,682,912
Total liabilities	241,658,453	224,765,483
Common stock, $.01 par value, 8,000,000 shares authorized, 4,364,044 shares issued and outstanding	43,640	43,640
Additional paid in capital	43,892,448	43,801,987
Retained earnings, substantially restricted	23,726,118	22,091,243
Treasury stock at cost, 643,543 and 218,202 shares	(12,715,376)	(4,895,754)
Unearned ESOP shares, 263,105 and 268,709	(2,631,058)	(2,687,093)
Deferred stock awards	(1,119,130)	(2,126,299)
Accumulated other comprehensive income, net	(509,127)	486,246
Total stockholders' equity	50,687,515	56,713,970
Total liabilities and stockholders' equity	$ 292,345,968	$ 281,479,453

</TABLE>

See Notes to Consolidated Financial Statements.

NEWSOUTH BANCORP, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

<TABLE>
<CAPTION>

THREE MONTHS ENDED NINE MONTHS ENDED

	JUNE 30		JUNE 30	
	1999	1998	1999	1998
Interest income:				
<S>	<C>	<C>	<C>	<C>
Interest and fees on loans	$ 4,966,334	$ 4,868,752	$14,459,317	$13,783,889
Interest and dividends on investments and deposits	969,045	733,786	2,752,242	2,388,412
Total interest income	5,935,379	5,602,538	17,211,559	16,172,301
Interest expense:				
Interest on deposits	2,316,870	2,337,281	6,883,531	6,735,842
Interest on borrowings	182,916	19,714	485,565	87,312
Total interest expense	2,499,786	2,356,995	7,369,096	6,823,154
Net interest income before provision for possible loan losses	3,435,593	3,245,543	9,842,463	9,349,147
Provision for possible loan losses	0	110,000	50,000	210,000
Net interest income	3,435,593	3,135,543	9,792,463	9,139,147
Other income:				
Loan fees and service charges	314,786	267,537	929,721	720,871
Loan servicing fees	168,841	154,721	546,812	485,912
Gain on sale of real estate, net	2,772	-2,972	41,420	29,090
Gain on sale of mortgage loans and mortgage-backed securities	120,718	207,300	533,182	610,044
Other income	77,928	51,782	179,580	153,170
Total other income	685,045	678,368	2,230,715	1,999,087
General and administrative expenses:				
Compensation and fringe benefits	1,698,507	1,822,310	5,186,793	5,462,103
Federal insurance premiums	30,734	28,605	90,981	82,885
Premises and equipment	121,156	84,477	349,484	248,391
Advertising	27,642	35,365	103,855	95,565
Payroll and other taxes	157,330	135,536	419,877	320,384
Other	539,138	457,503	1,559,166	1,220,389
Total general and administrative expenses	2,574,507	2,563,796	7,710,156	7,429,717
Income before income taxes	1,546,131	1,250,115	4,313,022	3,708,517
Income taxes	761,618	467,000	1,920,645	1,402,500
NET INCOME	$ 784,513	$ 783,115	$ 2,392,377	$ 2,306,017
Basic earnings per share	$ 0.23	$ 0.20(1)	$ 0.67	$ 0.59(1)
Diluted earnings per share	$ 0.23	$ 0.20(1)	$ 0.67	$ 0.59(1)
Dividends per share	$ 0.07	$ 0.067(1)	$ 0.21	$ 0.20(1)
Average number of common shares outstanding	3,439,285(2)	3,912,119(1)(2)	3,595,206(2)	3,894,464(1)(2)

</TABLE>

(1) Adjusted for three-for-two stock split of August 19, 1998.
(2) Excludes ESOP and MRP benefit plan shares not committed to be released or vested, and treasury stock.

See Notes to Consolidated Financial Statements.

NEWSOUTH BANCORP, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
NINE MONTHS ENDED JUNE 30, 1999
(UNAUDITED)

<TABLE>
<CAPTION>

	Common	Additional Paid-in	Retained Earnings Substantially	Treasury	Unearned ESOP	Deferred Stock	Accumulated Other Comprehensive Income,

	Stock	Capital	Restricted	Stock	Shares	Awards	Net	Total
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Balance September 30, 1998	$43,640	$43,801,987	$ 22,091,243	$ (4,895,754)	$(2,687,093)	$(2,126,299)	$ 486,246	$56,713,970
Net income			2,392,377					2,392,377
Change in unrealized gains on securities available-for-sale, net of taxes							(995,373)	(995,373)
MRP amortization						1,007,169		1,007,169
Acquisition of treasury shares				(7,819,622)				(7,819,622)
Dividends ($.21 per share)			(757,502)					(757,502)
Release of ESOP shares		90,461			56,035			146,496
Balance June 30, 1999	$43,640	$43,892,448	$ 23,726,118	$(12,715,376)	$(2,631,058)	$(1,119,130)	$(509,127)	$50,687,515

</TABLE>

See Notes to Consolidated Financial Statements.

NEWSOUTH BANCORP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

<TABLE>
<CAPTION>

	Nine Months Ended June 30	
	1999	1998
Operating activities:		
<S>	<C>	<C>
Net Income	$ 2,392,377	$ 2,306,017
Adjustments to reconcile net income to net cash used in operating activities:		
Provision for loan losses	50,000	210,000
Depreciation	212,617	116,099
ESOP compensation	146,496	626,047
MRP compensation	1,007,169	1,343,346
Accretion of discounts on securities	279	279
Gain on disposal of real estate acquired in settlement of loans	(41,420)	(29,090)
Gain on sale of loans and mortgage-backed securities	(533,182)	(610,044)
Originations of loans held for sale, net	(54,221,698)	(50,747,939)
Proceeds from sale of loans held for sale	36,671,185	25,701,112
Other operating activities	(908,058)	(1,340,591)
Net cash used in operating activities	(15,224,235)	(22,424,764)
Investing activities:		
Proceeds from principal repayments and sales of mortgage-backed securities available for sale	12,604,820	14,734,602
Loan originations, net of principal repayments of loans held for investment	(14,422,131)	(12,277,376)
Proceeds from disposal of premises and equipment and real estate acquired in settlement of loans	625,327	361,838
Purchases FHLB Stock	(96,400)	(76,300)
Purchases of premises and equipment	(272,746)	(79,950)
Net cash provided (used) in investing activities	(1,561,130)	2,662,814
Financing activities:		
Net increase in deposit accounts	13,942,409	23,953,105
Proceeds from FHLB borrowings	61,000,000	13,500,000
Repayments of FHLB borrowings	(56,500,000)	(19,500,000)
Acquisition of MRP shares	0	(1,224,768)
Treasury stock purchased	(7,819,622)	(1,072,194)
Cash dividends paid	(757,502)	(783,451)
Net change in repurchase agreements	(1,111,623)	627,552
Net cash provided by financing activities	8,753,662	15,500,244
Increase (decrease) in cash and cash equivalents	(8,031,703)	(4,261,706)
Cash and cash equivalents, beginning of period	17,011,841	15,772,251

Cash and cash equivalents, end of period	$ 8,980,138	$ 11,510,545
	============	============
Supplemental disclosures:		
Real estate acquired in settlement of loans	$ 766,717	$ 323,973
Exchange of loans for mortgage-backed securities	$ 40,125,838	$ 17,958,559

</TABLE>

See Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1. NATURE OF BUSINESS

NewSouth Bancorp, Inc. (the"Company") was formed for the purpose of issuing common stock and owning 100% of the stock of NewSouth Bank (the "Bank") and operating through the Bank, a commercial banking business. The Bank has determined that it has one significant operating segment, the providing of general commercial banking services to its markets located in eastern North Carolina.

The common stock of the Company is traded on the Nasdaq Amex System under the symbol "NSBC".

NOTE 2. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements (except for the Statement of Financial Condition at September 30, 1998, which is audited) have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments necessary for a fair presentation of the financial position and results of operations for the periods presented have been included, none of which were other than normal recurring accruals. The financial statements of the Company are presented on a consolidated basis with those of the Bank. The results of operations for the three and nine month periods ended June 30, 1999 are not necessarily indicative of the results of operations that may be expected for the year ended September 30, 1999.

NOTE 3. EARNINGS PER SHARE

The Company's earnings per share for the three and nine month periods ended June 30, 1999 is based on weighted average shares of 3,439,285 and 3,595,206, respectively, of common stock outstanding, excluding ESOP and deferred stock award plan shares not committed to be released or vested, and treasury shares. Earnings per share have been calculated in accordance with Statement of Position 93-6, "Employers' Accounting for Employee Stock Ownership Plans" and Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings Per Share". The Company's outstanding stock options and deferred stock awards plan shares were not included in the diluted earnings per share calculation for the three and nine month periods ended June 30, 1999, as their effect would have been anti-dilutive.

NOTE 4. DIVIDENDS DECLARED

On June 17, 1999, the Board of Directors declared a cash dividend of $0.07 per share payable July 22, 1999 to stockholders of record as of July 2, 1999. This dividend payment represents a payout ratio of 30.4% of the consolidated earnings for the quarter ended June 30, 1999, and is the Company's ninth consecutive quarterly cash dividend.

NOTE 5. COMPREHENSIVE INCOME.

On October 1, 1998, the Company adopted Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income". As required by SFAS No. 130, prior year information has been modified to conform with the new presentation.

Comprehensive income includes net income and all other changes to the Company's equity, with the exception of transactions with shareholders ("other comprehensive income"). The Company's only component of other comprehensive income relates to unrealized gains on available for sale securities.

Information concerning the Company's other comprehensive income for the three and nine month periods ended June 30, 1999 and 1998 is as follows:

	Three Months Ended June 30, 1999	Three Months Ended June 30, 1998	Nine Months Ended June 30, 1999	Nine Months Ended June 30, 1998
Net income	$ 784,513	$ 783,115	$ 3,362,377	$ 2,306,017
Reclassification of gains recognized in net income, net of income taxes	(120,718)	(181,577)	(138,881)	(272,724)
Gains unrealized, net of income taxes	(707,302)	67,350	(856,492)	333,852
Other comprehensive income	(828,020)	(114,227)	(995,373)	61,128
Comprehensive income	$ (43,507)	$ 668,888	$ 2,367,004	$ 2,367,145

NOTE 6. FORWARD LOOKING STATEMENTS.

This Form 10-Q contains certain forward looking statements consisting of estimates with respect to the financial condition, results of operations and other business of the Company that are subject to various factors which could cause actual results to differ materially from those estimates. Factors which could influence the estimates include changes in general and local market conditions, legislative and regulatory conditions, and an adverse interest rate environment.

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

The Company has engaged in no activity other than holding the stock of the Bank and operating through the Bank, a commercial banking business. Therefore, this discussion focuses primarily on the Bank's results of operations.

COMPARISON OF FINANCIAL CONDITION AT JUNE 30, 1999 AND SEPTEMBER 30, 1998

Total assets were $292.3 million at June 30, 1999 compared to $281.5 million at September 30, 1998. Total earning assets increased by $10.1 million to $278.4 million at June 30, 1999 from $268.3 million at September 30, 1998.

Interest-bearing deposits in financial institutions were $4.3 million at June 30, 1999 compared to $11.8 million at September 30, 1998. These funds are primarily used to support the Bank's daily liquidity management activities and operations. Since September 30, 1998, the Bank has implemented various investment strategies to increase its regulatory liquidity levels. The Bank has securitized certain mortgage loans previously held for sale into mortgage-backed securities, resulting in a mortgage-backed securities portfolio of $53.1 million at June 30, 1999 compared to $27.0 million at September 30, 1998. Consequently, loans held for sale have declined to $16.2 million at June 30, 1999 from $38.4 million at September 30, 1998. The Bank continues to experience favorable retail consumer and commercial loan demand as loans held for investment increased to $200.2 million at June 30, 1999 from $186.6 million at September 30, 1998. To support the risk associated with these types of loans, the Bank had reserves for potential loan losses of $3.3 million at June 30, 1999 and $3.4 million at September 30, 1998, or 1.5% of loans outstanding at the end of each period. Earning assets amounted to 95.2% of total assets at June 30, 1999, compared to 95.3% at September 30, 1998.

Total interest-bearing liabilities increased to $233.9 million at June 30, 1999 from $216.6 million at September 30, 1998. Total deposits increased by $14.0 million, to $218.6 million at June 30, 1999 from $204.6 million at September 30, 1998. Borrowings increased to $15.3 million at June 30, 1999 from $11.9 million, supporting the growth in earning assets and banking operations during the period.

Stockholders' equity was $50.7 million at June 30, 1999, compared to $56.7 million at September 30, 1998. See "Consolidated Statements of Stockholders' Equity". At June 30, 1999, the Company's equity to assets ratio was 17.3% compared to 20.1% at September 30, 1998. As a North Carolina chartered commercial bank, the Bank must meet various capital standards required by federal and state banking regulatory agencies. The Bank's stand-alone capital was $42.5 million at June 30, 1999, substantially in excess of all regulatory capital requirements. See "Liquidity and Capital Resources" below.

During the nine months ended June 30, 1999, the Company purchased 425,341 shares of its common stock through open market and private purchases, totaling approximately $7.8 million, pursuant to stock repurchase plans adopted by the board of directors. These shares are being held as treasury stock, at cost. At June 30, 1999, treasury shares were 643,543 totaling $12.7 million, compared to 218,202 shares totaling $4.9 million at September 30, 1998.

On June 17, 1999 the board of directors of the Company declared a quarterly cash dividend of $0.07 per share, payable July 22, 1999 to stockholders of record of July 2, 1999. This dividend payment is the Company's ninth consecutive quarterly cash dividend and represents a payout ratio of 30.4% of the consolidated earnings for the three months ended June 30, 1999.

COMPARISON OF OPERATING RESULTS FOR THE THREE AND NINE MONTHS ENDED JUNE 30, 1999 AND 1998

GENERAL. Net income for the three and nine months ended June 30, 1999 was $785,000 and $2.4 million, compared to $783,000 and $2.3 million for the three and nine months ended June 30, 1998. Earnings per share for the three and nine months ended June 30, 1999 were $0.23 and $0.67 per share, compared to $0.20 and $0.59 per share for the three and nine months ended June 30, 1998 (adjusted for an August 19, 1998 three-for-two stock split).

INTEREST INCOME. Interest income increased to $5.9 million and $17.2 million for the three and nine months ended June 30, 1999, from $5.6 million and $16.2 million for the three and nine months ended June 30, 1998. This increase is primarily attributable to the growth of interest-earning assets. Average interest-earning assets were $283.2 million and $278.8 million, for the three and nine months ended June 30, 1999, compared to $255.0 million and $246.8 million for the three and nine months ended June 30, 1998. The yield on average interest-earning assets was 8.4% and 8.2% for the three and nine months ended June 30, 1999, compared to 8.8% and 8.7% for the three and nine months ended June 30, 1998.

INTEREST EXPENSE. Interest expense on deposits and borrowings increased to $2.5 million and $7.4 million for the three and nine months ended June 30, 1999, from $2.4 million and $6.8 million for the three and nine months ended June 30, 1998. Average interest-bearing liabilities increased to $235.8 million and $228.4 million for the three and nine months ended June 30, 1999, from $202.9 million and $195.0 million for the three and nine months ended June 30, 1998. The effective cost of average interest-bearing liabilities decreased to 4.2% and 4.3% for the three and nine months ended June 30, 1999 from 4.6% and 4.7% for the three and nine months ended June 30, 1998. The Bank has increased its checking account base by 20.3%, to $52.8 million at June 30, 1999 from $43.9 million at June 30, 1998, reflecting its efforts of attracting lower costing core deposits.

NET INTEREST INCOME. Net interest income increased to $3.4 million and $9.8 million for the three and nine months ended June 30, 1999, from $3.2 million and $9.3 million for the three and nine months ended June 30, 1998. The Bank's interest rate spread (the difference between the effective yield on average interest-earning assets and the effective cost of average interest-bearing liabilities) was 4.2% and 3.9%for the three and nine months ended June 30, 1999, compared to 4.2% and 4.0% for the three and nine months ended June 30, 1998. The Bank's net yield on interest-earning assets (net interest income divided by average interest-earning assets) was 4.9% and 4.7% for the three and nine months ended June 30, 1999, compared to 5.1% for both the three and nine months ended June 30, 1998.

PROVISION FOR LOAN LOSSES. The Bank recorded no provisions for loan losses during the three months ended June 30, 1999, compared to $110,000 during the three months ended June 30, 1998. During the nine months ended June 30, 1999 and 1998, the Bank recorded provisions for

loan losses of $50,000 and $210,000, respectively. Provisions are charged to operations and the Bank believes the resulting allowance for loan losses is adequate to absorb potential losses on loans that may become uncollectible. Increases or decreases in the provision and resulting allowances are based upon a review and classification of the Bank's loan portfolio and other factors, such as past collection experience, changes in the nature and volume of the loan portfolio, risk characteristics of individual loans or groups of similar loans and underlying collateral, overall portfolio quality and current and prospective economic conditions. The $3.3 million allowance for loan losses maintained at June 30, 1999 represents 1.5% of total loans outstanding at the end of the period. The Bank believes the current level of its allowance for loan losses is adequate to provide for possible future losses, although there are no assurances that possible future losses, if any, will not exceed estimated amounts.

NONINTEREST INCOME. Noninterest income was $685,000 and $2.2 million for the three and nine months ended June 30, 1999, compared to $678,000 and $2.0 million for the three and nine months ended June 30, 1998. Noninterest income consisting of fees and service charges earned on loans, service charges on deposit accounts, gains from sales of loans and mortgage-backed securities and other miscellaneous income, continues to increase from period to period along with the growth in earning assets and deposits.

NONINTEREST EXPENSE. Noninterest expenses were $2.6 million and $7.7 million for the three and nine months ended June 30, 1999, compared to $2.6 million and $7.4 million for the three and nine months ended June 30, 1998. The largest single component of these expenses, compensation and fringe benefits, was $1.7 million and $5.2 million for the three and nine months ended June 30, 1999, compared to $1.8 million and $5.5 million for the three and nine months ended June 30, 1998. During the three and nine months ended June 30, 1999, the Bank recorded $336,000 and $1.0 million of benefits expense under a deferred stock awards Management Recognition Plan, compared to $411,000 and $1.6 million for the three and nine months ended June 30, 1998. During the three and nine months ended June 30, 1999, the Bank recorded $189,000 and $667,000 in benefits expense for the Employee Stock Ownership Plan, compared to $219,000 and $626,000 for the three and nine months ended June 30, 1998. Other noninterest expenses including premises and equipment, advertising, and office supplies has also grown proportionately with the growth in earning assets and deposits from period to period. On March 29, 1999, the Company completed the reincorporation of its state of incorporation from Delaware to Virginia and is expected to reduce its annual franchise tax expense by approximately $40,000 per year in the future.

INCOME TAXES. Income tax expense was $762,000 and $1.9 million for the three and nine months ended June 30, 1999, compared to $467,000 and $1.4 million for the three and nine months ended June 30, 1998. The changes in the amounts of income tax provisions reflects the changes in pretax income, the application of permanent and temporary differences, and the estimated income tax rates in effect during the respective periods.

LIQUIDITY AND CAPITAL RESOURCES

The Bank must meet certain liquidity requirements established by the State of North Carolina Office of the Commissioner of Banks (the "Commissioner"). At June 30, 1999, the Bank's liquidity ratio exceeded such requirements. Liquidity generally refers to the Bank's ability to

generate adequate amounts of funds to meet its cash needs. Adequate liquidity guarantees that sufficient funds are available to meet deposit withdrawals, fund future loan commitments, maintain adequate reserve requirements, pay operating expenses, provide funds for debt service, pay dividends to stockholders, and meet other general commitments. At June 30, 1999, the Bank had cash, deposits in banks, investment securities, mortgage-backed securities, FHLB stock and loans held for sale totaling $82.8 million, or 28.3% of total assets, compared to $86.9 million at September 30, 1998, or 30.9% of total assets.

The Bank believes it can meet future liquidity needs with existing funding sources. The Bank's primary source of funds are deposits, payments on loans and mortgage-backed securities, maturities of investment securities, earnings and funds provided from operations, the ability to borrow from the Federal Home Loan Bank of Atlanta and the availability of loans held for sale. While scheduled repayments of loans and mortgage-backed securities are relatively predictable sources of funds, deposit flows and loan prepayments are substantially influenced by general market interest rates, economic conditions and competition. In addition, the Bank attempts to manage its deposit pricing in order to maintain a desired deposit mix.

The FDIC requires the Bank to meet a minimum leverage capital requirement of Tier I capital (consisting of retained earnings and common stockholders's equity, less any intangible assets) to assets ratio of 4%. The FDIC also requires the Bank to meet a ratio of total capital to risk-weighted assets of 8%, of which at least 4% must be in the form of Tier I capital. The Commissioner requires the Bank at all times to maintain a capital surplus of not less than 50% of common capital stock. The Bank was in compliance with all capital requirements of the FDIC and the Commissioner at June 30, 1999 and September 30, 1998.

IMPACT OF INFLATION AND CHANGING PRICES

The consolidated financial statements of the Company have been prepared in accordance with generally accepted accounting principles, which require the measurement of financial position and operating results in terms of historical dollars without considering the change in relative purchasing power of money over time and due to inflation. The assets and liabilities of the Company are primarily monetary in nature and changes in market interest rates have greater impact on the Company's performance than do the effects of general levels of inflation. The impact of inflation upon the Company is reflected in the cost and prices it pays for goods and services.

IMPACT OF RECENT ACCOUNTING STANDARDS

The Company will adopt SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", effective with the fiscal quarter beginning July 1, 1999. SFAS 133 establishes accounting and reporting standards for derivative instruments and for hedging activities. It requires that derivatives be recognized as either assets or liabilities in the statement of financial position and be measured at fair value. The accounting for changes in fair value of a derivative depends on the intended use of the derivative and whether or not the derivative is designated as a hedging instrument. SFAS 133 is not expected to have a material impact on the Company's financial statements.

SFAS No. 134, "Accounting for Mortgage-Backed Securities Retained after the Securitization of Mortgage Loans Held for Sale by a Mortgage Banking Enterprise", was issued in October 1998. SFAS 134 amends existing classification and accounting treatment of mortgage-backed securities retained after mortgage loans held for sale are securitized for entities engaged in mortgage banking activities. These securities were previously classified and accounted for as trading and now may be classified as held-to-maturity or available-for-sale. This statement is effective for the first fiscal quarter beginning after December 15, 1998. SFAS 134 is not expected to have a material impact on the Company's financial statements.

YEAR 2000 COMPLIANCE

A lot of attention has been given to the global computer problems that may occur in the year 2000 ("Y2K"). Many computer programs that can only read two digits of the year entered may read entries for the year 2000 as the year 1900 and compute payment, interest or delinquency based on the wrong date, or may be unable to compute payment, interest or delinquency. Rapid and accurate data processing is essential to the operations of the Bank, most other financial institutions and many other companies. In compliance with regulatory guidelines, the Bank has formed a Y2K committee to evaluate the effects the century date change may have on all current systems and to assess the potential risks associated with the Y2K issue. A formal Y2K strategic plan, business resumption contingency plan and cash contingency plan have been developed to insure that problems and disruptions related to Y2K are minimized.

All material data processing functions of the Bank that could be impacted by Y2K are provided by a national third party service bureau, Bisys, Inc. Bisys has dedicated significant resources in assuring its systems are Y2K compliant and developing a comprehensive testing and verification program. The remediated version of the Bisys client test facility has undergone extensive beta testing and has provided the Bank with end-to-end testing capabilities of all its hardware, software and related interfaces. On the Bisys host system, we have successfully completed testing the century date rollover from December 31, 1999 to January 3, 2000 for all applications. All Bank user departments have successfully completed testing their system applications and testing the business resumption contingency plan, assuring validation of the century date changes and system readiness. Additional testing is also taking place with all other external mission critical information systems and relationships with which the Bank exchanges data or information. Prior to year end, the Bank will continue to refine and monitor its Y2K preparedness to insure it is ready for this unprecedented event.

In addressing Y2K, the Bank has used its current internal staff with limited reliance on outside resources. Bisys has provided remediated host system software to the Bank and no major system is expected to be replaced in the near future. The Bank plans to increase its customer awareness efforts, implement its cash contingency plan and continue testing its hardware, software and related interfaces. As a result, estimated Y2K expenses of $70,000 were accrued during the nine months ended June 30, 1999. The Bank believes the cost of addressing the Y2K issue going forward will have no material impact on its results of operations, liquidity, capital resources, or uncertainty that would cause its reported financial condition not to be necessarily indicative of future operating results or financial condition.

PART II. OTHER INFORMATION

ITEM I. LEGAL PROCEEDINGS

The Company is not engaged in any legal proceedings at the present time. From time to time, the Bank is a party to legal proceedings within the ordinary course of business wherein it enforces its security interest in loans, and other matters of similar nature.

ITEM 2. CHANGES IN SECURITIES

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not applicable.

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

A. Exhibit 27 - Financial Data Schedule

B. Reports on Form 8-K:

1. A Form 8-K was filed on April 5, 1999 under Item 2: Acquisition or Disposition of Assets, reporting the Company had completed its reincorporation from the state of Delaware to the state of Virginia.

2. A Form 8-K was filed on May 4, 1999 under Item 5: Other Events, reporting the Company had completed a previously announced 5% stock repurchase program and had adopted a program to repurchase an additional 5% (187,081 shares) of its issued and outstanding shares of common stock.

SIGNATURES

Pursuant to 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.

NEWSOUTH BANCORP, INC.

Date: July 27, 1999

/s/ William L. Wall

William L. Wall
Executive Vice President
Chief Financial Officer
(Principal Financial Officer)

Date: July 27, 1999

/s/ Kristie W. Hawkins

Kristie W. Hawkins
Controller
Treasurer
(Principal Accounting Officer)

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