

# CapitalSouth<sup>®</sup>

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## BANCORP

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### **CAPITALSOUTH BANCORP ANNOUNCES FIRST QUARTER 2008 RESULTS**

BIRMINGHAM, Ala. (April 30, 2008) – CapitalSouth Bancorp (NASDAQ-GM: CAPB), the bank holding company for CapitalSouth Bank, today announced earnings of \$0.08 per diluted share for the first quarter ended March 31, 2008. During the quarter, the Company continued to face challenges from further weakening in the economy. Many of the loans identified in the latter half of 2007 as problem credits, which the Company provided for in the allowance for loan losses in 2007, migrated into non-performing status during the first quarter of 2008. Accordingly, the Company is reflecting increased non-performing loans and charge-offs over the prior year and fourth quarter. The Company continues to maintain a higher allowance for loan losses, reflective of the deterioration in the general market conditions and its impact on the credit quality of the Company's loan portfolio.

Key points of the Company's first quarter results included:

- Earnings per diluted share of \$0.08 for the first quarter of 2008, an increase over the fourth quarter 2007 loss and below \$0.23 per diluted share reported first quarter last year;
- Total assets for the first quarter of 2008 increased 49.67% over the first quarter of 2007, but declined 1.41% from the fourth quarter of 2007;
- Total loans, including loans held for sale of \$616,354,000 for the first quarter of 2008, increased over first quarter 2007 balances of \$384,708,000, but declined from the fourth quarter of 2007 balances of \$629,530,000;
- Total deposits increased from \$444,722,000 in the first quarter of 2007, and \$593,344,000 in the fourth quarter of 2007 to \$596,057,000 for the quarter ended March 31, 2008;
- Non-performing assets of \$35,100,000 or 5.68% of period-end loans and other real estate, up from \$17,430,000 or 2.79% in the fourth quarter of 2007 and \$2,404,000 or 0.62% in the year-earlier quarter;
- The allowance for loan losses, as a percentage of period-end loans, was 1.44% at March 31, 2008, compared with 1.43% at December 31, 2007, and 1.16% at March 31, 2007; and
- Annualized net charge-offs, as a percentage of average loans were 0.49% in the first quarter of 2008 compared with net charge-offs of 0.29% in the fourth quarter of 2007 and 0.00% in the first quarter of 2007.

The Company also announced that its Board of Directors has suspended the quarterly cash dividend to preserve the Company's retained capital. The Company continues to evaluate its options for bringing the Company's total risk based capital ratio to a well capitalized status. All other capital ratios meet the regulatory guidelines for well capitalized status.

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Commenting on the announcement, W. Dan Puckett, Chairman and Chief Executive Officer, said, "We are disappointed with the further increase in non-performing assets during the first quarter and its effect on our earnings. The impact included both continued provision for loan losses this quarter above historical levels, as well as significant erosion in our net interest margin in large part due to the reversal of interest income on loans now classified as non-accrual. From the outset, we have been aggressive in preparing for the challenges of a continued weak economy by indentifying problem loans quickly, providing for the potential loss exposure in our allowance for loan losses and forming a special assets group to deal exclusively with loan workouts."

Puckett noted that higher levels of non-performing loans reflect general softness in residential real estate across the Company's four markets, with much of the first quarter increase attributable to loans acquired in connection with the September 2007 purchase of Monticello Bancshares. Approximately one-fourth of the Company's loan portfolio was originated in the Jacksonville offices, including the former Monticello offices, as of March 31, 2008; however, these Jacksonville-originated loans accounted for about 60% of total period-end non-performing loans.

In terms of product lines, residential acquisition and development, builder and lot loans comprised approximately 17% of the Company's loan portfolio at the end of the first quarter of 2008, but accounted for 58% of total non-performing loans. The Company has 41% of its portfolio in commercial real estate, construction and acquisition and development loans, but these loans only represent 21% of the total non-accruals.

During the first quarter, non-performing assets increased to \$35,100,000 or 5.68% of period-end loans and other real estate, up from \$2,404,000 or 0.62% in the year-earlier quarter and from \$17,430,000 or 2.79% in the fourth quarter of 2007. The increase reflects rapidly deteriorating economic conditions and growing weakness in the residential real estate sector across the Company's markets since the latter half of 2007. At March 31, 2008, 94% of the Company's non-performing loans were secured by real estate. In evaluating the adequacy of the allowance for loan losses, the Company obtained updated external appraisals on many of the properties underlying the non-performing loans or performed internal valuations based on current market conditions. The Company recorded annualized net charge-offs, as a percentage of average loans, of 0.49% in the first quarter of 2008 compared with net charge-offs of 0.00% in the first quarter of 2007 and 0.29% in the fourth quarter of 2007.

Commenting on the increase in non-performing assets experienced since the fourth quarter, Puckett added, "The rising level of non-performing loans reflects a progression from past due loans on classified status to an assessment that the future collection of the past due interest is in question and, accordingly, that the accrual should be suspended, rather than newly identified problem credits. The Company identified many of these credits in the third and fourth quarter as problem credits and provided additional reserves to cover any anticipated principal losses with the significant provisions made in those quarters. We know the months ahead remain uncertain as current macroeconomic pressures beyond our control will play a key role in the eventual duration and depth of the real estate downturn. Nevertheless, we remain resolute in our efforts to proactively address the issues in our loan portfolio and strengthen our balance sheet."

Puckett also pointed out positive highlights of the first quarter compared with the prior-year period, including significantly higher levels of assets, loans and deposits, reflecting primarily the impact of the Company's Monticello acquisition. Also, due in part to the acquired operations of two Monticello branches in Jacksonville and its mortgage origination business, along with the Company's opening of two additional branches in the first quarter of 2008, CapitalSouth's income and expense levels were generally higher this year versus the same quarter last year. "While we do not underestimate the immediate obstacles we face, we are pleased with other aspects of our business, particularly the contribution of the branches and operations we acquired from Monticello, which have helped significantly increase our footprint in the Jacksonville market and expand our sources of non-interest income," Puckett said.

Net interest income for the first quarter of 2008 increased 20% to \$4,748,000 from \$3,954,000 in the year-earlier period, reflecting primarily an increase in interest-earning assets due to the Monticello acquisition. Net interest margin declined 76 basis points in the first quarter to 2.74% versus 3.50% in the same quarter last year and was down 40 basis points from 3.14% in the fourth quarter of 2007. Ongoing margin compression reflected primarily the impact of a rise in non-performing loans as well as recent rate cuts by the Federal Reserve totaling 200 basis points, which affected the Company's loan yields more rapidly than its funding costs. Management believes margin pressure will continue throughout 2008 due to the impact of non-performing loans and because reductions in deposit pricing are expected to lag declining asset yields as deposit market conditions remain highly competitive.

During the first quarter of 2008, CapitalSouth's provision for loan losses increased to \$658,000 versus \$136,000 in the year-earlier quarter, but was down from \$2,130,000 in the fourth quarter of 2007. The allowance for loan losses, as a percentage of period-end loans, was 1.44% at March 31, 2008, compared with 1.16% at March 31, 2007, and 1.43% at December 31, 2007.

Non-interest income for the first quarter increased 68% to \$1,201,000 versus \$717,000 in the year-earlier period, due primarily to higher income from deposit service fees, gains on sales of investment securities, and income from the Bank's newly acquired mortgage division in the form of gains on sales of mortgage loans. These gains offset lower investment banking income and income from Business Capital Group loans.

Non-interest expense for the first quarter increased 39% to \$4,932,000 from \$3,547,000 in the same period last year, reflecting the impact of new employees added from the Monticello acquisition as well as the Company's opening of additional offices in both Jacksonville and Huntsville, higher occupancy costs associated with the addition of a total of four branches since March 31, 2007, and expenses associated with an increase in other real estate owned.

For the first quarter of 2008, the Company reported significantly higher levels of assets, loans and deposits, with virtually all of the increases being attributable to the September 2007 acquisition of Monticello Bancshares. Total assets at March 31, 2008, were \$756,662,000, representing a 50% increase from \$505,558,000 at March 31, 2007. The Company's loan portfolio totaled \$611,256,000 at the end of the first quarter of 2008, up 59% from \$384,708,000 at March 31, 2007. Deposits increased 34% to \$596,057,000 at quarter's end versus \$444,722,000 at March 31, 2007. Stockholders' equity at March 31, 2008, totaled \$46,997,000, up 12% from \$42,033,000 at March 31,

2007. Book value per share was \$11.31 at March 31, 2008, versus \$14.07 a year ago, with the decline primarily reflecting the impact of the Company's goodwill impairment charge recorded in the fourth quarter of 2007. Tangible book value per share declined to \$8.78 per share at March 31, 2008, from \$13.64 at March 31, 2007, reflecting an increase in average shares outstanding.

CapitalSouth Bancorp is a bank holding company operating 12 full-service banking offices through its bank subsidiary, CapitalSouth Bank, with offices in Birmingham, Huntsville, and Montgomery, Alabama, and Jacksonville, Florida, as well as a mortgage origination office through Mortgage Lion, Inc., a wholesale mortgage origination operation based in Fitzgerald, Georgia. CapitalSouth Bank targets small to medium-sized businesses in the markets it serves. CapitalSouth Bank also operates "Banco Hispano," providing financial services to the growing Latino community. CapitalSouth Bank offers SBA lending services and other loan programs for business owners through its Business Capital Group, which operates through our full-service offices. CapitalSouth Bank also provides Internet banking services at [www.capitalsouthbank.com](http://www.capitalsouthbank.com) as well as personal investment services.

This press release contains "forward-looking" statements as defined by the Private Securities Litigation Reform Act of 1995, which are based on CapitalSouth's current expectations, estimates and projections about future events and financial trends affecting the financial condition of its business. These statements are not historical facts or guarantees of future performance, events, or results. Such statements involve potential risks and uncertainties and, accordingly, actual performance results may differ materially. CapitalSouth undertakes no obligation to publicly update or revise forward-looking statements, whether as a result of new, updated information, future events, or otherwise.

**CapitalSouth Bancorp**  
**Summary Unaudited Financial Information**  
(in thousands, except per share amounts)

|   | <b>Three Months Ended</b> |                |
|---|---------------------------|----------------|
|   | <b>March 31,</b>          |                |
|   | <b>2008</b>               | <b>2007</b>    |
| Interest income                                     | \$ 11,641                 | \$ 8,679       |
| Interest expense                                    | <u>6,893</u>              | <u>4,726</u>   |
| Net interest income                                 | 4,748                     | 3,953          |
| Provision for loan losses                           | <u>658</u>                | <u>136</u>     |
| Net interest income after provision for loan losses | 4,090                     | 3,817          |
| Noninterest income                                  | 1,201                     | 717            |
| Noninterest expense                                 | <u>4,932</u>              | <u>3,547</u>   |
| Net income before provision for<br>income taxes     | 359                       | 987            |
| Provision for income taxes                          | <u>37</u>                 | <u>280</u>     |
| Net income  | <u>\$ 322</u>             | <u>\$ 707</u>  |
| Net income per share                                |                           |                |
| Basic   | \$ 0.08                   | \$ 0.24        |
| Diluted   | \$ 0.08                   | \$ 0.23        |
| Weighted average shares outstanding                 |                           |                |
| Basic   | 4,151                     | 2,981          |
| Diluted   | 4,151                     | 3,016          |
|   |                           |                |
|   | <b>March 31,</b>          |                |
|   | <b>2008</b>               | <b>2007</b>    |
| Total assets  | \$ 756,662                | \$ 505,558     |
| Loans   | 611,256                   | 384,708        |
| Allowance for loan losses                           | <u>(8,787)</u>            | <u>(4,467)</u> |
| Net loans   | <u>602,469</u>            | <u>380,241</u> |
| Interest-bearing deposits                           | 533,548                   | 383,242        |
| Noninterest-bearing deposits                        | <u>62,509</u>             | <u>61,480</u>  |
| Total deposits                                      | <u>596,057</u>            | <u>444,722</u> |
| Stockholders' equity                                | 46,997                    | 42,033         |
| Book value per share                                | 11.31                     | 14.07          |
| Tangible book value per share                       | 8.78                      | 13.64          |

Unaudited supplemental financial information for the three months ended March 31, 2008 and 2007, may be obtained by following this link: <http://www.irinfo.com/CAPB/CAPB1Q08btu.pdf>.