

FIDELITY SOUTHERN CORP

Form 10-Q

August 11, 2008

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q**

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

For the quarterly period ended June 30, 2008

Commission File Number: 0-22374

**Fidelity Southern Corporation**

(Exact name of registrant as specified in its charter)

Georgia

58-1416811

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

3490 Piedmont Road, Suite 1550, Atlanta GA

30305

(Address of principal executive offices)

(Zip Code)

(404) 639-6500

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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  No

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.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Shares Outstanding at July 31, 2008
Common Stock, no par value	9,429,410



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**PART I FINANCIAL INFORMATION**  
**Item 1. Financial Statements**  
**FIDELITY SOUTHERN CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**

<i>(Dollars in thousands)</i>	<b>(Unaudited)</b> <b>June 30, 2008</b>	<b>December</b> <b>31,</b> <b>2007</b>
<b>Assets</b>		
Cash and due from banks	\$ 27,697	\$ 22,085
Interest-bearing deposits with banks	1,528	1,357
Federal funds sold	11,804	6,605
Cash and cash equivalents	41,029	30,047
Investment securities available-for-sale (amortized cost of \$125,955 and \$104,446 at June 30, 2008, and December 31, 2007, respectively)	123,100	103,149
Investment securities held-to-maturity (approximate fair value of \$26,393 and \$28,727 at June 30, 2008, and December 31, 2007, respectively)	26,767	29,064
Investment in FHLB stock	6,181	5,665
Loans held-for-sale	67,548	63,655
Loans	1,444,577	1,388,358
Allowance for loan losses	(22,521)	(16,557)
Loans, net of allowance for loan losses	1,422,056	1,371,801
Premises and equipment, net	19,595	18,821
Other real estate	10,901	7,307
Accrued interest receivable	8,667	9,367
Bank owned life insurance	27,233	26,699
Other assets	25,184	20,909
Total assets	\$ 1,778,261	\$ 1,686,484
<b>Liabilities</b>		
Deposits		
Noninterest-bearing demand deposits	\$ 134,823	\$ 131,597
Interest-bearing deposits:		
Demand and money market	281,666	314,067
Savings	215,530	216,442
Time deposits, \$100,000 and over	316,466	285,497
Other time deposits	503,088	458,022
Total deposits	1,451,573	1,405,625
Federal funds purchased	21,000	5,000
Other short-term borrowings	80,988	70,954
Subordinated debt	67,527	67,527
Other long-term debt	47,500	25,000
Accrued interest payable	5,947	6,760

Other liabilities	6,456	5,655
Total liabilities	1,680,991	1,586,521

**Shareholders' Equity**

Common stock, no par value. Authorized 50,000,000; issued and outstanding 9,410,192 and 9,368,904 at June 30, 2008, and December 31, 2007, respectively

Common stock, no par value. Authorized 50,000,000; issued and outstanding 9,410,192 and 9,368,904 at June 30, 2008, and December 31, 2007, respectively	46,512	46,164
Accumulated other comprehensive loss, net of taxes	(1,770)	(804)
Retained earnings	52,528	54,603
Total shareholders' equity	97,270	99,963
Total liabilities and shareholders' equity	\$ 1,778,261	\$ 1,686,484

*See accompanying notes to consolidated financial statements.*

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**FIDELITY SOUTHERN CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME**  
**(UNAUDITED)**

<i>(Dollars in thousands except per share data)</i>	<b>Six Months Ended</b>		<b>Three Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
<b>Interest income</b>				
Loans, including fees	\$ 49,848	\$ 51,866	\$ 24,133	\$ 26,413
Investment securities	3,694	3,683	1,978	1,836
Federal funds sold and bank deposits	95	169	53	68
<b>Total interest income</b>	<b>53,637</b>	<b>55,718</b>	<b>26,164</b>	<b>28,317</b>
<b>Interest expense</b>				
Deposits	25,214	28,745	11,895	14,606
Short-term borrowings	1,230	1,020	483	509
Subordinated debt	2,686	2,215	1,278	1,110
Other long-term debt	725	781	440	393
<b>Total interest expense</b>	<b>29,855</b>	<b>32,761</b>	<b>14,096</b>	<b>16,618</b>
<b>Net interest income</b>	<b>23,782</b>	<b>22,957</b>	<b>12,068</b>	<b>11,699</b>
Provision for loan losses	10,450	2,150	5,850	1,650
<b>Net interest income after provision for loan losses</b>	<b>13,332</b>	<b>20,807</b>	<b>6,218</b>	<b>10,049</b>
<b>Noninterest income</b>				
Service charges on deposit accounts	2,363	2,324	1,200	1,206
Other fees and charges	975	930	511	474
Mortgage banking activities	195	200	125	79
Brokerage activities	272	404	111	167
Indirect lending activities	3,096	2,679	1,510	1,306
SBA lending activities	777	1,214	363	570
Securities gains, net	1,264			
Bank owned life insurance	601	571	298	284
Other	499	489	247	260
<b>Total noninterest income</b>	<b>10,042</b>	<b>8,811</b>	<b>4,365</b>	<b>4,346</b>
<b>Noninterest expense</b>				
Salaries and employee benefits	13,224	12,691	6,368	6,272
Furniture and equipment	1,520	1,405	743	721
Net occupancy	2,022	1,927	983	956
Communication	818	866	430	467
Professional and other services	1,864	1,831	957	915
Advertising and promotion	274	429	119	185
Stationery, printing and supplies	345	380	166	206
Insurance	192	150	90	80
Other	3,588	3,237	2,605	1,577

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Total noninterest expense	23,847	22,916	12,461	11,379
Income (loss) before income tax expense	(473)	6,702	(1,878)	3,016
Income tax (benefit) expense	(681)	2,068	(976)	946
<b>Net Income</b>	\$ 208	\$ 4,634	\$ (902)	\$ 2,070
Earnings per share:				
Basic earnings per share	\$ .02	\$ .50	\$ (.10)	\$ .22
Diluted earnings per share	\$ .02	\$ .50	\$ (.10)	\$ .22
Dividends declared per share	\$ .18	\$ .18	\$ .09	\$ .09
Weighted average common shares outstanding-basic	9,384,856	9,310,016	9,393,797	9,322,956
Weighted average common shares outstanding-fully diluted	9,384,856	9,316,053	9,393,797	9,325,821

*See accompanying notes to consolidated financial statements.*

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**FIDELITY SOUTHERN CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(UNAUDITED)**

*(Dollars in thousands)*

	<b>Six Months Ended</b>	
	<b>June 30,</b>	
	<b>2008</b>	<b>2007</b>
<b>Operating Activities</b>		
Net income	\$ 208	\$ 4,634
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	10,450	2,150
Depreciation and amortization of premises and equipment	1,092	1,024
Other amortization	202	129
Share-based compensation	61	63
Impairment of other real estate	863	
Excess tax benefit from share-based compensation		(15)
Proceeds from sales of loans	106,964	149,779
Proceeds from sales of other real estate	2,826	
Loans originated for resale	(109,402)	(149,924)
Gains on loan sales	(1,455)	(1,519)
Gain on sale of investment securities	(1,264)	
Gain on sales of other real estate	(135)	
Net increase in deferred income taxes	(2,738)	(340)
Net decrease (increase) in accrued interest receivable	700	(154)
Net increase in cash value of bank owned life insurance	(534)	(492)
Net increase in other assets	(1,117)	(2,799)
Net (decrease) increase in accrued interest payable	(813)	77
Net increase (decrease) in other liabilities	207	(290)
 Net cash provided by operating activities	 6,115	 2,323
<b>Investing Activities</b>		
Purchases of investment securities available-for-sale	(34,562)	(6,549)
Purchases of investment in FHLB stock	(4,386)	(4,071)
Proceeds received from sale of investment securities	2,057	
Maturities and calls of investment securities held-to-maturity	2,303	2,234
Maturities and calls of investment securities available-for-sale	12,224	6,750
Redemption of FHLB stock	3,870	3,690
Net increase in loans	(67,372)	(20,370)
Capital improvements to other real estate owned	(481)	(70)
Purchases of premises and equipment	(1,866)	(1,014)
 Net cash used in investing activities	 (88,213)	 (19,400)
<b>Financing Activities</b>		
Net (decrease) increase in transactional accounts	(30,087)	5,527
Net increase (decrease) in time deposits	76,035	(767)
Proceeds of issuance of other long-term debt	27,500	
Repayment of other long-term debt	(5,000)	

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Net increase (decrease) in short-term borrowings	26,034	(22,243)
Dividends paid	(1,689)	(1,675)
Proceeds from the issuance of common stock	287	701
Excess tax benefit from share-based compensation		15
Net cash provided by (used in) financing activities	93,080	(18,442)
Net increase (decrease) in cash and cash equivalents	10,982	(35,519)
Cash and cash equivalents, beginning of period	30,047	58,975
Cash and cash equivalents, end of period	\$ 41,029	\$ 23,456
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	\$ 30,667	\$ 32,684
Income taxes	\$ 975	\$ 3,645
Non-cash transfers of loans to other real estate	\$ 6,667	\$ 2,814

*See accompanying notes to consolidated financial statements.*

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**FIDELITY SOUTHERN CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)  
JUNE 30, 2008**

**1. Basis of Presentation**

The accompanying unaudited consolidated financial statements include the accounts of Fidelity Southern Corporation and its wholly owned subsidiaries ( Fidelity ). Fidelity Southern Corporation ( FSC ) owns 100% of Fidelity Bank (the Bank ), and LionMark Insurance Company, an insurance agency offering consumer credit related insurance products. FSC also owns five subsidiaries established to issue trust preferred securities, which entities are not consolidated for financial reporting purposes in accordance with Financial Account Standard Board ( FASB ) Interpretation No. 46(R), as FSC is not the primary beneficiary. The Company , as used herein, includes FSC and its subsidiaries, unless the context otherwise requires.

These unaudited consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles followed within the financial services industry 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 notes required for complete financial statements.

In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the periods covered by the statements of income. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the calculations of and the amortization of capitalized servicing rights and the valuation of real estate or other assets acquired in connection with foreclosures or in satisfaction of loans. In addition, the actual lives of certain amortizable assets and income items are estimates subject to change. The Company principally operates in one business segment, which is community banking.

In the opinion of management, all adjustments considered necessary for a fair presentation of the financial position and results of operations for the interim periods have been included. All such adjustments are normal recurring accruals. Certain previously reported amounts have been reclassified to conform to current presentation. These reclassifications had no impact on net income or shareholders equity. The Company s significant accounting policies are described in Note 1 of the Notes to Consolidated Financial Statements included in our 2007 Annual Report on Form 10-K filed with the Securities and Exchange Commission. Other than as discussed in Note 9, there were no new accounting policies or changes to existing policies adopted in the first six months of 2008 which had a significant effect on the results of operations or statement of financial condition. For interim reporting purposes, the Company follows the same basic accounting policies and considers each interim period as an integral part of an annual period.

Operating results for the three and six month periods ended June 30, 2008, are not necessarily indicative of the results that may be expected for the year ended December 31, 2008. These statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K and Annual Report to Shareholders for the year ended December 31, 2007.

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**2. Shareholders Equity**

The Board of Governors of the Federal Reserve System (the FRB ) is the primary regulator of FSC, a bank holding company. The Bank is a state chartered commercial bank subject to Federal and state statutes applicable to banks chartered under the banking laws of the State of Georgia and to banks whose deposits are insured by the Federal Deposit Insurance Corporation (the FDIC ), the Bank's primary Federal regulator. The Bank is a wholly owned subsidiary of the Company. The Bank's state regulator is the Georgia Department of Banking and Finance (the GDBF ). The FDIC and the GDBF examine and evaluate the financial condition, operations, and policies and procedures of state chartered commercial banks, such as the Bank, as part of their legally prescribed oversight responsibilities.

The FRB, FDIC, and GDBF have established capital adequacy requirements as a function of their oversight of bank holding companies and state chartered banks. Each bank holding company and each bank must maintain certain minimum capital ratios. At June 30, 2008, and December 31, 2007, the Company exceeded all capital ratios required by the FRB, FDIC, and GDBF to be considered well capitalized.

**3. Contingencies**

In the first quarter of 2008, concurrent with the Company's mandatory redemption of 29,267 shares of Visa, Inc. common stock upon Visa's successful initial public offering, the Company reversed a pretax \$567,000 litigation expense accrual recorded in the fourth quarter of 2007 to recognize the Company's estimated proportional share of Visa litigation settlements and litigation reserves. Based on the continuing ownership of 46,436 shares of restricted class B Visa stock, further liabilities may arise based on ongoing involvement with Visa.

Due to the nature of their activities, the Company and its subsidiaries are at times engaged in various legal proceedings that arise in the course of normal business, some of which were outstanding as of June 30, 2008. While it is difficult to predict or determine the outcome of these proceedings, it is the opinion of management and its counsel that the ultimate liabilities, if any, will not have a material adverse impact on the Company's consolidated results of operations or its financial position.

**4. Comprehensive Income (Loss)**

Comprehensive income (loss) includes net income and other comprehensive income (loss), related to unrealized gains and losses on investment securities classified as available-for-sale. All other comprehensive income (loss) items are tax effected at a rate of 38%.

During the second quarter and the first six months of 2008, other comprehensive loss net of tax was \$2.3 million and \$1.0 million, respectively. Other comprehensive loss net of tax was \$1.7 million and \$1.5 million for the comparable periods of 2007. Comprehensive loss for the second quarter and the first six months of 2008 was \$3.2 million and \$758,000, respectively, compared to comprehensive income of \$382,000 and \$3.2 million for the same periods in 2007.

**5. Share-Based Compensation**

The Company's 1997 Stock Option Plan authorized the grant of options to management personnel for up to 500,000 shares of the Company's common stock. All options granted have three year to eight year terms and vest and become fully exercisable at the end of three years to five years of continued employment. No options may be or were granted after March 31, 2007, under this plan.

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The Fidelity Southern Corporation Equity Incentive Plan (the 2006 Incentive Plan), permits the grant of stock options, stock appreciation rights, restricted stock, restricted stock units, and other incentive awards ( Incentive Awards ). The maximum number of shares of the Company's common stock that may be issued under the 2006 Incentive Plan is 750,000 shares, all of which may be stock options. Generally, no award shall be exercisable or become vested or payable more than 10 years after the date of grant. Options granted under the 2006 Incentive Plan have four year terms and become fully exercisable at the end of three years of continued employment. Incentive awards available under the 2006 Incentive Plan totaled 673,333 shares at June 30, 2008. There were no options granted during the six months ended June 30, 2008 under the 2006 Incentive Plan.

A summary of option activity as of June 30, 2008, and changes during the six month period then ended is presented below:

	<b>Number of share options</b>	<b>Weighted Average Exercise Price</b>	<b>Weighted Average Remaining Contractual Terms</b>	<b>Aggregate Intrinsic Value</b>
Outstanding at January 1, 2008	178,905	\$ 18.10		
Granted				
Exercised				
Forfeited	3,666	18.70		
Outstanding at June 30, 2008	175,239	\$ 18.09	2.82 years	\$
Exercisable at June 30, 2008	65,950	\$ 17.55	2.70 years	\$

There were no share options exercised during six month period ended June 30, 2008.

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Other Long-term Debt is summarized as follows (dollars in thousands):

	<b>June 30, 2008</b>	<b>December 31, 2007</b>
FHLB three year European Convertible Advance with interest at 4.06% maturing November 5, 2010, with a one-time FHLB conversion options to reprice to a three-month LIBOR-based floating rate at the end of two years.	\$ 25,000	\$ 25,000
FHLB four year Fixed Rate Advance with interest at 3.2875% maturing March 12, 2012.	5,000	
FHLB five year European Convertible Advance with interest at 2.395% maturing March 12, 2013, with a one-time FHLB conversion option to reprice to a three-month LIBOR-based floating rate at the end of two years.	5,000	
FHLB five year European Convertible Advance with interest at 2.79% maturing March 12, 2013, with a one-time FHLB conversion option to reprice to a three-month LIBOR-based floating rate at the end of three years.	5,000	
FHLB five year European Convertible Advance with interest at 2.40% maturing April 3, 2013, with a one-time FHLB conversion option to reprice to a three-month LIBOR-based floating rate at the end of two years.	2,500	
FHLB two year Fixed Rate Advance with interest at 2.64% maturing April 5, 2010.	2,500	
FHLB four year Fixed Rate Advance with interest at 3.24% maturing April 2, 2012.	2,500	
	\$ 47,500	\$ 25,000

In March of 2008, the Bank purchased approximately \$20 million in fixed rate agency mortgage backed securities which were funded with \$20 million in laddered two year through five year maturity long-term Federal Home Loan Bank advances. During the second quarter of 2008, the Bank paid off one of these advances of \$5.0 million. In April of 2008, the Bank purchased \$10 million in fixed rate agency mortgage backed securities which were funded with \$10 million in laddered one year through five year maturity Federal Home Loan Bank advances. \$7.5 million of the borrowings were long-term and are shown in the table above.

**7. Fair Value**

Effective January 1, 2008, the Company adopted the provisions of SFAS No. 157, Fair Value Measurements for financial assets and financial liabilities. SFAS No. 157 establishes a common definition of fair value and framework for measuring fair value under U.S. GAAP. Fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. SFAS No. 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1

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measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy under SFAS No. 157 are described below:

Level 1 Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

Level 2 Quoted prices in markets that are not active, or inputs that are observable, either directly, for substantially the full term of the asset or liability;

Level 3 Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

A financial instrument's level within the hierarchy is based on the lowest level of input that is significant to the fair value measurement. The following table presents the assets that are measured at fair value on a recurring basis by level within the fair value hierarchy as reported on the consolidated statements of financial position at June 30, 2008 (dollars in thousands).

	<b>Fair Value Measurements at June 30, 2008</b>			
	<b>Total</b>	<b>Quoted Prices in Active Markets for Identical Securities Level 1</b>	<b>Significant Other Observable Inputs Level 2</b>	<b>Significant Unobservable Inputs Level 3</b>
Available-for-sale securities	\$ 123,100	\$	\$ 123,100	\$

Securities classified as available-for-sale are reported at fair value utilizing Level 2 inputs. For these securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things. The investments in the Company's portfolio are generally not quoted on an exchange but are actively traded in the secondary institutional markets.

The following table presents the assets that are measured at fair value on a non-recurring basis by level within the fair value hierarchy as reported on the consolidated statements of financial position at June 30, 2008 (dollars in thousands).

	<b>Fair Value Measurements at June 30, 2008</b>			
	<b>Total</b>	<b>Quoted Prices in Active Markets for Identical Securities Level 1</b>	<b>Significant Other Observable Inputs Level 2</b>	<b>Significant Unobservable Inputs Level 3</b>
Impaired loans	\$ 21,778	\$	\$	\$ 21,778
Other real estate	10,901		10,901	
	\$ 32,679	\$	\$ 10,901	\$ 21,778

Impaired loans are evaluated and valued at the time the loan is identified as impaired, at the lower of cost or fair value. Fair value is measured based on the value of the collateral securing these loans and is classified at a Level 3 in the fair value hierarchy. Collateral may include real estate, or business assets including equipment, inventory and

accounts receivable. The value of real estate collateral is determined based on an appraisal by qualified licensed appraisers hired by the Company. The value of business equipment is based on an appraisal by qualified licensed appraisers hired by the Company if significant, or the equipment's net book value on the business financial statements. Inventory and accounts receivable collateral are valued



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based on independent field examiner review or aging reports. Appraised and reported values may be discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business. Impaired loans are evaluated on at least a quarterly basis for additional impairment and adjusted accordingly.

Foreclosed assets are adjusted to fair value upon transfer of the loans to other real estate. Subsequently, foreclosed assets are carried at the lower of carrying value or fair value. Fair value is based upon independent market prices or appraised values of the collateral. The fair value of the collateral is based on an observable market price or a current appraised value, and therefore the foreclosed asset is recorded as nonrecurring Level 2.

**8. Other Real Estate**

Other real estate ( ORE ) consisted of the following (dollars in thousands):

	<b>June 30, 2008</b>	<b>December 31, 2007</b>
Commercial	\$	\$ 1,577
Residential	8,138	2,652
Lots	2,763	3,078
 Total other real estate	 \$ 10,901	 \$ 7,307

Capitalized costs represent disbursements made to complete construction or development of foreclosed property and are added to the cost of the ORE found on the Consolidated Balance Sheets. Gains on sales are included in Other Income in the Consolidated Statements of Income. Expensed costs are disbursements made for the maintenance or repair of properties held in ORE and are found in Other Expense in the Consolidated Statements of Income. Capitalized costs, gains on sales, and expensed costs related to ORE are summarized below (dollars in thousands):

	<b>For the Six Months Ended June 30,</b>	
	<b>2008</b>	<b>2007</b>
Capitalized costs of other real estate	\$ 481	\$ 70
Net gains on sales of other real estate	\$ 135	\$
Impairment write down of ORE	\$ 863	\$
Other ORE related expense	322	18
 Total ORE related expense	 \$ 1,185	 \$ 18

**9. Recent Accounting Pronouncements**

In September 2006, the FASB ratified the consensus on EITF issue No. 06-04, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements ( EITF No. 06-04 ). EITF No. 06-04 requires recognition of a liability and related compensation costs for endorsement split dollar life insurance policies that provide a benefit to an employee that extends to postretirement periods. The Company adopted EITF No. 06-04 effective January 1, 2008. The

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Company recorded a cumulative-effect debit adjustment to retained earnings of \$594,000 in the first quarter of 2008 and expects to have related ongoing expenses of approximately \$200,000 per year.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ( SFAS No. 157 ). This statement defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. It does not require any new fair value measurements but applies whenever other accounting pronouncements require or permit fair value measurements. The statement was effective as of the beginning of a company's first fiscal year after November 15, 2007, and interim periods within that fiscal year. The Company adopted this statement effective January 1, 2008. There was no material impact on the Company's financial condition and statement of operations as a result of the adoption of this statement. (See Note 7.)

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ( SFAS No. 159 ). This statement provides companies with an option to report selected financial assets and liabilities at fair value in an effort to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. It also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. The statement was effective as of the beginning of a company's first fiscal year after November 15, 2007. The Company adopted this statement effective January 1, 2008 and has not elected the fair value option on any financial assets or liabilities. There was no material impact on the Company's financial condition and statement of operations as a result of the adoption of this statement.

**Item 2. Management's Discussion and Analysis of  
Financial Condition and Results of Operations**

The following analysis reviews important factors affecting our financial condition at June 30, 2008, compared to December 31, 2007, and compares the results of operations for the second quarters and six months ended June 30, 2008 and 2007. These comments should be read in conjunction with our consolidated financial statements and accompanying notes appearing in this report and the *Risk Factors* set forth in our Annual Report on Form 10-K for the year ended December 31, 2007. All percentage and dollar variances noted in the following analysis are calculated from the balances presented in the accompanying financial statements.

**Forward-Looking Statements**

This report on Form 10-Q may include forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, that reflect our current expectations relating to present or future trends or factors generally affecting the banking industry and specifically affecting our operations, markets and products. Without limiting the foregoing, the words *believes*, *expects*, *anticipates*, *estimates*, *projects*, *intends*, and similar expressions are intended to identify forward-looking statements. These forward-looking statements are based upon assumptions we believe are reasonable and may relate to, among other things, the deteriorating economy and its impact on operating results and credit quality, the adequacy of the allowance for loan losses, changes in interest rates, and litigation results. These forward-looking statements are subject to risks and uncertainties. Actual results could differ materially from those projected for many reasons, including without limitation, changing events and trends that have influenced our assumptions. These trends and events include (i) a deteriorating economy and its impact on operations and credit quality; (ii) unique risks associated with our construction and land development loans; (iii) the impact of a slowing economy on our consumer loan portfolio and its potential impact on our commercial portfolio; (iv) changes in land values and economic conditions in Atlanta, Georgia; (v) our ability to maintain and service relationships with automobile dealers and indirect automobile loan purchasers and our ability to profitably manage changes in our indirect automobile lending

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operations; (vi) changes in the interest rate environment and their impact on our net interest margin; (vii) difficulties in maintaining quality loan growth; (viii) less favorable than anticipated changes in the national and local business environment, particularly in regard to the housing market in general and residential construction and new home sales in particular; (ix) adverse changes in the regulatory requirements affecting us; (x) greater competitive pressures among financial institutions in our market; (xi) changes in political, legislative and economic conditions; (xii) inflation; (xiii) greater loan losses than historic levels and an insufficient allowance for loan losses; and (xiv) failure to achieve the revenue increases expected to result from our investments in branch additions and in our transaction deposit and lending businesses.

This list is intended to identify some of the principal factors that could cause actual results to differ materially from those described in the forward-looking statements included herein and are not intended to represent a complete list of all risks and uncertainties in our business. Investors are encouraged to read the related section in our 2007 Annual Report on Form 10-K, including the Risk Factors set forth therein. Additional information and other factors that could affect future financial results are included in our filings with the Securities and Exchange Commission.

**Critical Accounting Policies**

Our accounting and reporting policies are in accordance with U.S. generally accepted accounting principles and conform to general practices within the financial services industry. Our financial position and results of operations are affected by management's application of accounting policies, including estimates, assumptions and judgments made to arrive at the carrying value of assets and liabilities and amounts reported for revenues, expenses and related disclosures. Different assumptions in the application of these policies, or conditions significantly different from certain assumptions, could result in material changes in our consolidated financial position or consolidated results of operations. Critical accounting and reporting policies include those related to the allowance for loan losses, the capitalization of servicing assets and liabilities and the related amortization, loan related revenue recognition, and income taxes. Our accounting policies are fundamental to understanding our consolidated financial position and consolidated results of operations. Significant accounting policies have been periodically discussed and reviewed with and approved by the Audit Committee of the Board of Directors and the Board of Directors.

Our critical accounting policies that are highly dependent on estimates, assumptions and judgment are substantially unchanged from the descriptions included in the notes to consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2007.

***Results of Operations***

**Earnings**

For the second quarter of 2008, the Company recorded a net loss of \$902,000 compared to net income of \$2.1 million for the second quarter of 2007. Basic and diluted earnings per share for the second quarter of 2008 and 2007 were (\$.10) and \$.22, respectively. Net income for the six months ended June 30, 2008 was \$208,000 compared to \$4.6 million for the same period in 2007. Basic and diluted earnings per share for the first six months of 2008 and 2007 were \$.02 and \$.50, respectively. The decrease in net income for the second quarter and first six months of 2008 when compared to the same periods in 2007 was primarily due to a \$4.2 million and \$8.3 million increase, respectively, in the provision for loan losses to \$5.9 million and \$10.5 million, respectively.

The Company benefited in the first quarter of 2008 from a pretax gain of \$1,252,000 on the mandatory redemption of 29,267 shares of Visa, Inc. common stock upon Visa's successful initial public offering. The Company reversed a pretax \$567,000 litigation expense accrual recorded in the fourth quarter of 2007 to

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recognize the Company's proportional share of Visa litigation settlements and litigation reserves. Fidelity now owns 46,436 shares of restricted class B Visa stock with a zero cost basis, convertible into 33,168 shares of Visa stock following the three year restricted period, as a result of the initial public offering.

**Net Interest Income**

Net interest income increased \$369,000 or 3.2% in the second quarter of 2008 to \$12.1 million compared to \$11.7 million for the same period in 2007 resulting primarily from a decrease in deposit interest expense due to an overall decrease in deposit interest rates in addition to a two basis point increase in the net interest spread.

The average balance of interest-earning assets increased by \$120.1 million or 7.8% to \$1.661 billion for the second quarter of 2008, when compared to the same period in 2007. The yield on interest-earning assets for the second quarter of 2008 was 6.36%, a decrease of 104 basis points when compared to the yield on interest-earning assets for the same period in 2007. The average balance of loans outstanding for the second quarter of 2008 increased \$101.1 million or 7.3% to \$1.490 billion when compared to the same period in 2007. The yield on average loans outstanding for the period decreased 113 basis points to 6.53% when compared to the same period in 2007 as a result of a net decrease in the prime lending rate and to a lesser extent, an increase in nonperforming loans.

The average balance of interest-bearing liabilities increased \$124.1 million or 9.0% to \$1.507 billion for the second quarter of 2008 and the rate on this average balance decreased 106 basis points to 3.76% when compared to the same period in 2007. The 106 basis point decrease in the cost of interest-bearing liabilities was greater than the 104 basis point decrease in the yield on interest earning assets, resulting in a two basis point increase in net interest spread. Net interest margin decreased 13 basis points to 2.95% for the second quarter of 2008 compared to 3.08% for the same period in 2007.

Net interest income increased \$825,000 or 3.6% in the first six months of 2008 to \$23.8 million compared to \$23.0 million for the same period in 2007 resulting primarily from a decrease in interest expense on deposits due to overall lower interest rates in addition to a three basis point increase in the net interest spread. The average balance of interest-earning assets increased by \$104.3 million or 6.8% to \$1.639 billion for the first six months of 2008, when compared to the same period in 2007. The yield on interest-earning assets for the first six months of 2008 was 6.61%, a decrease of 74 basis points when compared to the yield on interest-earning assets for the same period in 2007. The average balance of loans outstanding for the first six months of 2008 increased \$100.0 million or 7.2% to \$1.481 billion when compared to the same period in 2007. The yield on average loans outstanding for the period decreased 82 basis points to 6.78% when compared to the same period in 2007 as a result of a net decrease in the prime lending rate and to a lesser extent, an increase in nonperforming loans.

The average balance of interest-bearing liabilities increased \$113.0 million or 8.2% to \$1.484 billion for six months ended June 30, 2008 and the rate on this average balance decreased 77 basis points to 4.05% when compared to the same period in 2007. The 77 basis point decrease in the cost of interest-bearing liabilities was greater than the 74 basis point decrease in the yield on interest-earning assets, resulting in a three basis point increase in net interest spread. Net interest margin decreased 10 basis points to 2.95% for the first six months of 2008 compared to 3.05% for the same period in 2007.

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**Provision for Loan Losses**

The allowance for loan losses is established and maintained through provisions charged to operations. Such provisions are based on management's evaluation of the loan portfolio including loan portfolio concentrations, economic conditions, past loan loss experience, adequacy of underlying collateral, and such other factors which, in management's judgment, require consideration in estimating loan losses. Loans are charged off or charged down when, in the opinion of management, such loans are deemed to be uncollectible or not fully collectible. Subsequent recoveries are added to the allowance.

For all loan categories, historical loan loss experience, adjusted for changes in the risk characteristics of each loan category, current trends, and other factors, is used to determine the level of allowance required. Additional amounts are allocated based on the probable losses of individual troubled loans and the effect of economic conditions on both individual loans and loan categories. Since the allocation is based on estimates and subjective judgment, it is not necessarily indicative of the specific amounts of losses that may ultimately occur.

In determining the allocated allowance, all portfolios are treated as homogenous pools. The allowance for loan losses for the homogenous pools is allocated to loan types based on historical net charge-off rates adjusted for any current changes in these trends. Within the commercial, commercial real estate, SBA, construction and business banking loan portfolios, every nonperforming loan and loans having greater than normal risk characteristics are not treated as homogenous pools and are individually reviewed for a specific allocation. The specific allowance for these individually reviewed loans is based on a specific loan impairment analysis.

In determining the appropriate level for the allowance, management ensures that the overall allowance appropriately reflects a margin for the imprecision inherent in most estimates of the range of probable credit losses. This additional allowance is reflected in the overall allowance. Management believes the allowance for loan losses is adequate to provide for losses inherent in the loan portfolio at June 30, 2008 (see Asset Quality).

The provision for loan losses for the second quarter and the first six months of 2008 was \$5.9 million and \$10.5 million, respectively, compared to \$1.7 million and \$2.2 million for the same periods in 2007. The allowance for loan losses as a percentage of loans at June 30, 2008, was 1.56% compared to 1.19% at December 31, 2007, and to 1.05% at June 30, 2007. The increase in the provision in the second quarter and first six months of 2008 as compared to the same periods in 2007 and the increase in the allowance as a percentage of loans at June 30, 2008, was due to management's assessment of the slowing economy and housing market, as well as increased charge-offs in both the residential construction and consumer loan portfolios. The ratio of net charge-offs to average loans on an annualized basis for the first six months of 2008 increased to .63% compared to .33% for the same period in 2007. The ratio of net charge-offs to average loans for the year ended December 31, 2007 was .45%. The following schedule summarizes changes in the allowance for loan losses for the periods indicated (dollars in thousands):

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	<b>Six Months Ended</b>		<b>Year Ended</b>
	<b>June 30,</b>		<b>December</b>
	<b>2008</b>	<b>2007</b>	<b>31,</b>
			<b>2007</b>
Balance at beginning of period	\$ 16,557	\$ 14,213	\$ 14,213
Charge-offs:			
Commercial, financial and agricultural SBA	14		200
Real estate-construction	850	811	1,934
Real estate-mortgage	124	49	82
Consumer installment	4,013	2,021	5,301
<b>Total charge-offs</b>	<b>5,001</b>	<b>2,881</b>	<b>7,517</b>
Recoveries:			
Commercial, financial and agricultural SBA	1	161	257
Real estate-construction	56		
Real estate-mortgage	5	40	190
Consumer installment	13	71	78
	440	433	836
<b>Total recoveries</b>	<b>515</b>	<b>705</b>	<b>1,361</b>
<b>Net charge-offs</b>	<b>4,486</b>	<b>2,176</b>	<b>6,156</b>
Provision for loan losses	10,450	2,150	8,500
<b>Balance at end of period</b>	<b>\$ 22,521</b>	<b>\$ 14,187</b>	<b>\$ 16,557</b>
Ratio of net charge-offs to average loans	.63%	.33%	.45%
Allowance for loan losses as a percentage of loans at end of period	1.56%	1.05%	1.19%

Substantially all of the consumer installment loan net charge-offs in the first six months of 2008 and 2007 were from the indirect automobile loan portfolio. Consumer installment loan net charge-offs increased \$2.0 million to \$3.6 million for the six months ended June 30, 2008, compared to the same period in 2007. The national economy as well as the Atlanta economy continued to decline in the first half of 2008, as what began as a real estate slowdown impacted other areas of the economy, including our consumer lending portfolio. The annualized ratio of net charge-offs to average consumer loans outstanding was .96% and .47% during the first six months of 2008 and 2007, respectively. Consumer loan net charge-offs represented 79.6% of total net charge-offs for the first six months of 2008.

Construction loan net charge-offs were \$845,000 in the first six months of 2008 compared to \$771,000 in the same period of 2007. Management will continue to monitor closely and aggressively address credit quality and trends in the residential construction loan portfolio. The residential construction loan portfolio will require close scrutiny through at least the remainder of the calendar year. Based on increasing adverse trends in the consumer and construction loan

portfolios, it is anticipated that the loan losses will continue to increase.

**Noninterest Income**

Noninterest income for the second quarter and first six months of 2008 was \$4.4 million and \$10.0 million, respectively, compared to \$4.3 million and \$8.8 million for the same periods in 2007, an increase of \$19,000 for the quarter and \$1.2 million for the six month period. The increase for the quarter was due to increased income from indirect lending activities. The increase for the six month period was due in part to a gain of \$1.3 million on the mandatory redemption of 29,267 shares of Visa, Inc. common stock upon Visa's successful initial public offering.

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Income from indirect lending activities, which includes both net gains from the sale of indirect automobile loans and servicing and ancillary loan fees on loans sold, for the second quarter and first six months of 2008 increased \$204,000 or 15.6% and \$417,000 or 15.6% compared to the same periods in 2007. The increases were due primarily to increased net servicing fees and other ancillary fees on loans sold. Indirect automobile loans serviced for others totaled \$272 million and \$291 million at June 30, 2008 and 2007, respectively, a decrease of \$19 million or 6.5% due to monthly principal payments, and prepayments which exceeded the additional loans serviced for others added because of fewer loan sales with servicing retained. The increase in net servicing income is a result of an increase in the expected lives of the servicing assets and the related reduction in amortization due to an overall reduction in prepayments and loan payoffs experienced. Through June 30, 2008, there were servicing retained sales of \$56 million of indirect automobile loans, \$28 million of which occurred in the second quarter, and a servicing released sale of \$24 million, in the first quarter of 2008. In 2007 there were servicing retained sales of \$104 million during the first six months, \$30 million in the second quarter, and no servicing released sales.

Income from SBA lending activities decreased \$207,000 or 36.3% and \$437,000 or 36.0% for the second quarter and first six months of 2008, respectively, due to a reduction in the gain on loans sold and a reduction in the volume of loans sold. SBA loans sold totaled \$5.8 million for the second quarter of 2008, of which none were SBA 504 loans, compared to \$9.1 million sold in the second quarter of 2007, which included \$4.6 million in SBA 504 loans. In the first six months of 2008 \$12.5 million in SBA loans were sold compared to \$20.5 million for the same period in 2007. No SBA 504 loans were sold in 2008 compared to \$9.8 million in the same period in 2007. With the continuing volatility in credit and asset-backed securitization markets, the market price and thus the profit on sales of SBA 504 loans has been less than normal. While it is management's intent to sell the SBA 504 loans, we believe it is more advantageous to hold these high yielding loans until the market recovers to a more normal level.

**Noninterest Expense**

Noninterest expense was \$12.5 million for the second quarter of 2008, compared to \$11.4 million for the same period in 2007, an increase of \$1.1 million or 9.5%. The increase was primarily a result of higher other operating expenses, which increased 65.2% or \$1.0 million to \$2.6 million in the second quarter of 2008 compared to the same period in 2007. Higher other real estate owned related expenses caused the overall increase due to the increased foreclosed assets held by the Bank during the second quarter. ORE related expense increased to \$1.1 million for the quarter compared to zero in 2007 because of \$863,000 in ORE write downs and \$200,000 in maintenance, real estate taxes, and other related expenses.

Noninterest expense was \$23.8 million for the first six months of 2008, compared to \$22.9 million for the same period in 2007, an increase of \$931,000 or 4.1%. In the fourth quarter of 2007, the Company recorded a \$567,000 expense to recognize its proportional share of Visa litigation settlements, litigation reserves and certain other litigation. Because a portion of the proceeds from the Visa initial public offering funded a \$3 billion litigation liability reserve for the American Express settlement, the Discover litigation, and other specific litigation matters, on which our \$567,000 litigation accrual was based, management reversed the accrual during the first quarter of 2008. Partially offsetting the reversal was an increase in salaries and employee benefits expense, which increased 4.2% or \$533,000 to \$13.2 million in the first half of 2008 compared to the same period in 2007. The increase was primarily attributable to the addition in the second half of 2007 of seasoned loan production and branch operations staff, including SBA, indirect automobile, and commercial lenders to increase lending volume, and staff for the three new branches added in the second and third quarters of 2007. At June 30, 2008, full time equivalent employees totaled 394 compared to 415 at June 30, 2007 and 406 at December 31, 2007. In addition, the increase in ORE related expenses discussed above also contributed to the higher noninterest expense.



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**Provision for Income Taxes**

The provision for income taxes for the second quarter and first six months of 2008 was a benefit of \$976,000 and \$681,000, respectively, compared to expense of \$946,000 and \$2.1 million for the same periods in 2007. The income tax benefit recorded in the second quarter and first six months of 2008 was primarily the result of the decrease in income before taxes and the amount of state income tax credits relative to the pretax income. In addition, the average balance of tax exempt investment securities increased during the second quarter and first six months of 2008 compared to the same periods in 2007.

***Financial Condition***

**Assets**

Total assets were \$1.778 billion at June 30, 2008, compared to \$1.686 billion at December 31, 2007, an increase of \$91.8 million, or 5.4%. This increase was due to a \$56.2 million increase in loans, an \$18.2 million increase in investments, and a \$10.9 million increase in cash and cash equivalents.

Loans increased \$56.2 million or 4.05% to \$1.445 billion at June 30, 2008 compared to \$1.388 billion at December 31, 2007. The increase in loans was primarily the result of an increase in total commercial loans including SBA loans of \$21.7 million or 7.1% to \$328.1 million and growth in consumer installment loans of \$17.7 million or 2.5% to \$723.9 million.

Investment securities increased \$18.2 million or 13.2% to \$156.0 million at June 30, 2008 compared to \$137.9 million at December 31, 2007. The increase was a result of management's decision to enter into a series of transactions in March and April of 2008 to take advantage of the steepness of the yield curve. In March, the Bank purchased \$19.6 million in agency (U.S. government sponsored entity) mortgage backed securities and funded the transaction with \$20.0 million in laddered maturity advances from the Federal Home Loan Bank. In April, the Bank purchased \$10.0 million in agency (U.S. government sponsored entity) mortgage backed securities and funded the transaction with \$10 million in laddered maturity advances from the Federal Home Loan Bank. In addition, the Bank added six general obligation municipal bonds to the portfolio for a total of \$5.0 million. Decreasing the size of the investment portfolio in the first six months of 2008 were principal paydowns on mortgage backed securities, a \$5.0 million agency note which was called at par and the sale of a \$792,000 general obligation municipal security for a gain of \$12,000.

Cash and cash equivalents increased 36.5% or \$11.0 million to \$41.0 million at June 30, 2008 compared to December 31, 2007. This balance varies with the Bank's liquidity needs and is influenced by scheduled loan closings, timing of customer deposits, loan sales, and the day of the week on which the quarter ends.

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The following schedule summarizes our total loans at June 30, 2008, and December 31, 2007 (dollars in thousands):

	<b>June 30, 2008</b>	<b>December 31, 2007</b>
<b>Loans:</b>		
Commercial, financial and agricultural	\$ 126,711	\$ 107,325
Tax exempt commercial	8,829	9,235
Real estate mortgage commercial	192,605	189,881
Total commercial	328,145	306,441
Real estate construction	289,844	282,056
Real estate mortgage residential	102,710	93,673
Consumer installment	723,878	706,188
Loans	1,444,577	1,388,358
Allowance for loan losses	22,521	16,557
Loans, net of allowance	\$ 1,422,056	\$ 1,371,801
<b>Total Loans:</b>		
Loans	\$ 1,444,577	\$ 1,388,358
<b>Loans Held-for-Sale:</b>		
Residential mortgage	1,442	1,412
Consumer installment	31,000	38,000
SBA	35,106	24,243
Total loans held-for-sale	67,548	63,655
Total loans	\$ 1,512,125	\$ 1,452,013

**Asset Quality**

The following schedule summarizes our asset quality position at June 30, 2008, and December 31, 2007 (dollars in thousands):

	<b>June 30, 2008</b>	<b>December 31, 2007</b>
<b>Nonperforming assets:</b>		
Nonaccrual loans	\$ 45,045	\$ 14,371
Repossessions	1,363	2,512
Other real estate	10,901	7,308
Total nonperforming assets	\$ 57,309	\$ 24,191
Loans 90 days past due and still accruing	\$	\$ 23

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Allowance for loan losses	\$ 22,521	\$ 16,557
Ratio of loans past due and still accruing to loans	%	%
Ratio of nonperforming assets to total loans ORE, and repossessions	3.76%	1.73%
Allowance to period-end loans	1.56%	1.19%
Allowance to nonaccrual loans and repossessions (coverage ratio)	.49x	.98x

The increase in nonperforming assets from December 31, 2007 to June 30, 2008, was primarily driven by increases in nonaccrual loans and other real estate, approximately 92% of which totals are secured by real estate. Approximately \$26.7 million of the \$30.1 million increase in nonaccrual loans from December 31, 2007 to June 30, 2008, was related to the residential construction portfolio.

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The \$45.0 million in nonaccrual loans at June 30, 2008, included \$39.5 million in residential construction related loans, \$3.4 million in commercial and SBA loans and \$2.1 million in retail and consumer loans. Of the \$39.5 million in residential construction related loans on nonaccrual, \$23.5 million was related to 109 single family construction loans with completed homes and homes in various stages of completion, \$15.5 million was related to 189 single family developed lots, and \$.5 million related to other loans.

Management anticipates an increase in total nonperforming assets in the near term, including one builder relationship with loans totaling \$6.6 million put on nonaccrual in July. This builder relationship had previously been identified as requiring increased monitoring and management. The \$6.6 million consisted of \$3.7 million in five residential single family construction properties including both completed homes and homes in various stages of completion and \$2.9 million in 16 single family developed lots. The total net increase in construction loan nonaccruals is expected to be \$5.1 million in July. The reversal of interest accrued on these loans will not be material to third quarter operating results. Specific allowances related to these loans will be appropriately reflected in the allowance for loan losses at the end of the third quarter.

The \$10.9 million in other real estate at June 30, 2008, was made up entirely of residential construction related balances and consisted of \$8.1 million in 50 residential single family homes completed or substantially completed and \$2.8 million in 79 single family developed lots.

As of June 30, 2008, we had filed and advertised for July 2008 foreclosures on \$1.7 million in nonperforming residential construction properties consisting of \$1.3 million in four residential single family construction properties including both completed homes and homes in various stages of completion and \$378,000 in 13 single family developed lots.

Management's assessment of the overall loan portfolio is that loan quality and performance are continuing to be adversely affected by the slowing economy in general and the real estate market in particular. This section should be read in conjunction with the discussion in Provision for Loan Losses .

**Investment Securities**

Total unrealized losses on investment securities available-for-sale, net of unrealized gains of \$61,000, were \$2.9 million at June 30, 2008. Total unrealized losses on investment securities available-for-sale, net of unrealized gains of \$242,000, were \$1.3 million at December 31, 2007. Net unrealized losses on investment securities available-for-sale increased \$1.6 million during the first half of 2008.

Declines in fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than temporary impairment losses, management considers, among other things, (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer, (iii) the financial condition and near term prospects of the insurer, if applicable, and (iv) the intent and ability of the Company to retain our investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

Two individual investment securities were in a continuous unrealized loss position in excess of 12 months at June 30, 2008, with an aggregate unrealized loss of \$353,000. Both securities were agency pass-through mortgage backed securities and the unrealized loss positions resulted not from credit quality issues, but from market interest rate increases over the interest rates prevalent at the time the mortgage backed securities were purchased, and are considered temporary, with full collection of principal and interest anticipated.

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Also, as of June 30, 2008, management had the ability and intent to hold the temporarily impaired securities for a period of time sufficient for a recovery of cost. Accordingly, as of June 30, 2008, management believes the impairments discussed above are temporary and no impairment loss has been recognized in our Consolidated Statements of Income.

**Deposits**

Total deposits at June 30, 2008, were \$1.452 billion compared to \$1.406 billion at December 31, 2007, a \$45.9 million or 3.3% increase. Noninterest-bearing demand deposits increased \$3.2 million or 2.5% to \$134.8 million. Savings deposits decreased \$912,000 or .4% to \$215.5 million. Interest-bearing demand and money market accounts decreased \$32.4 million or 10.3% to \$281.7 million. Time deposits increased \$76.0 million or 9.28% to \$819.6 million. Some of the decrease in interest-bearing demand and money market accounts can be attributed to movement of consumer deposits into higher yielding certificates of deposit, which increased during the first six months of 2008, as overall interest rates have decreased. To help manage the duration of the Bank's deposit liabilities and projected liquidity, management offers special rates in certain certificate of deposit items in order to increase balances. The number of transaction accounts has continued to increase as a result of the extensive transaction account acquisition program. Management believes that the number of our transaction deposit accounts will continue to increase during the remainder of 2008.

**Short-Term Borrowings**

There were \$21.0 million in Federal funds purchased at June 30, 2008, compared to \$5.0 million at December 31, 2007, an increase of \$16.0 million. Other short-term borrowings at June 30, 2008, totaled \$81.0 million compared to \$71.0 million at December 31, 2007, an increase of \$10.0 million or 14.1%. Other short-term borrowings at June 30, 2008, consisted of \$46.5 million in overnight repurchase agreements primarily with commercial transaction account customers, \$22.5 million in FHLB advances, and \$12.0 million of other collateralized debt maturing during 2008.

Federal funds purchased varies with the daily liquidity needs of the Bank and averaged \$14.8 million for the six months ended June 30, 2008 compared to \$10.3 million for the year ended December 31, 2007. Other short-term borrowings increased because of higher balances of securities sold under repurchase agreements which increased \$22.5 million to \$46.5 million at June 30, 2008, compared to December 31, 2007. FHLB advances decreased \$13.0 million to \$23.0 million because of the maturity of a \$15 million fixed rate credit advance which was not replaced.

**Other Long-Term Debt**

Other long-term debt increased \$22.5 million or 90.0% to \$47.5 million at June 30, 2008 compared to \$25.0 million at December 31, 2007. In March of 2008, the Bank purchased approximately \$20.0 million in fixed rate agency mortgage backed securities which were funded with \$20.0 million in laddered two year through five year maturity long-term Federal Home Loan Bank advances. In April 2008, the Bank purchased \$10 million in fixed rate agency mortgage backed securities which were funded with \$10 million in laddered one year through five year Federal Home Loan Bank advances. The long-term advances are discussed below.

On March 12, 2008, the Company entered into a \$5.0 million four year FHLB fixed rate advance collateralized with pledged qualifying real estate loans and maturing March 12, 2012. The advance bears interest at 3.2875%. The Bank may prepay the advance subject to a prepayment penalty. However, should the FHLB receive compensation from its hedge parties upon a prepayment, that compensation would be payable to the Bank less an administrative fee.

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On March 12, 2008, the Company entered into a \$5.0 million two year FHLB Bermudan convertible advance collateralized with pledged qualifying real estate loans and maturing March 12, 2010. The FHLB exercised its option on June 12, 2008 to convert the interest rate from a fixed rate to a variable rate based on three month LIBOR plus a spread charged by the FHLB to its members for an adjustable rate credit advance with the same remaining maturity. As a result of the conversion the Bank elected to prepay the advance on the conversion date.

On March 12, 2008, the Company entered into a \$5.0 million five year FHLB European convertible advance collateralized with pledged qualifying real estate loans and maturing March 12, 2013. The advance had an interest rate of 2.395% at June 30, 2008. The FHLB has the one time option on March 12, 2010 to convert the interest rate from a fixed rate to a variable rate based on three month LIBOR plus a spread charged by the FHLB to its members for an adjustable rate credit advance with the same remaining maturity.

On March 12, 2008, the Company entered into a \$5.0 million five year FHLB European convertible advance collateralized with pledged qualifying real estate loans and maturing March 12, 2013. The advance had an interest rate of 2.79% at June 30, 2008. The FHLB has the one time option on March 14, 2011 to convert the interest rate from a fixed rate to a variable rate based on three month LIBOR plus a spread charged by the FHLB to its members for an adjustable rate credit advance with the same remaining maturity.

On April 3, 2008, the Company entered into a \$2.5 million five year FHLB European convertible advance collateralized with pledged qualifying real estate loans and maturing April 3, 2013. The advance had an interest rate of 2.40% at June 30, 2008. The FHLB has the one time option on April 5, 2010 to convert the interest rate from a fixed rate to a variable rate based on three month LIBOR plus a spread charged by the FHLB to its members for an adjustable rate credit advance with the same remaining maturity.

On April 1, 2008, the Company entered into a \$2.5 million four year FHLB Fixed Rate advance collateralized with pledged qualifying real estate loans and maturing April 2, 2012. The advance had an interest rate of 3.24% at June 30, 2008.

On April 4, 2008, the Company entered into a \$2.5 million two year FHLB Fixed Rate advance collateralized with pledged qualifying real estate loans and maturing April 5, 2010. The advance had an interest rate of 2.64% at June 30, 2008.

If the Bank should decide to prepay any of the convertible advances above prior to conversion by the FHLB, it will be subject to a prepayment penalty. However, should the FHLB receive compensation from its hedge parties upon a prepayment, that compensation would be payable to the Bank less an administrative fee. Also, should the FHLB decide to exercise its option to convert the advances to variable rate, the Bank can prepay the advance on the conversion date and each quarterly interest payment date thereafter with no prepayment penalty.

**Subordinated Debt**

The Company has five unconsolidated business trust ( trust preferred ) subsidiaries that are variable interest entities: FNC Capital Trust I, Fidelity National Capital Trust I, Fidelity Southern Statutory Trust I, Fidelity Southern Statutory Trust II, and Fidelity Southern Statutory Trust III. Our subordinated debt consists of the outstanding obligations of the five trust preferred issues and the amounts to fund the investments in the common stock of those entities.

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The following schedule summarizes our subordinated debt at June 30, 2008 (dollars in thousands):

<b>Type</b>	<b>Issued<sup>(1)</sup></b>	<b>Par</b>	<b>Subordinated Debt<sup>(2)</sup></b>	<b>Interest Rate</b>
Trust Preferred	March 8, 2000	\$ 10,500	\$ 10,825	Fixed @ 10.875%
Trust Preferred	July 19, 2000	10,000	10,309	Fixed @ 11.045%
Trust Preferred	June 26, 2003	15,000	15,464	Variable @ 5.909% <sup>(3)</sup>
Trust Preferred	March 17, 2005	10,000	10,310	Variable @ 4.704% <sup>(4)</sup>
Trust Preferred	August 20, 2007	20,000	20,619	Fixed @ 6.620% <sup>(5)</sup>
		\$65,500	\$67,527	

1. Each trust preferred security has a final maturity thirty years from the date of issuance.
2. Includes investments in the common stock of these entities.
3. Reprices quarterly at a rate 310 basis points over three month LIBOR and is subject to refinancing or repayment at par in June 2008 with regulatory approval.
4. Reprices quarterly at a rate 189 basis points over three month LIBOR.
5. Five year fixed rate, and then

reprices  
quarterly at a  
rate 140 basis  
points over  
three month  
LIBOR.

### **Liquidity and Capital Resources**

Market and public confidence in our financial strength and that of financial institutions in general will largely determine the access to appropriate levels of liquidity. This confidence is significantly dependent on our ability to maintain sound credit quality and the ability to maintain appropriate levels of capital resources.

Liquidity is defined as the ability to meet anticipated customer demands for funds under credit commitments and deposit withdrawals at a reasonable cost and on a timely basis. Management measures the liquidity position by giving consideration to both on-balance sheet and off-balance sheet sources of and demands for funds on a daily and weekly basis.

Sources of liquidity include cash and cash equivalents, net of Federal requirements to maintain reserves against deposit liabilities; investment securities eligible for sale or pledging to secure borrowings from dealers and customers pursuant to securities sold under agreements to repurchase ( repurchase agreements ); loan repayments; loan sales; deposits and certain interest-sensitive deposits; brokered deposits; a collateralized line of credit at the Federal Reserve Bank of Atlanta ( FRB ) Discount Window; a collateralized line of credit from the Federal Home Loan Bank of Atlanta ( FHLB ); and borrowings under unsecured overnight Federal funds lines available from correspondent banks. The principal demands for liquidity are new loans, anticipated fundings under credit commitments to customers, and deposit withdrawals.

Management seeks to maintain a stable net liquidity position while optimizing operating results, as reflected in net interest income, the net yield on interest-earning assets and the cost of interest-bearing liabilities in particular. Our Asset/Liability Management Committee ( ALCO ) meets regularly to review the current and projected net liquidity positions and to review actions taken by management to achieve this liquidity objective. Managing the levels of total liquidity, short-term liquidity, and short-term liquidity sources continues to be an important exercise because of the orchestration of the projected SBA and indirect automobile loan production and sales, SBA loans held-for-sale balances, indirect automobile loans held-for-sale balances, and individual loans and pools of loans sold anticipated to increase from time to time during the year.

As of June 30, 2008, we had unused sources of liquidity in the form of unpledged securities, brokered deposits available through investment banking firms and significant additional FHLB and FRB lines of credit, subject to available qualifying collateral. In this poor economic environment, banks are reviewing Federal funds lines regularly. As of July 31, 2008, we had \$52 million in Federal funds lines.



**Table of Contents****Shareholders Equity**

Shareholders equity was \$97.3 million at June 30, 2008, and \$100 million at December 31, 2007. Shareholders equity as a percent of total assets was 5.5% at June 30, 2008, compared to 5.9% at December 31, 2007. The decrease in shareholders equity in the first half of 2008 was primarily the result of net income plus common stock issued, more than offset by dividends paid, the effect of the change in other comprehensive income and the cumulative effect adjustment as a result of the adoption of EITF No. 06-04 Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements. (See Note 9.)

At June 30, 2008, and December 31, 2007, FSC exceeded all minimum capital ratios required by the FRB, as reflected in the following schedule:

	FRB Minimum		December
Capital Ratios:	Capital	June 30,	31,
Leverage	Ratio	2008	2007
Risk-Based Capital	4.00%	7.44%	7.93%
Tier I	4.00	7.95	8.43
Total	8.00	11.18	11.55

The following table sets forth the capital requirements for the Bank under FDIC regulations and the Bank's capital ratios at June 30, 2008, and December 31, 2007, respectively:

	FDIC Regulations		December
Capital Ratios:	Well	June 30,	31,
Leverage	Capitalized	2008	2007
Risk-Based Capital	5.00%	7.96%	8.10%
Tier I	6.00	8.49	8.60
Total	10.00	10.35	10.30

During the first six months of 2008, we declared and paid dividends on our common stock of \$.18 per share totaling \$1.7 million, which was equal to the amount of dividends paid per share when compared to the same period in 2007. Dividends for the remainder of 2008 will be reviewed quarterly, with the declared and paid dividend consistent with current earnings, capital requirements and forecasts of future earnings. The third quarter dividend has been reduced to \$.01 per share.

**Market Risk**

Our primary market risk exposures are credit risk and interest rate risk and, to a lesser extent, liquidity risk. We have little or no risk related to trading accounts, commodities, or foreign exchange.

Interest rate risk is the exposure of a banking organization's financial condition and earnings ability to withstand adverse movements in interest rates. Accepting this risk can be an important source of profitability and shareholder value; however, excessive levels of interest rate risk can pose a significant threat to assets, earnings, and capital. Accordingly, effective risk management that maintains interest rate risk at prudent levels is essential to our success.

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ALCO, which includes senior management representatives, monitors and considers methods of managing the rate and sensitivity repricing characteristics of the balance sheet components consistent with maintaining acceptable levels of changes in portfolio values and net interest income with changes in interest rates. The primary purposes of ALCO are to manage interest rate risk consistent with earnings and liquidity, to effectively invest our capital, and to preserve the value created by our core business operations. Our exposure to interest rate risk compared to established tolerances is reviewed on at least a quarterly basis by our Board of Directors.

Evaluating a financial institution's exposure to changes in interest rates includes assessing both the adequacy of the management process used to control interest rate risk and the organization's quantitative levels of exposure. When assessing the interest rate risk management process, we seek to ensure that appropriate policies, procedures, management information systems, and internal controls are in place to maintain interest rate risk at prudent levels with consistency and continuity. Evaluating the quantitative level of interest rate risk exposure requires us to assess the existing and potential future effects of changes in interest rates on our consolidated financial condition, including capital adequacy, earnings, liquidity, and, where appropriate, asset quality.

Interest rate sensitivity analysis, referred to as Equity at Risk, is used to measure our interest rate risk by computing estimated changes in earnings and the net present value of our cash flows from assets, liabilities, and off-balance sheet items in the event of a range of assumed changes in market interest rates. Net present value represents the market value of portfolio equity and is equal to the market value of assets minus the market value of liabilities, with adjustments made for off-balance sheet items. This analysis assesses the risk of loss in the market risk sensitive instruments in the event of a sudden and sustained 200 basis point increase or decrease in market interest rates (equity at risk).

Our policy states that a negative change in net present value (equity at risk) as a result of an immediate and sustained 200 basis point increase or decrease in interest rates should not exceed the lesser of 2% of total assets or 15% of total regulatory capital. It also states that a similar increase or decrease in interest rates should not negatively impact net interest income or net income by more than 5% or 15%, respectively.

The most recent rate shock analysis indicated that the effects of an immediate and sustained increase or decrease of 200 basis points in market rates of interest would fall well within policy parameters and approved tolerances for equity at risk, net interest income, and net income.

We have historically been asset sensitive to six months; however, we have been liability sensitive from six months to one year, largely mitigating the potential negative impact on net interest income and net income over a full year from a sudden and sustained decrease in interest rates. Likewise, historically the potential positive impact on net interest income and net income of a sudden and sustained increase in interest rates is reduced over a one-year period as a result of our liability sensitivity in the six month to one year time frame.

As discussed, the negative impact of an immediate and sustained 200 basis point increase in market rates of interest on the net present value (equity at risk) was well within established tolerances as of the most recent shock analysis and was significantly less than that for the prior quarter, primarily because of the reduced sensitivity in our loans and investment securities. Also, the negative impact of an immediate and sustained 200 basis point decrease in market rates of interest on net interest income and net income was well within established tolerances and reflected a decrease in interest rate sensitivity compared to the prior quarter. We follow FDIC guidelines for non-maturity deposits such as interest-bearing transaction and savings accounts in the interest rate sensitivity (gap) analysis; therefore, this analysis does not reflect the full impact of rapidly rising or falling market rates of interest on these accounts compared to the results of the rate shock analysis.

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Rate shock analysis provides only a limited, point in time view of interest rate sensitivity. The gap analysis also does not reflect factors such as the magnitude (versus the timing) of future interest rate changes and asset prepayments. The actual impact of interest rate changes upon earnings and net present value may differ from that implied by any static rate shock or gap measurement. In addition, net interest income and net present value under various future interest rate scenarios are affected by multiple other factors not embodied in a static rate shock or gap analysis, including competition, changes in the shape of the Treasury yield curve, divergent movement among various interest rate indices, and the speed with which interest rates change.

**Interest Rate Sensitivity**

The major elements used to manage interest rate risk include the mix of fixed and variable rate assets and liabilities and the maturity and repricing patterns of these assets and liabilities. It is our policy not to invest in derivatives. We perform a quarterly review of assets and liabilities that reprice and the time bands within which the repricing occurs. Balances generally are reported in the time band that corresponds to the instrument's next repricing date or contractual maturity, whichever occurs first. However, fixed rate indirect automobile loans, mortgage backed securities, and residential mortgage loans are primarily included based on scheduled payments with a prepayment factor incorporated. Through such analyses, we monitor and manage our interest sensitivity gap to minimize the negative effects of changing interest rates.

The interest rate sensitivity structure within our balance sheet at June 30, 2008, indicated a cumulative net interest sensitivity liability gap of 12.10% when projecting out one year. In the near term, defined as 90 days, there was a cumulative net interest sensitivity asset gap of 3.02% at June 30, 2008. When projecting forward six months, there was a cumulative net interest sensitivity liability gap of 3.67%. This information represents a general indication of repricing characteristics over time; however, the sensitivity of certain deposit products may vary during extreme swings in the interest rate cycle. Since all interest rates and yields do not adjust at the same velocity, the interest rate sensitivity gap is only a general indicator of the potential effects of interest rate changes on net interest income. Our policy states that the cumulative gap at six months and one year should generally not exceed 15% and 10%, respectively. Our cumulative gap at one year slightly exceeds the 10% threshold established for this measure through the actions of ALCO have improved this measure since the end of the first quarter of 2008. The Bank continues to offer competitive long-term interest rates to incent our customers to extend the maturities of their certificates of deposit. Management intends to continue this pricing strategy through the third quarter of 2008. The interest rate shock analysis is generally considered to be a better indicator of interest rate risk and it reflects this increase in liability sensitivity.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

See Item 2 Market Risk and Interest Rate Sensitivity for quantitative and qualitative discussion about our market risk.

**Item 4. Controls and Procedures****Evaluation of Disclosure Controls and Procedures**

Pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934, Fidelity's management supervised and participated in an evaluation, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures (as defined under Rule 13a-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based on, or as of the date of, that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the

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SEC's rules and forms, and that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

**Changes in Internal Control over Financial Reporting**

There has been no change in the Company's internal control over financial reporting during the six months ended June 30, 2008, that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

**PART II OTHER INFORMATION**

***Item 1. Legal Proceedings***

We are a party to claims and lawsuits arising in the course of normal business activities. Although the ultimate outcome of all claims and lawsuits outstanding as of June 30, 2008, cannot be ascertained at this time, it is the opinion of management that these matters, when resolved, will not have a material adverse effect on our results of operations or financial condition.

***Item 1A. Risk Factors***

While the Company attempts to identify, manage, and mitigate risks and uncertainties associated with its business to the extent practical under the circumstances, some level of risk and uncertainty will always be present. Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2007, describes some of the risks and uncertainties associated with our business. These risks and uncertainties have the potential to materially affect our cash flows, results of operations, and financial condition. We do not believe that there have been any material changes to the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2007.

***Item 4. Submission of Matters To A Vote Of Security Holders***

There was one matter submitted to a vote of security holders at Fidelity's annual meeting of shareholders held on April 24, 2008.

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The proposal was the election of nine directors to serve until the next annual meeting of shareholders or until their successors are elected and qualified. There were 9,380,812 shares of Common Stock of Fidelity eligible to be voted at the Annual Meeting and 8,399,043 shares were represented at the meeting by the holders thereof, which constituted a quorum. The number of votes for the election of the directors was as follows:

Director	Votes Cast For	Votes Withheld
James B. Miller, Jr.	7,555,768	843,375
David B. Bockel	6,970,588	1,428,455
Edward G. Bowen, M.D.	7,536,772	862,271
Kevin S. King	7,555,772	843,271
James H. Miller, III	7,527,852	871,191
H. Palmer Proctor, Jr.	7,549,710	849,333
Robert J. Rutland	7,510,852	888,191
W. Clyde Shepherd, III	6,989,518	1,409,525
Rankin M. Smith, Jr.	7,524,852	874,191

**Item 6. Exhibits**

(a) Exhibits. The following exhibits are filed as part of this Report.

- 3(a) and 4(a) Amended and Restated Articles of Incorporation of Fidelity Southern Corporation (incorporated by reference from Exhibit 3(f) to Fidelity Southern Corporation's Annual Report on Form 10-K for the year ended December 31, 2003)
- 3(b) By-Laws (incorporated by reference from Exhibit 3(b) to Fidelity Southern Corporation's Annual Report on Form 10-K for the year ended December 31, 2005)
- 31.1 Certification of Principal Executive Officer pursuant to Securities Exchange Act Rules 13a-14 and 15d-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Principal Financial Officer pursuant to Securities Exchange Act Rules 13a-14 and 15d-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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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.

**FIDELITY SOUTHERN CORPORATION**

(Registrant)

Date: August 11, 2008

BY: /s/ James B. Miller, Jr.  
James B. Miller, Jr.  
Chief Executive Officer

Date: August 11, 2008

BY: /s/ Stephen H. Brolly  
Stephen H. Brolly  
Interim Chief Financial Officer