

SCBT FINANCIAL CORP  
Form 10-K  
March 17, 2008

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

**FORM 10-K**

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the fiscal year ended: **December 31, 2007**

**Commission file number 001-12669**

**SCBT FINANCIAL CORPORATION**

(Exact name of registrant as specified in its charter)

**South Carolina**  
(State or other jurisdiction of incorporation)

**57-0799315**  
(IRS Employer Identification No.)

**520 Gervais Street**  
**Columbia, South Carolina**  
(Address of principal executive offices)

**29201**  
(Zip Code)

**(800) 277-2175**

(Registrant's telephone number, including area code)  
Securities registered pursuant to Section 12 (b) of the Act:

<b>Title of each class</b>	<b>Name of each exchange on which registered</b>
Common stock, \$2.50 par value per share	The NASDAQ Global Select Market <sup>SM</sup>
	Securities registered pursuant to Section 12 (g) of the Act: None.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No .

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No .

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 twelve (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 o.

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Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer," and "smaller reporting company" 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 Act). Yes  No .

The aggregate market value of the voting stock of the registrant held by non-affiliates was \$314,977,000 based on the closing sale price of \$36.40 per share on June 29, 2007. For purposes of the foregoing calculation only, all directors and executive officers of the registrant have been deemed affiliates. The number of shares of common stock outstanding as of March 4, 2008 was 10,185,143.

**Documents Incorporated by Reference**

Portions of the Registrant's Proxy Statement for its 2008 Annual Meeting of Shareholders are incorporated by reference into Part III, Items 10-14.

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## SCBT Financial Corporation

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(1) All or portions of this item are incorporated by reference to the Registrant's Proxy Statement for its 2008 Annual Meeting of Shareholders.

## Forward-Looking Statements

*This Report contains statements which constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements are based on many assumptions and estimates and are not guarantees of future performance. Our actual results may differ materially from those anticipated in any forward-looking statements, as they will depend on many factors about which we are unsure, including many factors which are beyond our control. The words "may," "would," "could," "will," "expect," "anticipate," "believe," "intend," "plan," and "estimate," as well as similar expressions, are meant to identify such forward-looking statements. Potential risks and uncertainties include, but are not limited to those described below under "Risk Factors."*

## PART I

### Item 1. Business

SCBT Financial Corporation ("SCBT"), headquartered in Columbia, South Carolina, is a bank holding company incorporated in 1985 under the laws of South Carolina. We were formerly named First National Corporation until February 2004. We provide a wide range of banking services and products to our customers through our wholly-owned subsidiaries: South Carolina Bank and Trust, N.A. and South Carolina Bank and Trust of the Piedmont, N.A., both national banks that opened for business in 1932 and 1996, respectively. On November 30, 2007, we acquired our third banking subsidiary, The Scottish Bank, N.A. Our common stock trades on The NASDAQ Global Select Market<sup>SM</sup> under the ticker symbol "SCBT."

SCBT Financial Corporation is a legal entity separate and distinct from our subsidiaries. We coordinate the financial resources of the consolidated enterprise and thereby maintain financial, operation and administrative systems that allow centralized evaluation of subsidiary operations and coordination of selected policies and activities. SCBT Financial Corporation's operating revenues and net income are derived primarily from cash dividends received from its bank subsidiaries.

Our subsidiaries provide a full range of retail and commercial banking services, mortgage lending services, trust and investment services, and consumer finance loans through 50 financial centers in 16 South Carolina counties and Mecklenburg County of North Carolina, and have served the Carolinas for more than seventy-three years. At December 31, 2007, the Corporation had approximately \$2.6 billion in assets, \$2.1 billion in loans, \$1.9 billion in deposits, \$215.1 million in shareholders' equity, and a market capitalization of \$321.8 million.

We began operating in 1934 in Orangeburg, South Carolina and have maintained our ability to provide superior local service while also leveraging our size to offer many products more common to super-regional banks. We have pursued a growth strategy that relies primarily on organic growth, supplemented by the acquisition of select financial institutions or branches in certain market areas.

We have continued to expand our business in South Carolina and North Carolina, as highlighted below:

November 2007 acquired TSB Financial Corporation, Inc. ("TSB") and its wholly-owned subsidiary, The Scottish Bank. On December 3, 2007, we converted The Scottish Bank from a North Carolina state-chartered bank to a national association. The Scottish Bank, N.A. has four full-service branch locations and a loan production office ("LPO") in the following Charlotte, North Carolina market areas: SouthPark, Myers Park, Cotswold, Mint Hill, and Cornelius (the LPO).

October 2007 we merged The Mortgage Banc, Inc. into our lead banking subsidiary, South Carolina Bank and Trust.

August 2007 opened a full-service branch in Lexington, South Carolina to replace the limited-service branch.

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April 2007 opened a full-service branch at 46 Broad Street in Charleston, South Carolina to replace a limited-service branch at another Charleston location.

March 2007 replaced a loan production office in Myrtle Beach, South Carolina with a full-service branch in a banking location purchased in 2006.

October 2006 opened a limited-service branch in Irmo, South Carolina.

June 2006 opened our Indian Land full-service branch in Fort Mill, South Carolina as part of South Carolina Bank and Trust of the Piedmont. The branch was converted from a loan production office. We also opened a limited-service branch in Lexington, South Carolina.

April 2006 opened a loan production office in Daniel Island, South Carolina. Also in April, we converted our Devine Mortgage location to a full-service branch on Forest Drive in Columbia, South Carolina.

March 2006 merged SunBank, N.A. into our lead bank subsidiary, South Carolina Bank and Trust.

February 2006 opened a loan production office in Charleston, South Carolina as part of South Carolina Bank and Trust and converted the location to a limited-service branch in 2006. We moved the South Carolina Bank and Trust of the Piedmont loan production office in Fort Mill, South Carolina to a full-service branch location.

November 2005 expanded our footprint farther up the South Carolina coast with the acquisition of Sun Bancshares, Inc. and its subsidiary, SunBank. The acquisition provided us with two additional branches in Murrells Inlet and Georgetown, South Carolina. SunBank's third property was a loan production office located in Myrtle Beach, South Carolina.

July 2005 formed SCBT Capital Trust III for the purpose of issuing an aggregate of \$20 million of trust preferred securities.

May 2005 purchased Devine Mortgage, a small South Carolina mortgage originator.

April 2005 formed SCBT Capital Trust I and SCBT Capital Trust II for the purpose of issuing an aggregate of \$20 million of trust preferred securities.

April 2005 continued to expand in the western portion of South Carolina with our acquisition of New Commerce BanCorp and merged its subsidiary, New Commerce Bank, into our lead subsidiary bank. The acquisition provided us with two new branches in Simpsonville and Greenville, South Carolina. Both branches are located in one of the fastest growing markets in the state.

Our principal executive offices are located at 520 Gervais Street, Columbia, South Carolina 29201. Our mailing address at this facility is Post Office Box 1030, Columbia, South Carolina 29202 and our telephone number is (800) 277-2175.

### Available Information

We provide our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 on our website at [www.scbtonline.com](http://www.scbtonline.com). These filings are made accessible as soon as reasonably practicable after they have been filed electronically with the SEC. These filings are also accessible on the SEC's website at [www.sec.gov](http://www.sec.gov). In addition, we make available on our website the following: (i) Corporate Governance Guidelines, (ii) Code of Conduct & Ethics, which applies to our directors and all employees, and (iii) the charters of the Audit, Compensation, and Corporate Governance & Nominating Committees of our Board of Directors. These materials are available in a printed format free of charge to shareholders who request them in writing. Please address your request to: Financial Management Division, SCBT Financial Corporation, 520

Gervais Street,

Columbia, South Carolina 29201. Statements of beneficial ownership of equity securities filed by directors, officers, and 10% or greater shareholders under Section 16 of the Securities Exchange Act of 1934 are also available through our website. The information on our website is not incorporated by reference into this report.

### **Territory Served and Competition**

We serve customers through our subsidiary banks located in the Carolinas: South Carolina Bank and Trust, South Carolina Bank and Trust of the Piedmont, and The Scottish Bank. Through our lead bank, South Carolina Bank and Trust, we conduct our business from forty financial centers in fourteen South Carolina counties. We conduct our Piedmont business from six financial centers in two South Carolina counties. We conduct our business from four financial centers in Mecklenburg County of North Carolina.

We compete in the highly competitive banking and financial services industry. Our profitability depends principally on our ability to effectively compete in the markets in which we conduct business. We expect competition in the industry to continue to increase as a result of consolidation among banking and financial services firms. Competition may further intensify as additional companies enter the markets where we conduct business and we enter mature markets in accordance with our expansion strategy.

We experience strong competition from both bank and non-bank competitors in certain markets. Broadly speaking, we compete with super-regional, smaller community banks, and non-traditional internet-based banks. We compete for deposits and loans with commercial banks, savings institutions, and credit unions. In addition, we compete with other financial intermediaries and investment alternatives such as mortgage companies, credit card issuers, leasing companies, finance companies, money market mutual funds, brokerage firms, governmental and corporation bonds, and other securities. Many of these non-bank competitors are not subject to the same regulatory oversight, affording them a competitive advantage in some instances. In many cases, our competitors have substantially greater resources, can provide higher lending limits, and offer certain services that we are unable to provide to our customers.

We encounter strong competition in making loans and attracting deposits. We compete with other financial institutions to offer customers the competitive interest rates on deposit accounts, the competitive interest rates charged on loans and other credit, and reasonable service charges. Our customers also consider the quality and scope of the services provided, the convenience of banking facilities, and relative lending limits in the case of loans to commercial borrowers. Our customers may also take into account the fact that other banks offer different services from those that we provide. The large national and super-regional banks may have significantly greater lending limits and may offer additional products. However, we believe that SCBT has been able to compete successfully with our competitors, regardless of their size. We do this by emphasizing customer service and by providing a wide variety of services.

### **Employees**

As of December 31, 2007, our subsidiaries had 701 full-time equivalent employees compared to 634 as of the same date in 2006. We consider our relationship with our employees instrumental to the success of our business. We provide our employees with a comprehensive employee benefit program which includes the following: group life, health and dental insurance, paid vacation, sick leave, educational opportunities, a cash incentive plan, a stock purchase plan, stock incentive, deferred compensation plans for officers and key employees, a defined benefit pension plan for employees hired on or before December 31, 2005 (except for employees acquired in the SunBank acquisition), and a 401(k) plan with company match.

## Regulation and Supervision

As a financial institution, we operate under a regulatory framework. The framework outlines a regulatory environment applicable to financial holding companies, bank holding companies, and their subsidiaries. Below, we have provided some specific information relevant to SCBT. The regulatory framework under which we operate is intended primarily for the protection of depositors and the Deposit Insurance Fund and not for the protection of our security holders and creditors. To the extent that the following information describes statutory and regulatory provisions, it is qualified in its entirety by reference to the particular statutory and regulatory provisions.

### *General*

The current regulatory environment for financial institutions includes substantial enforcement activity by the federal banking agencies, the U.S. Department of Justice, the Securities and Exchange Commission, and other state and federal law enforcement agencies, reflecting an increase in activity over prior years. This environment entails significant potential increases in compliance requirements and associated costs.

We are a bank holding company registered with the Board of Governors of the Federal Reserve System and are subject to the supervision of, and to regular inspection by, the Federal Reserve Board. Our banks are organized as national banking associations. They are subject to regulation, supervision, and examination by the Office of the Comptroller of the Currency (the "OCC"). In addition, SCBT and our banks are subject to regulation (and in certain cases examination) by the Federal Deposit Insurance Corporation (the "FDIC"), other federal regulatory agencies, the South Carolina State Board of Financial Institutions (the "State Board") and the North Carolina Office of the Commissioner of Banks. The following discussion summarizes certain aspects of banking and other laws and regulations that affect SCBT and its subsidiaries.

Under the Bank Holding Company Act (the "BHC Act"), our activities and those of our subsidiaries are limited to banking, managing or controlling banks, furnishing services to or performing services for our subsidiaries, or any other activity which the Federal Reserve Board determines to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. The BHC Act requires prior Federal Reserve Board approval for, among other things, the acquisition by a bank holding company of direct or indirect ownership or control of more than 5% of the voting shares or substantially all the assets of any bank, or for a merger or consolidation of a bank holding company with another bank holding company. The BHC Act also prohibits a bank holding company from acquiring direct or indirect control of more than 5% of the outstanding voting stock of any company engaged in a non-banking business unless such business is determined by the Federal Reserve Board to be so closely related to banking as to be a proper incident thereto. Further, under South Carolina law, it is unlawful without the prior approval of the State Board for any South Carolina bank holding company (i) to acquire direct or indirect ownership or control of more than 5% of the voting shares of any bank or any other bank holding company, (ii) to acquire all or substantially all of the assets of a bank or any other bank holding company, or (iii) to merge or consolidate with any other bank holding company.

The Graham-Leach-Bliley Act amended a number of federal banking laws affecting SCBT and our banks. In particular, the Graham-Leach-Bliley Act permits a bank holding company to elect to become a "financial holding company," provided certain conditions are met. A financial holding company, and the companies it controls, are permitted to engage in activities considered "financial in nature" as defined by the Graham-Leach-Bliley Act and Federal Reserve Board interpretations (including, without limitation, insurance and securities activities), and therefore may engage in a broader range of activities than permitted by bank holding companies and their subsidiaries. We remain a bank holding company, but may at some time in the future elect to become a financial holding company.

***Interstate Banking***

National banks are required by the National Bank Act to adhere to branch office banking laws applicable to state banks in the states in which they are located. In July 1994, South Carolina enacted legislation which effectively provided that, after June 30, 1996, out-of-state bank holding companies may acquire other banks or bank holding companies in South Carolina, subject to certain conditions. Further, pursuant to the Riegel-Neal Interstate Banking and Branching Efficiency Act of 1994 (the "Interstate Banking and Branching Act"), a bank holding company became able to acquire banks in states other than its home state, beginning in September 1995, without regard to the permissibility of such acquisition under state law, subject to certain exceptions. The Interstate Banking and Branching Act also authorized banks to merge across state lines, thereby creating interstate branches, unless a state, prior to the July 1, 1997 effective date, determined to "opt out" of coverage under this provision. In addition, the Interstate Banking and Branching Efficiency Act authorized a bank to open new branches in a state in which it does not already have banking operations if such state enacted a law permitting such "de novo" branching.

Effective July 1, 1996, South Carolina law was amended to permit interstate branching through acquisitions but not de novo branching by an out-of-state bank. We believe that the foregoing legislation has increased takeover activity of South Carolina financial institutions by out-of-state financial institutions.

North Carolina has opted-in to the provision of the Interstate Banking and Branching Act that allows out-of-state banks to branch into their state by establishing a de novo branch in the state, but only on a reciprocal basis. This means that an out-of-state bank may establish a de novo branch in North Carolina only if the home state of such bank would allow North Carolina banks (including national banks with their home office in North Carolina) to establish de novo branches in that home state under substantially the same terms as allowed in North Carolina. Because some states impose greater limits on de novo branching by out-of-state banks, this provides a limited barrier of entry into the North Carolina banking market, which protects us from a segment of potential competition. However, for those states that have also opted-in to the interstate branching legislation, our subsidiary The Scottish Bank, N.A., which has its home office in North Carolina, could establish a de novo branch in those states with prior OCC approval.

***Obligations of Holding Company to its Subsidiary Banks***

Under the policy of the Federal Reserve Board, a bank holding company is required to serve as a source of financial strength to its subsidiary depository institutions and to commit resources to support such institutions in circumstances where it otherwise might not desire or be able to do so. Under the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"), to avoid receivership of its insured depository institution subsidiary, a bank holding company is required to guarantee the compliance of any insured depository institution subsidiary that may become "undercapitalized" within the terms of any capital restoration plan filed by such subsidiary with its appropriate federal banking agency up to the lesser of (i) an amount equal to 5% of the institution's total assets at the time the institution became undercapitalized, or (ii) the amount which is necessary (or would have been necessary) to bring the institution into compliance with all applicable capital standards as of the time the institution fails to comply with such capital restoration plan.

In addition, the "cross-guarantee" provisions of the Federal Deposit Insurance Act, as amended ("FDIA"), require insured depository institutions under common control to reimburse the FDIC for any loss suffered or reasonably anticipated by the FDIC as a result of the default of a commonly controlled insured depository institution or for any assistance provided by the FDIC to a commonly controlled insured depository institution in danger of default. The FDIC's claim for damages is superior to claims of shareholders of the insured depository institution or its holding company, but is

subordinate to claims of depositors, secured creditors and holders of subordinated debt (other than affiliates) of the commonly controlled insured depository institutions.

The FDIA also provides that amounts received from the liquidation or other resolution of any insured depository institution by any receiver must be distributed (after payment of secured claims) to pay the deposit liabilities of the institution prior to payment of any other general or unsecured senior liability, subordinated liability, general creditor or shareholder. This provision would give depositors a preference over general and subordinated creditors and shareholders in the event a receiver is appointed to distribute the assets of the Banks.

Any capital loans by a bank holding company to any of its subsidiary banks are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary bank. In the event of a bank holding company's bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank will be assumed by the bankruptcy trustee and entitled to a priority of payment.

Under the National Bank Act, if the capital stock of a national bank is impaired by losses or otherwise, the OCC is authorized to require payment of the deficiency by assessment upon the bank's shareholders, pro rata, and if any such assessment is not paid by any shareholder after three months notice, to sell the stock of such shareholder to make good the deficiency.

### *Capital Adequacy*

The various federal bank regulators, including the Federal Reserve Board and the OCC, have adopted risk-based capital requirements for assessing bank holding company and bank capital adequacy. These standards define what qualifies as capital and establish minimum capital standards in relation to assets and off-balance sheet exposures, as adjusted for credit risks. Capital is classified into tiers. For bank holding companies, Tier 1 or "core" capital consists primarily of common and qualifying preferred shareholders' equity, less certain intangibles and other adjustments ("Tier 1 Capital"). Tier 2 capital consists primarily of the allowance for possible loan losses (subject to certain limitations) and certain subordinated and other qualifying debt ("Tier 2 Capital"). A minimum ratio of total capital to risk-weighted assets of 8.00% is required and Tier 1 Capital must be at least 50% of total capital. The Federal Reserve Board also has adopted a minimum leverage ratio of Tier 1 Capital to adjusted average total assets (not risk-weighted) of 3%. The 3% Tier 1 Capital to average total assets ratio constitutes the leverage standard for bank holding companies and national banks, and is used in conjunction with the risk based ratio in determining the overall capital adequacy of banking organizations.

The Federal Reserve Board and the OCC have emphasized that the foregoing standards are supervisory minimums and that an institution would be permitted to maintain such levels of capital only if it had a composite rating of "1" under the regulatory rating systems for bank holding companies and banks. All other bank holding companies are required to maintain a leverage ratio of 3% plus at least 1% to 2% of additional capital. These rules further provide that banking organizations experiencing internal growth or making acquisitions will be expected to maintain capital positions substantially above the minimum supervisory levels and comparable to peer group averages, without significant reliance on intangible assets. The Federal Reserve Board continues to consider a "tangible Tier 1 leverage ratio" in evaluating proposals for expansion or new activities. The tangible Tier 1 leverage ratio is the ratio of a banking organization's Tier 1 Capital less all intangibles, to total assets, less all intangibles. The Federal Reserve Board has not advised us of any specific minimum leverage ratio applicable to SCBT. As of

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December 31, 2007 and 2006, our subsidiary banks had the following leverage ratios and total risk-based capital:

(In percent)	December 31,	
	2007	2006
<b>Tier 1 Leverage Ratios</b>		
SCBT Financial Corporation	8.42	8.11
South Carolina Bank and Trust	7.75	8.02
South Carolina Bank and Trust of the Piedmont	7.53	7.56
The Scottish Bank	9.66	n/a
<b>Total Risk-Based Capital</b>		
SCBT Financial Corporation	10.89	11.36
South Carolina Bank and Trust	10.76	11.18
South Carolina Bank and Trust of the Piedmont	10.71	11.12
The Scottish Bank	10.62	n/a

The FDICIA, among other items, identifies five capital categories for insured depository institutions (well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized) and requires the respective Federal regulatory agencies to implement systems for "prompt corrective action" for insured depository institutions that do not meet minimum capital requirements within such categories. The FDICIA also imposes progressively more restrictive constraints on operations, management and capital distributions, depending on the category in which an institution is classified. Failure to meet the capital guidelines could also subject a banking institution to capital raising requirements. An "undercapitalized" bank must develop a capital restoration plan and its parent holding company must guarantee that bank's compliance with the plan (see "Obligations of Holding Company to its Subsidiary Banks," above). In addition, the FDICIA requires the various regulatory agencies to prescribe certain non-capital standards for safety and soundness relating generally to operations and management, asset quality, and executive compensation. The FDICIA permits regulatory action against a financial institution that does not meet such standards.

The various regulatory agencies have adopted substantially similar regulations that define the five capital categories identified by the FDICIA, using the total risk-based capital, Tier 1 risk-based capital, and Tier 1 leverage ratios as the relevant capital measures. Such regulations establish various degrees of corrective action to be taken when an institution is considered undercapitalized. Under the regulations, a "well capitalized" institution must have a Tier 1 capital ratio of at least 6%, a total risk-based capital ratio of at least 10%, a Tier 1 leverage ratio of at least 5% and not be subject to a capital directive order. An "adequately capitalized" institution must have a Tier 1 capital ratio of at least 4%, a total risk-based capital ratio of at least 8%, and a Tier 1 leverage ratio of at least 4% (or 3% in some cases). Under these guidelines, each Bank is considered well capitalized.

Banking agencies have also adopted final regulations which mandate that regulators take into consideration (i) concentration of credit risk, (ii) interest rate risk (when the interest rate sensitivity of an institution's assets does not match the sensitivity of its liabilities or its off-balance-sheet position), and (iii) risks from non-traditional activities, as well as an institution's ability to manage those risks, when determining the adequacy of an institution's capital. That evaluation will be made as a part of the institution's regular safety and soundness examination. In addition, the banking agencies have amended their regulatory capital guidelines to incorporate a measure for market risk. In accordance with the amended guidelines, if we were to engage in significant trading activity (as defined in the amendment) we must incorporate a measure for market risk in our respective regulatory capital calculations effective for reporting periods after January 1, 1998.

### *Payment of Dividends*

SCBT is a legal entity separate and distinct from its subsidiaries. Funds for cash distributions to our shareholders are derived primarily from dividends received from our bank subsidiaries. Each of our banks is subject to various general regulatory policies and requirements relating to the payment of dividends. Any restriction on the ability of our banks to pay dividends will indirectly restrict the ability of SCBT to pay dividends.

The approval of the OCC is required if the total of all dividends declared by a national bank in any calendar year will exceed the total of its retained net profits for that year combined with its retained net profits for the two preceding years, less any required transfers to surplus. In addition, national banks can only pay dividends to the extent that retained net profits (including the portion transferred to surplus) exceed statutory bad debts in excess of the bank's allowance for loan losses. Further, if in the opinion of the OCC a bank under its jurisdiction is engaged in or is about to engage in an unsafe or unsound practice (which, depending on the financial condition of the bank, could include the payment of dividends), the OCC may require, after notice and a hearing, that such bank cease and desist from such practice. The OCC has indicated that paying dividends that deplete a national bank's capital base to an inadequate level would be an unsafe and unsound banking practice. The Federal Reserve Board, the OCC, and the FDIC have issued policy statements which provide that bank holding companies and insured banks should generally only pay dividends out of current operating earnings.

In addition to the foregoing, the ability of SCBT and its banks to pay dividends may be affected by the various minimum capital requirements and the capital and non-capital standards established under the FDICIA, as described above. The right of SCBT, its shareholders, and its creditors to participate in any distribution of the assets or earnings of its subsidiaries is further subject to the prior claims of creditors of SCBT's subsidiaries.

### *Certain Transactions by SCBT and its Affiliates*

Various legal limitations place restrictions on the ability of the banks to lend or otherwise supply funds to SCBT and its affiliates. The Federal Reserve Act limits a bank's "covered transactions," which include extensions of credit, with any affiliate to 10% of such bank's capital and surplus. All covered transactions with all affiliates cannot in the aggregate exceed 20% of a bank's capital and surplus. All covered and exempt transactions between a bank and its affiliates must be on terms and conditions consistent with safe and sound banking practices, and banks and their subsidiaries are prohibited from purchasing low-quality assets from the bank's affiliates. Also, the Federal Reserve Act requires that all of a bank's extensions of credit to an affiliate be appropriately secured by acceptable collateral, generally United States government or agency securities. In addition, the Federal Reserve Act limits covered and other transactions among affiliates to terms and circumstances, including credit standards, that are substantially the same or at least as favorable to a bank holding company, a bank or a subsidiary of either as prevailing at the time for transactions with unaffiliated companies.

### *Insurance of Deposits*

Deposits at the bank are insured by the Deposit Insurance Fund as administered by the FDIC, up to the applicable limits established by law generally \$100,000 per accountholder and \$250,000 for certain retirement accountholders. As FDIC-insured institutions, our banks are subject to insurance assessments imposed by the FDIC. Under current law, the insurance assessment to be paid by FDIC-insured institutions is as specified in a schedule required to be issued by the FDIC that specifies, at semi-annual intervals, target reserve ratios designed to increase the FDIC insurance fund's reserve ratio to 1.25% of estimated insured deposits (or such higher ratio as the FDIC may determine in accordance with the statute) in 15 years. Further, the FDIC is authorized to impose one or more

special assessments in any amount deemed necessary to enable repayment of amounts borrowed by the FDIC from the United States Department of the Treasury. The actual assessment to be paid by each FDIC-insured institution is based on the institution's assessment risk classification, which is determined based on whether the institution is considered "well capitalized," "adequately capitalized" or "undercapitalized," as such terms have been defined in applicable federal regulations, and whether such institution is considered by its supervisory agency to be financially sound or to have supervisory concerns (see "Capital Adequacy" above). As a result of the current provisions of federal law, the assessment rates on deposits could increase over present levels. Based on the current financial condition and capital levels of our banks, we do not expect that the current FDIC risk-based assessment schedule will have a material adverse effect on the earnings of our banks in 2008.

***International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001***

On October 26, 2001, the President signed the USA Patriot Act of 2001 into law. This act contains the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001 (the "IMLAFA"). The IMLAFA contains anti-money laundering measures affecting insured depository institutions, broker-dealers, and certain other financial institutions. The IMLAFA requires U.S. financial institutions to adopt new policies and procedures to combat money laundering. Further, the Act grants the Secretary of the Treasury broad authority to establish regulations and to impose requirements and restrictions on financial institution's operations. We have adopted policies and procedures to comply with the provisions of the IMLAFA.

***Other Laws and Regulations***

Interest and certain other charges collected or contracted for by our banks are subject to state usury laws and certain federal laws concerning interest rates. Our banks' operations are also subject to certain federal laws applicable to credit transactions, such as the following:

Federal Truth-In-Lending Act, which governs disclosures of credit terms to consumer borrowers,

Community Reinvestment Act requiring financial institutions to meet their obligations to provide for the total credit needs of the communities they serve (which includes the investment of assets in loans to low- and moderate-income borrowers),

Home Mortgage Disclosure Act of 1975 requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves,

Equal Credit Opportunity Act prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit,

Fair Credit Reporting Act of 1978 governing the use and provision of information to credit reporting agencies,

Fair Debt Collection Act governing the manner in which consumer debts may be collected by collection agencies, and

rules and regulations of the various federal agencies charged with the responsibility of implementing such federal laws.

The deposit operations of our banks are also subject to the Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records, and the Electronic Funds Transfer Act and Regulation E issued by the Federal Reserve Board to implement that act, which govern automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services.

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From time to time, bills come before the United States Congress and in the North Carolina and South Carolina state legislatures that in certain cases contain wide-ranging proposals for altering the structure, regulation, and competitive relationships of financial institutions. Among such bills are proposals to prohibit banks and bank holding companies from conducting certain types of activities, to subject banks to increased disclosure and reporting requirements, to alter the statutory separation of commercial and investment banking, and to further expand the powers of banks, bank holding companies and competitors of banks. We cannot predict whether or in what form any of these proposals will be adopted or the extent to which our business may be affected.

### *Fiscal and Monetary Policy*

Banking is a business that depends largely on interest rate differentials. In general, the difference between the interest we pay on our deposits and other borrowings, and the interest we receive on our loans and securities holdings, constitutes the major portion of our banks' earnings. Thus, our earnings and growth will be subject to the influence of economic conditions generally, both domestic and foreign, and also to the monetary and fiscal policies of the United States and its agencies, particularly the Federal Reserve Board. The Federal Reserve Board regulates, among other things, the supply of money through various means, including open-market dealings in United States government securities, the discount rate at which banks may borrow from the Federal Reserve Board, and the reserve requirements on deposits. We cannot predict the nature and timing of any changes in such policies and their impact on our business.

### *Executive Officers of SCBT*

Executive officers of SCBT are elected by the Board of Directors annually and serve at the pleasure of the Board of Directors. The executive officers and their ages, positions with SCBT, past five year employment history and terms of office as of March 1, 2008, are as follows:

Name (age)	Position with SCBT and Five Year History	With SCBT Since
Robert R. Hill, Jr. (41)	President, Chief Executive Officer and Director President and Chief Operating Officer of South Carolina Bank and Trust (2004 - 1999)	1995
John C. Pollok (42)	Senior Executive Vice President, Chief Financial Officer and Chief Operating Officer	1996
Joe E. Burns (53)	Senior Executive Vice President and Chief Credit Officer	2000
Richard C. Mathis (57)	Executive Vice President and Chief Risk Officer Chief Financial Officer (2007 - 2000)	2000
John F. Windley (55)	President, South Carolina Bank and Trust Regional President, South Carolina Bank and Trust (2006 - 2002)	2002
Thomas S. Camp (56)	President and Chief Executive Officer, South Carolina Bank and Trust of the Piedmont	1998
Dane H. Murray (58)	Senior Executive Vice President and Division Head of Lowcountry and Orangeburg Regions	1971

None of the above officers are related and there are no arrangements or understandings between them and any other person pursuant to which any of them was elected as an officer, other than arrangements or understandings with the directors or officers of SCBT acting solely in their capacities as such.

**Item 1A. Risk Factors**

Our business operations may be adversely affected by certain risk factors outside of our control. We believe the risk factors listed could materially and adversely affect our business, financial condition or results of operations. We may also be adversely affected by additional risks and uncertainties or those that we believe are currently immaterial to our business operations. In such cases, you could lose part or all of your investment.

**General Business Risks**

***Our net interest income may decline based on the interest rate environment.***

We depend on our net interest income to drive profitability. Differences in volume, yields or interest rates and differences in income earning products such as interest-earning assets and interest-bearing liabilities determine our net interest income. We are exposed to changes in general interest rate levels and other economic factors beyond our control. Net interest income may decline if:

In a declining interest rate environment, more interest-earning assets than interest-bearing liabilities re-price or mature, or

In a rising interest rate environment, more interest-bearing liabilities than interest-earning assets re-price or mature.

Our net interest income may decline based on our exposure to a difference in short-term and long-term interest rates. If the difference between the interest rates shrinks or disappear; the difference between rates paid on deposits and received on loans could narrow significantly resulting in a decrease in net interest income. In addition to these factors, if market interest rates rise rapidly, interest rate adjustment caps may limit increases in the interest rates on adjustable rate loans, thus reducing our net interest income. Also, certain adjustable rate loans re-price based on lagging interest rate indices. This lagging effect may also negatively impact our net interest income when general interest rates continue to rise periodically.

***We are exposed to the possibility that more prepayments may be made by customers to pay down loan balances, which could reduce our interest income and profitability.***

Prepayment rates stem from consumer behavior, conditions in the housing and financial markets, general United States economic conditions, and the relative interest rates on fixed-rate and adjustable-rate loans. Therefore, changes in prepayment rates are difficult to predict. Recognition of deferred loan origination costs and premiums paid in originating these loans are normally recognized over the contractual life of each loan. As prepayments occur, the rate at which net deferred loan origination costs and premiums are expensed will accelerate. The effect of the acceleration of deferred costs and premium amortization may be mitigated by prepayment penalties paid by the borrower when the loan is paid in full within a certain period of time, which varies between loans. If prepayment occurs after the period of time when the loan is subject to a prepayment penalty, the effect of the acceleration of premium and deferred cost amortization is no longer mitigated. We recognize premiums paid on mortgage-backed securities as an adjustment from interest income over the expected life of the security based on the rate of repayment of the securities. Acceleration of prepayments on the loans underlying a mortgage-backed security shortens the life of the security, increases the rate at which premiums are expensed and further reduces interest income. We may not be able to reinvest loan and security prepayments at rates comparable to the prepaid instrument particularly in a period of declining interest rates.

***We may not be able to adequately anticipate and respond to changes in market interest rates.***

We may be unable to anticipate changes in market interest rates, which are affected by many factors beyond our control including but not limited to inflation, recession, unemployment, money supply, monetary policy, and other changes that affect financial markets both domestic and foreign. Our net interest income is affected not only by the level and direction of interest rates, but also by the shape of the yield curve and relationships between interest sensitive instruments and key driver rates, as well as balance sheet growth, customer loan and deposit preferences, and the timing of changes in these variables. In the event rates increase, our interest costs on liabilities may increase more rapidly than our income on interest earning assets, thus a deterioration of net interest margins. As such, fluctuations in interest rates could have significant adverse effects on our financial condition and results of operations.

***Our estimated allowance for loan losses may be inadequate and an increase in the allowance would reduce earnings.***

We are exposed to the risk that our customers will be unable to repay their loans according to their terms and that any collateral securing the payment of their loans will not be sufficient to assure full repayment. Credit losses are inherent in the lending business and could have a material adverse effect on our operating results and ability to meet obligations. The volatility and deterioration in foreign and domestic markets may also increase our risk for credit losses. The composition of our loan portfolio, primarily secured by real estate, reduces loss exposure. At December 31, 2007, we had approximately 12,000 loans secured by real estate with an average loan balance of approximately \$129,000. We evaluate the collectability of our loan portfolio and provide an allowance for loan losses that we believe to be adequate based on a variety of factors including but not limited to: the risk characteristics of various classifications of loans, previous loan loss experience, specific loans that have loss potential, delinquency trends, estimated fair market value of the collateral, current economic conditions, the views of our regulators, and geographic and industry loan concentrations. If our evaluation is incorrect and borrower defaults cause losses that exceed our allowance for loan losses, our earnings could be significantly and adversely affected. No assurance can be given that the allowance will be adequate to cover loan losses inherent in our portfolio. We may experience losses in our loan portfolios or perceive adverse conditions and trends that may require us to significantly increase our allowance for loan losses in the future, a decision that would reduce earnings.

***We are exposed to higher credit risk by commercial real estate, commercial business, and construction lending.***

Commercial real estate, commercial business and construction lending usually involves higher credit risks than that of single-family residential lending. These types of loans involve larger loan balances to a single borrower or groups of related borrowers. Commercial real estate loans may be affected to a greater extent than residential loans by adverse conditions in real estate markets or the economy because commercial real estate borrowers' ability to repay their loans depends on successful development of their properties, as well as the factors affecting residential real estate borrowers. These loans also involve greater risk because they generally are not fully amortizing over the loan period, but have a balloon payment due at maturity. A borrower's ability to make a balloon payment typically will depend on being able to either refinance the loan or sell the underlying property in a timely manner.

Risk of loss on a construction loan depends largely upon whether our initial estimate of the property's value at completion of construction equals or exceeds the cost of the property construction (including interest) and the availability of permanent take-out financing. During the construction phase, a number of factors can result in delays and cost overruns. If estimates of value are inaccurate or if actual construction costs exceed estimates, the value of the property securing the loan may be insufficient to ensure full repayment when completed through a permanent loan or by seizure of collateral.

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Commercial business loans are typically based on the borrowers' ability to repay the loans from the cash flow of their businesses. These loans may involve greater risk because the availability of funds to repay each loan depends substantially on the success of the business itself. In addition, the collateral securing the loans have the following characteristics: (i) depreciate over time, (ii) difficult to appraise and liquidate, and (iii) fluctuate in value based on the success of the business.

Commercial real estate, commercial business, and construction loans are more susceptible to a risk of loss during a downturn in the business cycle. Our underwriting, review, and monitoring cannot eliminate all of the risks related to these loans.

***A significant portion of our loan portfolio is secured by real estate, and events that negatively impact the real estate market could hurt our business.***

A significant portion of our loan portfolio is secured by real estate. As of December 31, 2007, approximately 81.3% of our loans had real estate as a primary or secondary component of collateral. The real estate collateral in each case provides an alternate source of repayment in the event of default by the borrower and may deteriorate in value during the time the credit is extended. A weakening of the real estate market in our primary market area could result in an increase in the number of borrowers who default on their loans and a reduction in the value of the collateral securing their loans, which in turn could have an adverse effect on our profitability and asset quality. If we are required to liquidate the collateral securing a loan to satisfy the debt during a period of reduced real estate values, our earnings and capital could be adversely affected. Acts of nature, including hurricanes, tornados, earthquakes, fires and floods, which may cause uninsured damage and other loss of value to real estate that secures these loans, may also negatively impact our financial condition.

***Our business is predominately in two states, South Carolina, and the Mecklenburg County of North Carolina; therefore, adverse economic conditions in South Carolina and this North Carolina County could negatively impact results from operations and financial condition.***

Because of our concentration of business in the same geographical region, adverse economic conditions in that particular region could make it more difficult to attract deposits and could cause higher rates of loss and delinquency on our loans than if the loans were more geographically diversified.

***We could experience a loss due to competition with other financial institutions.***

The banking and financial services industry is very competitive. Legal and regulatory developments have made it easier for new and sometimes unregulated competitors to compete with us. The financial services industry has and is experiencing an ongoing trend towards consolidation in which fewer large national and regional banks and firms are replacing many smaller and more local banks and firms. These larger firms hold a large accumulation of assets. These larger institutions have significantly greater resources and a wider geographic presence or greater accessibility. In some instances, these banks operate without the traditional brick and mortar facilities that restrict geographic presence. Some competitors are able to offer more services, more favorable pricing or greater customer convenience than SCBT. In addition, competition has grown from new banks and other financial services providers that target our existing or potential customers. As consolidation continues among large banks, we expect other smaller institutions to try to compete in the markets we serve.

Technological developments have allowed competitors, including some non-depository institutions, to compete more effectively in local markets and have expanded the range of financial products, services and capital available to our target customers. If we are unable to implement, maintain and use such technologies effectively, we may not be able to offer products or achieve cost-efficiencies necessary

to compete in the industry. In addition, some of these competitors have fewer regulatory constraints and lower cost structures.

***We are exposed to the possibility of technology failure.***

We rely on our computer systems and the technology of outside service providers. Our daily operations depend on the operational effectiveness of their technology. We rely on our systems to accurately track and record our assets and liabilities. If our computer systems or outside technology sources become unreliable, fail, or experience a breach of security, our ability to maintain accurate financial records may be impaired, which could materially affect our business operations and financial condition.

***We are exposed to a possible loss of our employees and critical management team.***

We are dependent on the ability and experience of a number of key management personnel who have substantial experience with our operations, the financial services industry, and the markets in which we offer products and services. The loss of one or more senior executives or key managers may have an adverse effect on our operations. Also, as we continue to grow operations, our success depends on our ability to continue to attract, manage, and retain other qualified middle management personnel. We cannot guarantee that we will continue to attract or retain such personnel.

***We are exposed to a need for additional capital resources for the future and the fact that these capital resources may not be available when needed or at all.***

We may need to incur additional debt or equity financing in the future to make strategic acquisitions or investments. We cannot provide assurance that such financing will be available to us on acceptable terms or at all.

**Legal and Regulatory Risks**

***We are subject to extensive regulation that could restrict our activities and impose financial requirements or limitations on the conduct of our business and limit our ability to receive dividends from our bank subsidiaries.***

We are subject to Federal Reserve Board regulation. Our banks are subject to extensive regulation, supervision, and examination by their primary federal regulator, the Office of the Comptroller of the Currency ("OCC"), and by the Federal Deposit Insurance Corporation ("FDIC"), the regulating authority that insures customer deposits. Also, as a member of the Federal Home Loan Bank ("FHLB"), our banks must comply with applicable regulations of the Federal Housing Finance Board and the FHLB. Regulation by these agencies is intended primarily for the protection of our depositors and the deposit insurance fund and not for the benefit of our shareholders. Our banks' activities are also regulated under consumer protection laws applicable to our lending, deposit, and other activities. A sufficient claim against our subsidiaries under these laws could have a material adverse effect on our results of operations.

***We are exposed to changes in the regulation of financial services companies.***

Proposals for further regulation of the financial services industry are continually being introduced in the Congress of the United States of America, the General Assembly of the State of South Carolina, and the General Assembly of the State of North Carolina. The agencies regulating the financial services industry also periodically adopt changes to their regulations. For example, regulation of government-sponsored entities has been receiving significant attention recently. It is possible that one or more legislative proposals may be adopted or regulatory changes may be made that would have an adverse effect on our business.

*We are exposed to declines in the value of qualified pension plan assets or unfavorable changes in laws or regulations that govern pension plan funding, which could require us to provide significant amounts of funding for our qualified pension plan.*

We expect to make material cash contributions to our qualified defined benefit pension plan in the near and long term. A significant decline in the value of qualified pension plan assets in the future or unfavorable changes in laws or regulations that govern pension plan funding could materially change the timing and amount of required pension funding. As a result, we may be required to fund our qualified defined benefit pension plan with a greater amount of cash from operations, perhaps by an additional material amount.

#### **Other Risk Factors**

*We may decide to make future acquisitions, which could dilute current shareholders' stock ownership and we may become more susceptible to adverse economic events.*

In accordance with our strategic plan, we continually evaluate opportunities to acquire other banks and/or branch locations to expand SCBT. As a result, we may be involved in negotiations or discussions that, if they were to result in a transaction, could have a material effect on our operating results and financial condition, including short and long-term liquidity.

Our acquisition activities could be material to SCBT. For example, we could issue additional shares of common stock in a purchase transaction, which could dilute current shareholders' ownership interest in SCBT. These activities could require us to use a substantial amount of cash, other liquid assets, and/or incur debt. In those events, we could become more susceptible to economic downturns and competitive pressures.

*We may be exposed to difficulties in combining the operations of acquired entities such as TSB into our own operations, which may prevent us from achieving the expected benefits from our acquisition activities.*

We may not be able to fully achieve the strategic objectives and operating efficiencies that we anticipate in our acquisition activities. Inherent uncertainties exist in integrating the operations of an acquired entity. In addition, the markets and industries in which SCBT and our potential acquisition targets operate are highly competitive. We may lose customers or the customers of acquired entities as a result of an acquisition. We also may lose key personnel from the acquired entity as a result of an acquisition. We may not discover all known and unknown factors when examining a company for acquisition during the due diligence period. These factors could produce unintended and unexpected consequences for us. Undiscovered factors as a result of acquisition, pursued by non-related third party entities, could bring civil, criminal, and financial liabilities against us, our management, and the management of those entities acquired. These factors could contribute to SCBT not achieving the expected benefits from its acquisitions within desired time frames, if at all.

*Our stock price may be volatile.*

Our stock price has been volatile in the past and several factors could cause the price to fluctuate substantially in the future. These factors include but are not limited to: actual or anticipated variations in earnings, changes in analysts' recommendations or projections, our announcement of developments related to our businesses, operations and stock performance of other companies deemed to be peers, new technology used or services offered by traditional and non-traditional competitors, news reports of trends, concerns, irrational exuberance on the part of investors, and other issues related to the financial services industry. Our stock price may fluctuate significantly in the future, and these fluctuations may be unrelated to our performance. General market declines or market volatility in the future could adversely affect the price of SCBT's common stock, and the current market price may not be indicative of future market prices.

*The accuracy of our financial statements and related disclosures could be affected because we are exposed to conditions or assumptions different from the judgments, assumptions or estimates used in our critical accounting policies.*

The preparation of financial statements and related disclosure in conformity with accounting principles generally accepted in the United States of America ("US GAAP") requires us to make judgments, assumptions, and estimates that affect the amounts reported in our consolidated financial statements and accompanying notes. Our critical accounting policies, included in this document, describe those significant accounting policies and methods used in the preparation of our consolidated financial statements that are considered "critical" by us because they require judgments, assumptions and estimates that materially impact our consolidated financial statements and related disclosures. As a result, if future events differ significantly from the judgments, assumptions and estimates in our critical accounting policies, such events or assumptions could have a material impact on our audited consolidated financial statements and related disclosures.

**Item 1B. Unresolved Staff Comments**

None.

**Item 2. Properties**

Our corporate headquarters are located in a four-story facility, located at 520 Gervais Street, Columbia, South Carolina. The Midlands region lead branch of South Carolina Bank and Trust is also located in this 57,000 square-foot building. The main offices of South Carolina Bank and Trust are in a four-story facility with approximately 48,000 square feet of space for operating and administrative purposes, located at 950 John C. Calhoun Drive, S.E., Orangeburg, South Carolina. South Carolina Bank and Trust also owns twenty-eight other properties and leases twenty-four properties, all of which are used, substantially, as branch locations or for housing other operational units.

South Carolina Bank and Trust of the Piedmont owns a 12,000 square foot office building that serves as its main office, located at 1127 Ebenezer Road, Rock Hill, South Carolina. The bank owns three additional properties and leases three others, all of which are used as branches.

The Scottish Bank leases a 7,000 square foot office building that serves as its main office, located at 6525 Morrison Boulevard, Charlotte, North Carolina. The bank owns one property and leases four others, which are used as branches and a loan production office.

Although the properties owned and leased are generally considered adequate, we have a continuing program of modernization, expansion, and when necessary, occasional replacement of facilities.

**Item 3. Legal Proceedings**

We are not a party to, nor is any of our property the subject of, any pending material proceeding other than those that may occur in our ordinary course of business as of December 31, 2007 and the date of this Form 10-K.

**Item 4. Submission of Matters to a Vote of Security Holders**

No matters were submitted to a vote of shareholders in the fourth quarter of 2007.

## PART II

## Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

(a)

The table below describes historical information regarding our common equity securities:

	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
<b>Stock Performance</b>					
Dividends per share	\$ 0.68	\$ 0.68	\$ 0.68	\$ 0.65	\$ 0.63
Dividend payout ratio	29.17%	30.88%	34.29%	36.66%	33.98%
Dividend yield (based on the average of the high and low for the year)	1.94%	1.81%	2.14%	2.06%	2.47%
Price/earnings ratio (based on year-end stock price and diluted earnings per share)	13.65x	19.39x	17.29x	20.49x	16.49x
Price/book ratio (end of year)	1.50x	2.25x	1.95x	2.27x	2.05x
<b>Common Stock Statistics</b>					
Stock price ranges:					
High	\$ 41.84	\$ 42.93	\$ 34.94	\$ 37.61	\$ 30.71
Low	28.297,596,223	7,321,668			
<b>Research and development expenses</b>					
	2,369,683	2,383,903			
<b>Total operating expenses</b>					
	15,546,228	15,230,357			
<b>Loss from operations</b>					
	(833,413)	(2,051,739)			
<b>Other income:</b>					
Interest income	35,345	53,225			
Interest expense	(353,070)	(357,075)			
Royalty income and license fees	539,413	672,263			
Royalty expense	(262,867)	(16,928)			
Other	179,129	4,857			
Total other income	137,950	356,342			
<b>Loss before minority interest and income taxes</b>					
	(695,463)	(1,695,397)			
<b>Minority interest in net income (loss) of consolidated subsidiaries</b>					
	47,580	(12,819)			
<b>Loss before income taxes</b>					
	(743,043)	(1,682,578)			

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	<u>2007</u>		<u>2006</u>		<u>2005</u>	<u>2004</u>	<u>2003</u>
Income tax benefit	<b>(205,562)</b>		(634,680)				
Net loss	<b>\$ (537,481)</b>	\$	(1,047,898)	\$			
Net loss per share – Basic	<b>\$ (.08)</b>	\$	(.15)	\$			
Net loss per share – Diluted	<b>\$ (.08)</b>	\$	(.15)	\$			
Weighted average common shares outstanding – Basic	<b>7,001,369</b>		6,923,044				
Weighted average common shares outstanding – Diluted	<b>7,001,369</b>		6,923,044				

*See Accompanying Notes to Consolidated Financial Statements.*

**MISONIX, INC. and Subsidiaries**  
**Consolidated Statements of Operations**  
**(Unaudited)**

	For the three months ended March 31,	
	2008	2007
Net sales	\$ 11,803,026	\$ 10,583,924
Cost of goods sold	6,920,580	6,123,927
Gross profit	4,882,446	4,459,997
Operating expenses:		
Selling expenses	1,993,137	2,003,430
General and administrative expenses	2,470,147	2,614,237
Research and development expenses	724,131	735,518
Total operating expenses	5,187,415	5,353,185
Loss from operations	(304,969)	(893,188)
Other income:		
Interest income	10,759	11,111
Interest expense	(101,890)	(130,582)
Royalty income and license fees	206,695	213,788
Royalty expense	(99,399)	(5,577)
Other	57,005	(7,473)
Total other income	73,170	81,267
Loss before minority interest and income taxes	(231,799)	(811,921)
Minority interest in net income (loss) of consolidated subsidiaries	24,269	(38,318)
Loss before income taxes	(256,068)	(773,603)
Income tax benefit	(62,031)	(244,567)
Net loss	(194,037)	(529,036)
Net loss per share – Basic	\$ (.03)	\$ (0.08)
Net loss per share – Diluted	\$ (.03)	\$ (0.08)
Weighted average common shares outstanding – Basic	7,001,369	6,962,802
Weighted average common shares outstanding – Diluted	7,001,369	6,962,802

*See Accompanying Notes to Consolidated Financial Statements.*

**MISONIX, INC. and Subsidiaries**  
**Consolidated Statement of Stockholders' Equity**  
**(Unaudited)**

Nine months ended March 31, 2008

	<b>Common Stock, \$.01 Par Value</b>		<b>Treasury Stock</b>		<b>Additional paid-in capital</b>	<b>Accumulated deficit</b>	<b>Accumulated other comprehensive income</b>	<b>Total stockholders' equity</b>
	<b>Number of shares</b>	<b>Amount</b>	<b>Number of shares</b>	<b>Amount</b>				
Balance, June 30, 2007	7,079,169	\$ 70,792	(77,800)	\$ (412,424)	\$ 24,871,444	\$ (3,507,788)	\$ 384,617	\$ 21,406,641
Net loss	-	-	-	-	-	(537,481)	-	(537,481)
Foreign currency translation adjustment	-	-	-	-	-	-	(31,706)	(31,706)
Comprehensive loss	-	-	-	-	-	-	-	(569,187)
Cumulative transition adjustment for FIN 48	-	-	-	-	-	(234,571)	-	(234,571)
Stock-based compensation	-	-	-	-	151,262	-	-	151,262
<b>Balance, March 31, 2008</b>	<b>7,079,169</b>	<b>\$ 70,792</b>	<b>(77,800)</b>	<b>\$ (412,424)</b>	<b>\$ 25,022,706</b>	<b>\$ (4,279,840)</b>	<b>\$ 352,911</b>	<b>\$ 20,754,145</b>

*See Accompanying Notes to Consolidated Financial Statements.*

**MISONIX, INC. and Subsidiaries**  
**Consolidated Statements of Cash Flows**  
**(Unaudited)**

	For the nine months ended March 31,	
	2008	2007
<b>Operating activities</b>		
Net loss	\$ (537,481)	\$ (1,047,898)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization and other non-cash items	1,268,696	1,467,533
Bad debt expense (recovery)	(56,405)	81,807
Deferred income tax benefit	(246,753)	(739,076)
Loss on disposal of property, plant and equipment	63,159	117,054
Minority interest in net income (loss) of subsidiaries	47,580	(12,819)
Stock-based compensation	151,262	140,341
Deferred income	(96,269)	(75,013)
Deferred leasehold costs	(144,233)	17,791
Changes in operating assets and liabilities:		
Accounts receivable	(624,458)	(1,369,184)
Inventories	(669,705)	(847,951)
Income taxes	21,584	826,813
Prepaid expenses and other current assets	615,601	(174,766)
Accounts payable and accrued expenses	40,369	(40,726)
Foreign income taxes payable	-	39,894
Other	(19,944)	(803,461)
Net cash used in operating activities	(186,997)	(2,419,661)
<b>Investing activities</b>		
Acquisition of property, plant and equipment	(367,958)	(559,279)
Investment in UKHIFU Limited	(37,781)	-
Acquisition of minority interest	(839,653)	-
Net cash used in investing activities	(1,245,392)	(559,279)
<b>Financing activities</b>		
Proceeds from short-term borrowings	18,519,219	5,648,062
Payments of short-term borrowings	(18,032,773)	(2,302,175)
Principal payments on capital lease obligations	(348,398)	(273,066)
Proceeds from exercise of stock options	-	134,570
Payments of long-term debt	-	(44,556)
Net cash provided by financing activities	138,048	3,162,835
Effect of exchange rate changes on cash	1,512	7,703
Net (decrease) increase in cash	(1,292,829)	191,598
Cash at beginning of period	2,900,358	675,400
Cash at end of period	\$ 1,607,529	\$ 866,998
<b>Supplemental disclosure of cash flow information:</b>		
Cash paid for:		
Interest	\$ 363,311	\$ 330,621

Income taxes	\$	19,607	\$	(762,309)
<b>Supplemental disclosure of noncash investing and financing activities:</b>				
Capital lease additions	\$	391,900	\$	133,146
Inventory transferred to property, plant and equipment		-	\$	413,567

*See Accompanying Notes to Consolidated Financial Statements.*

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**MISONIX, INC. and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
(Information with respect to interim periods is unaudited)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the nine months ended March 31, 2008 are not necessarily indicative of the results that may be expected for the year ending June 30, 2008 or any interim period.

The balance sheet at June 30, 2007 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended June 30, 2007.

2. Net Loss Per Share of Common Stock

In accordance with Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings Per Share", basic net loss per common share ("basic EPS") is computed by dividing net loss by the weighted average number of common shares outstanding. Diluted net loss per common share ("diluted EPS") is computed by dividing net loss by the weighted average number of common shares and dilutive common share equivalents outstanding. Diluted EPS for periods with a net loss is the same as basic EPS, as the inclusion of the effect of common stock equivalents then outstanding would be anti-dilutive. For this reason, we excluded from the calculation of diluted EPS all outstanding options for the nine and three-month periods ended March 31, 2008 and 2007.

3. Comprehensive (Loss) Income

Total comprehensive loss was \$569,187 and \$199,652 for the nine months and three months ended March 31, 2008 and \$779,723 and \$547,901 for the nine months and three months ended March 31, 2007, respectively. The components of comprehensive loss are net loss and foreign currency translation adjustments.

4. Stock-Based Compensation

The Company adopted the fair-value recognition provisions of SFAS 123R, "Share-Based Payment" ("SFAS No. 123R"), effective July 1, 2005. Compensation cost recognized in the nine and three-month periods ended March 31, 2008 and 2007 include compensation cost for all share-based payments granted prior to, but not yet vested as of, July 1, 2005, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, and compensation cost for all share-based payments granted subsequent to July 1, 2005, based on the grant date fair value estimated in accordance with the provisions of SFAS 123R.

Stock options are granted with exercise prices not less than the fair market value of our common stock at the time of the grant, with an exercise term (as determined by the Committee administering the applicable option plan (the "Committee")) not to exceed 10 years. The Committee determines the vesting period for the Company's stock options. Generally, such stock options have vesting periods of immediate to four years. Certain option awards provide for

accelerated vesting upon meeting specific retirement, death or disability criteria, and upon a change in control. During the three-month periods ended March 31, 2008 and 2007, the Company granted options to purchase 0 and 75,000 shares of the Company's common stock, respectively, and during the nine month-periods ended March 31, 2008 and 2007, the Company granted options to purchase 61,850 and 127,400 shares of the Company's common stock, respectively.

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**MISONIX, INC. and Subsidiaries**  
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Stock-based compensation expense for the nine month-periods ended March 31, 2008 and 2007 was approximately \$151,000 and \$140,000, respectively. Stock-based compensation expense for the three- month periods ended March 31, 2008 and 2007 was \$53,000 and \$40,000, respectively. Compensation expense is recognized in the general and administrative expenses line item of the Company's statements of operations on a straight-line basis over the vesting periods. As of March 31, 2008, there was \$392,208 of total unrecognized compensation cost related to non-vested share-based compensation arrangements to be recognized over a weighted-average period of 2.3 years.

Total cash received from the exercise of stock options was \$0 and \$134,570 for the nine-month periods ended March 31, 2008 and 2007, respectively. SFAS No. 123R requires that cash flows from tax benefits attributable to tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) be classified as financing cash flows.

We estimated the fair value of stock options using the following assumptions:

	For the Nine Months		For the Three Months	
	March 31,		March 31,	
	2008	2007	2007	
Risk-free interest rate	4.3%	4.67%	4.48%	
Expected option life in years	6.5	6.0	6.0	
Expected stock price volatility	54.7%	53.8%	52.3%	
Expected dividend yield	0%	0%	0%	
Weighted-average fair value of options granted	\$ 2.51	\$ 2.57	\$ 2.99	

The expected life was based on historical exercises and terminations. The expected volatility over the expected life of the options is determined using historical volatilities based on historical stock prices. The expected dividend yield is 0% as the Company has historically not declared dividends and does not expect to declare any in the future.

**MISONIX, INC. and Subsidiaries**  
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Changes in outstanding stock options during the nine months ended March 31, 2008 were as follows:

	Number of Shares	Weighted Average Exercise Price	Options Weighted Average Remaining Contractual Life (years)	Aggregate Intrinsic Value
Outstanding as of June 30, 2007	1,802,566	\$ 5.88	5.4	
Granted	61,850	4.33		
Exercised	—	—		
Forfeited	11,380	6.04		
Expired	25,000	14.80		
Outstanding as of March 31, 2008	1,828,036	\$ 5.70	5.1	\$ 106,719
Exercisable and vested at March 31, 2008	1,663,912	\$ 5.79	4.5	\$ 74,380
Available for grant at March 31, 2008	604,627			

#### 5. Income Taxes

The Company adopted the provisions of Financial Accounting Standards Board (“FASB”) Interpretation No. 48 (“FIN 48”), an interpretation of SFAS 109, effective July 1, 2007. In response to the issuance of FIN 48, the Company reviewed its uncertain tax positions in accordance with the recognition standards established by FIN 48. As a result of this review, the Company has adjusted its estimate of its uncertain tax positions by recognizing an additional liability (including interest) of approximately \$235,000 through a charge to accumulated deficit. The liability is included in deferred income taxes payable. There have not been any new uncertain income tax positions identified in the nine and three month periods ended March 31, 2008. The Company does not expect any material changes to the estimated amount of liability associated with its uncertain tax positions through July 1, 2008.

The Company generally recognizes interest and penalties related to uncertain tax positions through income tax expense. As of July 1, 2007, the Company had accrued approximately \$32,000 for the payment of tax-related interest. An additional \$12,000 was accrued during the nine months ended March 31, 2008.

There are no federal, state or foreign income tax audits in process as of March 31, 2008. Open tax years related to federal and state income tax filings are for the years ended June 30, 2005, 2006 and 2007. The Company files state tax returns in New York and Colorado and its tax returns in those states have never been examined. The Company’s foreign subsidiaries, Labcaire Systems Ltd. (“Labcaire”), Misonix, Ltd. and UKHIFU Limited (“UKHIFU”) file tax returns in England. The England Inland Revenue Service has not examined these tax returns.

In June 2006, the FASB ratified the consensus reached by the Emerging Issues Tax Force in Issue No. 06-3 (“EITF 06-3”), “How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That is, Gross versus Net Presentation).” The scope of EITF 06-3 includes any tax assessed by a governmental authority that is directly imposed on a revenue-producing activity between a seller and a customer and may include, but is not limited to, sales, use, value added, and some excise taxes. EITF 06-3 also concluded that the presentation of taxes within its scope on either a gross (included in revenues and costs) or net (excluded from revenues) basis is an accounting policy decision subject to appropriate disclosure. EITF 06-3 is effective for periods

beginning after December 15, 2006. The Company currently presents these taxes on a net basis and has elected not to change its presentation method.

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6. Inventories

Inventories are summarized as follows:

	March 31, 2008	June 30, 2007
Raw material	\$ 6,453,615	\$ 6,593,458
Work-in-process	3,153,288	2,624,212
Finished goods	4,845,888	4,599,040
	<b>14,452,791</b>	13,816,710
Less valuation reserve	2,051,780	1,913,416
	<b>\$ 12,401,011</b>	\$ 11,903,294

7. Accrued Expenses and Other Current Liabilities

The following summarizes accrued expenses and other current liabilities:

	March 31, 2008	June 30, 2007
Customer deposits and deferred contracts	\$ 1,020,109	\$ 1,084,412
Accrued payroll and vacation	1,212,680	567,296
Accrued VAT on sale of Labcaire building	-	631,229
Accrued VAT and sales tax	483,386	118,176
Accrued commissions and bonuses	416,074	484,022
Accrued professional fees	127,353	47,413
Litigation	324,000	419,000
Other	300,775	606,095
	<b>\$ 3,884,377</b>	\$ 3,957,643

8. Revolving Credit Facilities

On December 29, 2006, the Company and its subsidiaries, Acoustic Marketing Research, Inc. d/b/a Sonora Medical Systems (“Sonora”) and Hearing Innovations, Inc. (“Hearing Innovations”) (the Company, Sonora and Hearing Innovations collectively referred to as the “Borrowers”) and Wells Fargo Bank entered into a (i) Credit and Security Agreement and a (ii) Credit and Security Agreement Export-Import Subfacility (collectively referred to as the “Credit Agreements”). The aggregate credit limit under the Credit Agreements is \$8,000,000 consisting of a revolving facility in the amount of up to \$8,000,000. Up to \$1,000,000 of the revolving facility is available under the Export-Import Agreement as a subfacility for Export-Import working capital financing. All credit facilities under the Credit Agreements mature on December 29, 2009. Payment of amounts outstanding under the Credit Agreements may be accelerated upon the occurrence of an Event of Default (as defined in the Credit Agreements). All loans and advances under the Credit Agreements are secured by a first priority security interest in all of the Borrowers’ accounts receivable, letter-of-credit rights, and all other business assets. The Borrowers have the right to terminate or reduce the

credit facility prior to December 29, 2009 by paying a fee based on the aggregate credit limit (or reduction, as the case may be) as follows: (i) during year one of the Credit Agreements, 3%; (ii) during year two of the Credit Agreements, 2%; and (iii) during year three of the Credit Agreements, 1%.

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The Credit Agreements, as amended, contain financial covenants requiring that the Borrowers (i) on a consolidated basis not have a Net Loss (as defined in the Credit Agreements) of more than (a) \$40,000 for the fiscal quarter ended March 31, 2008 and (b) \$175,000 for the fiscal quarter ending June 30, 2008; and (ii) not incur or contract to incur Capital Expenditures (as defined in the Credit Agreements) of more than \$1,000,000 in the aggregate in any fiscal year or more than \$1,000,000 in any one transaction. At March 31, 2008, the Borrowers were in compliance with all financial covenants under the Credit Agreements.

The available amount under the Credit Agreements is the lesser of \$8,000,000 or the amount calculated under the Borrowing Base (as defined in the Credit Agreements). The Borrowers must maintain a minimum outstanding amount of \$1,250,000 under the Credit Agreements at all times and pay a fee equal to the interest rate set forth on any such shortfall. Interest on amounts borrowed under the Credit Agreements is payable at Wells Fargo's prime rate of interest plus 1% per annum floating, payable monthly in arrears. The default rate of interest is 3% higher than the rate otherwise payable. A fee of ½ % per annum on the Unused Amount (as defined in the Credit Agreements) is payable monthly in arrears. At March 31, 2008, the balance outstanding under the Credit Agreement was \$2,830,656 and an additional \$833,496 was available under this line of credit.

Labcaire has a debt purchase agreement with Lloyds TSB Commercial Finance ("Lloyds"). The amount of this facility bears interest at Lloyd's base rate (5.5%) at March 31, 2008 plus 2.0% and fluctuates based on the outstanding United Kingdom and European receivables. The agreement expires September 28, 2008. The agreement covers all United Kingdom and European sales. At March 31, 2008, the balance outstanding under this credit facility was \$1,619,949 and Labcaire was in compliance with all financial covenants.

9. Commitments and Contingencies

A jury in the District Court of Boulder County, Colorado has returned a verdict against Sonora in the amount of \$419,000 which was recorded by the Company during the fourth quarter of fiscal 2005. The judgment was decreased to \$324,000 and the \$95,000 reduction is included in other income during the three months ended March 31, 2008. The case involved royalties claimed on recoating of transesophageal probes, which is a process performed by Sonora. Approximately 80% of the judgment was based on the jury's estimate of royalties for potential sales of the product in the future. Sonora has moved for judgment notwithstanding the verdict based on, among other things, the award of damages for future royalties. Sonora has also moved for a new trial in the case.

The Company is a defendant in claims and lawsuits arising in the ordinary course of business. The Company believes that it has meritorious defenses to such claims and lawsuits and is vigorously contesting them. Although the outcome of litigation cannot be predicted with certainty, the Company believes that these actions will not have a material adverse effect on the Company's consolidated financial position or results of operations.

On September 6, 2007, but effective as of August 30, 2007, the Company and William H. Phillips ("Phillips") entered into a Settlement Agreement (the "Agreement"). Pursuant to the Agreement, the Company and Phillips resolved certain disputes between them concerning the purchase price to be paid by the Company for shares of the common stock of Sonora owned by Phillips. The Company owned ninety (90%) percent of the outstanding shares of Sonora prior to the execution of the Agreement.

Pursuant to the Agreement, the Company paid Phillips the aggregate sum of \$1,214,780 (the "Purchase Price"). The Company paid Phillips \$296,118 on June 7, 2007, \$311,272 on August 30, 2007 and \$306,220 on November 28, 2007. The Company paid the final installment of \$301,169 on February 28, 2008. As of March 1, 2008, the Company

owns 95% of the outstanding shares of Sonora.

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**MISONIX, INC. and Subsidiaries**  
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The effect of this transaction was to increase goodwill by \$969,800, decrease minority interest by \$149,737 and record interest expense of \$95,242.

10. Recent Accounting Standards

In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets" ("SFAS 156"), an amendment of SFAS 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities". SFAS 156 requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable, and permits an entity to subsequently measure those servicing assets and servicing liabilities at fair value. SFAS 156 is effective for fiscal years beginning after September 15, 2006. The Company adopted SFAS 156 effective July 1, 2007 and the adoption of SFAS 156 did not have a material effect on the Company's consolidated financial position or results of operations.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS 157"). SFAS 157 provides a new single authoritative definition of fair value and provides enhanced guidance for measuring the fair value of assets and liabilities and requires additional disclosures related to the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. This Statement is effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007. The Company is currently evaluating the impact that the adoption of SFAS 157 may have on the Company's consolidated financial position and results of operations.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS 159"), which provides companies with an option to report selected financial assets and liabilities at fair value in an attempt to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. This Statement is effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007. The Company is currently evaluating the impact that the adoption of SFAS 159 may have on the Company's consolidated financial position and results of operations.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements — an amendment of ARB No. 51" ("SFAS 160"). SFAS 160 amends ARB No. 51 to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a noncontrolling interest in a subsidiary, which is sometimes referred to as a minority interest, is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. Among other requirements, this Statement requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and noncontrolling interest. It also requires disclosure, on the face of the consolidated statement of operations, of the amounts of consolidated net income (loss) attributable to the parent and to the noncontrolling interest. SFAS 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Earlier adoption is prohibited. The Company is currently evaluating the impact that the adoption of SFAS 160 may have on the Company's consolidated financial position and results of operations.

11. Related Party

The Company has subcontracted Focus Surgery, Inc. ("Focus") to perform research and development activities for which the Company recorded expenses of \$229,200 and \$44,000 to Focus during the nine months ended March 31, 2008 and 2007, respectively, which amounts are recorded as research and development expenses in the accompanying statements of operations. During fiscal 2004, Focus entered into an exclusive agreement with the Company to

distribute the Sonablate® 500 in the European market.

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**MISONIX, INC. and Subsidiaries**  
**Notes to Consolidated Financial Statements**

(Information with respect to interim periods is unaudited)

The Company purchased approximately \$510,000 and \$578,000 of product from Focus during the nine months ended March 31, 2008 and 2007, respectively. Total sales to Focus were approximately \$407,000 and \$584,000 for the nine months ended March 31, 2008 and 2007, respectively. Accounts receivable due from Focus at March 31, 2008 and June 30, 2007 were approximately \$149,000 and \$4,000, respectively. Accounts payable to Focus totaled approximately \$497,000 and \$508,000 at March 31, 2008 and June 30, 2007, respectively.

On March 3, 2008 the Company, USHIFU, LLC (“USHIFU”), FS Acquisition Company and certain other stockholders of Focus entered into a Stock Purchase Agreement (the “Focus Agreement”). Pursuant to the Focus Agreement, the Company agreed to sell to USHIFU the 2,500 shares of Series M Preferred Stock of Focus owned by the Company for a cash payment of \$837,500. The Company will also receive at the closing of the transactions contemplated by the Focus Agreement (the “Closing”) fifty percent (50%) of the outstanding principal and accrued interest of loans previously made by the Company to Focus with the remaining fifty percent (50%) of such amount due eighteen (18) months from the Closing. The balance of the debt owed to the Company by Focus at March 31, 2008 is approximately \$1,335,000.

Consummation of the transactions contemplated by the Focus Agreement is subject to fulfillment of customary conditions as well as (i) USHIFU obtaining no less than \$10,000,000.00 of new financing through the issuance of equity in USHIFU or an affiliate thereof; (ii) repayment of fifty percent (50%) of the debt due to the Company and to Takai Hospital Supply Co., Ltd (“THS”); (iii) dismissal of the pending arbitration between USHIFU and Focus; (iv) the execution of amendments to certain distributorship and license agreements between Focus and an affiliate of THS; (v) the execution of amendments to and/or agreements concerning certain distributorship, license and manufacturing arrangements between Focus and the Company; and (vi) the execution of employment and joint venture agreements between the President of Focus and Focus.

The Company’s investments in Focus for both equity and debt were totally written down in 2001 as a result of both the debt and equity being deemed impaired. Under the impairment treatment, the equity and debt have been carried on our balance sheet at a zero value since 2001, therefore this amount will be totally incremental to earnings. Additionally, since in 2001 we were not certain of any capital gain offset, we established a tax valuation reserve which will also be partially reversed at Closing. Upon the Closing, we will realize approximately \$1,500,000 in non-recurring income or approximately \$.21 per share.

## 12. Business Segments

The Company operates in two business segments which are organized by product types: medical devices and laboratory and scientific products. Medical devices include the AutoSonix™ ultrasonic cutting and coagulatory system, the Sonablate 500® (used to treat prostate cancer), refurbishing of high-performance ultrasound systems and replacement transducers for the medical diagnostic ultrasound industry, ultrasonic lithotripter, ultrasonic neuroaspirator (used for neurosurgery), soft tissue aspirator (used primarily for the cosmetic surgery market) and the wound debrider. Laboratory and scientific products include the Sonicator Ultrasonic liquid processor, Aura ductless fume enclosure and the Labcaire ISIS and Guardian endoscope disinfectant systems. The Company evaluates the performance of the segments based upon income from operations before general and administrative expenses. The accounting policies of the segments are the same as those described in the summary of significant accounting policies (Note 1) in the Company’s Annual Report on Form 10-K for the year ended June 30, 2007.

Certain items are maintained at the corporate headquarters (corporate) and are not allocated to the segments. They primarily include general and administrative expenses. General and administrative expenses at the Company’s Sonora,

Labcaire, UKHIFU and Misonix, Ltd. subsidiaries are included in corporate and unallocated amounts in the tables below. The Company does not allocate assets by segment. Summarized financial information for each of the segments is as follows:

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**MISONIX, INC. and Subsidiaries**  
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(Information with respect to interim periods is unaudited)

For the nine months ended March 31, 2008

	<b>Medical Device Products</b>	<b>Laboratory and Scientific Products</b>	<b>Corporate and Unallocated</b>	<b>Total</b>
Net sales	\$ 17,854,832	\$ 16,080,484	\$ -	\$ 33,935,316
Cost of goods sold	9,053,042	10,169,459	-	19,222,501
Gross profit	8,801,790	5,911,025	-	14,712,815
Selling expenses	3,566,860	2,013,462	-	5,580,322
Research and development	1,569,483	800,200	-	2,369,683
General and administrative	-	-	7,596,223	7,596,223
Total operating expenses	5,136,343	2,813,662	7,596,223	15,546,228
Income (loss) from operations	\$ 3,665,447	\$ 3,097,362	\$ (7,596,223)	\$ (833,413)

For the nine months ended March 31, 2007

	<b>Medical Device Products</b>	<b>Laboratory and Scientific Products</b>	<b>Corporate and Unallocated</b>	<b>Total</b>
Net sales	\$ 17,082,915	\$ 13,782,973	\$ -	\$ 30,865,888
Cost of goods sold	9,595,991	8,091,279	-	17,687,270
Gross profit	7,486,924	5,691,694	-	13,178,618
Selling expenses	3,701,453	1,823,333	-	5,524,786
Research and development	1,503,853	880,050	-	2,383,903
General and administrative	-	-	7,321,668	7,321,668
Total operating expenses	5,205,306	2,703,383	7,321,668	15,230,357
Income (loss) from operations	\$ 2,281,618	\$ 2,988,311	\$ (7,321,668)	\$ (2,051,739)

**MISONIX, INC. and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
(Information with respect to interim periods is unaudited)

For the three months ended March 31, 2008

	<b>Medical Device Products</b>	<b>Laboratory and Scientific Products</b>	<b>Corporate and Unallocated</b>	<b>Total</b>
Net sales	\$ 6,518,512	\$ 5,284,514	\$ -	\$ 11,803,026
Cost of goods sold	3,389,720	3,530,860	-	6,920,580
Gross profit	3,128,792	1,753,654	-	4,882,446
Selling expenses	1,271,232	721,905	-	1,993,137
Research and development	450,418	273,713	-	724,131
General and administrative	-	-	2,470,147	2,470,147
Total operating expenses	1,721,650	995,618	2,470,147	5,187,415
Income (loss) from operations	\$ 1,407,142	\$ 758,036	\$ (2,470,147)	\$ (304,969)

For the three months ended March 31, 2007:

	<b>Medical Device Products</b>	<b>Laboratory and Scientific Products</b>	<b>Corporate and Unallocated</b>	<b>Total</b>
Net sales	\$ 6,031,451	\$ 4,552,473	\$ -	\$ 10,583,924
Cost of goods sold	3,415,415	2,708,512	-	6,123,927
Gross profit	2,616,036	1,843,961	-	4,459,997
Selling expenses	1,357,631	645,799	-	2,003,430
Research and development	454,827	280,691	-	735,518
General and administrative	-	-	2,614,237	2,614,237
Total operating expenses	1,812,458	926,490	2,614,237	5,353,185
Income (loss) from operations	\$ 803,578	\$ 917,471	\$ (2,614,237)	\$ (893,188)

The Company's revenues are generated from various geographic regions. The following is an analysis of net sales by geographic region:

	Nine Months ended March 31,		Three Months ended March 31,	
	<b>2008</b>	2007	<b>2008</b>	2007
United States	\$ 18,394,922	\$ 17,913,069	\$ 6,500,446	\$ 5,988,210
United Kingdom	10,643,913	8,275,812	3,606,265	2,835,142
Europe	1,854,825	2,536,617	664,350	843,293
Asia	1,454,322	1,394,017	310,971	640,683
Canada and Mexico	513,151	331,296	242,265	149,163
Middle East	230,488	87,413	93,577	31,176
Other	843,695	327,664	385,152	95,627
	\$ 33,935,316	\$ 30,865,888	\$ 11,803,026	\$ 10,583,924

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

Nine months ended March 31, 2008 and 2007

**Net sales:** Net sales increased \$3,069,428 to \$33,935,316 for the nine months ended March 31, 2008 from \$30,865,888 for the nine months ended March 31, 2007. This difference in net sales is principally due to an increase in laboratory and scientific products sales of \$2,297,511 to \$16,080,484 for the nine months ended March 31, 2008 from \$13,782,973 for the nine months ended March 31, 2007. This difference in net sales is also due to an increase in sales of medical device products of \$771,917 to \$17,854,832 for the nine months ended March 31, 2008 from \$17,082,915 for the nine months ended March 31, 2007. The increase in sales of medical device products is due to an increase in sales of therapeutic medical device products of \$237,704 plus an increase of \$534,213 in sales of diagnostic medical device products. The increase in sales of therapeutic medical device products was primarily attributable to the increased sales of the Company's ultrasonic surgical aspirator of \$1,087,376, an increase in sales of the Company's ultrasonic assisted liposuction product of \$971,670, and an increase in sales of the Company's wound debridement product of \$85,157, which were partially offset by a decrease in AutoSonix sales to United States Surgical ("USS"), a subsidiary of Covidien Ltd., of \$561,492, a decrease in Sonablate 500® unit sales of \$1,343,479 and a decrease in sales of other therapeutic medical device products of \$1,526. The increase in sales of diagnostic medical device products was attributable to several new customers, an increase in customer demand for several new products and increased repair capability. The increase in sales of laboratory and scientific products is due to a \$2,025,941 increase in Labcaire Systems, Ltd. ("Labcaire") products sales, an increase of ultrasonic product sales of \$436,923 and an increase of \$382,767 in ductless fume enclosure product sales, partially offset by a \$548,118 decrease in sales of wet scrubber products. The Company has limited the opportunities it pursues for wet scrubber products. The increase in Labcaire sales of \$2,025,941 is due to shipments of its new ISIS endoscope cleaning system and the strengthening of the English Pound versus the U.S. dollar which accounted for approximately \$510,000 of the sales increase. The increase in ductless fume enclosure product sales and ultrasonic product sales is due to an increase in customer demand for several products and is not attributable to a single customer, distributor or any other specific factor.

Export sales from the United States are remitted in U.S. dollars and export sales for Labcaire are remitted in English Pounds. UKHIFU Limited ("UKHIFU") sales are remitted in English Pounds and Misonix, Ltd. sales to date have been remitted in English pounds and Euros. To the extent that the Company's revenues are generated in English Pounds, its operating results were translated for reporting purposes into U.S. dollars using weighted average rates of 2.01 and 1.91 for the nine months ended March 31, 2008 and 2007, respectively. A strengthening of the English Pound and Euro, in relation to the U.S. dollar, will have the effect of increasing recorded revenues and profits, while a weakening of the English Pound and Euro will have the opposite effect. Since the Company's operations in England generally set prices and bids for contracts in English Pounds, a strengthening of the English Pound, while increasing the value of its UK assets, might place the Company at a pricing disadvantage in bidding for work from manufacturers based overseas. The Company collects its receivables predominately in the currency of the country the subsidiary resides in. The Company has not engaged in foreign currency hedging transactions, which include forward exchange agreements. See Item 3. "Quantitative and Qualitative Disclosures About Market Risk."

**Gross profit:** Gross profit increased to 43.4% for the nine months ended March 31, 2008 from 42.7% for the nine months ended March 31, 2007. Gross profit for laboratory and scientific products decreased to 36.8% for the nine months ended March 31, 2008 from 41.3% for the nine months ended March 31, 2007 due to lower margins at Labcaire due to higher costs related to the ISIS units shipped. Gross profit for medical device products increased to 49.3% for the nine months ended March 31, 2008 from 43.8% for the nine months ended March 31, 2007. Gross profit for therapeutic medical device products was positively impacted by a favorable product mix due to increased sales of ultrasonic surgical aspirator products in foreign markets which have higher selling prices, increased sales of the ultrasonic surgical aspirator products in the United States and increased sales of ultrasonic assisted liposuction products which have higher gross profits than the AutoSonix products. The March 2008 period also benefited from a favorable mix of diagnostic medical device products sales.



**Selling expenses:** Selling expenses increased \$55,536 to \$5,580,322 for the nine months ended March 31, 2008 from \$5,524,786 for the nine months ended March 31, 2007. Laboratory and scientific products selling expenses increased \$190,128, predominately due to increased selling and service expenses at Labcaire related to higher sales and the impact of the stronger English Pound of approximately \$68,000. Selling expenses for therapeutic medical device products decreased \$82,477, principally due to decreased clinical trial expenses, consulting fees and exhibition expenses, which were partially offset by increased salaries related to additional staff. Selling expenses related to diagnostic medical device products decreased \$52,116, principally due to decreased costs associated with consignment equipment.

**General and administrative expenses:** General and administrative expenses increased \$274,555 from \$7,321,668 in the nine months ended March 31, 2007 to \$7,596,223 in the nine months ended March 31, 2008. General and administrative expenses increased for the nine months ended March 31, 2008, principally due to increased staffing expense of \$225,428, increased depreciation expense of \$134,986, increased recruiting fees of \$104,109, increased bank fees of \$64,452 and higher consulting fees of \$90,740, which were partially offset by decreased insurance expense of \$170,703, decreased bad debt expense of \$135,500 and lower rent expense of \$26,982. The decrease in bad debt expense was due to receiving a check in April 2008 from a customer to pay a past due balance which was reserved for in prior periods. The higher consulting fees include approximately \$150,000 related to the implementation of Section 404(a) of the Sarbanes-Oxley Act of 2002. The Company entered into revolving credit facility with Wells Fargo Bank on December 29, 2006 and bank fees in the 2008 period are for nine months compared to three months in the 2007 period.

**Research and development expenses:** Research and development expenses decreased \$14,220 from \$2,383,903 for the nine months ended March 31, 2007 to \$2,369,683 for the nine months ended March 31, 2008. Research and development expenses for medical device products increased \$65,630. Therapeutic medical device products research and development expenses increased approximately \$13,000, primarily due to milestone charges of \$210,000 from Focus Surgery, Inc. ("Focus") related to the High Intensity Focused Ultrasound kidney cancer research project, and increased amortization expense of \$23,000, which was partially offset by reduced salary, consulting and other expenses of approximately \$139,000, and approximately \$81,000 of decreased other expenses. Research and development expenses for diagnostic medical device products increased \$52,812 related to developing new products and services which were introduced during the current fiscal year. Laboratory and scientific products research and development expenses decreased \$79,850 due to reduced efforts on the Labcaire ISIS product which was introduced and launched in the fourth quarter of fiscal 2007 and completing the S-4000 digital Sonicator product introduced during the first quarter of fiscal 2008.

**Other income:** Other income for the nine months ended March 31, 2008 was \$137,950 as compared to other income of \$356,342 for the nine months ended March 31, 2007. The decrease of \$218,392 was primarily due to decreased royalty income and license fees of \$132,850 from USS, increased royalty expense of \$167,751 at Acoustic Marketing Research, Inc. d/b/a Sonora Medical Systems ("Sonora") related to licensed probe repair technology and sale of Acoustic Power tanks, increased royalty expense related to the Company's Lysonix product of \$78,188, decreased interest expense of \$4,005 and decreased interest income of \$17,880. The March 2008 period includes \$150,000 in income from the realization of a previously impaired Secured Cumulative Convertible Debenture from Focus. Other expense in the March 31, 2008 period includes a \$65,000 legal expense related to the settlement of a lawsuit by a former employee of the Company and a reduction in legal liability of \$95,000 relating to litigation against Sonora.

**Income taxes:** The effective tax rate was 27.7% for the nine months ended March 31, 2008, as compared to an effective tax rate of 37.7% for the nine months ended March 31, 2007. The effective tax rate for the nine months ended March 31, 2007 was favorably impacted by an additional \$98,000 of Research and Experimentation Credits provided by the enactment of the Tax Relief and Healthcare Act of 2006 (HR6111) which retroactively extended the tax credit for Research and Experimentation expenditures. The March 2008 effective income tax rate differs from the statutory rate due to the impact of permanent differences related to SFAS123R stock-based compensation and

non-deductible entertainment expenses on taxable income. In addition, the \$150,000 income from the realization of a previously written off debt from Focus was not tax effected because the Company did not record an income tax benefit when the debt was originally written off.

Three months ended March 31, 2008 and 2007

**Net sales:** Net sales increased \$1,219,102 to \$11,803,026 for the three months ended March 31, 2008 from \$10,583,924 for the three months ended March 31, 2007. The increase in net sales is due to an increase in laboratory and scientific products sales of \$732,041 to \$5,284,514 for the three months ended March 31, 2008 from \$4,552,473 for the three months ended March 31, 2007. Sales of medical device products increased \$487,061 to \$6,518,512 for the three months ended March 31, 2008 from \$6,031,451 for the three months ended March 31, 2007. The increase in sales of medical device products is due to an increase in sales of therapeutic medical device products of \$230,702 plus an increase of \$256,359 in sales of diagnostic medical device products. The increase in sales of therapeutic medical device products was primarily attributable to an increase in sales of the Company's surgical aspirator product of \$238,945 and an increase in the sales of the ultrasonic assisted liposuction product of \$477,227, partially offset by a decrease in sales of other therapeutic medical device products of \$485,470, primarily related to a decrease in sales of the Company's Sonablate 500® of \$310,000 and a decrease in sales of the Company's lithotripter medical device products of \$163,000. The increase in sales of diagnostic medical device products was not attributable to a single customer, distributor or any other specific factor. The increase in sales of laboratory and scientific products is due to a \$512,045 increase in Labcaire products sales, an increase of \$167,355 in ultrasonic product sales and an increase of \$52,641 ductless fume enclosure product sales. The increase in Labcaire sales of \$512,045 is due to shipments of its new ISIS endoscope cleaning system and the strengthening of the English Pound versus the U.S. dollar which accounted for approximately \$50,000 of the sales increase. The increase in ductless fume enclosure product sales and ultrasonic product sales is due to an increase in customer demand for several products and is not attributable to a single customer, distributor or any other specific factor.

Export sales from the United States are remitted in U.S. dollars and export sales for Labcaire are remitted in English Pounds. UKHIFU sales are remitted in English Pounds and Misonix, Ltd. sales to date have been remitted in Euros. To the extent that the Company's revenues are generated in English Pounds, its operating results were translated for reporting purposes into U.S. dollars using weighted average rates of 1.98 and 1.95 for the three months ended March 31, 2008 and 2007, respectively. A strengthening of the English Pound and Euro, in relation to the U.S. dollar, will have the effect of increasing recorded revenues and profits, while a weakening of the English Pound and Euro will have the opposite effect. Since the Company's operations in England generally set prices and bids for contracts in English Pounds, a strengthening of the English Pound, while increasing the value of its UK assets, might place the Company at a pricing disadvantage in bidding for work from manufacturers based overseas. The Company collects its receivables predominately in the currency of the country the subsidiary resides in. The Company has not engaged in foreign currency hedging transactions, which include forward exchange agreements. See Item 3. "Quantitative and Qualitative Disclosures About Market Risk."

**Gross profit:** Gross profit decreased to 41.4% for the three months ended March 31, 2008 from 42.1% for the three months ended March 31, 2007. Gross profit for medical device products increased to 48.0% for the three months ended March 31, 2008 from 43.4% for the three months ended March 31, 2007. Gross profit for laboratory and scientific products decreased to 33.2% for the three months ended March 31, 2008 from 40.5% for the three months ended March 31, 2007. Gross profit for medical device products was favorably impacted by increased sales of Lysonix and neuroaspirator products and a decrease in AutoSonix products sales. The neuroaspirator and ultrasonic assisted liposuction products have higher gross profits than the AutoSonix products. The increased margin from increased sales of neuroaspirator and ultrasonic assisted liposuction products was partially offset by decreased sales of the Sonablate 500®. The March 2008 quarter also benefited from a favorable mix of high and low margin product deliveries of diagnostic medical device products sales. The decrease in gross profit in the March 2008 quarter for laboratory and scientific products is due to lower margins at Labcaire due to higher costs related to the first ISIS units shipped, and an unfavorable mix of high and low margin product deliveries of fume products.

**Selling expenses:** Selling expenses decreased \$10,293 to \$1,993,137 for the three months ended March 31, 2008 from \$2,003,430 for the three months ended March 31, 2007. Laboratory and scientific products selling expenses increased \$76,106, predominantly due to an increase in commissions and advertising expenses of approximately \$33,000 related to increased sales of the Company's ultrasonic and fume products and increased selling and servicing expenses of approximately \$43,000 at Labcaire related to increased sales. Medical device products selling expenses decreased \$86,399, principally due to a decrease in consulting expenses of \$215,000, exhibition expenses of \$44,000, and clinical expenses of \$32,000, partially offset by increased salary expense of \$114,000 relocation expenses of \$44,000 and advertising expenses of \$22,000 and increased travel expense of \$23,000.

**General and administrative expenses:** General and administrative expenses decreased \$144,090 from \$2,614,237 in the three months ended March 31, 2007 to \$2,470,147 in the three months ended March 31, 2008. General and administrative expenses decreased for the three months ended March 31, 2008 primarily due to reversing a bad debt expense of \$226,000 due to receiving a check in April 2008 from a customer to pay a past due balance reserved for in prior periods and lower insurance costs of \$59,300. These decreases were partially offset by increased consulting fees of \$131,191, related to the implementation of Section 404(a) of the Sarbanes-Oxley Act of 2002, and increased directors' fees of \$10,418.

**Research and development expenses:** Research and development expenses decreased \$11,387 from \$735,518 for the three months ended March 31, 2007 to \$724,131 for the three months ended March 31, 2008. Laboratory and scientific products research and development expenses decreased approximately \$6,978 due to reduced use of subcontractors and components relating to the Labcaire ISIS product which was introduced and launched in the fourth quarter of fiscal 2007. Research and development expenses for medical device products decreased \$4,409. Medical device products research and development expenses for therapeutic medical device products increased approximately \$1,960 primarily due to higher amortization costs of \$36,933, partially offset by lower product development labor charges of \$28,633, as well as lower salary related expenses of \$5,336 and legal expenses of \$2,751. Research and development expenses for diagnostic medical device products decreased approximately \$6,369 due to lower consulting expenses of \$32,629, partially offset by higher labor related expenses of \$25,461.

**Other income:** Other income for the three months ended March 31, 2008 was \$73,170 as compared to other income of \$81,267 for the three months ended March 31, 2007. The decrease was primarily due to increased royalty expense of approximately \$94,000 related to sales of licensed probe repair technology, sales of Acoustic Power tanks and sales of the Company's ultrasonic assisted liposuction products. The March 2008 period included litigation expense of \$65,000 related to the settlement of a former employee lawsuit. In addition, royalty income and license fees from USS were approximately \$7,000 less in the March 2008 period than the March 2007 period. These decreases to other income were partially offset by a \$95,000 reduction in the litigation award against Sonora and a refund of value added taxes paid of approximately \$32,000. Interest expense decreased approximately \$29,000 principally due to decreased borrowing by Labcaire which was partially offset by interest related to the purchase of shares of Sonora from a shareholder.

**Income taxes:** The effective tax rate was 24.2% for the three months ended March 31, 2008, as compared to an effective tax rate of 31.6% for the three months ended March 31, 2007. The March 31, 2008 effective income tax rate differs from the statutory rate due to the impact of permanent differences related to SFAS 123R stock-based compensation and non-deductible entertainment expenses on taxable income.

#### **Critical Accounting Policies:**

The Company prepares its consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. Certain of these accounting policies require the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and the related disclosure of contingent assets and liabilities, revenues and expenses. On an ongoing basis, the Company bases its estimates on

historical data and experience, when available, and on various other assumptions that are believed to be reasonable under the circumstances, the combined results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources.

Actual results may differ from these estimates. There have been no material changes in the Company's critical accounting policies and estimates from those discussed in Item 7 of the Company's Annual Report on Form 10-K for the year ended June 30, 2007.

### **Recent Accounting Standards**

In March 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 156, "Accounting for Servicing of Financial Assets" ("SFAS 156"), an amendment of SFAS 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities". SFAS 156 requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable, and permits an entity to subsequently measure those servicing assets and servicing liabilities at fair value. SFAS 156 is effective for fiscal years beginning after September 15, 2006. The Company adopted SFAS 156 effective July 1, 2007 and the adoption of SFAS 156 did not have a material effect on the Company's consolidated financial position or results of operations.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS 157"). SFAS 157 provides a new single authoritative definition of fair value and provides enhanced guidance for measuring the fair value of assets and liabilities and requires additional disclosures related to the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. SFAS 157 is effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007. The Company is currently evaluating the impact that the adoption of SFAS 157 may have on the Company's consolidated financial position and results of operations.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS 159"), which provides companies with an option to report selected financial assets and liabilities at fair value in an attempt to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. This Statement is effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007. The Company is currently evaluating the impact that the adoption of SFAS 159 may have on the Company's consolidated financial position and results of operations.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements — an amendment of ARB No. 51" ("SFAS 160"). SFAS 160 amends ARB No. 51 to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a noncontrolling interest in a subsidiary, which is sometimes referred to as a minority interest, is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. Among other requirements, this Statement requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and noncontrolling interest. It also requires disclosure, on the face of the consolidated statement of operations, of the amounts of consolidated net income (loss) attributable to the parent and to the noncontrolling interest. SFAS 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Earlier adoption is prohibited. The Company is currently evaluating the impact that the adoption of SFAS 160 may have on the Company's consolidated financial position and results of operations.

### **Forward Looking Statements**

This Report contains certain 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 (the "Exchange Act"), which are intended to be covered by the safe harbors created thereby. Although the Company believes that the assumptions underlying the forward looking statements contained herein are reasonable, any of the assumptions could be inaccurate, and therefore, there can be no assurance that the forward looking statements contained in this Report will prove to be accurate. Factors that could cause actual results to differ from the results specifically discussed in the

forward looking statements include, but are not limited to, the absence of anticipated contracts, higher than historical costs incurred in performance of contracts or in conducting other activities, product mix in sales, results of joint ventures and investments in related entities, future economic, competitive and market conditions, and the outcome of legal proceedings as well as management business decisions.

## Liquidity and Capital Resources

Working capital at March 31, 2008 and June 30, 2007 was \$9,852,096 and \$11,165,090, respectively. For the nine months ended March 31, 2008, cash used in operations totaled \$186,997. A major source of cash from operations was the receipt of \$629,000 held by the Bank of America (“BOA”) to secure a standby letter of credit after the Company terminated its credit agreement with BOA. This amount was included in prepaid expenses and other current assets at June 30, 2007. The major use of cash from operations was related to increased accounts receivable and inventories of approximately \$624,000 and \$670,000, respectively, during the nine months ended March 31, 2008. The increases were attributable to the Company’s Labcaire subsidiary. For the nine months ended March 31, 2008, cash used in investing activities totaled \$1,245,392, primarily consisting of the purchase of property, plant and equipment during the regular course of business and the purchase of shares of the common stock of Sonora increasing the Company’s ownership to 95%. For the nine months ended March 31, 2008, cash provided by financing activities was \$138,048, primarily consisting of proceeds from short-term borrowings of \$18,519,000, partially offset by principal payments on short-term borrowings and capital lease obligations of approximately \$18,033,000 and \$348,000, respectively.

## Revolving Credit Facilities

On December 29, 2006, the Company and its subsidiaries, Sonora and Hearing Innovations, Inc. (“Hearing Innovations”) (the Company, Sonora and Hearing Innovations collectively referred to as the “Borrowers”) and Wells Fargo Bank entered into a (i) Credit and Security Agreement and a (ii) Credit and Security Agreement Export-Import Subfacility (collectively referred to as the “Credit Agreements”). The aggregate credit limit under the Credit Agreements is \$8,000,000 consisting of a revolving facility in the amount of up to \$8,000,000. Up to \$1,000,000 of the revolving facility is available under the Export-Import Agreement as a subfacility for Export-Import working capital financing. All credit facilities under the Credit Agreements mature on December 29, 2009. Payment of amounts outstanding under the Credit Agreements may be accelerated upon the occurrence of an Event of Default (as defined in the Credit Agreements). All loans and advances under the Credit Agreements are secured by a first priority security interest in all of the Borrowers’ accounts receivable, letter-of-credit rights, and all other business assets. The Borrowers have the right to terminate or reduce the credit facility prior to December 29, 2009 by paying a fee based on the aggregate credit limit (or reduction, as the case may be) as follows: (i) during year one of the Credit Agreements, 3%; (ii) during year two of the Credit Agreements, 2%; and (iii) during year three of the Credit Agreements, 1%.

The Credit Agreements, as amended, contain financial covenants requiring that the Borrowers (i) on a consolidated basis not have a Net Loss (as defined in the Credit Agreements) of more than (a) \$40,000 for the fiscal quarter ended March 31, 2008 and (b) \$175,000 for the fiscal quarter ending June 30, 2008 and (ii) not incur or contract to incur Capital Expenditures (as defined in the Credit Agreements) of more than \$1,000,000 in the aggregate in any fiscal year or more than \$1,000,000 in any one transaction. At March 31, 2008, the Borrowers were in compliance with all financial covenants under the Credit Agreements.

The available amount under the Credit Agreements is the lesser of \$8,000,000 or the amount calculated under the Borrowing Base (as defined in the Credit Agreements). The Borrowers must maintain a minimum outstanding amount of \$1,250,000 under the Credit Agreements at all times and pay a fee equal to the interest rate set forth on any such shortfall. Interest on amounts borrowed under the Credit Agreements is payable at Wells Fargo’s prime rate of interest plus 1% per annum floating, payable monthly in arrears. The default rate of interest is 3% higher than the rate otherwise payable. A fee of ½ % per annum on the Unused Amount (as defined in the Credit Agreements) is payable monthly in arrears. At March 31, 2008, the balance outstanding under the Credit Agreement was \$2,830,656 and an additional \$833,496 was available under this line of credit.

Labcaire has a debt purchase agreement with Lloyds TSB Commercial Finance. The amount of this facility bears interest at the bank's base rate (5.5% at March 31, 2008) plus 2% and fluctuates based upon the outstanding United Kingdom and European receivables. The agreement expires September 28, 2008. The agreement covers all United Kingdom and European sales. At March 31, 2008, the balance outstanding under this credit facility was \$1,619,949 and Labcaire was in compliance with all financial covenants.

### **Off-Balance Sheet Arrangements**

The Company has no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on the Company's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to the Company.

### **Other**

In the opinion of management, inflation has not had a material effect on the operations of the Company.

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

#### *Market Risk:*

The principal market risks (i.e., the risk of loss arising from adverse changes in market rates and prices) to which the Company is exposed are interest rates on short-term investments and foreign exchange rates, which generate translation gains and losses due to the English Pound to U.S. Dollar conversion of Labcaire, Misonix, Ltd. and UKHIFU.

#### *Foreign Exchange Rates:*

Approximately 33.1% and 31.9% of the Company's revenues in the nine-month and three-month period ended March 31, 2008, respectively, were received in English Pounds currency. To the extent that the Company's revenues are generated in English Pounds, its operating results were translated for reporting purposes into U.S. Dollars using rates of 2.01 and 1.91 for the nine months ended March 31, 2008 and 2007, respectively, and 1.98 and 1.95 for the three months ended March 31, 2008 and 2007, respectively. A strengthening of the English Pound, in relation to the U.S. Dollar, will have the effect of increasing reported revenues and profits, while a weakening will have the opposite effect. Since the Company's operations in England generally set prices and bids for contracts in English Pounds, a strengthening of the English Pound, while increasing the value of its UK assets, might place the Company at a pricing disadvantage in bidding for work from manufacturers based overseas. The Company collects its receivables predominately in the currency of the country the subsidiary resides in. Misonix, Ltd. invoices certain customers in Euros and as a result there is an exchange rate exposure between the English Pound and the Euro. The Company has not engaged in foreign currency hedging transactions, which include forward exchange agreements.

#### *Interest Rate Risk:*

The Company earns interest on cash balances and pays interest on debt incurred. In light of the Company's existing cash, results of operations, terms of its debt obligations and projected borrowing requirements, the Company does not believe a 10% change in interest rates would have a significant impact on its consolidated financial position.

**Item 4. Controls and Procedures.**

Our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) are designed to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission. The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of March 31, 2008 and, based on their evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective.

There has been no change in the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) that occurred during the three months ended March 31, 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 1A. Risk Factors

Risks and uncertainties that, if they were to occur, could materially adversely affect our business or that could cause our actual results to differ materially from the results contemplated by the forward-looking statements contained in this Report and other public statements were set forth in the “Item 1A. Risk Factors” section of our Annual Report on Form 10-K for the year ended June 30, 2007. There have been no material changes from the risk factors disclosed in that Form 10-K.

Item 6. Exhibits

Exhibit 31.1- Rule 13a-14(a)/15d-14(a) Certification

Exhibit 31.2- Rule 13a-14(a)/15d-14(a) Certification

Exhibit 32.1- Section 1350 Certification of Chief Executive Officer

Exhibit 32.2- Section 1350 Certification of Chief Financial Officer

**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.

Date: May 12, 2008

MISONIX, INC.  
(Registrant)

By: /s/ Michael A. McManus, Jr.  
Michael A. McManus, Jr.  
President and Chief Executive Officer

By: /s/ Richard Zaremba  
Richard Zaremba  
Senior Vice President, Chief Financial Officer,  
Treasurer and Secretary