LAMSON & SESSIONS CO
Form 10-K
February 24, 2006

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**UNITED STATES**
**SECURITIES AND EXCHANGE COMMISSION**
**WASHINGTON, D.C. 20549**
**FORM 10-K**

**x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)**
**OF THE SECURITIES EXCHANGE ACT OF 1934**
**For the fiscal year ended December 31, 2005**
**OR**
**o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)**
**OF THE SECURITIES EXCHANGE ACT OF 1934**
**For the transition period from __________ to __________**
**COMMISSION FILE NUMBER 1-313**
**THE LAMSON & SESSIONS CO.**
**(Exact name of Registrant as specified in its charter)**

| | |
|---|---|
| **Ohio** | **34-0349210** |
| **(State of Incorporation)** | **(I.R.S. Employer Identification No.)** |

**25701 Science Park Drive, Cleveland, Ohio 44122**

**(Address of Principal Executive Offices, Zip Code)**
**216-464-3400**

**(Registrant s telephone number, including area code)**
**SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:**

| **Title of each class** | **Name of each exchange on which registered** |
|---|---|
| **Common Shares, without par value** | **New York Stock Exchange**<br>**Pacific Stock Exchange** |

**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 x

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

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. o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. Large accelerated filer o Accelerated filer x Non-accelerated filer o

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

As of July 1, 2005, (the last trading day of the Company s fiscal 2005 second quarter) the aggregate market value of the registrant s common stock held by non-affiliates of the registrant was $169,741,672 based on the closing sale price of $11.95 as reported on the New York Stock Exchange.

As of February 3, 2006 the registrant had outstanding 15,317,723 common shares.

**DOCUMENTS INCORPORATED BY REFERENCE**

| Document | Parts Into Which Incorporated |
|---|---|
| Proxy Statement for the Annual Meeting of Shareholders to be held on April 28, 2006 | Part III |

**THE LAMSON & SESSIONS CO.**
**INDEX TO**
**ANNUAL REPORT ON FORM 10-K**
**For The Fiscal Year Ended December 31, 2005**

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# PART I

## Item 1. BUSINESS

The Lamson & Sessions Co., an Ohio corporation, (the Company or Lamson & Sessions ), founded in 1866, is a diversified manufacturer and distributor of a broad line of thermoplastic electrical, consumer, telecommunications and engineered sewer products for major domestic markets. The markets for thermoplastic electrical conduit, related fittings and accessories, wiring devices and sewer pipe include: the construction, utility and telecommunications industries, municipalities, other government agencies, and contractors; and do-it-yourself home remodelers.

**Principal Products and Markets**

The Company is engaged in the manufacture and distribution of a broad line of thermoplastic electrical, telecommunications and engineered sewer products. In addition, the Company distributes a wide variety of consumer electrical wiring devices, home security devices, wireless electrical and other wireless products.

All of the Company s thermoplastic electrical products compete with and serve as substitutes for similar metallic products. The Company s thermoplastic electrical products offer several advantages over these other products. Specifically, non-metallic electrical and telecommunications conduit and related fittings and accessories are generally less expensive, lighter and easier to install than metallic products. They do not rust, corrode or conduct electricity. Thermoplastics, either polyvinyl chloride (PVC) or high density polyethylene (HDPE), are the materials of choice to protect fiber optic cable.

Three business segments serve specific markets, each of which has unique product and marketing requirements. These markets are:

Carlon Industrial, Residential, Commercial, Telecommunications and Utility Construction: The major customers served are electrical contractors and distributors, original equipment manufacturers, electric power utilities, cable television (CATV), and telephone and telecommunications companies. The principal products sold by this segment include electrical and telecommunications raceway systems and a broad line of enclosures, electrical outlet boxes and fittings. Examples of the applications for the products included in this segment are multi-cell duct systems and HDPE conduit designed to protect underground fiber optic cables, allowing future cabling expansion and flexible conduit used inside buildings to protect communications cable.

Lamson Home Products Consumer: The major customers served are home centers and mass merchandisers for the do-it-yourself (DIY) home improvement market. The products included in this segment are electrical outlet boxes, liquidtight conduit, electrical fittings, door chimes and lighting controls.

PVC Pipe: This business segment primarily supplies electrical, power and communications conduit to the electrical distribution, telecommunications, consumer, power utility and sewer markets. The electrical and telecommunications conduit is made from PVC resin based compound and is used to protect wire or fiber optic cables supporting the infrastructure of power or telecommunications systems.

A breakdown of net sales as a percent of total net sales by major business segments for 2005, 2004 and 2003 is as follows:

| | 2005 | | 2004 | | 2003 | |
|---|---|---|---|---|---|---|
| *(Dollars in thousands)* | | | | | | |
| Carlon | $223,500 | 45% | $183,800 | 48% | $154,090 | 45% |
| Lamson Home Products | 105,039 | 21% | 86,510 | 22% | 81,514 | 24% |
| PVC Pipe | 165,656 | 34% | 116,829 | 30% | 104,883 | 31% |
| | $494,195 | 100% | $387,139 | 100% | $340,487 | 100% |

See discussion of business segments results in Note L to the consolidated financial statements.

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**Competition**

Each of the three segments in which the Company presently operates is highly competitive based on service, price and quality. Most of the competitors are either national or smaller regional manufacturers who compete with limited product offerings. Unlike a majority of the Company s competitors, the Company manufactures a broad line of thermoplastic products, complementary fittings and accessories. The Company believes that with its breadth of product line and investment in information technology infrastructure, it will continue to compete favorably. However, certain of the Company s competitors have greater financial resources than the Company, which occasionally can adversely affect the Company through price competition strategies in selected products and markets.

**Distribution**

The Company distributes its products through a nationwide network of more than 106 manufacturers representatives and a direct field sales force of approximately 27.

**Raw Materials**

The Company is a large purchaser of pipe grade PVC and HDPE resins. The Company has entered into a long-term supply contract for PVC resin. PVC resin producers are operating at near capacity with no substantial net capacity additions planned until late 2007. Sustained demand and high energy costs are expected to support historically high resin costs for the foreseeable future. The Company has generally been able to pass through these raw material cost increases, depending on the end-market strength. HDPE is purchased by the Company from various sources and has historically been readily available.

**Patents and Trademarks**

The Company owns various patents, patent applications, licenses, trademarks and trademark applications relating to its products and processes. While the Company considers that, in the aggregate, its patents, licenses and trademarks are of importance in the operation of its business, it does not consider that any individual patent, license or trademark, or any technically-related group, is of such importance that termination would materially affect its business.

**Seasonal Factors**

Two of the Company s three business segments experience moderate seasonality caused principally by a decrease in construction activity during the winter months. They are subject also to the economic cycles affecting the residential, commercial, industrial and telecommunications construction markets. The Company s consumer products business segment is affected by existing home sales, consumer spending and consumer confidence.

**Major Customers**

Sales to Affiliated Distributors, a cooperative buying group reported within the Carlon and PVC Pipe segments not otherwise affiliated with the Company, totaled approximately 12.6% of consolidated net sales in 2005, 11.0% of consolidated net sales in 2004 and 14.0% of consolidated net sales in 2003. Sales to Home Depot, a customer of the Lamson Home Products segment not otherwise affiliated with the Company, totaled approximately 10.2% of consolidated net sales in 2003.

**Backlog**

In the Company s three business segments, the order-to-delivery cycle ranges from several days to a few weeks. Therefore, the measurement of backlog is not a significant factor in the evaluation of the Company s prospects.

**Research and Development**

The Company is engaged in product development programs, which concentrate on identifying, creating and introducing innovative applications for thermoplastic and wireless electrical products. The Company maintains a material testing lab and development center in its Cleveland, Ohio headquarters to facilitate this effort and to improve manufacturing processes. The Company s research and development expenditures totaled $1.9 million in 2005 and 2003 and $2.2 million in 2004.

**Environmental Regulations**

The Company believes that its current operations and its use of property, plant and equipment conform in all material respects to applicable environmental laws and regulations presently in effect. The Company has facilities at numerous geographic locations, which are subject to a range of federal, state and local environmental laws and regulations. Compliance with these laws has, and will, require expenditures on a continuing basis. See also Note F to the Consolidated Financial Statements.

**Associates**

At December 31, 2005, the Company had 1,263 associates, 1,096 of whom were employed at the Company s manufacturing facilities and distribution centers. The remainder of associates were primarily employed at the Company s corporate headquarters and field sales offices.

**Foreign Operations**

The net sales, operating earnings and assets employed outside the United States are not significant. Export sales were approximately 3.5% of consolidated net sales in 2005, 4.6% of consolidated net sales in 2004, and 3.0% of consolidated net sales in 2003, respectively, and were made principally to customers in Canada and the Caribbean.

The Company files annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, amendments to those reports and other information with the Securities and Exchange Commission ( SEC ). The public can obtain copies of these materials by visiting the SEC s Public Reference Room at 450 Fifth Street, NW, Washington, D.C. 20549, by calling the SEC at 1-800-SEC-0330, or by accessing the SEC s Web site at http://www.sec.gov. In addition, as soon as reasonably practicable, after such materials are filed with or furnished to the SEC, the Company makes copies available to the public, free of charge, on or through its Web site at http://www.lamson-sessions.com.

**Item 1A. RISK FACTORS**

From time to time, information we provide, statements by our employees or information included in our filings with the Securities and Exchange Commission may contain forward-looking statements that are not historical facts. Those statements are forward-looking within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements, and our future performance, operating results, financial position and liquidity, are subject to a variety of factors that could materially affect results, including those described below. Any forward-looking statements made in this report or otherwise speak only as of the date of such statement, and we undertake no obligation to update such statements. Comparisons of results for current and any prior periods are not intended to express any future trends or indications of future performance, unless expressed as such, and should only be viewed as historical data.

You should carefully consider each of the risks and uncertainties we describe below and all other information in this report. The risks and uncertainties we describe below are not the only ones we face. Additional risks and uncertainties of which we are currently unaware or that we currently believe to be immaterial may also adversely affect our business.

**Profitability of the PVC Pipe segment is dependent on the spread between selling price and cost per pound.**

The PVC Pipe segment s profitability is dependent on the comparative spread between the selling price of PVC conduit and the raw material cost of PVC resin. Both of these prices and the profitability of the PVC Pipe segment have been historically volatile. The selling price of PVC conduit is adjusted often in response to conduit demand and inventory levels. PVC resin costs, which are adjusted monthly, are driven by vinyl chloride monomer (VCM) feedstock and energy (natural gas) costs along with demand and inventory levels. In the event of a significant increase in PVC resin capacity or a significant decrease in the demand for PVC resin, resulting in a period where there is an excess supply of PVC resin, our margins and profitability could be negatively impacted.

While we generally attempt to pass along increased raw materials prices to our customers in the form of price increases, there may be a time delay between the increased raw materials prices and our ability to increase the price of our products, or we may be unable to increase the prices of our products due to pricing pressure or other factors. In either case, there may be a material adverse impact on our profitability.

**We are dependent on limited suppliers, and our ability to produce products or otherwise meet customer needs could be adversely impacted if these suppliers were unable to meet our requirements in a timely manner.**

Over the past several years, approximately 90-95% of the PVC pipe grade resin that we use has been supplied to us by two resin manufacturers. As of the beginning of 2006, we have entered into a long-term agreement with one of these suppliers to provide substantially all of our PVC resin requirements. In addition, this supplier provides us with the majority of our PVC molding compound.

Approximately 12-15% of our molded products, sold through the Carlon or Lamson Home Products business segments, are made by domestic outsource molders. There are a limited number of vendors capable of molding these PVC products, and our molding facilities are run nearly at capacity.

Any significant accidents, labor disputes, fires, severe weather, floods or other difficulties encountered by our principal suppliers could result in production delays or the inability to fulfill orders on a timely basis. For example, in September and October of 2005, all five PVC resin suppliers declared force majeure (meaning acts of nature that allow the suppliers to avoid contractual obligations) due to the effects of Hurricanes Katrina and Rita and due to an accident at one resin manufacturing facility. This resulted in constrained resin supply and significantly higher resin and transit costs through the last four months of 2005. We maintain a relatively small inventory of raw materials and component parts, and any interruption or delay in the supply of our raw materials or products from our current principal suppliers or our inability to obtain our products from alternative sources at acceptable quality and price levels and within a reasonable amount of time could substantially impair our ability to meet scheduled product deliveries to our customers and could cause our customers to cancel orders, both of which could have a material adverse effect on our business and results of operations. During the last four months of 2005, the continued demand for conduit products, coupled with material shortages and cost increases resulting from the declaration of force majeure by our suppliers after the hurricanes, drove the selling price of our PVC conduit products up dramatically and led to higher than usual backlog and delivery lead times.

**Because we experience seasonal fluctuations in our sales, our quarterly results will fluctuate, and our annual performance will be affected by those fluctuations.**

Although demand and selling prices increased in the fourth quarter of 2005 primarily due to the effects of Hurricanes Katrina and Rita on the supply of PVC resin, we have generally had weaker demand for our products in the first and fourth quarters due to seasonal factors affecting our customers in the construction industry. If winter weather conditions occur early in the fourth quarter, we are not able to recover the loss of revenues in that quarter. If our revenue during any quarter were to fall below the expectations of investors or securities analysts, our share price could decline, perhaps significantly.

**The demand for our products is dependent on the strength of construction and telecommunications industries, which have been cyclical industries.**

A substantial number of our customers are in the construction and telecommunications industries. Each of those industries is cyclical in nature, influenced by a combination of factors, including, among other things, periods of economic growth and recession, strength and weakness of the United States dollar, prevailing interest rates and the rate of construction of telecommunications infrastructure. In addition, adverse weather conditions may affect construction activity, which is generally strongest in the late spring, summer and fall. These factors, in turn, affect our sales.

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Most of our products are sold into the various construction market segments. Commercial and industrial construction is the largest market (35-40% of net sales) serviced by us, and it has only recently begun to expand. Residential, including both new construction and home improvement activity, is the next largest end market (25-30% of net sales) and has seen robust growth in the last couple of years but is starting to level off and decline slightly.

The telecommunications infrastructure industry is another major market in which we participate (20-25% of net sales). Spending by our telecom customers plummeted in 2001, negatively impacting net sales and operating results for a few years.

Our business is dependent on continued capital spending by the construction and telecommunications industries, and an increase in interest rates could affect their capital spending and our revenue.

**Loss of a significant facility or operating problems in our business may materially adversely affect our financial condition and results of operations.**

The occurrence of material operating problems at our facilities may have a material adverse effect on our results of operations, both during and after the period of operational difficulties. While there is some overlap among our facilities in the products which each facility can produce, each facility produces a limited array of products, and our ability to supply certain products to our customers could be adversely affected if a facility were shut down as a result of a natural disaster or other cause. For example, if our Clinton, Iowa facility were shut down, our ability to produce outlet boxes would be substantially reduced.

In addition, many of our products are subject to certification under industry standards promulgated by organizations such as Underwriters Laboratory, National Electrical Manufacturers Association, the American Society for Testing and Materials and Canadian Standards Association, and failure to produce products that consistently meet those standards would have an adverse impact on sales and scrap rates.

Approximately 43% of our employees were covered by five collective bargaining agreements, the earliest of which expires in May 2007. Although we believe our relations with the unions are good, we cannot assure you that these agreements will be renewed on similar terms or renegotiated on acceptable terms. Any prolonged work stoppages in one or more of our facilities could materially adversely affect our results of operations.

**We are dependent on key customers.**

We rely on several key customers. For the year ended December 31, 2005, our top ten customers accounted for approximately 63% of our net sales. Many of our customers place orders for products on an as-needed basis and operate in cyclical industries, and as a result, their order levels have varied from period to period in the past and may vary significantly in the future. Due to competitive issues, we have lost business with key customers in the past and may again in the future. Customer orders are dependent upon their markets and may be subject to delays or cancellations. As a result of dependence on our key customers, we could experience a material adverse effect on our business and results of operations if any of the following were to occur:

- the loss of a key customer, in whole or in part;

- the insolvency or bankruptcy of any key customer;

- a declining market in which customers reduce order or demand reduced prices; or

- a strike or work stoppage at a key customer facility, which could affect both their suppliers and customers.

There is also customer concentration within our segments. For example, over 90% of Lamson Home Products net sales are to its top ten customers in the Do-it-Yourself home improvement market. These customers businesses are dependent on servicing them at high order fill rate levels. In addition, we support them with a significant amount of marketing support through customized packaging and point of purchase materials. We may not be able to increase or sustain our amount of retail shelf space or promotional resources or offer retailers price discounts, and as a result, our sales and results of operations may be adversely affected. Additionally, economic downturns or recessions could force retailers to negotiate better terms of sale, which we may be unable to accept. Retailers may give higher priority to products other than ours, thus reducing their efforts to sell our products.

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**We may encounter difficulties in expanding our business through strategic alliances and targeted acquisitions.** As part of our business strategy, we have pursued, and may continue to pursue, strategic alliances and targeted acquisition opportunities that we believe would complement our business. Any strategic alliances or targeted acquisitions will be accompanied by the risks commonly encountered in strategic alliances and acquisitions of businesses. We may not be successful in overcoming these risks or any other problems encountered in connection with any of our strategic alliances or acquisitions. For example, depending upon the nature, size and timing of future acquisitions, we may be required to obtain the consent of our senior lenders or raise additional financing, which may not be available to us upon acceptable terms. Further, we may not be able to successfully integrate any acquired business with our existing businesses or recognize any expected advantages from any completed acquisition. We cannot assure you that we will be successful in entering into any strategic alliance or consummating any acquisition.

**Item 1B. UNRESOLVED STAFF COMMENTS**

Not applicable.

**Item 2. PROPERTIES**

The Company owns (O) or leases (L) manufacturing and distribution facilities, which are suitable and adequate for the production and marketing of its products. The Company owns a building which houses its executive and administrative offices (located in Cleveland, Ohio), which occupy 68,000 square feet in a suburban office complex. The following is a list of the Company s manufacturing and distribution center locations:

| **Manufacturing Facilities** | **Approximate Square Feet** |
|---|---|
| Woodland, California(O) | 71,000 |
| High Springs, Florida(O) | 110,000 |
| Tennille, Georgia(O) | 41,000 |
| Clinton, Iowa(O) | 159,000 |
| Mountain Grove, Missouri(O) | 36,000 |
| Bowling Green, Ohio(O) | 67,000 |
| Oklahoma City, Oklahoma(O) | 172,000 |
| Nazareth, Pennsylvania(O) | 61,000 |
| Erie, Pennsylvania(L) | 56,000 |
| Cranesville, Pennsylvania(L) | 10,000 |
| **Distribution Centers** | |
| Columbia, South Carolina(L) | 350,000 |
| Woodland, California(L) | 127,000 |
| Fort Myers, Florida(O) | 4,000 |

The above manufacturing facilities were operated at approximately 76.0% of their productive capacity during 2005.

**Item 3. LEGAL PROCEEDINGS**

The Company is party to various claims and matters of litigation incidental to the normal course of its business. Management believes that the final resolution of these matters will not have a material adverse effect on the Company s financial position, cash flows or results of operations.

**Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

None.

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**Executive Officers of the Registrant**

**JOHN B. SCHULZE**
Chairman, President and Chief Executive Officer
Executive Officer since January 1988. Age 68.

**JAMES J. ABEL**
Executive Vice President, Secretary, Treasurer and Chief Financial Officer
Executive Officer since December 1990. Age 59.

**NORMAN E. AMOS**
Vice President
Executive Officer since February 21, 2001. Vice President Supply Chain Management since August 1, 2000. Manager, Transportation and Logistics with Xerox Corporation July 1995 July 2000. Age 60.

**ALBERT J. CATANI, II**
Vice President
Executive Officer since February 27, 1997. Vice President, Manufacturing since August 1995. Age 58.

**EILEEN E. CLANCY**
Vice President
Executive Officer since January 2, 2002. Vice President, Human Resources since January 2, 2002. Director of Human Resources Development, December 1995 December 2001. Age 55.

**DONALD A. GUTIERREZ**
Senior Vice President
Executive Officer since February 26, 1998. Senior Vice President since February 21, 2001. Vice President, Carlon since March 1998. Age 48.

**CHARLES W. HENNON**
Vice President
Executive Officer since February 25, 1999. Vice President and Chief Information Officer since April 1998. Manager, Business Support Services with Ferro Corporation, 1993 April 1998. Age 60.

**LORI L. SPENCER**
Vice President
Executive Officer since February 27, 1997. Vice President and Controller since August 1997. Age 46.

**NORMAN P. SUTTERER**
Senior Vice President
Executive Officer since February 29, 1996. Senior Vice President since February 18, 2003. Vice President, Lamson Home Products since March 1998. Age 56.

## PART II

### Item 5. MARKET FOR REGISTRANT S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The Company s Common Stock is traded on the New York Stock Exchange and the Pacific Stock Exchange. High and low close prices for the Common Stock are included in Note N to the Consolidated Financial Statements. No dividends were paid in 2005, 2004 or 2003. The approximate number of shareholders of record of the Company s Common Stock at December 31, 2005 was 1,142.

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**Item 6. SELECTED FINANCIAL DATA**
**FIVE-YEAR CONSOLIDATED FINANCIAL SUMMARY**

| *(Dollars in thousands except per share data, associates and percentages)* | Fiscal Years Ended 2005 | 2004 | 2003 | 2002 | 2001 |
|---|---|---|---|---|---|
| **Operations:** | | | | | |
| **Net sales** | $494,195 | $387,139 | $340,487 | $312,429 | $350,914 |
| **Operating Income(1)** | 50,607 | 17,669 | 14,658 | 18,509 | 6,183 |
| **Income (Loss) From Continuing Operations Before Income Taxes and Cumulative Effect of Change in Accounting Principle** | 43,699 | 9,744 | 6,131 | 8,926 | (5,443) |
| **Income (Loss) From Continuing Operations Before Cumulative Effect of Change in Accounting Principle** | 27,395 | 6,148 | 3,740 | 5,026 | (3,843) |
| Income (loss) from discontinued operations, net of income taxes | | 401 | (2,738) | | |
| Cumulative effect of change in accounting principle, net of income taxes | | | | (46,250) | |
| **Net Income (Loss)** | $ 27,395 | $ 6,549 | $ 1,002 | $ (41,224) | $ (3,843) |
| **Basic Earnings (Loss) Per Common Share:** | | | | | |
| Earnings (Loss) from continuing operations before change in accounting principle | $ 1.91 | $ 0.45 | $ 0.27 | $ 0.36 | $ (0.28) |
| Earnings (Loss) from discontinued operations, net of tax | $ | $ 0.03 | $ (0.20) | $ | $ |
| Cumulative effect of change in accounting principle, net of tax | $ | $ | $ | $ (3.36) | $ |
| **Net Earnings (Loss)** | $ 1.91 | $ 0.47* | $ 0.07 | $ (2.99)* | $ (0.28) |
| **Diluted Earnings (Loss) Per Common Share:** | | | | | |
| Earnings (Loss) from continuing operations before change in accounting principle | $ 1.82 | $ 0.43 | $ 0.27 | $ 0.36 | $ (0.28) |
| Earnings (Loss) from discontinued operations, net of tax | $ | $ 0.03 | $ (0.20) | $ | $ |
| | $ | $ | $ | $ (3.36) | $ |

| | | | | | |
|---|---|---|---|---|---|
| Cumulative effect of change in accounting principle, net of tax | | | | | |
| **Net Earnings (Loss)** | $ 1.82 | $ 0.46 | $ 0.07 | $ (2.99)* | $ (0.28) |
| **Year-End Financial Position:** | | | | | |
| Current Assets | $129,197 | $100,745 | $ 81,377 | $ 84,764 | $ 94,085 |
| Total Assets | 240,007 | 218,502 | 208,313 | 213,705 | 273,821 |
| Current Liabilities(2) | 71,978 | 131,112 | 57,026 | 64,112 | 62,890 |
| Long-Term Debt(2) | 55,026 | 11,876 | 82,990 | 84,350 | 104,266 |
| Other Long-Term Liabilities | 22,704 | 30,138 | 29,782 | 29,067 | 25,441 |
| Shareholders Equity | 90,299 | 45,376 | 38,515 | 36,176 | 81,224 |
| **Statistical Information:** | | | | | |
| Number of associates | 1,263 | 1,189 | 1,122 | 1,116 | 1,115 |
| Market price per share | $ 25.02 | $ 9.10 | $ 5.50 | $ 3.40 | $ 5.24 |
| Market capitalization | $377,295 | $126,371 | $ 75,829 | $ 46,844 | $ 72,195 |
| Gross profit as a % of net sales | 20.6% | 16.4% | 15.9% | 19.2% | 17.0% |
| Total operating expenses as a % of net sales | 10.4% | 11.4% | 11.6% | 13.3% | 14.6% |
| Operating income as a % of net sales | 10.2% | 4.5% | 4.3% | 5.9% | 1.8% |

(1) In 2002, the Company adopted SFAS No. 142, *Goodwill and Other Intangible Assets,* which eliminated the amortization of goodwill. Operating expenses in 2001 include $4,605 in goodwill amortization.

(2) In 2004, the Company s Credit Facility of $75,000 was classified as current as it had a maturity date of August 2005. (See Note C to the Consolidated Financial Statements.)

* Earnings per share do not sum to total, due to rounding.

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## Item 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

The following discussion and analysis provides information which management believes is relevant to an assessment and understanding of the Company s consolidated results of operations and financial condition. The discussion should be read in conjunction with the Consolidated Financial Statements and footnotes.

### Executive Overview

In 2005 the Company experienced solid growth in both telecom and electrical product sales, leading to a record annual net sales level of $494.2 million, almost 28% higher than 2004. The rate of growth slowed slightly to about 20% for shipments of products to support the telecommunication customers construction of Fiber-to-the-Premise infrastructure. However, electrical product demand accelerated to a double digit growth rate as residential construction stayed strong and commercial and industrial construction began to have slight growth of around 2-3%.

The Company was significantly impacted by the rising costs of PVC and HDPE resins and compounds. Costs had been steadily increasing throughout the year, much like 2004, but then jumped dramatically by a third in the fourth quarter after the effect of two major Gulf Coast hurricanes were felt. Prices for the Company s PVC conduit increased by about 80% in the fourth quarter over third quarter 2005 reflecting the higher costs, increased demand and constrained supply.

Transportation continued to be an issue in 2005 which was exacerbated by the hurricane recovery efforts. The Company incurred approximately 21% higher freight rates on average in 2005 due to fuel cost increases and truck availability.

In the second half of 2005 the Company encountered process control, equipment and training issues in its PVC Pipe extrusion plants as the Company attempted to get maximum output from aging equipment. These issues led to higher than normal scrap rates and inefficiencies impacting the results unfavorably by approximately $2.3 million. The Company took corrective actions to address these issues including investing in new extrusion equipment, adding additional quality control professionals and developing more formal training programs for hourly associates. Noticeable improvement in operations is anticipated in the second half of 2006 from these actions.

At the end of the second quarter of 2005, the Company renewed its Credit Facility for an additional five years (see Note C). This lowered the Company s effective interest rate and provided more flexibility to pursue growth opportunities.

In summary, net income increased to a record $27.4 million in 2005 compared with $6.5 million in 2004 resulting in $1.82 diluted earnings per share in 2005 versus $0.46 diluted earnings per share in 2004.

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### Results of Continuing Operations

The following table sets forth for the periods indicated certain items from the Consolidated Statements of Operations as a percentage of net sales for years ended:

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | **2005** | | | **2004** | | | **2003** | |
| *(Dollars in thousands)* | | | | | | | | | |
| Net Sales | | $494,195 | 100.0% | $387,139 | | 100.0% | | $340,487 | 100.0% |
| Cost of products sold | | 392,580 | 79.4% | 323,455 | | 83.6% | | 286,300 | |
| Net income | $ 90,183 | 114,697 | $ 0.79 | $ 30,454 | 114,892 | | $ 0.27 | | |
| Effect of dilutive securities | | | | | | | | | |
| Options | | 637 | | | 803 | | | | |
| Convertible debentures | 136 | 552 | | 39 | 504 | | | | |
| Diluted EPS | $ 90,319 | 115,886 | $ 0.78 | $ 30,493 | 116,199 | | $ 0.26 | | |

**NOTE F: SEGMENT INFORMATION**

Through its wholly owned subsidiary, Colonial Bank, BancGroup has one distinct line of business, Commercial Banking. Colonial Bank provides general banking services in 267 branches throughout 6 states.

**NOTE G: LONG TERM BORROWINGS**

During March 2002, BancGroup issued $100 million in Trust Preferred Securities through a statutory business trust. These securities bear interest of 8.32% and are subject to redemption by BancGroup, in whole or in part, at any time after

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March 2007, until maturity in April 2032. In connection with this issuance, BancGroup executed an interest rate swap whereby BancGroup receives a fixed rate and pays a floating rate, effectively converting the fixed rate notes to floating. The result of this interest rate swap created an effective floating rate on the notes of 3 month LIBOR + 1.40%. As of September 30, 2002, the net effective floating rate was 3.26%. The proceeds from this issuance are being used for general corporate purposes as well as a previously announced stock repurchase program.

**NOTE H: DERIVATIVES:**

BancGroup maintains positions in derivative financial instruments to manage interest rate risk and facilitate asset/liability management strategies. Currently, the only derivative instruments being utilized are interest rate swaps, all of which qualify for shortcut accounting, according to Statement of Financial Accounting Standards No. 133, and are designated as fair value hedges.

The aforementioned interest rate swaps were executed in order to convert fixed rate subordinated debt, trust-preferred debt and certain fixed rate loans to floating rates. Because each swap meets all of the requirements for shortcut accounting, BancGroup assumes no ineffectiveness. Therefore, no gains or losses were recognized in 2002 as the gain/(loss) on the underlying asset was offset by an equal amount related to the market value of the associated swap.

**NOTE I: INTANGIBLE ASSETS**

Under SFAS No. 142 goodwill and other intangible assets with indefinite useful lives will no longer be amortized, but instead are tested for impairment as of the date of adoption and at least annually. The standard also requires that intangible assets with finite useful lives be amortized over their respective estimated useful lives to their estimated residual values, and be reviewed for impairment if a triggering event occurs, as described by SFAS No. 121.

Amortizable intangible assets at September 30, 2002 are as follows (in thousands):

| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
|---|---|---|---|
| Core deposits and other intangibles | $ 35,590 | $ (2,490) | $ 33,100 |

Aggregate amortization expense for the nine months ended September 30, 2002 was $1,767,000. Aggregate annual amortization expense of currently recorded core deposits and other intangibles for December 31, 2002 is estimated to be $2.8 million and $4.4 million for years ended December 31, 2003 through 2006.

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The changes in the carrying amount of goodwill for the nine months ended September 30, 2002 are as follows (in thousands):

| | |
|---|---|
| Balance at January 1, 2002 | $ 112,704 |
| Acquisitions (primarily related to First Mercantile and Palm Beach, see note C) | 114,037 |
| Balance at September 30, 2002 | $ 226,741 |

The following table presents net income and earnings per share as reported and adjusted to exclude tax effected amortization of goodwill that is no longer being amortized (in thousands, except per share amounts).

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2002 | 2001 | 2002 | 2001 |
| Reported net income | $ 35,130 | $ 30,454 | $ 105,364 | $ 90,183 |
| Goodwill amortization, net of tax | | $ 1,327 | | $ 4,294 |
| Adjusted net income | $ 35,130 | $ 31,781 | $ 105,364 | $ 94,477 |
| Reported basic earnings per share | $ 0.29 | $ 0.27 | $ 0.89 | $ 0.79 |
| Goodwill amortization, net of tax | | $ 0.01 | | $ 0.04 |
| Adjusted basic earnings per share | $ 0.29 | $ 0.28 | $ 0.89 | $ 0.83 |
| Reported diluted earnings per share | $ 0.29 | $ 0.26 | $ 0.88 | $ 0.78 |
| Goodwill amortization, net of tax | | $ 0.01 | | $ 0.04 |
| Adjusted diluted earnings per share | $ 0.29 | $ 0.27 | $ 0.88 | $ 0.82 |

**NOTE J: DISCONTINUED OPERATIONS**

In July 2000 BancGroup announced definitive plans to exit the mortgage servicing business and discontinue operations of mortgage servicing as a separate business unit. As of December 31, 2000 all loan servicing transfers were completed and the mortgage servicing rights removed from the Company s balance sheet. Due to the volume of loans transferred and the costs and complexity in providing certain documentation, the Company revised its estimate of the cost to complete disposition of this business, resulting in charges of $705,000 and $613,000, net of tax expense, in the third quarters of 2002 and 2001, respectively. Currently, substantially all receivables associated with these sales have been collected and provision has been made for the Company s best estimate of any costs associated with documentation deficiencies and related indemnifications.

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**Item 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**CRITICAL ACCOUNTING POLICIES:**

Accounting policies involving significant estimates and assumptions by management, which have, or could have, a material impact on the carrying value of certain assets and impact comprehensive income, are considered critical accounting policies. BancGroup recognizes the following as critical accounting policies: Accounting for Acquisitions, Accounting for Allowance for Loan Losses, and Accounting for Income Taxes.

*Accounting for Acquisitions.* BancGroup s growth in business, profitability and market share over the past several years has been enhanced significantly by mergers and acquisitions. BancGroup s acquisition strategy has historically utilized the pooling-of-interest and purchase business combination methods of accounting. Effective July 1, 2001, BancGroup adopted SFAS No. 141, Business Combinations, which allows only the use of the purchase combination method of accounting. For acquisitions under the purchase method, BancGroup is required to record assets acquired and liabilities assumed at their fair value, which in many instances involves estimates based on third party, internal, or other valuation techniques. These estimates also include the establishment of various accruals for planned facilities dispositions and employee benefit related considerations, among other acquisition-related items. In addition, purchase acquisitions typically result in goodwill or other intangible assets, which are subject to ongoing periodic impairment tests. These tests, based on the fair value of net assets acquired compared to the carrying value of goodwill and other intangibles, also contain estimates such as discount rate and time periods in their calculations. Furthermore, the determination of which intangible assets have finite lives is subjective, as well as the determination of the amortization period for such intangible assets.

*Accounting for Allowance for Loan Losses*. Management s ongoing evaluation of the adequacy and allocation of the allowance considers both impaired and unimpaired loans and takes into consideration the Bank s past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrowers ability to repay, estimated value of any underlying collateral, the reviews of regulators, and an analysis of current economic conditions. While management believes that it has exercised prudent judgment and applied reasonable assumptions which have resulted in an allowance presented in accordance with generally accepted accounting principles, there can be no assurance that in the future, adverse economic conditions, increased nonperforming loans, regulatory concerns, or other factors will not require further increases in, or re-allocation of the allowance.

*Accounting for Income Taxes.* BancGroup uses the asset and liability method of accounting for income taxes. Determination of the deferred and current provision requires analysis by management of certain transactions and the related tax laws and regulations. Management exercises significant judgment in

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evaluating the amount and timing of recognition of the resulting tax liabilities and assets. Those judgments and estimates are re-evaluated on a continual basis as regulatory and business factors change.

**FINANCIAL CONDITION:**

Ending balances of total assets, securities, mortgage loans held for sale, net loans, deposits, and long and short term debt changed for the nine months and twelve months ended September 30, 2002, respectively, as follows:

| *(Dollars in thousands)* | December 31, 2001 to September 30, 2002 Increase (Decrease) | | September 30, 2001 to September 30, 2002 Increase (Decrease) | |
|---|---|---|---|---|
| | Amount | % | Amount | % |
| Assets: | | | | |
| Total Assets | 1,903,622 | 14.4% | 2,302,320 | 18.0% |
| Securities | 689,607 | 36.6% | 633,721 | 32.7% |
| Mortgage loans held for sale | 119,299 | 336.5% | 130,084 | 527.3% |
| Loans, net of unearned income | 828,757 | 8.0% | 1,217,304 | 12.2% |
| Total Deposits | 832,972 | 10.0% | 894,830 | 10.8% |
| Short-term debt | 620,843 | 29.2% | 861,904 | 45.7% |
| Long-term debt | 257,567 | 14.4% | 366,548 | 21.9% |

**Assets:**

BancGroup s assets have increased 18.0% since September 30, 2001 and 14.4% since December 31, 2001. The growth from September 30, 2001 is primarily the result of increases in securities, internal loan growth throughout BancGroup s banking regions as well as the Mortgage Warehouse Lending unit, the purchase of 13 branches from Union Planters, the acquisition of Mercantile Bancorp in Texas and Palm Beach National Holding Company in Florida. The growth from December 31, 2001 is primarily the result of increases in securities, loans in the Mortgage Warehouse Lending unit and the acquisitions of Mercantile and Palm Beach. Other assets include approximately $10.3 million invested in certain non-banking entities including two Atlanta based real estate developments and an interest in a company providing internet and ACH services to banks. The Company continually investigates non-banking investment opportunities.

**Securities:**

Investment securities and securities available for sale have increased $633.7 million (32.7%) and $689.6 million (36.6%) from September 30, 2001 and December 31, 2001, respectively. These increases are the result of an effort to maintain earning asset growth during a period of slow to declining loan growth. Selectively purchasing short average life securities has enabled BancGroup to take advantage of spreads to short-term funding costs. The short-term funding of investment purchases mitigates the risk to falling rates. Securities purchased have consisted primarily of mortgage-backed securities and collateralized mortgage obligations and have been subject to accelerated prepayments in the quarter ended September 30, 2002.

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**Loans and Mortgage Loans Held for Sale:**

Loans net of unearned income, have increased $1,217.3 million (12.2%) and $828.8 million (8.0%) from September 30, 2001 and December 31, 2001, respectively. The increase in loans from September 30, 2001 and December 31, 2001 was primarily due to an increase in Real Estate Construction loans mostly from acquisitions, of $589.2 million and $432.5 million respectively, as well as an increase in Mortgage Warehouse Lending loans, of $607.9 million and $168.9 million respectively. The volume in the mortgage warehouse lending unit has been abnormally high in the third quarter due to increases in mortgage refinancing activity resulting from all time lows in mortgage rates. The increase in mortgage loans held for sale of $130.1 million and $119.3 million from September 30, 2001 and December 31, 2001, respectively, is also due to the significant increase in mortgage refinancing activity. The following table reflects the change in loan mix as of September 30, 2002.

| **GROSS LOANS BY CATEGORY** (***Dollars in thousands***) | **September 30, 2002** | **December 31, 2001** | **September 30, 2001** |
|---|---|---|---|
| Commercial, financial, and agricultural | $ 1,084,934 | $ 1,145,409 | $ 1,184,310 |
| Real estate-commercial | 3,613,631 | 3,417,517 | 3,449,252 |
| Real estate-construction | 2,728,157 | 2,295,675 | 2,138,990 |
| Real estate-residential | 1,983,186 | 1,942,821 | 2,065,662 |
| Installment and consumer | 244,167 | 240,836 | 251,958 |
| Mortgage warehouse lending | 1,455,330 | 1,286,399 | 847,448 |
| Other | 87,214 | 39,019 | 41,852 |
| Total Loans | $ 11,196,619 | $ 10,367,676 | $ 9,979,472 |

Residential real estate loans represent 17.7% of total loans at September 30, 2002 compared to 18.7% at December 31, 2001 and 20.7% at September 30, 2001. This decrease is primarily due to a drop in demand for adjustable rate mortgages as more borrowers are looking for long-term fixed rate loans, which the Company originates, but sells in the secondary market. Substantially all of these loans are adjustable rate first mortgages on single-family, owner-occupied properties, and therefore, have minimal credit risk and lower interest rate sensitivity. BancGroup has a history of successfully lending in the residential real estate market and its quality ratios remain favorable in this portfolio segment.

Commercial loans collateralized by real estate and construction loans increased approximately $196.1 million and $432.5 million, respectively from December 31, 2001. Commercial loans collateralized by real estate increased $164.4 million from September 30, 2001 while construction loans increased $589.2 million from the same period. These increases result mostly from acquisitions as well as internal loan growth.

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Management believes that any existing distribution of loans, whether geographically, by industry, or by borrower, does not expose BancGroup to unacceptable levels of risk. The current distribution of loans remains diverse in location, size, and collateral function. Our diversity, in addition to our emphasis on quality underwriting, serves to reduce the risk of losses. The following chart reflects the geographic diversity and industry distribution of Construction and Commercial Real Estate loans as of September 30, 2002.

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**CONSTRUCTION & COMMERCIAL REAL ESTATE**
**GEOGRAPHIC DIVERSITY AND INDUSTRY DISTRIBUTION**
**SEPTEMBER 30, 2002**

| *(Dollars in thousands)* | Construction | Commercial Real Estate |
|---|---|---|
| **Average Loan Size** | $ 517 | $ 512 |
| **Geographic Diversity** | | |
| Alabama | $ 324,914 | $ 865,031 |
| Georgia | 443,765 | 428,258 |
| Florida | 1,282,210 | 1,648,826 |
| Texas | 384,032 | 245,181 |
| Nevada | 154,486 | 152,263 |
| Other | 138,750 | 274,072 |
| Total | $ 2,728,157 | $ 3,613,631 |

| **Industry Distribution** | **% of Industry Distribution to** | |
|---|---|---|
| | **Construction Portfolio** | **Total Portfolio** |
| Developments (w/Land) | 39% | 10% |
| 1-4 Family Residential | 21% | 5% |
| Condominiums | 12% | 3% |
| Multi-Family | 8% | 2% |
| Retail | 6% | 1% |
| Office | 4% | 1% |
| Other (13 types) | 10% | 2% |
| **Total Construction** | 100% | 24% |

| **Industry Distribution** | **% of Industry Distribution to** | |
|---|---|---|
| | **Commercial Real Estate Portfolio** | **Total Portfolio** |
| Retail | 19% | 6% |
| Office | 16% | 5% |
| Multi-Family | 13% | 4% |
| Lodging | 11% | 3% |
| Office/Warehouse | 7% | 2% |
| Nursing Home | 4% | 1% |
| Other (11 types) | 30% | 11% |
| **Total Commercial Real Estate** | 100% | 32% |

**Characteristics of the 75 Largest Construction and Commercial Real Estate Loans**

| | Construction | Commercial Real Estate |
|---|---|---|
| **75 Largest Loans Total (in thousands)** | $ 1,035,154 | $ 770,596 |
| % of 75 largest loans to category total | 38.0% | 21.3% |
| Average Loan to Value Ratio (75 largest loans) | 68% | 70% |
| Debt Coverage Ratio (75 largest loans) | N/A | 1.36x |

Substantially all Construction and Commercial Real Estate loans have personal guarantees of the principals involved. Owner-occupied Commercial Real Estate portfolio totals represented 23% of the total Commercial Real Estate portfolio at September 30, 2002.

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Outstanding loans in our international division, located in our South Florida Region, represent 0.8% of our total outstanding loans at September 30, 2002. This exposure is spread among approximately 22 banking institutions in six Latin American/Caribbean countries. The banks are primarily top tier institutions. These transactions are trade related involving letters of credit as well as participations in commercial paper back up lines.

BancGroup does not have a syndicated lending department. However, the Company has 25 credits with total commitments (funded and unfunded) of $514 million that fall within the bank regulatory definition of a Shared National Credit (generally defined as a total loan commitment in excess of $20 million that is shared by three or more lenders). The largest outstanding amount to any single borrower is approximately $51 million (which is a mortgage warehouse facility), with the smallest credit being approximately $138,000 (not counting the credits with unfunded balances). As of September 30, 2002, $303 million of these commitments were funded.

Although by definition these commitments are considered Shared National Credits, BancGroup s loan officers have established long-term relationships with each of these borrowers. These commitments are comprised of the following:

17% - commercial real estate projects located within existing markets,

12% - international credits which are primarily unfunded short-term commitments to tier one correspondent banks,

62% - mortgage warehouse lines to eight large institutions (the mortgage warehouse lending department conducts its own audits of these borrowers), and

9% - operating facilities to two large national corporations headquartered in the Florida markets and one large Alabama corporation headquartered in Montgomery, Alabama.

Management believes that these are sound participations involving credits that fit within Colonial Bank s lending philosophy and meet its conservative underwriting guidelines.

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**ALLOCATION OF THE ALLOWANCE FOR LOAN LOSSES**

Allocations of the allowance for loan losses are made on an individual loan basis for all loans rated less than satisfactory with a percentage allocation for the remaining portfolio. The allocation of the remaining allowance represents an approximation of the reserves for each category of loans based on management s evaluation of the respective historical charge-off experience and risk within each loan type.

| *(Dollars in thousands)* **Balance at end of periodApplicable to:** | **September 30, 2002** | **Percent of Loans to Total Loans** | **December 31, 2001** | **Percent of Loans to Total Loans** | **September 30, 2001** | **Percent of Loans to Total Loans** |
|---|---|---|---|---|---|---|
| Commercial, financial, and agricultural | $ 34,253 | 9.7% | $ 33,326 | 11.1% | $ 36,307 | 11.9% |
| Real estate-commercial | 57,003 | 32.3% | 50,393 | 33.0% | 43,907 | 34.6% |
| Real estate-construction | 23,740 | 24.4% | 17,256 | 22.1% | 16,086 | 21.4% |
| Real estate-residential | 9,916 | 17.7% | 9,714 | 18.7% | 10,328 | 20.7% |
| Installment and consumer | 2,872 | 2.2% | 2,390 | 2.3% | 2,544 | 2.5% |
| Mortgage warehouse lending | 3,638 | 13.0% | 3,216 | 12.4% | 2,119 | 8.5% |
| Other | 4,938 | 0.7% | 5,905 | 0.4% | 4,053 | 0.4% |
| TOTAL | $ 136,360 | 100.0% | $ 122,200 | 100.0% | $ 115,344 | 100.0% |

The ratio of annualized net charge-offs to average loans was 0.27%, 0.34%, and 0.37% for the third quarter of 2002, the fourth quarter of 2001, and the third quarter of 2001, respectively. The ratio of annualized net charge-offs to average loans was 0.24% year to date at September 30, 2002 compared to 0.28% for all of 2001 and 0.27% year to date at September 30, 2001, respectively. As a result of the Company s localized lending strategies and early identification of potential problem loans, BancGroup s net charge-offs have been consistently low compared to industry and peer data.

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**SUMMARY OF LOAN LOSS EXPERIENCE**

| *(Dollars in thousands)* | September 30, 2002 | December 31, 2001 | September 30, 2001 |
|---|---|---|---|
| Allowance for loan losses January 1 | $ 122,200 | $ 110,055 | $ 110,055 |
| Charge-offs: | | | |
| Commercial, financial, and agricultural | 10,628 | 14,731 | 9,343 |
| Real estate-commercial | 3,384 | 9,354 | 8,268 |
| Real estate-construction | 1,306 | 292 | 45 |
| Real estate-residential | 3,527 | 3,148 | 2,275 |
| Installment and consumer | 2,595 | 4,049 | 2,480 |
| Other | 861 | 1,155 | 627 |
| Total charge-offs | 22,301 | 32,729 | 23,038 |
| Recoveries: | | | |
| Commercial, financial, and agricultural | 914 | 698 | 566 |
| Real estate-commercial | 948 | 404 | 310 |
| Real estate-construction | 62 | 9 | 8 |
| Real estate-residential | 455 | 565 | 326 |
| Installment and consumer | 1,173 | 1,999 | 1,559 |
| Other | 297 | 330 | 149 |
| Total recoveries | 3,849 | 4,005 | 2,918 |
| Net charge-offs | 18,452 | 28,724 | 20,120 |
| Allowance added from bank acquisitions | 7,835 | 1,296 | 566 |
| Addition to allowance charged to operating expense | 24,777 | 39,573 | 24,843 |
| Allowance for loan losses-end of period | $ 136,360 | $ 122,200 | $ 115,344 |
| Net charge-offs as a percent of average net loans - (annualized basis): | | | |
| Quarter to date | 0.27% | 0.34% | 0.37% |
| Year to date | 0.24% | 0.28% | 0.27% |

The following schedule reflects BancGroup s 237% coverage of nonperforming loans (nonaccrual and renegotiated) by the allowance for loan losses at September 30, 2002. While management has not targeted any specific coverage ratio in excess of 100%, management is committed to maintaining adequate reserve levels to absorb estimated future losses in the current loan portfolio.

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**NONPERFORMING ASSETS ARE SUMMARIZED BELOW**

| *(Dollars in thousands)* | September 30, 2002 | December 31, 2001 | September 30, 2001 |
|---|---|---|---|
| Aggregate loans for which interest is not being accrued | $ 56,336 | $ 49,675 | $ 58,441 |
| Aggregate loans renegotiated to provide a reduction or deferral of interest or principal because of deterioration in the financial condition of the borrower | 1,191 | 1,507 | 1,125 |
| Total nonperforming loans * | 57,527 | 51,182 | 59,566 |
| Other real estate owned and repossessions | 20,712 | 15,553 | 12,805 |
| Total nonperforming assets * | $ 78,239 | $ 66,735 | $ 72,371 |
| Aggregate loans contractually past due 90 days for which interest is being accrued | $ 25,696 | $ 28,249 | $ 21,095 |
| Net charge-offs quarter-to-date | $ 7,167 | $ 8,602 | $ 9,199 |
| Net charge-offs year-to-date | $ 18,452 | $ 28,724 | $ 20,120 |
| Total nonperforming assets as a percent of net loans and other real estate | 0.70% | 0.64% | 0.72% |
| Allowance as a percent of net loans | 1.22% | 1.18% | 1.16% |
| Allowance as a percent of nonperforming assets * | 174% | 183% | 159% |
| Allowance as a percent of nonperforming loans * | 237% | 239% | 194% |

* Does not include loans contractually past due 90 days or more which are still accruing interest.

Nonperforming assets increased to $78.2 million or 0.70% of net loans and other real estate at September 30, 2002, compared to $66.7 million or 0.64% at December 31, 2001. The increase primarily resulted from classifying as nonperforming the Company s outstanding portfolio ($15 million) of credits to Argentine banks. The 2002 Shared National Credit Examination by the Federal Reserve and other regulatory agencies required all banks to classify such loans as nonperforming. Management continuously monitors and evaluates recoverability of problem assets and adjusts loan loss reserves accordingly. The loan loss reserve was 1.22% of loans at September 30, 2002 compared to 1.18% at December 31, 2001 and 1.16% at September 30, 2001. Fluctuations from year to year in the balances of nonperforming assets are attributable to several factors including changing economic conditions in various markets, nonperforming assets obtained in various acquisitions and the disproportionate impact of larger (over $1,000,000) individual credits.

Management, through its loan officers, internal credit review staff and external examinations by regulatory agencies, has identified approximately $295 million of loans, which have been placed, on a classified loan list. The increase from the $288 million reported last quarter is primarily due to loans from the acquisition of Palm Beach National. The status of these loans is reviewed at least monthly by loan officers and annually by BancGroup s centralized credit review function and by regulatory agencies. In connection with such reviews, collateral values are updated where considered necessary. If collateral values are judged insufficient or other sources of repayment inadequate, the loans are reduced to estimated recoverable amounts through increases in reserves allocated to the loans or charge-offs. As of September 30, 2002, substantially all of these loans are current with their existing repayment terms. Management believes that classification of such loans well in advance of their reaching a delinquent status allows the Company the greatest flexibility in correcting problems and providing adequate reserves. Given the reserves and the ability of the borrowers to comply with the existing repayment terms, management believes any exposure from these loans has been adequately addressed at the present time.

Nonperforming loans represent all material credits for which management has serious doubts as to the ability of the borrowers to comply with the loan repayment terms. Management also expects that the resolution of these problem credits as well as other performing loans will not materially impact future operating results, liquidity or capital resources. The recorded investment in impaired loans at September 30, 2002 was $52.6 million and these loans had a corresponding valuation allowance of $20.8 million.

**LIQUIDITY:**

BancGroup has addressed its liquidity and interest rate sensitivity through its policies and structure for asset/liability management. BancGroup has an Asset/Liability Management Committee ( ALMCO ), the objective of which is to optimize the net interest margin while assuming reasonable business risks. ALMCO annually establishes operating constraints for critical elements of BancGroup s business, such as liquidity and interest rate sensitivity. ALMCO constantly monitors performance and takes action in order to meet its objectives.

A prominent focus of ALMCO is maintenance of adequate liquidity. Liquidity is the ability of an organization to meet its financial commitments and obligations on a timely basis. These commitments and obligations include credit needs of customers, withdrawals by depositors, repayment of debt when due and payment of operating expenses and dividends.

Core deposit growth is a primary focus of BancGroup s funding and liquidity strategy. Efforts to emphasize relationship deposit growth are having a positive impact. Average retail deposits in the third quarter 2002, excluding broker and time deposits, grew 19% over the same quarter in 2001, and 9% growth excluding acquisitions. The non-interest bearing portion of these retail deposits grew 6% excluding acquisitions over the same period and improved the non-interest bearing deposit mix from 16% to 17% of total retail deposits. As there was a decreased emphasis on higher cost time deposits versus more core deposits, average retail time deposits decreased 5% compared to third quarter 2001, a 10% decrease excluding acquisitions. As a result of the decrease in time deposits, the non-time deposit share of retail deposits increased to 50% in third quarter 2002 from 45% in third quarter 2001.

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In addition to funding growth through core deposits, BancGroup has worked to expand the availability of short and long term wholesale funding sources. As of September 30, 2002 the Bank utilized 67% vs. 57% at December 31, 2001 of the total wholesale funding sources (primarily Federal Home Loan Bank borrowings), estimated to be available. This increased utilization was a result of the increase in Mortgage Warehouse loans due to a refinancing boom caused by low mortgage rates. These floating rate loans were funded with short-term wholesale funds. Once refinancing activity subsides the funding utilization ratio is expected to decrease. Management believes its liquidity sources and funding strategies are adequate given the nature of its asset base and current loan demand.

**INTEREST RATE SENSITIVITY:**

ALMCO s goal is to minimize volatility in the net interest margin from changes in interest rates by taking an active role in managing the level, mix, repricing characteristics and maturities of assets and liabilities. ALMCO monitors the impact of changes in interest rates on net interest income using several tools, including static rate sensitivity reports, or Gap reports, and income simulation modeling under multiple rate scenarios.

The following table represents the output from the Company s most recent simulation model based on the balance sheet as of September 30, 2002, when the Fed Funds Rate was 1.75%, and measures the impact on net interest income of an immediate and sustained change in interest rates in 100 basis point increments for the 12 calendar months following the date of the change. Given the 50 basis point reduction in the Fed funds rate on November 6, 2002, a down 50 basis point rate shock has been added as well. This twelve month projection of Net Interest Income under these scenarios is compared to the twelve month Net Interest Income projection with rates unchanged.

| | Fed Funds Rate | Percentage Change in 12 Month Projected Net Interest Income vs. Net Interest Income assuming no changes (1) |
|---|---|---|
| **Basis Points change** | | |
| +200 | 3.75% | 10% |
| +100 | 2.75 | 6 |
| No Change | 1.75 | |
| - 50 | 1.25 | (2) |
| - 100 | .75 | (3) |

(1) The computation of prospective effects of hypothetical interest rate changes are based on numerous assumptions, including relative levels of market interest rates, loan prepayments and deposit decay rates, and should not be relied upon as indicative of actual results. Further, the computations do not contemplate any actions BancGroup could undertake in response to changes in interest rates.

This table shows that under these rate shock scenarios, net interest income would benefit from rising rates,

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however, the risk to declining rates is acceptable considering the overall level of interest rates. The initial impact of a rate decline will be greater in the first quarter after a rate drop, and will improve as the liability side of the balance sheet has more time to adjust down to the new lower rate levels. The projections in the table are based on rate shocks where all rate indices are changed by the same amount. Therefore these simulations do not take into account the risk of yield curve shifts or change in the basis risk or spread between various rate indices. They also do not take into account balance sheet volume and mix changes that might occur due to changes in rates or yield curve slope. Additionally, interest rate floors have been written into approximately $2 billion of floating rate loans. However competitive pressures may not allow the bank to realize the full benefit of these floors, therefore this benefit is not included in the declining scenarios.

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The following table summarizes BancGroup s Maturity / Rate Sensitivity or Gap at September 30, 2002.

| | (Dollars in millions) | |
|---|---|---|
| | **0-90 days** | **0-365 days** |
| **Rate Sensitive Assets (RSA)** | $ 8,300 | $ 10,124 |
| **Rate Sensitive Liabilities (RSL)** | 5,034 | 8,029 |
| **Cumulative Gap (RSA-RSL)** | 3,266 | 2,095 |
| **Cumulative Gap Ratio (Cum Gap / Total Assets)** | 22% | 14% |

The last two lines of the proceeding table represents interest rate sensitivity gap which is the difference between rate sensitive assets and rate sensitive liabilities. BancGroup s somewhat asset-sensitive position is primarily the result of growth in floating rate loans and run off in fixed rate loans and securities.

In reviewing the table, it should be noted that the balances are shown for a specific point in time and, because the interest sensitivity position is dynamic, it can change significantly over time. For all interest earning assets and interest bearing liabilities, variable rate assets and liabilities are reflected in the time interval of the assets or liabilities earliest repricing date. Fixed rate assets and liabilities have been allocated to various time intervals based on contractual repayment and prepayment assumptions. Furthermore, the balances reflect contractual repricing of the deposits and management s position on repricing certain deposits where management discretion is permitted. Certain demand deposit accounts and regular savings accounts have been classified as repricing beyond one year in accordance with regulatory guidelines. While these accounts are subject to immediate withdrawal, experience and analysis have shown them to be relatively rate insensitive.

**CAPITAL ADEQUACY AND RESOURCES:**

Management is committed to maintaining capital at a level sufficient to protect shareholders and depositors, provide for reasonable growth and fully comply with all regulatory requirements. Management s strategy to achieve these goals is to retain sufficient earnings while providing a reasonable return to shareholders in the form of dividends and return on equity. The Company s dividend payout ratio target range is 30-45%. Dividend rates are determined by the Board of Directors in consideration of several factors including current and projected capital ratios, liquidity and income levels and other bank dividend yields and payment ratios.

The amount of a cash dividend, if any, rests within the discretion of the Board of Directors of BancGroup as well as upon applicable statutory constraints such as the Delaware law requirement that dividends may be paid only out of capital surplus or net profits for the fiscal year in which the dividend is declared or the preceding fiscal year.

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BancGroup also has access to equity capital markets through both public and private issuances. Management considers these sources and related return in addition to internally generated capital in evaluating future expansion or acquisition opportunities.

The Federal Reserve Board has issued guidelines identifying minimum Tier I leverage ratios relative to total assets and minimum capital ratios relative to risk-adjusted assets. The minimum leverage ratio is 3% but is increased from 100 to 200 basis points based on a review of individual banks by the Federal Reserve. The minimum risk adjusted capital ratios established by the Federal Reserve are 4% for Tier I and 8% for total capital. BancGroup s actual capital ratios and the components of capital and risk adjusted asset information (subject to regulatory review) as of September 30, 2002 are stated below:

| | | |
|---|---|---|
| **Capital (in thousands):** | | |
| Tier I Capital: | | |
| Shareholders equity (excluding unrealized gain on securities available for sale intangibles, and 8% of equity investments in nonfinancial entities plus Trust Preferred Securities) | $ | 951,346 |
| Tier II Capital: | | |
| Allowable loan loss reserve | | 136,360 |
| Subordinated debt | | 261,071 |
| 45% of net unrealized gains on available for sale equity securities | | 168 |
| Total Capital | $ | 1,348,945 |
| **Risk Adjusted Assets (in thousands)** | $ | 12,060,548 |
| **Total Assets (in thousands)** | $ | 15,088,725 |

| | September 30, 2002 | December 31, 2001 |
|---|---|---|
| Tier I leverage ratio | 6.93% | 6.24% |
| Risk Adjusted Capital Ratios: | | |
| Tier I Capital Ratio | 7.89% | 7.39% |
| Total Capital Ratio | 11.18% | 10.91% |

BancGroup has increased capital gradually through normal earnings retention as well as through stock registrations to capitalize acquisitions. In addition to these sources, the Tier I Capital Ratio and Total Capital Ratio have been increased from the issuance of $100 million of Trust Preferred Securities during the first quarter of 2002. These securities provide additional flexibility for liquidity, capital management and growth.

Management continuously monitors its capital levels in order to ensure it is taking the necessary steps to support future internally generated growth and fund the quarterly dividend rates that were $0.13 per share each quarter of 2002 and are anticipated to be the same or slightly higher in 2003.

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**AVERAGE VOLUME AND RATE (UNAUDITED)**

| *(Dollars in thousands)* | Three Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2002 | | | 2001 | | |
| | Average Volume | Interest | Rate | Average Volume | Interest | Rate |
| **ASSETS** | | | | | | |
| Loans, net (1) | $ 9,488,834 | $ 155,985 | 6.53% | $ 9,172,886 | $ 181,210 | 7.85% |
| Mortgage warehouse lending | 1,076,290 | 11,432 | 4.16% | 840,376 | 11,854 | 5.52% |
| Mortgage loans held for sale | 42,623 | 625 | 5.87% | 22,733 | 357 | 6.28% |
| Investment securities and securities available for sale and other interest-earning assets (2) | 2,521,772 | 31,058 | 4.93% | 1,810,740 | 28,461 | 6.29% |
| Total interest-earning assets (1) | 13,129,519 | $ 199,100 | 6.02% | 11,846,735 | $ 221,882 | 7.44% |
| Non-earning assets | 884,225 | | | 683,969 | | |
| Total assets | $ 14,013,744 | | | $ 12,530,704 | | |
| **LIABILITIES AND SHAREHOLDERS EQUITY:** | | | | | | |
| Interest-bearing non-time deposits | $ 2,954,052 | $ 9,511 | 1.28% | $ 2,464,768 | $ 13,253 | 2.13% |
| Time deposits | 4,413,896 | 37,643 | 3.38% | 4,667,992 | 64,234 | 5.46% |
| Short-term borrowings | 2,131,628 | 10,318 | 1.92% | 1,496,364 | 13,104 | 3.47% |
| Long-term debt | 2,005,537 | 25,018 | 4.95% | 1,708,905 | 25,478 | 5.92% |
| Total interest-bearing liabilities | 11,505,113 | $ 82,490 | 2.84% | 10,338,029 | $ 116,069 | 4.45% |
| Noninterest-bearing demand deposits | 1,442,664 | | | 1,257,231 | | |
| Other liabilities | 74,249 | | | 96,308 | | |
| Total liabilities | 13,022,026 | | | 11,691,568 | | |
| Shareholders equity | 991,718 | | | 839,136 | | |
| Total liabilities and shareholders equity | $ 14,013,744 | | | $ 12,530,704 | | |
| **RATE DIFFERENTIAL** | | | 3.18% | | | 2.99% |
| | | $ 116,610 | 3.53% | | $ 105,813 | 3.56% |

| | | |
|---|---|---|
| **NET INTEREST INCOME AND NET YIELD ON INTEREST-EARNING ASSETS (3)** | | |

(1) Loans classified as non-accruing are included in the average volume calculation. Interest earned and average rates on non-taxable loans are reflected on a tax equivalent basis. This interest is included in the total interest for loans. Tax equivalent interest earned is actual interest earned times 145%.

(2) Interest earned and average rates on obligations of states and political subdivisions are reflected on a tax equivalent basis. Tax equivalent interest earned is equal to actual interest earned times 145%. Tax equivalent average rate is tax equivalent interest earned divided by average volume.

(3) Net interest income divided by average total interest-earning assets

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**AVERAGE VOLUME AND RATE (UNAUDITED)**

| *(Dollars in thousands)* | Nine Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2002 | | | 2001 | | |
| | Average Volume | Interest | Rate | Average Volume | Interest | Rate |
| **ASSETS** | | | | | | |
| Loans, net (1) | $ 9,330,396 | $ 466,318 | 6.68% | $ 9,351,895 | $ 580,565 | 8.30% |
| Mortgage warehouse lending | 925,632 | 29,949 | 4.27% | 736,256 | 34,133 | 6.11% |
| Mortgage loans held for sale | 27,873 | 1,303 | 6.23% | 19,209 | 933 | 6.48% |
| Investment securities and securities available for sale and other interest-earning assets (2) | 2,209,461 | 87,917 | 5.31% | 1,672,076 | 81,049 | 6.46% |
| Total interest-earning assets (1) | 12,493,362 | $ 585,487 | 6.26% | 11,779,436 | $ 696,680 | 7.90% |
| Non-earning assets | 833,565 | | | 668,101 | | |
| Total assets | $ 13,326,927 | | | $ 12,447,537 | | |
| **LIABILITIES AND SHAREHOLDERS EQUITY:** | | | | | | |
| Interest-bearing non-time deposits | $ 2,847,220 | $ 27,601 | 1.30% | $ 2,463,698 | $ 48,914 | 2.65% |
| Time deposits | 4,268,096 | 113,744 | 3.56% | 4,782,946 | 211,263 | 5.91% |
| Short-term borrowings | 1,870,025 | 26,116 | 1.87% | 1,617,382 | 55,927 | 4.62% |
| Long-term debt | 1,917,182 | 74,170 | 5.17% | 1,469,713 | 65,937 | 5.99% |
| Total interest-bearing liabilities | 10,902,523 | $ 241,631 | 2.96% | 10,333,739 | $ 382,041 | 4.94% |
| Noninterest-bearing demand deposits | 1,396,336 | | | 1,199,493 | | |
| Other liabilities | 82,004 | | | 101,365 | | |
| Total liabilities | 12,380,863 | | | 11,634,597 | | |
| Shareholders equity | 946,064 | | | 812,940 | | |
| Total liabilities and shareholders equity | $ 13,326,927 | | | $ 12,447,537 | | |

| | | | | |
|---|---|---|---|---|
| **RATE DIFFERENTIAL** | | 3.30% | | 2.96% |
| **NET INTEREST INCOME AND NET YIELD ON INTEREST-EARNING ASSETS (3)** | $ 343,856 | 3.67% | $ 314,639 | 3.57% |

(1) Loans classified as non-accruing are included in the average volume calculation. Interest earned and average rates on non-taxable loans are reflected on a tax equivalent basis. This interest is included in the total interest for loans. Tax equivalent interest earned is actual interest earned times 145%.

(2) Interest earned and average rates on obligations of states and political subdivisions are reflected on a tax equivalent basis. Tax equivalent interest earned is equal to actual interest earned times 145%. Tax equivalent average rate is tax equivalent interest earned divided by average volume.

(3) Net interest income divided by average total interest-earning assets

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**ANALYSIS OF INTEREST INCREASES / (DECREASES)**
**(UNAUDITED)**

| *(Dollars in thousands)* | Three Months Ended September 30, 2002 Change from 2001 | | |
|---|---|---|---|
| | | Attributed to (1) | |
| | Total | Volume | Rate |
| **INTEREST INCOME:** | | | |
| Loans, net | $ (25,225) | $ 36,881 | $ (62,106) |
| Mortgage Warehouse Lending | (422) | 11,954 | (12,376) |
| Mortgage loans held for sale | 268 | 423 | (155) |
| Investment securities and securities for sale and other interest-earning assets | 2,597 | 33,524 | (30,927) |
| Total interest income(2) | (22,782) | 82,782 | (105,564) |
| **INTEREST EXPENSE:** | | | |
| Interest-bearing deposits | $ (30,333) | $ 8,647 | $ (38,980) |
| Short-term borrowings | (2,786) | 21,242 | (24,028) |
| Long-term debt | (460) | 16,825 | (17,285) |
| Total interest expense | (33,579) | 46,714 | (80,293) |
| Net interest income | $ 10,797 | $ 36,068 | $ (25,271) |

(1) Increases (decreases) are attributed to volume changes and rate changes on the following basis: Volume Change = change in volume times old rate. Rate Change = change in rate times old volume. The Rate/Volume Change = change in volume times change in rate, and it is allocated between Volume Change and Rate Change at the ratio that the absolute value of each of those components bear to the absolute value of their total.

(2) Interest earned and average rates on obligations of states and political subdivisions are reflected on a tax equivalent basis. Tax equivalent interest earned is: actual interest earned times 145%. Tax equivalent average rate is: tax equivalent interest earned divided by average volume.

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**ANALYSIS OF INTEREST INCREASES / (DECREASES)**
**(UNAUDITED)**

| *(Dollars in thousands)* | Nine Months Ended September 30, 2002 Change from 2001 | | |
|---|---|---|---|
| | | Attributed to (1) | |
| | Total | Volume | Rate |
| **INTEREST INCOME:** | | | |
| Loans, net | $ (114,247) | $ (1,393) | $ (112,854) |
| Mortgage Warehouse Lending | (4,184) | 10,555 | (14,739) |
| Mortgage loans held for sale | 370 | 429 | (59) |
| Investment securities and securities for sale and other interest earning assets | 6,868 | 29,200 | (22,332) |
| Total interest income(2) | (111,193) | 38,791 | (149,984) |
| **INTEREST EXPENSE:** | | | |
| Interest-bearing deposits | $ (118,832) | $ (4,601) | $ (114,231) |
| Short-term borrowings | (29,811) | 12,301 | (42,112) |
| Long-term debt | 8,233 | 22,306 | (14,073) |
| Total interest expense | (140,410) | 30,006 | (170,416) |
| Net interest income | $ 29,217 | $ 8,785 | $ 20,432 |

(1) Increases (decreases) are attributed to volume changes and rate changes on the following basis: Volume Change = change in volume times old rate. Rate Change = change in rate times old volume. The Rate/Volume Change = change in volume times change in rate, and it is allocated between Volume Change and Rate Change at the ratio that the absolute value of each of those components bear to the absolute value of their total.

(2) Interest earned and average rates on obligations of states and political subdivisions are reflected on a tax equivalent basis. Tax equivalent interest earned is: actual interest earned times 145%. Tax equivalent average rate is: tax equivalent interest earned divided by average volume.

**NET INTEREST INCOME:**

Net interest income is the foremost component of BancGroup s earnings and represents the difference or spread between interest and fee income generated from earning assets and the interest expense paid on deposits and borrowed funds. Interest rate volatility in addition to changes in the volume and mix of earning assets and interest bearing liabilities can significantly impact net interest income.

Net interest income on a tax equivalent basis increased $10.8 million to $116.6 million for the quarter ended September 30, 2002 from $105.8 million for the quarter ended September 30, 2001. Net interest income on a tax equivalent basis increased $29.2 million to $343.9 million for the nine months ended September 30, 2002 from $314.6 million for the same period in 2001. The net interest margin declined 3 basis points to 3.53% for the third quarter of 2002 versus 3.56% for the third quarter of 2001. Year to date

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net interest margin improved 10 basis points to 3.67% at September 30, 2002 from 3.57% at September 30, 2001.

The average rate on loans was 6.53% for the third quarter of 2002 compared to 7.85% for the third quarter of 2001. Additionally, the average rate of investment securities was 4.93 % for the third quarter of 2002 compared to 6.29% for the third quarter of 2001. Sharp declines in mortgage and treasury rates have resulted in record prepayments on loans and investment securities. These prepayments have resulted in lower security yields due to reinvestment of funds at lower yields, as well as accelerated amortization of premiums paid to acquire securities. During the same period, the rate on average interest-bearing liabilities was 2.84% for the third quarter of 2002 compared to 4.45% for the third quarter of 2001.

The 50 basis point cut in the fed funds rate announced by the Federal Reserve in November 2002 will hurt the margin. Some of the short term negative impact will be offset in later months as the CD portfolio, which has an average remaining term at September 30, 2002 of 12 months, will reprice to lower levels. Additionally, current low mortgage rates have increased refinancing activity. Because of this, mortgage warehouse volumes have increased, and as this low risk line of business has a lower margin, it will increase net interest income while having a negative impact on the net interest margin ratio. Lower mortgage rates have also resulted in continued increase of prepayments on mortgage backed loans and securities, thus lowering the yield on both these portfolios, these trends are also expected to continue.

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**LOAN LOSS PROVISION:**

The provision for loan losses for the quarter ended September 30, 2002 was $6,803,000 compared to $7,901,000 for the same period in 2001. Year to date loan loss provision was $24,777,000 and $24,843,000 for the nine months ended September 30, 2002 and 2001, respectively. The Company continues to focus its efforts on relationship based lending to known customers in its local market areas.

The reduction in loan loss provision during the third quarter 2002 was primarily the result of flat loan growth in the Company s regional banks, excluding Mortgage Warehouse Lending and acquisitions. With this reduction, BancGroup maintained a 237% coverage of nonperforming loans compared to 239% at December 31, 2001 and 194% at September 30, 2001. See management s discussion of loan quality and the allowance for loan losses presented in the Financial Condition section of this report.

**NONINTEREST INCOME:**

Noninterest income excluding securities gains increased $4.3 million (20.5%) and $8.9 million (14.3%) for the three months and nine months ended September 30, 2002 compared to the same period in 2001. Sources of noninterest income include financial planning services, electronic banking services, mortgage origination income, and cash management services which are included in service charges on deposit accounts.

Financial planning services experienced a $1.2 million (61%) increase in fee income during the three months ended September 30, 2002 over the same period in 2001 and a $1.8 million (27%) increase for the nine months ended September 30, 2002 over 2001. As a result of investor uncertainty in the economy, the Company has experienced a decline in sales of investments to customers; however, this decline was more than offset by an increase in fixed rate annuity sales.

BancGroup continues to expand electronic banking services through its ATM network, business and personal check card services, and internet banking. Noninterest income from electronic banking services increased $523,000 (31%) for the three months ended September 30, 2002 when compared to the same period in 2001 and $1.3 million (27%) for the nine months ended September 30, 2002 over 2001 through increased penetration of its customer base and the introduction of the Colonial Bank Business Check Card.

Mortgage origination fees increased $2.0 million (103%) for the three months ended September 30, 2002 compared to the three months ended September 30, 2001 and $3.5 million (64%) for the nine months ended September 30, 2002 over 2001. These increases are due to additional production of one-to-four family mortgage loans sold in the secondary market resulting from increases in refinancing activity. As stated earlier, in the third quarter 2002 mortgage rates reached the lowest level in 41 years.

Service charges on deposit accounts increased $698,000 (7%) for the three months ended September 30, 2002 over the same period in 2001 and $2.2 million (7%) for the nine months ended September 30, 2002

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over 2001. These increases are the result of an increase in normal deposit account related fees which includes an increase in cash management fees of approximately $201,000 (28%) for the third quarter and $553,000 (27%) year to date over the same periods in 2001. BancGroup also had additional branches in operation, 26 of which were acquired, for the three months and nine months ended September 30, 2002 as compared to the same periods in 2001.

**NONINTEREST EXPENSES:**

In support of the Company s sales culture, BancGroup continues to make strategic investments in its product and service offerings, technology systems, sales incentives and branch network to enhance the Company s competitive presence in existing markets. Some of these investments include improved automation of branch delivery systems, enhanced internet banking and wire transfer systems and an image processing system. BancGroup s philosophy is to make strategic investments in the tools employees need to optimize its customers financial success. Accordingly, noninterest expense excluding amortization of intangibles increased 7% for the quarter ended September 30, 2002 and 2% for the nine months ended September 30, 2002 as compared to the same periods in 2001. These comparisons also exclude $6.4 million and $12.7 million in additional operating expenses from acquired banks.

BancGroup s net overhead (total noninterest expense less noninterest income, excluding security gains, and amortization of intangibles) was $54.4 million for the three months ended September 30, 2002 compared to $46.5 million for the three months ended September 30, 2001, respectively. Year to date net overhead was $154.8 million at September 30, 2002 compared to $142.3 million at September 30, 2001.

Total noninterest expense increased $11.0 million for the third quarter of 2002 compared to the third quarter of 2001 and year to date noninterest expense increased $17.7 million over the same period in 2001. Annualized noninterest expense excluding amortization of intangibles to average assets was 2.27% for the three months ended September 30, 2002 compared to 2.15% for the three months ended September 30, 2001. Year to date annualized noninterest expense excluding amortization of intangibles to average assets was 2.26% for the nine months ended September 30, 2002 compared to 2.19% at September 30, 2001.

The increase in bank related expenses is primarily due to an increase of approximately $7.0 million and $12.9 million for the three months and nine months ended September 30, 2002 over the same periods in 2001, respectively, in salaries and employee benefits. These salary increases are the result of acquisitions completed during the current and previous year, additional branches opened, normal salary increases, additional incentive and production related compensation, and increased pension costs.

In order to improve the Company s market presence, three of its regional headquarters were relocated in 2001. The Company also acquired 13 branches from Union Planters in October 2001, First Mercantile

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Bank with five branches in March 2002 and completed the acquisition of Palm Beach National Holding Company with eight branches in September 2002. Primarily as a result of these efforts, occupancy and equipment expense for the three months and nine months ended September 30, 2002 increased $1.8 million and $3.4 million, respectively, when compared to the same periods in 2001.

Intangible asset amortization decreased $1.2 million and $3.6 million for the three months and nine months ended September 30, 2002, respectively, over the same periods in 2001 due primarily to the implementation of SFAS No. 142 discussed in Note I Intangible Assets.

The remaining increases in other expense of $3.4 million and $5.1 million for the three months and nine months ended September 30, 2002 over the same periods in 2001, respectively, are the result of the aforementioned acquisitions, improvements to the data communications network, and other normal operating expense.

In July of 2001 Colonial launched the Eagle project. The objective of the Eagle project is to implement retail delivery solutions that should enhance our ability to produce sales, provide exceptional service and promote profitable customer relationships while gaining operational efficiencies. We began implementation of new retail delivery systems in September 2002 with additional Internet banking capabilities and an enhanced call center. This will be followed in 2003 with new branch service delivery and loan delivery systems.

**PROVISION FOR INCOME TAXES:**

BancGroup s provision for income taxes is based on an approximate 34.5% and 36.0%, estimated annual effective tax rate for the years 2002 and 2001, respectively. The provision for income taxes for the three months ended September 30, 2002 and 2001 was $18.9 million and $17.5 million, respectively. The year to date provision for income taxes ended September 30, 2002 and 2001 was $55.9 million and $51.2 million, respectively.

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

The information required by this item is included in Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.

**Item 4. Controls and Procedures.**

The Company s management, including the Chief Executive Officer and Chief Financial Officer, evaluated the Company s disclosure controls and procedures (as defined in Rule 13a-14(c) under the Securities and Exchange Act of 1934, as amended) within 90 days prior to the filing date of this quarterly report. Based on this evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the Company s disclosure controls and procedures are effective. There were no significant changes in internal controls (including any corrective actions with regard to significant deficiencies or material weaknesses in the Company s internal controls) that could significantly affect the disclosure controls and procedures since the date of the evaluation. See the certifications by the Company s Chief Executive Officer and Chief Financial Officer following the signature page of this Report.

**Part II Other Information**

**Item 1: Legal Proceedings - See Note B - COMMITMENTS AND CONTINGENCIES AT PART 1**

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**Item 2: Changes in Securities and Use of Proceeds - N/A**

**Item 3: Defaults Upon Senior Securities - N/A**

**Item 4: Submission of Matters to a Vote of Security Holders N/A**

**Item 5: Other Information**

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, a certification of the Quarterly Report on Form 10-Q has been submitted to the Securities and Exchange Commission by each of the Chief Executive Officer and the Chief Financial Officer of BancGroup.

**Item 6: Exhibits and Reports on Form 8-K**

(a) Exhibits required by Item 601 of Regulation S-K None

(b) Reports on Form 8-K

1. Form 8-K was furnished on October 15, 2002 as Regulation F-D Disclosure in regard to third quarter 2002 earnings.

2. Form 8-K was furnished on September 9, 2002 as Regulation F-D Disclosure in regard to presentations made by management to institutional investors.

3. Form 8-K was furnished on August 14, 2002 as Regulation F-D Disclosure in regard to correspondence transmitted to the Securities and Exchange Commission on August 14, 2002 in compliance with Section 906 of the Sarbanes-Oxley Act of 2002.

4. Form 8-K was furnished on July 16, 2002 as Regulation F-D Disclosure in regard to second quarter 2002 earnings.

**SIGNATURE**

Pursuant to the requirements of Section 13 or 15(d) 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.

THE COLONIAL BANCGROUP, INC.

Date: November 14, 2002 By: /s/ SHEILA MOODY

**Sheila Moody**
**Its Chief Accounting Officer**

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CERTIFICATIONS*

I, Flake Oakley, certify that:

1. I have reviewed this quarterly report on Form 10-Q of The Colonial BancGroup, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant s other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

   a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

   b) evaluated the effectiveness of the registrant s disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date ); and

   c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluations as of the Evaluation Date;

5. The registrant s other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant s auditors and the audit committee of registrant s board of directors (or persons performing the equivalent function):

   a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant s ability to record, process, summarize and report financial data and have identified for the registrant s auditors any material weaknesses in internal controls; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant s internal controls; and

6. The registrant s other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: October 14, 2002

/s/ W. Flake Oakley
W. Flake Oakley
Chief Financial Officer

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CERTIFICATIONS*

I, Robert E. Lowder, certify that:

1. I have reviewed this quarterly report on Form 10-Q of The Colonial BancGroup, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant s other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

   a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

   b) evaluated the effectiveness of the registrant s disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date ); and

   c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluations as of the Evaluation Date;

5. The registrant s other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant s auditors and the audit committee of registrant s board of directors (or persons performing the equivalent function):

   a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant s ability to record, process, summarize and report financial data and have identified for the registrant s auditors any material weaknesses in internal controls; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant s internal controls; and

6. The registrant s other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: October 14, 2002

/s/ Robert E. Lowder
Robert E. Lowder
Chief Executive Officer