FLAG FINANCIAL CORP
Form 10-Q
November 13, 2001

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2001

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the Transition Period from _____ to ______

Commission file number 0-24532

FLAG FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

Georgia	58-2094179
(State of incorporation)	(I.R.S. Employer Identification No.)
P.O. Box 3007 LaGrange, Georgia	30241
(Address of principal executive offices)	(Zip Code)

(706) 845-5000

(Telephone Number)

Indicate by check mark whether the registrant has (1) 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 XX NO

Common stock, par value $1 per share: 7,547,672 shares
Outstanding as of November 5, 2001

FLAG FINANCIAL CORPORATION AND SUBSIDIARY

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
FLAG FINANCIAL CORPORATION AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS

	SEPTEMBER 30, 2001	DECEMBER 31, 2000
ASSETS	(UNAUDITED)	
Cash and due from banks	$ 16,418,896	$ 19,143,110
Federal funds sold	6,038,000	2,730,000
Total cash and cash equivalents	22,456,896	21,873,110

Interest-bearing deposits	59,756	3,451,440
Investment securities available-for-sale	126,552,151	100,721,942
Other investments	5,835,093	5,360,609
Mortgage loans held for sale	4,414,300	4,120,659
Loans, net	368,044,332	384,661,335
Premises and equipment, net	13,910,499	14,933,761
Other assets	25,471,439	23,914,244
Total assets	$ 566,744,466	$ 559,037,100
LIABILITIES		
Non interest-bearing deposits	$ 45,872,245	$ 55,110,513
Interest-bearing deposits	410,090,998	406,326,454
Federal funds purchased and repurchase agreements	865,071	661,482
Other borrowings	3,250,000	1,500,000
Advances from Federal Home Loan Bank	40,558,518	31,973,304
Other liabilities	9,955,633	7,966,736
Total liabilities	510,592,465	503,538,489
STOCKHOLDERS' EQUITY		
Preferred stock (10,000,000 shares authorized, none issued and outstanding)	-	-
Common stock ($1 par value, 20,000,000 shares authorized 8,277,995 and 8,275,405 shares issued in 2001 and 2000, respectively)	8,277,995	8,275,405
Additional paid-in capital	11,354,511	11,348,106
Retained earnings	39,062,697	37,068,696
Accumulated other comprehensive income (loss)	2,167,244	(265,517
Less: Treasury stock at cost; 692,607 shares in 2001 and 152,744 shares in 2000	(4,710,446)	(928,079
Total stockholders' equity	56,152,001	55,498,611
Total liabilities and stockholders' equity	$ 566,744,466	$ 559,037,100

See Accompanying Notes To Consolidated Financial Statements.

3

CONSOLIDATED STATEMENTS OF EARNINGS

	(UNAUDITED) THREE MONTHS ENDED SEPTEMBER 30, 2001	2000	NINE S 200
INTEREST INCOME			

Interest and fees on loans	$ 9,017,780	10,145,625	28,55
Interest on securities	1,994,886	1,499,817	5,42
Interest on federal funds sold and interest-bearing deposits	105,678	233,686	53
Total interest income	11,118,344	11,879,128	34,52
INTEREST EXPENSE			
Interest on deposits	4,440,623	4,978,858	14,11
Interest on borrowings	660,486	709,527	1,65
Total interest expense	5,101,109	5,688,385	15,77
Net interest income before provision for loan losses	6,017,235	6,190,743	18,75
PROVISION FOR LOAN LOSSES	84,000	2,182,890	58
Net interest income after provision for loan losses	5,933,235	4,007,853	18,16
OTHER INCOME			
Fees and service charges	1,013,277	1,040,070	2,98
Loss on sale of securities available for sale	-	(248,671)	
Gain on sale of loans	321,440	182,463	75
Gain on sale of branch offices	-	5,079,636	
Other income	596,194	583,920	1,69
Total other income	1,930,911	6,637,418	5,44
OTHER EXPENSES			
Salaries and employee benefits	3,389,703	3,892,086	10,31
Occupancy	865,111	1,112,242	2,74
Other operating	2,005,403	2,639,024	5,89
Total other expenses	6,260,217	7,643,352	18,95
Earnings before provision for income taxes	1,603,929	3,001,919	4,65
Provision for income taxes	437,957	924,015	1,24
Net earnings	$ 1,165,972	2,077,904	3,40
Basic earnings per share	$ 0.15	$ 0.25	$
Diluted earnings per share	$ 0.15	$ 0.25	$

See Accompanying Notes To Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	(UN	
	THREE MONTHS ENDED SEPTEMBER 30,	
	2001	2000

Net earnings	$1,165,972	2,077,
Other comprehensive income, net of tax:		
Unrealized gains (losses) on investment securities available-for-sale:		
Unrealized gains (losses) arising during the period, net of tax of $1,352,243, $329,948, $1,463,021, and $143,433, respectively.	817,317	538,
Reclassification adjustment for losses included in net earnings, net of tax of $94,495 and $78,536 respectively	-	154,
Unrealized gain (loss) on cash flow hedges, net of tax of $270,589 and $28,026 respectively.	(441,487)	
Other comprehensive income (loss).	375,830	692,
Comprehensive income	$1,541,802	2,770,

See Accompanying Notes To Consolidated Financial Statements

5

CONSOLIDATED STATEMENTS OF CASH FLOWS

	NINE MONTH SEPTEMB
	2001 (UNAUDI
CASH FLOWS FROM OPERATING ACTIVITIES:	
Net earnings.	$ 3,407,228
Adjustment to reconcile net earnings to net cash (used in) provided by operating activities:	
Depreciation, amortization and accretion.	2,099,121
Provision for loan losses	588,000
Gain on sale of branch offices	
Loss on sale of investment securities available-for-sale.	-
Gain on sale of loans	(759,096)
Loss on sale of other real estate	(64,658)
Change in:	
Mortgage loans held for sale	465,455
Other.	(1,930,467)
Net cash provided by operating activities	3,805,583
CASH FLOWS FROM INVESTING ACTIVITIES:	
Cash paid in sale of branch offices	
Net change in interest-bearing deposits	3,391,684
Proceeds from sales and maturities of investment securities available-for-sale	23,381,350
Proceeds from maturities of investment securities held-to-maturity.	-
Purchases of other investments.	(733,350)
Purchases of investment securities available-for-sale	(45,066,491)

Net change in loans	16,029,003
Proceeds from sale of other real estate	735,029
Proceeds from sale of premises and equipment	34,066
Purchases of premises and equipment	(750,775)
Purchases of cash surrender value life insurance	(120,793)
Net cash (used in) provided by investing activities	(3,100,277)
CASH FLOWS FROM FINANCING ACTIVITIES:	
Net change in deposits	(5,473,724)
Change in federal funds purchased and repurchase agreements	203,589
Change in other borrowed funds	1,750,000
Proceeds from FHLB advances	10,000,000
Payments of FHLB advances	(1,414,786)
Purchase of treasury stock	(3,782,367)
Proceeds from exercise of stock options	8,995
Cash dividends paid	(1,413,227)
Net cash (used in) financing activities	(121,520)
Net change in cash and cash equivalents	583,786
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	21,873,110
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 22,456,896

See Accompanying Notes to Consolidated Financial Statements

6

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The accompanying consolidated financial statements have not been audited. The results of operations are not necessarily indicative of the results of operations for the full year or any other interim periods.

The accounting principles followed by FLAG Financial Corporation ("FLAG") and its bank subsidiary and the methods of applying these principles conform with generally accepted accounting principles and with general practices within the banking industry. Certain principles, which significantly affect the determination of financial position, results of operations, and cash flows are summarized below and in FLAG's annual report on Form 10-K for the year ended December 31, 2000.

Note 1. Basis of Presentation

The consolidated financial statements include the accounts of FLAG and its wholly owned subsidiary, FLAG Bank (Vienna, Georgia). All significant inter-company accounts and transactions have been eliminated in consolidation.

The consolidated financial information furnished herein represents all adjustments that are, in the opinion of management, necessary to present a fair statement of the results of operations, and financial position for the periods covered herein and are normal and recurring in nature. For further information, refer to the consolidated financial statements and footnotes included in FLAG's annual report on Form 10-K for the year ended December 31, 2000.

Note 2. Earnings Per Share

Net earnings per common share are based on the weighted average number of common shares outstanding during each period. The calculation of basic and diluted earnings per share is as follows:

		THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER30,	
		2001	2000	2001	2000
Basic earnings per share:					
Net earnings	$	1,165,972	2,077,904	3,407,228	3,413,945
Weighted average common shares Outstanding.		7,768,959	8,217,223	7,923,701	8,225,041
Per share amount	$	0.15	0.25	0.43	0.42
Diluted earnings per share:					
Net earnings	$	1,165,972	2,077,904	3,407,228	3,413,945
Effect of dilutive securities stock options.		48,852	11,738	28,213	17,107
Diluted earnings per share	$	0.15	0.25	0.43	0.41

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

FINANCIAL CONDITION

OVERVIEW

Total assets were $566.7 million at September 30, 2001, an increase of $7.7 million or 1.3 percent from December 31, 2000. The increase in total assets was primarily due to increases in investment securities available-for-sale as well as an increase in other assets and other investments during the nine months ended September 30, 2001. These increases were partially offset by decreases in net loans outstanding as well as interest-bearing deposits.

ASSETS AND FUNDING

At September 30, 2001, earning assets totaled $511.0 million, an increase of $10.0 million from December 31, 2000. Loans comprised 72 percent of earning assets and investment securities available-for-sale were 25 percent of earning assets at September 30, 2001. Net loans decreased $16.6 million or 4 percent for the nine months ended September 30, 2001 primarily due to the sale of $24 million in mortgage loans during 2001.

At September 30, 2001, interest-bearing deposits increased $3.8 million compared to December 31, 2000. Non-interest bearing deposits decreased $9.2 million in the first nine months of 2001 and totaled $46.0 million at September 30, 2001. The decrease in non-interest bearing deposits for the first nine months of 2001 was mainly attributed to a seasonal reduction of approximately $5 million in one commercial demand deposit account. Federal Home Loan Bank advances increased $8.6 million in the first nine months of 2001 and totaled $40.5 million at

September 30, 2001. At September 30, 2001 deposits represented 90 percent of FLAG's interest-bearing liabilities and Federal Home Loan Bank advances represented 9 percent.

The increase in Federal Home Loan Bank advances was the result of additional borrowings in the amount of $10 million maturing in 5 years. The advances, in addition to $10 million in brokered certificates of deposits and $5 million of overnight funds were used to fund the acquisition of $20 million in investment securities available-for-sale as well as $5 million in loan participations as part of a specifically matched leverage transaction.

LIQUIDITY AND CAPITAL RESOURCES

Net cash provided by operating activities totaled $3.8 million for the nine months ended September 30, 2001. Net cash used in investing activities totaling $3.1 million consisted largely of purchases of investment securities available-for-sale of $45.0 million partially offset by $23.3 million in proceeds from sales and maturities of investment securities available-for-sale and a net decrease in loans of $16.0 million. Net cash provided by financing activities consisted largely of a $10.0 million increase in Federal Home Loan Bank, partially offset by a $5.5 million decrease in deposits as well as purchases of treasury stock of $3.8 million.

Total stockholders' equity at September 30, 2001, was 9.91 percent of total assets compared to 9.93 percent at December 31, 2000.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS

Nine months and quarters ended September 30, 2001 and 2000.

OVERVIEW

Net earnings for the nine months ended September 30, 2001 remained stable compared to the first nine months of 2000. Net earnings per common share increased 2 percent for the first nine months of 2001 and are $0.43 compared to $0.42 for the first nine months of 2000. Net interest income decreased 4 percent for the nine months ended September 30, 2001 over the same period of 2000 to $18.8 million.

Net earnings for the quarter ended September 30, 2001 decreased $912,000 or 44 percent compared to the quarter ended September 30, 2000. Net earnings per common share decreased 40 percent for the quarter ended September 30, 2001 and are $0.15 compared to $0.25 in the quarter ended September 30, 2000. The decrease in net income for the quarter ended September 30, 2001 was due largely to gains on sale of assets during the quarter ended September 30, 2000.

During the quarter ended September 30, 2000, FLAG sold loans in the amount of $58 million, deposits in the amount of $74 million as well as property of its bank branches in Cobbtown, Metter, Statesboro, Blackshear, Homerville and Waycross, Georgia, and recognized a gain of on the sale of approximately $5 million.

NET INTEREST INCOME

Net interest income for the nine months ended September 30, 2001 decreased $682,000 compared to the first nine months of 2000. This decrease resulted from a $1,265,000 or 4.0 percent decrease in interest income offset by a $583,000 or 4.0 percent decrease in interest expense. Net interest income for the quarter ended September 30, 2001 decreased $174,000 compared to the quarter ended

September 30, 2000. This decrease resulted from a $761,000 or 6.4 percent decrease in interest income offset by a $587,000, or 10.0 percent decrease in interest expense. Decreases in net interest income are a result of lower interest rates, resulting in lower interest rate spreads.

NON-INTEREST INCOME AND EXPENSE
Non-interest income for the first nine months ended September 30, 2001 decreased $4,998,000 or 48 percent compared to the first nine months of 2000. Non-interest income for the quarter ended September 30, 2001 decreased $4,706,000 or 71 percent compared to the quarter ended September 30, 2000.

The decrease in non-interest income for the nine months and quarter ended September 30, 2001 was due largely to a decrease of $5,080,000 in gain on sale of assets representing gains on sales of branches during September 30, 2000.

Gain on sale of loans increased $87,000 or 13% for the nine months ended September 30, 2001 compared to the same period in 2000. Gain on sale of loans increased $139,000 or 76% for the quarter ended September 30, 2001 compared to the same period in 2000. The increases in gain on sale of loans were attributed to increased service release fees on loan sales, due to increased mortgage loan activity.

==

Non-interest expense decreased $2,804,000 or 13 percent for the first nine months of 2001 compared to the same period of 2000. Non-interest expense decreased $1,383,000 or 18 percent for the quarter ended September 30, 2001 compared to the same period of 2000. Salaries and employee benefits decreased $998,000 or 9 percent during the first nine months of 2001 compared to 2000 and decreased $502,000 or 13 percent during the quarter ended September 30, 2001 compared to the same period of 2000. These decreases in non-interest expense were primarily attributed to reduced expenses as a result of the sale of branches during the third quarter of 2000.

INCOME TAXES
Income tax expense for the first nine months of 2001 was $1,243,000 compared to $1,192,000 for the first nine months of 2000. The effective tax rate for the nine months ended September 30, 2001 was 27 percent and for the nine months ended September 30, 2000 was 26 percent. Income tax expense for the quarter ended September 30, 2001 was $438,000 compared to $924,000 for the same period in 2000. The effective tax rate for the quarter ended September 30, 2001 was 27 percent and for the quarter ended September 30, 2000 was 31 percent.

==

PROVISION AND ALLOWANCE FOR POSSIBLE LOAN AND LEASE LOSSES
The adequacy of the allowance for loan and lease losses is determined through management's informed judgment concerning the amount of risk inherent in FLAG's loan and lease portfolios. This judgment is based on such factors as the change in levels of non-performing and past due loans and leases, historical loan loss experience, borrowers' financial condition, concentration of loans to specific

borrowers and industries, estimated values of underlying collateral, and current and prospective economic conditions. The allowance for loan and lease losses was $6.5 million at September 30, 2001 and at December 31, 2000 was $6.6 million. The ratio of the allowance for loan losses to net outstanding loans at September 30, 2001 and December 31, 2000 was 1.74 percent and 1.68 percent, respectively.

The provision for loan losses for the first nine months and quarter ended September 30, 2001 decreased $2,921,000 and $2,099,000, respectively compared to the same period in 2000. This decrease was a result of additional provisions that were made in 2000 for certain loans retained as a result of the Homerville, Georgia branch sale.

Management performs an on-going loan review process. Based on the results of these reviews, we evaluate the adequacy of the allowance for possible loan losses. This evaluation considers historical loan losses by risk grade under each major category of loans, i.e., commercial, real estate and consumer. It also considers current portfolio risk, industry concentrations and the uncertainty associated with changing economic conditions. All new loans are risk rated under loan policy guidelines. On a monthly basis, we evaluate the composite risk ratings in a model that assesses the adequacy of the current allowance for loan losses. This evaluation is presented to the board of directors each month. Management performs loan reviews for compliance with underwriting policy on new loans and presents the results in the monthly asset review committee meeting. Past due loans are reviewed weekly. Risk ratings may be changed if it appears that new loans may not have received the proper initial grading or, if on existing loans, credit conditions have improved or worsened.

Management believes that the allowance for loan losses is both adequate and appropriate. However, the future level of the allowance for loan losses is highly dependent upon loan growth, loan loss experience, and other factors, which cannot be anticipated with a high degree of certainty.

NON-PERFORMING ASSETS AND PAST DUE LOANS

Non-performing assets, comprised of real estate owned, non-accrual loans and loans for which payments are more than 90 days past due, totaled $9.6 million at September 30, 2001 compared to $12.8 million at December 31, 2000. Non-performing assets as a percentage of net loans and other real estate owned at September 30, 2001 and December 31, 2000 were 2.61 percent and 3.28 percent, respectively.

FLAG has a loan review function that continually monitors selected accruing loans for which general economic conditions or changes within a particular industry could cause the borrowers financial difficulties. The loan review function also identifies loans with high degrees of credit or other risks. The focus of loan review as well as FLAG management is to maintain a low level of non-performing assets and return current non-performing assets to earning status.

11

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

==

At September 30, 2001, FLAG and its bank were in compliance with various regulatory capital requirements administered by Federal and State banking agencies. The following is a table representing FLAG's consolidated Tier-1 Capital, Tangible Capital, and Risk-Based Capital:

SEPTEMBER 30, 2001

	ACTUAL AMOUNT	%	REQUIRED AMOUNT	%	EXCESS AMOUNT	%
Tier 1 Capital	$47,175	8.52%	$21,351	4.00%	$25,824	4.52%
Tangible Capital	$47,175	8.52%	$ 8,307	1.50%	$38,868	7.02%
Risk-Based Capital	$52,812	11.90%	$35,506	8.00%	$17,306	3.90%

12

PART 2. OTHER INFORMATION
FLAG FINANCIAL CORPORATION AND SUBSIDIARIES

PART II. Other Information

Item 1. Legal Proceedings

FLAG and the Bank are periodically involved as plaintiff or defendant in various legal actions in the ordinary course of its business.

As previously reported, FLAG Bank purchased certain warehouse loans of Gulf Properties Financial Services, Inc., a residential mortgage broker. The loans that Gulf Properties sold to FLAG Bank were fraudulent. Gulf Properties filed Chapter 11 bankruptcy on December 30, 1998. FLAG Bank is serving on the creditors' committee and is assisting in the liquidation of assets, which will be distributed on a pro rata basis among the creditors. The perpetrators of the fraud have pled guilty to criminal charges and have been sentenced to prison. FLAG Bank obtained a restitution order as part of the criminal sentence. FLAG Bank's exposure as a result of the fraud was approximately $3 million. Several other banks also purchased fraudulent loans from Gulf Properties and the total amount of exposure of all banks is approximately $32 million. FLAG Bank has recovered all of the amounts lost as a result of the fraud including attorney's fees spent in the recovery effort.

On June 28, 2000, David and Trenne Baker filed a suit against America's Homeplace, Southern Homestead Mortgage and FLAG Bank in Superior Court of Bartow County, Georgia. The Complaint alleges that the defendants are liable to the plaintiffs for unspecified damages for fraud, suppression and concealment, breach of contract, intentional infliction of emotional distress, negligent infliction of emotional distress, conspiracy and violations of Georgia RICO arising out of the construction and purchase of a house from a co-defendant by the plaintiff. FLAG Bank provided the construction financing on the home. Co-defendant America's Homeplace filed a motion to compel arbitration in accordance with the plaintiff's contract. The motion was granted and the plaintiffs are now pursuing their claim against AHP only in an arbitration proceeding. FLAG Bank intends to vigorously defend the claims, if the plaintiffs continue to pursue a claim against FLAG at the conclusion of the arbitration.

In September 2000, Bank of Milan filed suit against one of its Borrowers, Walter T. Branyan, to collect upon an outstanding loan in the amount of

$1,349,066.66. The Bank of Milan also filed suit against the borrower's father, Walter C. Branyan, and a business associate, R. Tommy Gilder as Guarantors of the obligation. Walter C. Branyan has settled his obligation with the Bank of Milan and the court has entered a default judgment against Walter T. Branyan. R. Tommy Gilder recently settled favorably with the Bank of Milan.

13

OTHER INFORMATION

==

Item 2. Changes in Securities - None

Item 3. Defaults upon Senior Securities - None

Item 4. Submission of Matters to a Vote of Security Holders - None

Item 5. Other Information

Pursuant to Rule 14a-14(c)(1) promulgated under the Securities Exchange Act of 1934, as amended, shareholders desiring to present a proposal for consideration at the Company's 2002 Annual Meeting of Shareholders must notify the Company in writing to the Secretary of the Company, at Eagle's Landing, 235 Corporate Center Drive, Stockbridge, Georgia 30281 of the contents of such proposal no later than November 12, 2001 to be included in the 2002 Proxy Materials. A shareholder must notify the Company before January 26, 2002 of a proposal for the 2002 Annual Meeting that the shareholder intends to present other than by inclusion in the Company's proxy material. If the Company does not receive such notice prior to January 26, 2002, proxies solicited by the management of the Company will confer discretionary authority upon the management of the Company to vote upon any such matter.

Item 6. Exhibits and Report on Form 8-K

Reports on Form 8-K filed during the Third Quarter of 2001:

None.

Reports on Form 8-K filed from Third Quarter End 2001 to Present:

None.

14

FLAG FINANCIAL CORPORATION AND SUBSIDIARIES

==

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

FLAG Financial Corporation

By: /s/ J. Daniel Speight, Jr.

J. Daniel Speight, Jr.
(Chief Executive Officer)

By: /s/ Thomas L. Redding

Thomas L. Redding
(Chief Financial Officer)

Date: 11/9/01
