FLAG FINANCIAL CORP
Form 10-Q
August 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 June 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: 7,806,564 shares
Outstanding as of August 10, 2001

FLAG FINANCIAL CORPORATION AND SUBSIDIARIES

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FLAG FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	JUNE 30, 2001	DECEMBER 31, 2000
ASSETS	(UNAUDITED)	
Cash and due from banks	$ 13,840,090	$ 19,143,110
Federal funds sold.	2,461,000	2,730,000
Total cash and cash equivalents	16,301,090	21,873,110
Interest-bearing deposits	59,475	3,451,440
Investment securities available-for-sale.	131,017,736	100,721,942

Other investments	5,785,093	5,360,609
Mortgage loans held for sale	7,274,111	4,120,659
Loans, net	367,518,689	384,661,335
Premises and equipment, net	14,169,497	14,933,761
Other assets	24,331,489	23,914,244
Total assets	$566,457,180	$ 559,037,100
LIABILITIES		
Non interest-bearing deposits	$ 44,975,023	$ 55,110,513
Interest-bearing deposits	407,874,356	406,326,454
Federal funds purchased and repurchase agreements	6,138,000	661,482
Other borrowings	1,958,424	1,500,000
Advances from Federal Home Loan Bank	40,675,744	31,973,304
Other liabilities	7,514,503	7,966,736
Total liabilities	509,136,050	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	38,352,820	37,068,696
Accumulated other comprehensive income (loss)	1,791,414	(265,517)
Less: Treasury stock at cost; 383,556 shares in 2001 and 152,744 shares in 2000	(2,455,610)	(928,079)
Total stockholders' equity	57,321,130	55,498,611
Total liabilities and stockholders' equity	$566,457,180	$ 559,037,100

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

CONSOLIDATED STATEMENTS OF EARNINGS

(UNAUDITE

	THREE MONTHS ENDED JUNE 30, 2001	2000	
INTEREST INCOME			
Interest and fees on loans	$ 9,574,793	$10,488,721	19
Interest on securities	1,702,953	1,464,443	3
Interest on federal funds sold and interest-bearing deposits	272,596	77,030	

Total interest income	11,550,342	12,030,194	23
INTEREST EXPENSE			
Interest on deposits	4,712,175	4,824,338	9
Interest on borrowings	503,187	644,607	
Total interest expense	5,215,362	5,468,945	10
Net interest income before provision for loan losses	6,334,980	6,561,249	12
PROVISION FOR LOAN LOSSES	252,000	733,070	
Net interest income after Provision for loan losses	6,082,980	5,828,179	12
OTHER INCOME			
Fees and service charges	781,235	1,048,513	1
Gain on sale of available for sale securities	-	-	
Gain on sale of loans	164,507	294,369	
Other income	732,350	544,630	1
Total other income	1,678,092	1,887,512	3
OTHER EXPENSES			
Salaries and employee benefits	3,446,046	3,607,946	6
Occupancy	935,340	1,069,866	1
Other operating	2,085,167	2,257,805	3
Total other expenses	6,466,553	6,935,617	12
Earnings before provision for income taxes	1,294,519	780,074	3
Provision for income taxes	322,638	120,439	
Net earnings	$ 971,881	659,635	2
Basic earnings per share	$ 0.12	$ 0.08	$
Diluted earnings per share	$ 0.12	$ 0.08	$

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	(UNAUDIT		
	THREE MONTHS ENDED JUNE 30,		
	2001	2000	
Net earnings	$ 971,881	659,635	2,
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 $1,944,969, $162,527, $962,085, and $473,381, respectively	224,591	(265,175)	1,
Less: Reclassification adjustment for gains included in net earnings, net of tax of $15,959	-	-	
Unrealized gain on cash flow hedges, net of tax of $222,614 and $298,614 respectively.	363,213		
Other comprehensive income (loss)	587,804	(265,175)	2,
Comprehensive income.	$1,559,685	394,460	4,

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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CONSOLIDATED STATEMENTS OF CASH FLOWS

	SIX MONTH JUNE 2001
	(UNAUD
CASH FLOWS FROM OPERATING ACTIVITIES:	
Net earnings	$ 2,241,256
Adjustment to reconcile net earnings to net cash (used in) provided by operating activities:	
Depreciation, amortization and accretion.	1,599,591
Provision for loan losses	504,000
Gain on sale of investment securities available-for-sale.	-
Gain on sale of loans	(437,656)
Loss on sale of other real estate	13,917
Change in:	
Mortgage loans held for sale	(2,715,796)
Other.	(2,118,277)
Net cash (used in) provided by operating activities	(912,965)
CASH FLOWS FROM INVESTING ACTIVITIES:	
Net change in interest-bearing deposits	3,391,965
Proceeds from sales and maturities of investment securities available-for-sale	16,107,627
Proceeds from maturities of investment securities held-to-maturity.	-
Purchases of other investments.	(683,350)
Purchases of investment securities available-for-sale	(43,575,000)
Net change in loans	16,638,646
Proceeds from sale of other real estate	421,927
Proceeds from sale of premises and equipment.	20,967
Purchases of premises and equipment	(463,169)
Purchases of cash surrender value life insurance.	(92,794)
Net cash (used in) provided by investing activities.	(8,233,181)

CASH FLOWS FROM FINANCING ACTIVITIES:	
Net change in deposits	(8,587,588)
Change in federal funds purchased and repurchase agreements	5,476,518
Change in other borrowed funds	458,424
Proceeds from FHLB advances	10,000,000
Payments of FHLB advances	(1,297,560)
Purchase of treasury stock	(1,527,531)
Proceeds from exercise of stock options	8,995
Cash dividends paid	(957,132)
Net cash provided by (used in) financing activities	3,574,126
Net change in cash and cash equivalents	(5,572,020)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	21,873,110
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 16,301,090

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 JUNE 30, 2001	THREE MONTHS ENDED JUNE 30, 2000	SIX MONTHS ENDED JUNE 30, 2001	SIX MONTHS ENDED JUNE 30, 2000
Basic earnings per share:				
Net earnings.	$ 971,881	659,635	2,241,256	1,336,041
Weighted average common shares outstanding	7,973,448	8,217,905	8,002,355	8,228,897
Per share amount	$ 0.12	0.08	0.28	0.16
Diluted earnings per share:				
Net earnings.	$ 971,881	659,635	2,241,256	1,336,041
Effect of dilutive securities - stock options	21,788	13,579	23,834	17,292
Diluted earnings per share	$ 0.12	0.08	0.28	0.16

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

FINANCIAL CONDITION

OVERVIEW

Total assets were $566.5 million at June 30, 2001, an increase of $7.4 million or 1.0 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 loans held for sale during the six months ended June 30, 2001. These increases were partially offset by decreases in net loans outstanding as well as cash and due from banks.

ASSETS AND FUNDING

At June 30, 2001 earning assets totaled $514.1 million, an increase of $13.1 million from December 31, 2000. Loans comprised 71 percent of earning assets and investment securities available-for-sale were 25 percent of earning assets at June 30, 2001. Net loans decreased $17.1 million or 4 percent for the first six months ended June 30, 2001 primarily as a result of the sale of $24 million in mortgage loans during the quarter ended June 30, 2001.

At June 30, 2001, interest-bearing deposits increased $1.5 million compared to December 31, 2000. Non-interest bearing deposits decreased $10.1 million in the first six months of 2001 and totaled $45.0 million at June 30, 2001. The decrease in non-interest bearing deposits for the first six 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 $8.7 million in the first six months of 2001 and totaled $40.7 million at June 30, 2001. At June 30, 2001 deposits represented 89 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, with an average duration of

3 years.

LIQUIDITY AND CAPITAL RESOURCES

Net cash used by operating activities totaled $913 thousand for the six months ended June 30, 2001. Net cash used in investing activities totaling $8.2 million consisted largely of purchases of investment securities available-for-sale of $43.6 million partially offset by $16.1 million in proceeds from sales and maturities of investment securities available-for-sale and a net decrease in loans of $16.6 million. Net cash provided by financing activities consisted largely of a $10.0 million increase in Federal Home Loan Bank advances and an increase in repurchase agreements, partially offset by a $8.6 million decrease in deposits.

Total stockholders' equity at June 30, 2001, was 10.12 percent of total assets compared to 9.93 percent at December 31, 2000. The increase is attributed to a $2.2 million increase in net earnings since December 31, 2000, less dividends paid to stockholders.

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

RESULTS OF OPERATIONS

Six months and quarters ended June 30, 2001 and 2000

OVERVIEW

Net earnings for the six months ended June 30, 2001 increased $905,000 or 68 percent compared to the first six months of 2000. Net earnings per common share increased 75 percent for the first six months of 2001 and are $0.28 compared to $0.16 for the first six months of 2000. Net earnings for the quarter ended June 30, 2001 increased $312,000 or 47 percent compared to the quarter ended June 30, 2000. Net earnings per common share increased 50 percent for the quarter ended June 30, 2001 and are $0.12 compared to $0.08 in the quarter ended June 30, 2000. Net interest income decreased 4 percent for the six months ended June 30, 2001 over the same period of 2000 to $12.7 million. The increase in net income for the six months and quarter ended June 30, 2001 was due to a reduction in the provision for loan losses and a decrease in other expenses partially offset by decreases in net interest income and other income.

Effective 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 on the sale of approximately $5 million.

NET INTEREST INCOME

Net interest income for the first six months ended June 30, 2001 decreased $508,000 compared to the first six months of 2000. This decrease resulted from a $504,000 or 2.0 percent decrease in interest income coupled with a $4,000 or .04 percent increase in interest expense. Net interest income for the quarter ended June 30, 2001 decreased $226,000 compared to the quarter ended June 30, 2000. This decrease resulted from a $480,000 or 4 percent decrease in interest income offset with a $254,000, or 5 percent decrease in interest expense. Decreases in net interest income are a result of lower interest rates coupled with lower loan volume.

NON-INTEREST INCOME AND EXPENSE

Non-interest income for the first six months ended June 30, 2001 decreased $292,000 or 8 percent compared to the first six months of 2000. This decrease was due largely to a decrease of $212,000 in fees and service charges, as well as a decrease of $52,000 in gain on sale of loans. Non-interest income for the quarter ended June 30, 2001 decreased $209,000 or 11 percent compared to the quarter ended June 30, 2000. This decrease was due largely to a decrease of $267,000 in fees and service charges, partially offset by an increase of $188,000 in other operating income.

Other operating income decreased $14,000 or 1 percent for the first six months ended June 30, 2001 compared to the same period in 2000. Other operating income increased $188,000 or 34 percent for the quarter ended June 30, 2001 compared to the same period in 2000. The increase in other operating income was due largely to increases in mortgage origination fees during the first six months of 2001 compared to the same period in 2000.

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

Non-interest expense decreased $1,421,000 or 10 percent for the first six months of 2001 compared to the same period of 2000. Non-interest expense decreased $469,000 or 7 percent for the quarter ended June 30, 2001 compared to the same period of 2000. Salaries and employee benefits decreased $495,000 or 7 percent during the first six months of 2001 compared to 2000 and decreased $162,000 or 4 percent during the quarter ended June 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 six months of 2001 was $805,000 compared to $268,000 for the first six months of 2000. The effective tax rate for the first six months ended June 30, 2001 was 26 percent and for the six months ended June 30, 2000 was 17 percent. Income tax expense for the quarter ended June 30, 2001 was $323,000 compared to $120,000 for the same period in 2000. The effective tax rate for the quarter ended June 30, 2001 was 25 percent and for the quarter ended June 30, 2000 was 15 percent.

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

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 at June 30, 2001 and at December 31, 2000 was $6.6 million. The ratio of the allowance for loan losses to net outstanding loans at June 30, 2001 and December 31, 2000 was 1.78 percent and 1.68 percent, respectively.

The provision for loan losses for the first six months and quarter ended June

30, 2001 decreased $822,000 and $481,000, 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 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 $9.4 million at June 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 June 30, 2001 and December 31, 2000 were 2.54 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.

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

At June 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:

JUNE 30, 2001

	ACTUAL AMOUNT	%	REQUIRED AMOUNT	%	EXCESS AMOUNT	%
Tier 1 Capital	$48,185	8.86%	$ 21,760	4.00%	$26,425	4.86%
Tangible Capital	$48,185	8.86%	$ 8,160	1.50%	$40,025	7.36%
Risk-Based Capital	$53,782	12.37%	$ 34,774	8.00%	$19,008	4.37%

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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. As of June 30, 2001 FLAG Bank has collected approximately $1,538,000 as part of the bankruptcy proceedings. Additionally, FLAG Bank has received $1.6 million from a claim under its fidelity bond regarding this matter. 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.

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 has 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.

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 is defending the suit and has counterclaimed against the Bank for breach of fiduciary duty based upon an alleged confidential relationship with the Bank of Milan. Gilder's defenses and counterclaims are without merit and the Bank of Milan intends to pursue and defend this matter vigorously.

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 Second Quarter of 2001:

None.

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

None.

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: 8/10/01