

FLAG FINANCIAL CORP  
Form 424B3  
August 15, 2005  
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Filed pursuant to Rule 424 (b) (3)  
Registration No. 333-126104

***MERGER PROPOSED YOUR VOTE IS IMPORTANT***

The Boards of Directors of Flag Financial Corporation ( Flag ) and First Capital Bancorp, Inc. ( First Capital ) have each agreed to a merger transaction that will result in First Capital merging with and into Flag. We expect the proposed merger will bring together two complementary institutions to create a company positioned for further growth. Furthermore, we believe the combined company will achieve stronger earnings growth and create more shareholder value than either could separately achieve.

Our combined company will provide additional commercial and retail banking services and products through the combination of our two banks, which will operate from 28 offices located in metro Atlanta and central and west Georgia. Based on our June 30, 2005 financial data, we believe the combined company will have assets of approximately \$1.6 billion.

Pursuant to our merger agreement, First Capital will merge with and into Flag, and Flag will be the surviving corporation. Each share of First Capital will be converted into 1.6 shares of Flag common stock, resulting in an issuance of approximately 6.8 million shares of Flag common stock on a fully diluted basis. Each share of Flag common stock will remain outstanding as a share of common stock of the combined company. Any non-institutional First Capital shareholder that would own more than 384,000 shares of Flag common stock following the merger will receive a cash payment, in lieu of shares of Flag common stock over the 384,000 share threshold, equal to the number of such excess shares multiplied by \$14.76 per share, the average closing price of Flag s common stock for the 20 trading days immediately following the public announcement of the merger.

**Your vote is important.** We cannot complete the merger of Flag and First Capital unless shareholders of both companies approve the merger agreement. Each of Flag and First Capital will hold a special meeting of its shareholders to vote on the merger proposal. Whether or not you plan to attend your shareholders meeting, please take the time to vote by completing and mailing the enclosed proxy card to us. If you do not return your proxy card or otherwise vote, or do not instruct your broker how to vote any shares held for you in your broker s name, the effect will be a vote against the merger.

The places, dates and times of the special meetings are as follows:

For Flag shareholders:  
Flag Financial Corporation

3475 Piedmont Road, N.E., Suite 550

Atlanta, Georgia 30305

For First Capital shareholders:  
Country Club of Roswell

2500 Club Springs Drive

Roswell, Georgia 30076

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September 20, 2005 at 1:00 p.m.

September 20, 2005 at 10:00 a.m.

**This joint proxy statement/prospectus provides detailed information about the special meetings and our proposed merger. We urge you to read this joint proxy statement/prospectus and the documents incorporated by reference into this joint proxy statement/prospectus carefully and in their entirety. In particular, see Risk Factors Relating to the Merger on page 11 of this joint proxy statement/prospectus.**

The common stock of Flag is currently listed on the Nasdaq National Market under the ticker symbol FLAG. The common stock of First Capital is quoted on the Over the Counter Bulletin Board under the ticker symbol FCBX.OB

We enthusiastically support this combination of our two companies and join with the members of our Boards of Directors in recommending that you vote in favor of the merger.

Joseph W. Evans, Chairman, President

and Chief Executive Officer

Flag Financial Corporation

David R. Hink, Chairman

First Capital Bancorp, Inc.

**Neither the Securities and Exchange Commission nor any state securities regulator has approved or disapproved of the securities to be issued under this document or determined if this joint proxy statement/prospectus is truthful or complete. Any representation to the contrary is a criminal offense. The securities we are offering through this document are not savings or deposit accounts or other obligations of any bank or non-bank subsidiary of either of our companies, and they are not insured by the Federal Deposit Insurance Corporation or any other governmental agency.**

This joint proxy statement/prospectus is dated August 12, 2005 and is first being mailed to shareholders of Flag and First Capital on or about August 18, 2005.

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**ADDITIONAL INFORMATION**

This joint proxy statement/prospectus incorporates important business and financial information about Flag and First Capital from other documents that are not included in or delivered with this joint proxy statement/prospectus. See **Where You Can Find More Information** beginning on page 110. This information is available to you without charge upon your written or oral request. You can obtain the documents incorporated by reference in this joint proxy statement/prospectus through the Securities and Exchange Commission ( SEC ) website at [www.sec.gov](http://www.sec.gov) or by requesting them in writing or by telephone at the appropriate address below:

If you are a Flag Shareholder:

By Mail: Flag Financial Corporation  
3475 Piedmont Road, N.E., Suite 550  
Atlanta, Georgia 30305  
Attention: Lisa G. Lane

Telephone: (404) 760-7700

If you are a First Capital Shareholder:

By Mail: First Capital Bancorp, Inc.  
3320 Holcomb Bridge Road, N.W., Suite A  
Norcross, Georgia 30092  
Attention: H.N. Padget, Jr.

Telephone: (770) 921-6400

**In order to receive timely delivery of the documents in advance of the special meetings of shareholders, you must request such information no later than September 15, 2005.**

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**FIRST CAPITAL BANCORP, INC.**

3320 Holcomb Bridge Road, N.W., Suite A

Norcross, Georgia 30092

(770) 921-6400

**NOTICE OF SPECIAL MEETING OF SHAREHOLDERS**

**TO BE HELD SEPTEMBER 20, 2005**

To the shareholders of First Capital Bancorp, Inc.:

A special meeting of shareholders of First Capital Bancorp, Inc. will be held at the Country Club of Roswell located at 2500 Club Springs Drive, Roswell, Georgia 30076 on Tuesday, September 20, 2005, at 10:00 a.m., local time, for the following purposes:

1. to approve the Agreement and Plan of Merger, dated as of May 26, 2005, by and between First Capital Bancorp, Inc. and Flag Financial Corporation, a bank holding company based in Atlanta, Georgia, pursuant to which First Capital will merge with and into Flag, as further described in the enclosed joint proxy statement/prospectus; and
2. to transact such other business as may properly come before the special meeting or any postponements or adjournments of the special meeting.

Only shareholders of record of First Capital common stock at the close of business on August 12, 2005 are entitled to vote at the special meeting or any postponements or adjournments thereof. The approval of the merger agreement requires the affirmative vote of at least a majority of all of the votes entitled to be cast at the special meeting.

**FIRST CAPITAL S BOARD OF DIRECTORS RECOMMENDS THAT FIRST CAPITAL SHAREHOLDERS VOTE FOR THE PROPOSAL TO APPROVE THE MERGER AGREEMENT.**

***Notice of Right to Dissent.*** If Proposal 1 above is approved and the merger is consummated, each shareholder of First Capital will have the right to dissent from approval of the merger and will be entitled to the rights and remedies of dissenting shareholders provided in the Georgia Business Corporation Code. The right of any such shareholder to any dissenters' rights is contingent upon consummation of the merger and upon strict compliance with the requirements of Sections 14-2-1301 through 14-2-1332 of the Georgia Business Corporation Code. The full text of these sections is attached as Appendix D to this proxy statement/prospectus. For a summary of these requirements, see Terms of the Merger Dissenters Appraisal Rights in this proxy statement/prospectus.

Each shareholder, whether or not he or she plans to attend the special meeting, is requested to sign, date and return the enclosed proxy without delay in the enclosed postage-paid envelope. Any proxy given by a shareholder may be revoked by filing with First Capital's Secretary a written revocation or a duly executed proxy bearing a later date. Any shareholder present at the special meeting may revoke his or her proxy and vote personally on each matter brought before the special meeting. However, if you are a shareholder whose shares are not registered in your own name, you will need additional documentation from the record holder of such shares to vote personally at the special meeting.

By Order of the Board of Directors,

H. N. Padget, Jr.

*President and Chief Executive Officer*

August 12, 2005

Norcross, Georgia

**IMPORTANT:** Please read the attached joint proxy statement/prospectus and then promptly complete, execute and return the enclosed proxy card in the accompanying postage-paid envelope. You can save First Capital the expense of further proxy solicitation by returning your proxy card promptly.

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**FLAG FINANCIAL CORPORATION**

3475 Piedmont Road, N.E., Suite 550

Atlanta, Georgia 30305

(404) 760-7700

**NOTICE OF SPECIAL MEETING OF SHAREHOLDERS**

**TO BE HELD SEPTEMBER 20, 2005**

To the shareholders of Flag Financial Corporation:

A special meeting of shareholders of Flag Financial Corporation will be held at its offices located at 3475 Piedmont Road, N.E., Suite 550, Atlanta, Georgia 30305 on Tuesday, September 20, 2005, at 1:00 p.m., local time, for the following purposes:

1. to approve the Agreement and Plan of Merger, dated as of May 26, 2005, by and between Flag Financial Corporation and First Capital Bancorp, Inc., a bank holding company based in Norcross, Georgia, pursuant to which First Capital will merge with and into Flag, as further described in the enclosed joint proxy statement/prospectus; and
2. to transact such other business as may properly come before the special meeting or any postponements or adjournments of the special meeting.

Only shareholders of record of Flag common stock at the close of business on July 29, 2005 are entitled to vote at the special meeting or any postponements or adjournments thereof. The approval of the merger agreement requires the affirmative vote of at least a majority of all of the votes entitled to be cast at the special meeting.

**FLAG S BOARD OF DIRECTORS RECOMMENDS THAT FLAG SHAREHOLDERS VOTE**

**FOR THE PROPOSAL TO APPROVE THE MERGER AGREEMENT.**

Each shareholder, whether or not he or she plans to attend the special meeting, is requested to sign, date and return the enclosed proxy without delay in the enclosed postage-paid envelope. Any proxy given by a shareholder may be revoked by filing with Flag s Secretary a written revocation or a duly executed proxy bearing a later date. Any shareholder present at the special meeting may revoke his or her proxy and vote personally on each matter brought before the special meeting. However, if you are a shareholder whose shares are not

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registered in your own name, you will need additional documentation from the record holder of such shares to vote personally at the special meeting.

By Order of the Board of Directors,

Joseph W. Evans

*Chairman, President and Chief Executive Officer*

August 12, 2005

Atlanta, Georgia

**IMPORTANT: Please read the attached joint proxy statement/prospectus and then promptly complete, execute and return the enclosed proxy card in the accompanying postage-paid envelope. You can save Flag the expense of further proxy solicitation by returning your proxy card promptly.**

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No dealer, salesman or other person has been authorized to give any information or to make any representations, other than those contained in this joint proxy statement/prospectus, and, if given or made, such other information or representations must not be relied upon as having been authorized by Flag or First Capital. Neither the delivery of this joint proxy statement/prospectus nor any sale made hereunder shall under any circumstances create any implication that there has been no change in the affairs of Flag or First Capital since the date hereof or that information contained herein is correct as of any time subsequent to any of the dates as of which information is furnished herein or the date hereof.

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**QUESTIONS AND ANSWERS ABOUT VOTING PROCEDURES**

**FOR THE SPECIAL MEETINGS**

**Q: What should I do now?**

**A:** After you have carefully read this joint proxy statement/prospectus, indicate on your proxy card how you want to vote, and sign and mail it in the enclosed postage-paid envelope as soon as possible so that your shares will be represented at your special meeting. If you sign and send in a proxy card but do not indicate how you want to vote, your proxy will be voted in favor of the proposal to approve and adopt the merger agreement.

**Q: Why is my vote important?**

**A:** In the case of First Capital, the merger agreement must be approved by the holders of a majority of the outstanding shares entitled to vote at the First Capital special meeting. Accordingly, if a First Capital shareholder fails to vote on the merger, it will have the same effect as a vote against the merger. In the case of Flag, the merger agreement must be approved by a majority of the votes cast at the Flag special meeting, provided that a quorum is present. Unless the holders of more than 50% of the outstanding shares return their proxy cards or appear in person at the Flag special meeting, a quorum will not be present and the merger agreement will not be approved.

**Q: If my shares are held in street name by my broker, will my broker vote my shares for me?**

**A:** No. Your broker will vote your shares only if you provide instructions on how to vote. Following the directions your broker provides, you should instruct your broker how to vote your shares. If you do not provide instructions to your broker, your shares will not be voted.

**Q: Can I change my vote after I have submitted my proxy?**

**A:** Yes. There are three ways you can change your vote. First, you may send a written notice to the person to whom you submitted your proxy stating that you would like to revoke your proxy. Second, you may complete and submit a later dated proxy with new voting instructions. The latest vote actually received by your company prior to your shareholders' meeting will be your vote. Any earlier votes will be revoked. Third, you may attend your shareholders' meeting and vote in person. Any earlier votes delivered by proxy will be revoked. Simply attending your meeting without voting, however, will not revoke your proxy. If you have instructed a broker to vote your shares, you must follow the directions you will receive from your broker to change or revoke your proxy.

**Q: Should I send in my stock certificates now?**

**A:** No. You should not send in your stock certificates at this time. Flag shareholders will not exchange their certificates in the merger. The certificates currently representing the shares of Flag common stock will represent an equal number of shares of Flag common stock after the merger.

First Capital shareholders will exchange their First Capital common stock certificates for Flag common stock certificates after we complete the merger. Instructions for exchanging First Capital common stock certificates will be sent to you promptly after the merger is completed.

**Q: Whom should I call with questions about the merger?**

**A:** First Capital shareholders should call H.N. Padget, Jr. at (770) 921-6400. Flag shareholders should call J. Daniel Speight at (404) 760-7700.

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**SUMMARY**

This summary highlights selected information from this joint proxy statement/prospectus. It may not contain all of the information that is important to you. To better understand the merger and its potential impact on you, we urge you to read this entire joint proxy statement/prospectus and the documents incorporated by reference into this joint proxy statement/prospectus carefully. See **Where You Can Find More Information** on page 110. Each item in this summary includes a page reference directing you to a more complete discussion of the item.

**The Companies (page 59)**

**Flag Financial Corporation**

3475 Piedmont Road, N.E., Suite 550

Atlanta, Georgia 30305

(404) 760-7700

Flag Financial Corporation was organized in 1993 and is headquartered in Atlanta, Georgia. As of June 30, 2005, Flag had approximately \$862.5 million in assets. Its state bank subsidiary, Flag Bank, operates 23 locations in the following cities and counties in Georgia: Atlanta (Fulton County, DeKalb County and Cobb County), Unadilla (Dooly County), Vienna (Dooly County), Montezuma (Macon County), Buena Vista (Marion County), LaGrange (Troup County), Hogansville (Troup County), Jonesboro (Clayton County), Duluth (Gwinnett County), Columbus (Muscogee County), Macon (Bibb County), Newnan (Coweta County) and Warner Robins (Houston County). The bank offers a broad range of banking products and services, including residential mortgage loans, consumer loans, commercial loans, commercial real estate loans, residential construction loans, securities investments and other services.

**First Capital Bancorp, Inc.**

3320 Holcomb Bridge Road, N.W., Suite A

Norcross, Georgia 30092

(770) 921-6400

First Capital Bancorp, Inc. was organized in 1997 and is headquartered in Norcross, Georgia. As of June 30, 2005, First Capital had approximately \$674.8 million in assets. Its state bank subsidiary, First Capital Bank, operates five locations in Norcross, Alpharetta, Duluth and Cumming, Georgia. The bank is a full service commercial bank that offers a broad range of banking products and services, including commercial, real estate, residential mortgage, SBA and consumer loans, cash management and other services. In addition, First Capital operates Capital Financial Software, LLC, which markets and sells a proprietary software package used by bankruptcy trustees to monitor and track the disposition of Chapter 7 bankruptcy cases.

**The Merger (page 38)**

We are proposing a merger between Flag and First Capital whereby First Capital will merge with and into Flag. Flag will be the surviving company after the merger. The merger will combine our businesses under a single holding company named Flag Financial Corporation. As a result of the merger, Flag will acquire ownership of First Capital Bank, and it will be immediately merged with and into Flag Bank, which will continue as Flag's sole banking subsidiary. First Capital's other subsidiary, Capital Financial Software, also will become a subsidiary of Flag Bank after the merger. Flag will also assume First Capital's trust subsidiary, First Capital Statutory Trust I, which was created in connection with First Capital's issuance of trust preferred securities.

After the merger, Flag's board of directors will have 12 members, nine from Flag and three from First Capital. The directors from Flag will be William H. Anderson, II, H. Speer Burdette, III, Stephen W. Doughty, Joseph W. Evans, Quill O. Healey, John D. Houser, James W. Johnson, J. Daniel Speight, and J. Thomas Wiley, Jr.

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The directors from First Capital will be H.N. Padget, Jr. and two other directors of First Capital in office immediately prior to the effective time of the merger. Mr. Evans will serve as the chairman of the board, president and chief executive officer, and Messrs. Doughty, Speight and Wiley will serve as vice chairmen. Mr. Padget will serve as the executive vice president of Flag and president of Flag Bank.

Upon the completion of the merger, each share of First Capital common stock will be converted into 1.6 shares of Flag common stock. The exchange ratio is fixed. Any non-institutional First Capital shareholder that would own more than 384,000 shares of Flag common stock following the merger will receive a cash payment, in lieu of shares of Flag common stock over the 384,000 share threshold, equal to the number of such excess shares multiplied by \$14.76 per share, the average closing price of Flag's common stock for the 20 trading days immediately following the public announcement of the merger. William R. Blanton, the vice chairman, chief financial officer and chief operating officer of First Capital, will be entitled to a cash payment of approximately \$19.1 million as a result. See Interests of Directors and Officers of Flag and First Capital that Differ from Your Interests below. After the merger, the market price of the Flag common stock that First Capital shareholders will receive as a result of the merger may be significantly higher or lower than its current value or its value on the date of the special meetings.

Cash payments will be made instead of issuing fractional shares. For example, if you hold 11 shares of First Capital common stock, you will receive 17 shares of Flag common stock ( $11 \times 1.6 = 17.6$ ), plus a cash payment equal to the value of 0.60 of a share of Flag common stock at the time of the merger based on the average of the closing price of Flag Common Stock for the 20 trading days immediately prior to the effective date of the merger.

After the merger, Flag's existing shareholders will own approximately 55.6% of the total shares outstanding, and First Capital's shareholders will own approximately 44.4% of Flag's outstanding shares.

**Reasons for the Merger (page 21)**

We are proposing to merge our two companies because we believe that:

the complementary, rather than competitive, geographical scope of our banks will allow us to continue to increase our banking presence in the metropolitan Atlanta market;

we will be better positioned to compete and grow in a consolidating financial services industry as a result of a larger capital base, additional leadership and greater financial resources;

we should be able to obtain greater efficiencies and attain a higher level of financial performance than our two companies could achieve separately;

the management and core competencies of the two companies are complimentary, as both are focused on banking the real estate sector and owner managed businesses and on various deposit gathering strategies; and

the increase in our shareholder base may, over time, increase the liquidity and marketability of our shares.

**Regulatory Matters (page 48)**

We cannot complete our merger unless we obtain the approval of applicable bank regulatory authorities, including the Federal Reserve Bank of Atlanta (the Federal Reserve ) and the Georgia Department of Banking and Finance (the Georgia Department ). We are in the process of preparing and filing applications for approval of the merger with the Federal Reserve and the Georgia Department. In connection with the applications, we propose to issue and sell up to \$25,000,000 in trust preferred securities through a newly formed trust subsidiary



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of Flag in an offering to accredited investors that is exempt from the registration requirements of the Securities Act of 1933. The offering of the trust preferred securities by Flag will be subject to the prior approval of the Federal Reserve and the Georgia Department. In connection with applications, we also plan to raise at least \$5,000,000 in additional capital through the issuance of common stock upon the exercise of existing warrants, some of which are held by certain members of our senior management team. After the consummation of the merger, we propose to merge Flag Bank and First Capital Bank, with Flag Bank remaining as the surviving banking corporation. We cannot complete the proposed bank merger unless we obtain the approval of applicable bank regulatory authorities, including the Federal Deposit Insurance Corporation (the FDIC ) and the Georgia Department. We are in the process of preparing and filing applications for approval of the bank merger with the FDIC and the Georgia Department.

**Flag Shareholders Meeting (page 15)**

Flag will hold its special shareholders meeting on Tuesday, September 20, 2005 at 1:00 p.m. local time at its offices located at 3475 Piedmont Road, N.E., Suite 550, Atlanta, Georgia 30305.

**Flag s Record Date and Voting (page 15)**

If you owned shares of Flag stock at the close of business on July 29, 2005, the record date, you are entitled to vote on the merger agreement, as well as any other matters considered at the meeting. On the record date, there were 8,546,086 shares of Flag stock outstanding. You will have one vote at the meeting for each share of Flag stock you owned on the record date. The affirmative vote of at least a majority of all of the votes cast at the special meeting is required to approve the merger agreement. As of the record date, Flag s current directors, executive officers and their affiliates beneficially owned approximately 22.8% of the outstanding shares of Flag common stock. Each of Flag s directors and executive officers has agreed, subject to several conditions, to vote his or her shares of Flag common stock in favor of the merger agreement.

**Flag s Board Recommends Shareholder Approval (page 18)**

Flag s board of directors believes that the merger is in the best interest of Flag and its shareholders and recommends that the shareholders vote **FOR** approval of the merger agreement.

**First Capital Shareholders Meeting (page 15)**

First Capital will hold its special shareholders meeting on Tuesday, September 20, 2005 at 10:00 a.m. local time at the Country Club of Roswell located at 2500 Club Springs Drive, Roswell, Georgia 30076.

**First Capital s Record Date and Voting (page 15)**

If you owned shares of First Capital stock at the close of business on August 12, 2005, the record date, you are entitled to vote on the merger agreement as well as any other matters considered at the meeting. On the record date, there were 5,079,502 shares of First Capital stock outstanding. You will have one vote at the meeting for each share of First Capital stock you owned on the record date. The affirmative vote of at least a majority of all of the votes entitled to be cast at the special meeting is required to approve the merger agreement. As of the record date, First Capital's directors and executive officers and their affiliates beneficially owned approximately 43% of the outstanding shares of First Capital common stock. Each of First Capital's directors and executive officers has agreed, subject to several conditions, to vote his or her shares of First Capital common stock in favor of the merger agreement.

**First Capital's Board Recommends Shareholder Approval (page 18)**

First Capital's board of directors believes that the merger is in the best interest of First Capital and its shareholders and recommends that the shareholders vote **FOR** approval of the merger agreement.

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**Interests of Directors and Officers of Flag and First Capital that Differ from Your Interests (page 43)**

When considering the recommendations of the Flag and First Capital boards of directors, you should be aware that some directors and officers have interests in the merger that differ from the interests of other shareholders, including the following:

in connection with the merger, Flag will pay cash to any non-institutional First Capital shareholder that would own more than 384,000 shares of Flag common stock following the merger will receive a cash payment, in lieu of shares of Flag common stock over the 384,000 share threshold, equal to the number of such excess shares multiplied by \$14.76 per share, the average closing price of Flag's common stock for the 20 trading days immediately following the public announcement of the merger. William R. Blanton, the vice chairman, chief financial officer and chief operating officer of First Capital, will receive a cash payment of approximately \$19.1 million as a result of this provision;

William R. Blanton has entered into a non-compete and consulting agreement with Flag pursuant to which he has agreed to be subject to non-compete covenants and to provide consulting services to Flag for a term of 21 months following the merger in exchange for a payment of \$900,000, and Flag has agreed to reimburse Mr. Blanton for up to \$20,000 in legal expenses incurred by him in connection with the non-compete and consulting agreement;

following the merger, Flag will employ H. N. Padget, Jr. as executive vice president of Flag and president of Flag Bank. We expect Mr. Padget will receive an annual base salary equal to \$180,000 and incentive compensation based on factors to be determined by the board of directors. Mr. Padget's employment agreement will have an initial term of one year, which will automatically renew each day after the effective date such that the term remains a 12-month term until either party gives notice of termination, except in the event of Mr. Padget's death;

following the merger, Flag will employ Steven G. Deaton as executive vice president of Flag Bank. We expect Mr. Deaton will receive an annual base salary equal to \$160,000 and incentive compensation based on factors to be determined by the board of directors. Mr. Deaton's employment agreement will have an initial term of one year, which will automatically renew each day after the effective date such that the term remains a 12-month term until either party gives notice of termination, except in the event of Mr. Deaton's death;

the initial board of directors of the combined company will include three current First Capital directors to be selected by the board of directors of First Capital and approved by Flag, one of whom will be H.N. Padget, Jr.;

following the merger, Flag will transfer to William R. Blanton the software development and deposit and loan production program of First Capital called Good Shepherds, which is targeted towards churches and other faith-based organizations, and First Capital and Flag have agreed, at Mr. Blanton's expense, to permit continued development of the software until the completion of the merger. In consideration of the transfer, Mr. Blanton will pay Flag cash equal to an 8% premium on the principal balance of the deposits developed by the Good Shepherds program as of May 26, 2005, and the principal balance of the loans developed by the Good Shepherds program, plus all accrued interest and other charges;

in connection with the merger agreement, Flag has agreed to provide generally to officers and employees of First Capital, who after the merger become employees of Flag or its subsidiaries, employee benefits under employee benefit plans, on terms and conditions substantially similar to those currently provided to similarly situated Flag officers and employees;

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in the event Messrs. Padgett and Deaton or any of the directors of First Capital are terminated, resign or are removed following the merger, they will receive retirement benefits under the supplemental retirement agreements as if they had been continuously employed until age 65 and their beneficiaries will receive the death benefit set forth in the split dollar agreements as if they had died while serving on the board of directors or while employed by First Capital or First Capital Bank, as applicable; and

following the merger, Flag will generally indemnify and provide liability insurance to the current directors and officers of First Capital.

The board of directors of each of Flag and First Capital were aware of these and other interests and considered them before approving and adopting the merger agreement.

### **Federal Income Tax Consequences (page 41)**

First Capital's shareholders generally will not recognize gain or loss for federal income tax purposes on the receipt of shares of Flag common stock in the merger in exchange for the shares of First Capital stock surrendered. First Capital shareholders will be taxed, however, on any cash that they receive instead of any shares of Flag stock, including cash in lieu of fractional shares of Flag stock. Flag shareholders also generally will have no tax consequences as a result of the merger. However, First Capital and Flag shareholders who properly exercise their rights to dissent from the merger will generally be taxed on all or a portion of the cash they receive. Tax matters are complicated, and the tax consequences of the merger vary among shareholders. We urge you to contact your own tax advisor to fully understand how the merger will affect you.

### **Comparative Rights of Shareholders (page 102)**

Both Flag and First Capital are incorporated under the laws of the State of Georgia and are subject to the laws set forth in the Georgia Business Corporation Code. Upon consummation of the merger, the shareholders of First Capital will become shareholders of Flag and the articles of incorporation and bylaws of Flag will govern their rights. Flag's articles of incorporation and bylaws differ somewhat from those of First Capital.

### **Conditions of the Merger (page 46)**

The completion of the merger depends on the fulfillment of a number of conditions, including the following:

Flag and First Capital shareholders must approve the merger agreement;

we must receive all required regulatory approvals, and any waiting periods required by law must have passed (see Regulatory Matters above);

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we must receive a legal opinion from counsel confirming the tax-free nature of the merger;

each party's representations, warranties, agreements and covenants, which are contained in the merger agreement, must be accurate in all material respects and must have been duly performed and complied with in all material respects;

each party must have delivered officers' certificates and its counsel's legal opinions to the other;

H. N. Padget, Jr. must have entered into an employment agreement with Flag, and must have terminated his existing employment agreement with First Capital;

each of the executive officers and directors of Flag and First Capital must have entered into a support agreement pursuant to which they agree to vote their shares in favor of the merger;

Flag must have received from each affiliate of First Capital an agreement stating, among other things, that he or she will comply with federal securities laws when transferring any shares of Flag common stock received in the merger (see Terms of the Merger Resales of Flag Common Stock );

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the registration statement registering the shares of Flag common stock to be received by First Capital shareholders, of which this joint proxy statement/prospectus is a part, must have been declared effective by the Securities and Exchange Commission, and all necessary approvals under federal and state securities laws relating to the issuance or trading of the shares of Flag common stock issuable pursuant to the merger must have been received;

William R. Blanton shall have entered into a non-compete and consulting agreement with Flag pursuant to which he agrees to be subject to non-compete covenants and to provide consulting services to Flag for a term of 21 months. In addition, Mr. Blanton shall have terminated, effective as of and subject to the closing of the merger, any existing employment with First Capital and its subsidiaries;

Flag's board of directors must have elected the three directors from First Capital as the members of Flag's board of directors effective as of the effective time of the merger; and

shares of Flag common stock issuable pursuant to the merger must be approved for listing on the Nasdaq National Market or other market on which its common stock is then listed.

Unless prohibited by law, either Flag or First Capital can elect to waive a condition that has not been satisfied and complete the merger. We cannot be certain whether or when any of these conditions will be satisfied, or waived where permissible, or that we will complete the merger.

**Termination of the Merger Agreement (page 48)**

Notwithstanding the approval of the merger by Flag and First Capital shareholders, we can agree at any time to terminate the merger agreement before completing the merger.

Either Flag or First Capital can also terminate the merger agreement:

if the merger is not approved by the other party's shareholders;

if the other party materially violates any of its representations or warranties under the merger agreement and fails to cure the violation;

if we do not complete the merger by March 31, 2006; or

if any governmental body whose approval is necessary to complete the merger makes a final decision not to approve the merger.

Prior to the shareholder approval of the merger, either Flag or First Capital can terminate the merger, subject to a termination fee of \$2,000,000, in order to enter into a definitive agreement with respect to a superior acquisition proposal, if such party's board of directors determines in good faith that to do so would be consistent with its fiduciary duty to the shareholders.

**Dissenters Appraisal Rights (page 52)**

Georgia law permits First Capital's shareholders to dissent from approving the merger agreement and to have the fair value of their First Capital shares paid to them in cash. To do this, First Capital's shareholders must follow specific procedures, including filing a written notice with First Capital prior to First Capital's shareholder vote on the merger agreement. If you follow the required procedures, your only right will be to receive the fair value of your common stock in cash.

**Accounting Treatment (page 51)**

The merger will be accounted for using the purchase method of accounting, with First Capital being treated as the acquired entity for accounting purposes. Under the purchase method of accounting, the assets and liabilities of First Capital as of the effective time will be recorded at their respective fair values and added to those of Flag.

**Table of Contents****Index to Financial Statements****Flag's Dividends Following the Merger (page 108)**

First Capital has never paid a dividend on its common stock. Flag has historically paid quarterly dividends on its common stock. However, Flag's future dividend policy after the merger will depend on Flag's earnings, capital requirements, financial condition and other factors considered relevant by the board of directors of Flag.

**Market Price of Flag and First Capital Common Stock**

The common stock of Flag is traded on Nasdaq National Market under the symbol FLAG. The common stock of First Capital trades on the Over the Counter Bulletin Board under the symbol FCBX.OB. The market for First Capital's common stock must be characterized as a limited market due to its relatively low trading volume and little analyst coverage. Therefore, the closing sales prices provided herein reflect inter-dealer prices without retail mark-up, mark-down or commissions and may not necessarily represent actual transactions.

The following table sets forth the closing sales prices per share of Flag and First Capital common stock on May 26, 2005, the last trading day prior to the public announcement of the merger agreement, and on August 12, 2005, the latest practicable date prior to the mailing of this joint proxy statement/prospectus, as well the equivalent per share value of First Capital common stock on those dates.

	<u>Flag</u>	<u>First Capital</u>	<u>Equivalent Price of First Capital Common Stock(1)</u>
May 26, 2005	\$ 15.90	\$ 18.00	\$ 25.44
August 12, 2005	\$ 15.15	\$ 23.60	\$ 24.24

- (1) The equivalent prices per share of First Capital common stock have been calculated by multiplying the exchange ratio by the closing price of Flag common stock on that date.

Flag common stock was held by approximately 781 shareholders of record as of the record date. First Capital common stock was held by approximately 127 shareholders of record as of the record date.

**Because the exchange ratio is fixed and because the market price of Flag common stock is subject to fluctuation, the market value of the shares of Flag common stock that you may receive in the merger may increase or decrease prior to and following the merger. You are urged to obtain current market quotations for Flag common stock.**



Table of ContentsIndex to Financial Statements**Comparative Unaudited Per Share Data**

The following unaudited financial information presents certain comparative per share data (i) for Flag and First Capital on a historical basis, (ii) for Flag on a pro forma combined basis assuming the merger has been effective during the periods presented, and (iii) for First Capital on a pro forma equivalent basis. The pro forma combined information has been prepared giving effect to the merger under the purchase method of accounting with Flag treated as the acquirer.

The information shown below should be read in conjunction with (i) the consolidated financial statements of Flag and the related notes, incorporated by reference herein, (ii) the consolidated financial statements of First Capital and the related notes, appearing elsewhere in this joint proxy statement/prospectus, and (iii) the unaudited pro forma financial statements appearing elsewhere in this joint proxy statement/prospectus. See *Where You Can Find More Information*, *Unaudited Pro Forma Condensed Combined Financial Information*, and *Financial Statements of First Capital Bancorp, Inc. and Subsidiaries*. The following information is not necessarily indicative of the results of operations or combined financial position that would have resulted had the merger been consummated at the beginning of the periods presented, nor is it necessary indicative of the result of operations of future periods or future combined financial position.

	<b>Six Months Ended</b>	<b>Year Ended</b>
	<b>June 30, 2005</b>	<b>December 31, 2004</b>
	<hr/>	<hr/>
<b>Net Income Per Share Fully Diluted:</b>		
Historical Flag (1)	0.45	0.82
Historical First Capital (2)	0.50	0.80
Pro Forma Combined	0.36	0.56
First Capital Pro Forma Equivalent (3)	0.58	0.90
<b>Cash Dividends Declared Per Share:</b>		
Historical Flag (1)	0.12	0.24
Historical First Capital (2)		
Pro Forma Combined	0.12	0.24
First Capital Pro Forma Equivalent (3)	0.19	0.38
	<b>At Period Ended</b>	
	<hr/>	<hr/>
	<b>June 30, 2005</b>	<b>December 31, 2004</b>
	<hr/>	<hr/>
<b>Book Value Per Share</b>		
Historical Flag (4)	8.47	8.14
Historical First Capital (4)	11.73	11.30
Pro Forma Combined	11.62	11.77
First Capital Pro Forma Equivalent (3)	18.59	18.84

- (1) Based on the weighted average shares of common stock outstanding during the indicated periods.
- (2) Based on the weighted average shares of common stock and dilutive common stock equivalents outstanding during the indicated periods.
- (3) First Capital Pro Forma Equivalent amounts represent pro forma combined information multiplied by the exchange ratio of 1.6 shares of Flag common stock for each share of First Capital common stock.
- (4) Based on shares of common stock outstanding at the indicated date.



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Set forth below are highlights from Flag's consolidated financial data as of and for the years ended December 31, 2000 through 2004 and Flag's unaudited consolidated financial data as of and for the six months ended June 30, 2004 and 2005. This information should be read together with Flag's consolidated financial statements and related notes included in Flag's Annual Report on Form 10-K for the year ended December 31, 2004, which is incorporated by reference in this document and from which this information is derived.

(Dollars in thousands except per share data)	Six Months Ended June 30,		Year Ended December 31				
	(Unaudited)						
	2005	2004	2004	2003	2002	2001	2000
Net interest income	\$ 26,851	19,745	30,564	25,987	24,302	23,980	24,961
Provision for loan losses	375	1,095	1,845	1,321	4,549	2,488	3,597
Non-interest income	5,194	7,283	11,468	10,365	7,395	10,668	11,962
Non-interest expense	16,539	14,721	29,509	26,202	31,005	25,701	27,633
Earnings (loss) before income taxes	6,106	5,958	10,678	8,829	(3,857)	6,459	5,693
Income taxes	1,973	1,941	3,310	2,724	(2,028)	1,753	1,409
Extraordinary items					165	696	
Net earnings (loss) income	4,133	4,017	7,368	6,105	(1,994)	4,010	4,284
<b>PER COMMON SHARE</b>							
Basic earnings per common share	\$ 0.48	0.47	0.88	0.72	(0.24)	0.51	0.52
Diluted earnings per common share	0.45	0.44	0.82	0.67	(0.24)	0.51	0.52
Cash dividends declared	0.12	0.12	0.24	0.24	0.24	0.24	0.24
Book value	8.47	7.55	8.14	7.65	7.24	7.33	6.83
<b>PERIOD END BALANCES</b>							
Loans, net of unearned income	\$ 647,862	530,338	596,101	477,095	374,784	368,967	384,661
Earning assets	805,442	693,613	772,387	647,481	569,755	512,942	501,046
Assets	862,509	749,371	828,337	703,857	636,131	570,202	559,037
Deposits	740,803	610,636	706,847	570,570	509,731	440,582	461,438
Shareholders' equity	72,389	64,392	69,202	65,260	60,749	54,023	55,498
Common shares outstanding	8,546	8,333	8,503	8,528	8,394	7,370	8,333
<b>AVERAGE BALANCES</b>							
Loans, net of unearned income	\$ 611,506	497,017	541,502	417,395	366,571	378,867	405,101
Earning assets	780,975	661,420	690,187	587,484	511,737	508,752	510,898
Assets	837,974	714,916	743,082	645,430	560,984	560,816	566,355
Deposits	719,083	578,219	612,712	516,067	442,645	449,985	455,338
Shareholders' equity	70,424	66,568	65,854	63,299	58,865	56,294	53,853
Weighted average shares outstanding diluted	9,249	9,036	8,396	8,471	8,201	7,808	8,210
<b>KEY PERFORMANCE RATIOS</b>							
Return on average assets	0.99%	1.12%	0.99%	0.95%	(0.36)%	0.72%	0.77%
Return on average shareholders' equity	11.74%	12.07%	11.19%	9.64%	(3.39)%	7.12%	7.95%
Net interest margin	4.65%	4.47%	4.48%	4.50%	4.86%	4.83%	4.99%
Dividend payout ratio	24.56%	25.27%	27.38%	33.35%	N/A	46.27%	45.98%

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Average equity to average assets	8.40%	9.27%	8.86%	9.81%	10.49%	10.04%	9.31%
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**RISK FACTORS RELATING TO THE MERGER**

If the merger is consummated and you are a First Capital shareholder, you will receive shares of Flag common stock in exchange for your shares of First Capital common stock. An investment in Flag common stock is subject to a number of risks and uncertainties, many of which also apply to your existing investment in First Capital common stock. Risks and uncertainties relating to general economic conditions are not summarized below. Those risks, among others, are highlighted on page 14 under the heading **A Warning About Forward-Looking Statements**.

However, there are a number of other risks and uncertainties relating to Flag and your decision on the merger that you should consider in addition to the risks and uncertainties associated with financial institutions generally. Many of these risks and uncertainties could affect Flag's future financial results and may cause Flag's future earnings and financial condition to be less favorable than Flag's expectations. This section summarizes those risks.

**Your merger consideration is fixed despite any change in Flag's stock price.**

Each share of First Capital common stock owned by you will be converted into the right to receive 1.6 shares of Flag common stock. The price of Flag common stock when the merger takes place may vary from its price at the date of this joint proxy statement/prospectus and at the date of First Capital's special meeting. Because the exchange ratio will not be adjusted to reflect any changes in the market value of Flag or First Capital common stock, the market value of the Flag common stock issued in the merger and the First Capital common stock surrendered in the merger may be higher or lower than the values of such shares on such earlier dates. Such variations in the price of Flag common stock may result from changes in the business, operations or prospects of Flag, regulatory considerations, general market and economic conditions and other factors. At the time of First Capital's special meeting, you will not know the exact value of the consideration you will receive when the merger is completed.

**You will experience a reduction in percentage ownership and voting power with respect to your shares as a result of the merger.**

Flag shareholders and First Capital shareholders will experience a substantial reduction in their respective percentage ownership interests and effective voting power relative to their respective percentage ownership interests in Flag and First Capital prior to the merger. If the merger is consummated, current Flag shareholders will own approximately 55.6% of Flag's outstanding common stock, on a fully diluted basis, and current First Capital shareholders will own approximately 44.4% of Flag's outstanding common stock, on a fully diluted basis. Accordingly, current First Capital shareholders will own less than a majority of the outstanding voting stock of the combined company and could, as a result, be outvoted by the current Flag shareholders if such current Flag shareholders voted together as a group. Therefore, neither group of shareholders will have the same control over the combined company as they currently have over their respective companies.

In the future, Flag may issue additional shares in public offerings, mergers and acquisitions or otherwise, all of which would further reduce your percentage ownership in Flag.

**If Flag and First Capital do not successfully integrate, the combined company may not realize the expected benefits from the merger.**

Flag and First Capital expect that the combined company will be able to maintain most of First Capital's and Flag's key customers and personnel and integrate their systems and procedures with a minimal amount of cost and diversion of management time and attention. There is a risk that integrating the two companies may take a greater amount of resources and time than we expect.

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Integrating a merger of similar size companies is difficult. The integration process relies on the combination of the management teams of both Flag and First Capital into an effective unit, and the melding of two bank holding companies that have previously operated independently. Accordingly, we may not be able to integrate the operations of the two companies without encountering difficulties. Such difficulties could include interruptions and dislocations associated with integrating the operating cultures and business strategies of the two companies. Furthermore, one-fourth of Flag's board of directors after the merger will consist of former First Capital directors. Disagreements among the board members of the combined company may result concerning the allocation of resources to various lines of business, strategic considerations relating to the emphasis or elimination of business groups and other matters. Flag's board of directors may not be able to work together successfully following the merger. In addition, persuading employees that the business cultures of Flag and First Capital are compatible, maintaining employee morale and retaining key employees are additional challenges involved in integrating the two companies.

Upon the completion of the merger, we plan to merge Flag Bank and First Capital Bank, the respective bank subsidiaries of Flag and First Capital, with Flag Bank being the surviving banking corporation. The bank merger will be subject to the approval of regulatory authorities, including the FDIC and the Georgia Department. The failure to receive the required approval for the bank merger may impair our ability to achieve the benefits of the merger and the anticipated cost savings.

Flag's ability to achieve the benefits of the merger depends on successfully integrating the two companies. Accordingly, if we are unable to integrate the merger in a timely manner, fail to realize anticipated cost savings, or disrupt customer relationships, there is a risk that the anticipated benefits may not be realized or that they may be less than we expect.

**In order to be successful, the combined company must retain the relationships of its directors and retain and motivate its key employees, and the failure to do so could seriously harm the combined company.**

The combined company's future success depends, in large part, upon the continuing contributions of the directors of First Capital Bank and Flag Bank as well as their key management personnel. If we lose the services of one or more of these important individuals following the merger, Flag could be adversely affected. Flag's future success is also dependent upon its continuing ability to attract and retain other highly qualified personnel. Although each of H.N. Padget, Jr., who will serve as executive vice president of Flag and president of Flag Bank after the merger, Steven G. Deaton, who will serve as executive vice president of Flag Bank after the merger, and William R. Blanton, who will serve as a consultant after the merger, will be subject to their respective employment agreements and consulting agreement, we cannot be assured of their continued service. Because we will continue to be customer focused and relationship driven, our directors' and key employees' community involvement, diverse backgrounds and extensive local business relationships are important to our future success. The unexpected loss of services of one or more of our key employees or directors could have a material adverse effect on our operations and possibly result in reduced earnings and revenues.

**The capital we intend to raise prior to completing the merger may not be adequate to support our future growth following the merger.**

In connection with our applications to the Federal Reserve and the Georgia Department for approval of the merger, we have proposed to raise \$25 million in additional capital through the issuance of trust preferred securities and \$5 million in additional capital through the issuance of common stock upon the exercise of the existing warrants, some of which are held by members of our senior management team. While we believe that the capital to be raised will be sufficient to meet our immediate capital needs following the merger, such amounts may be inadequate to support our growth or to maintain our minimum capital requirements. Consequently, we may need to seek additional long- and short-term financing, including subsequent sales of our common stock and/or preferred stock, to support any additional needs. Such financing, if needed, may not be available or, if available, may not be on terms acceptable to us. In the event such financing is needed and is not available, we may be

limited in our ability to grow in the future and our results of operations and financial condition may be adversely affected.



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**Additional issuances of Flag common stock may dilute your ownership, and shareholders do not enjoy preemptive rights.**

No holder of Flag common stock has preemptive rights with respect to the future issuance of shares of any class of Flag capital stock. We are authorized to issue up to 20,000,000 shares of common stock without the approval of shareholders, of which approximately 7,599,650 shares are expected to be issued upon completion of the merger, and of which approximately 16,145,736 shares are expected to be outstanding upon completion of the merger. Flag's directors could from time to time decide to issue additional shares of common stock in addition to the shares to be issued in the merger and the shares to be issued in this offering. The sale of additional shares of Flag common stock may be at prices lower than the price at which you purchase shares or on terms better than those of shares you purchase.

In addition, if the merger is completed, each existing option to purchase First Capital common stock will be converted into the right to purchase shares of Flag common stock. Holders of these options and Flag's original directors, officers and employees who hold options to purchase Flag common stock may exercise those options, which would result in the dilution of your proportionate interest in Flag. These individuals will have the opportunity to profit from any rise in the market value of the common stock or any increase in Flag's net worth. As of June 30, 2005, there were 555,672 options outstanding to purchase First Capital common stock, and as of June 30, 2005 there were 2,004,237 options and warrants outstanding to purchase Flag common stock. Based on the number of outstanding options and warrants as of June 30, 2005, following the completion of the merger, there will be 2,125,263 outstanding options and warrants to purchase Flag common stock, which will represent, post-merger, 11.6% of the outstanding common stock, options and warrants of Flag.

The exercise of options for the purchase of our common stock also could adversely affect the terms on which Flag can obtain additional capital. For instance, the holders of options may choose to exercise their options, when the securities underlying those options otherwise could be offered to others on terms and at prices more favorable to us than the terms and exercise prices provided for in the options.

**Flag may not pay dividends in the future.**

Flag has historically paid quarterly dividends of \$0.06 per share. However, no assurance can be provided that Flag will continue to pay dividends following the merger. After the merger, Flag's ability to pay dividends will depend largely on the ability of Flag Bank to pay dividends to Flag, which will be based primarily on Flag Bank's earnings, capital requirements and financial condition, among other factors. Bank holding companies and their bank subsidiaries are both subject to significant regulatory restrictions on the payment of cash dividends. Flag's dividend policy will depend on its earnings, capital requirements and financial condition, as well as other factors its board of directors considers relevant. See Comparative Rights of First Capital Shareholders and Flag Shareholders Dividends.

**The merger agreement limits Flag's and First Capital's abilities to pursue alternatives to the merger.**

The merger agreement contains no-solicitation provisions that, subject to specific exceptions, limit Flag's and First Capital's ability to discuss, facilitate or commit to competing third-party proposals to acquire all or a significant part of either Flag or First Capital. In addition, Flag or First Capital have agreed that if the merger agreement is terminated under certain circumstances, Flag or First Capital will pay the other a termination fee of \$2,000,000. These provisions might discourage a potential competing acquirer that might have an interest in acquiring all or a significant part of Flag or First Capital from considering or proposing an acquisition even if it were prepared to pay consideration with a higher per share price than that proposed in the merger, or might result in a potential competing acquirer proposing to pay a lower per share price to acquire Flag or First Capital than it might otherwise have proposed to pay.



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**The merger is subject to certain closing conditions that, if not satisfied or waived, will result in the merger not being completed, which may cause the market price of Flag common stock or First Capital common stock to decline.**

The merger is subject to customary conditions to closing, including the approval of regulatory authorities, including the Federal Reserve and the Georgia Department, and the receipt of required approvals of the shareholders of Flag and First Capital. If any condition to the merger is not satisfied or, if permissible, waived, the merger will not be consummated. In addition, Flag and First Capital may terminate the merger agreement in certain circumstances. If Flag and First Capital do not complete the merger, the market price of Flag or First Capital common stock may fluctuate to the extent that the current market prices of those shares reflect a market assumption that the mergers will be completed. Flag and First Capital will also be obligated to pay certain investment banking, financing, legal and accounting fees and related expenses in connection with the merger, whether or not the mergers are completed. In addition, Flag and First Capital have and will continue to divert significant management resources in an effort to complete the merger and are each subject to restrictions contained in the merger agreement on the conduct of its business. If the merger is not completed, Flag and First Capital will each have incurred significant costs, including the diversion of management resources, for which it will have received little or no benefit. Further, in specified circumstances, Flag and First Capital may be required to pay to the other a termination fee of \$2,000,000 if the merger agreement is terminated. For a detailed description of the circumstances in which such termination fee will be paid, see Terms of the Merger Amendment, Waiver and Termination.

**Directors and Officers of Flag and First Capital may have potential conflicts of interest in recommending that you vote in favor of the adoption of the merger agreement.**

A number of directors and officers of Flag and First Capital, who recommend that you vote in favor of the adoption of the merger agreement, have employment, consulting or severance agreements, equity compensation and other benefit arrangements or other interests that provide them with interests in the merger that differ from yours. In addition, certain directors of First Capital will continue as directors of Flag while other directors will not, and in either case, Flag will indemnify and provide insurance for their services as directors of Flag and First Capital prior to the merger. You should be aware of these interests when you consider your board of directors' recommendation that you vote in favor of the merger. For a detailed description of the interests of Flag and First Capital's directors and officers in the merger, see Terms of the Merger Interests of Employees and Directors of Flag and First Capital.

**A WARNING ABOUT FORWARD-LOOKING STATEMENTS**

We make forward-looking statements in this joint proxy statement/prospectus and the documents or information incorporated by reference in this joint statement/prospectus that are subject to risks and uncertainties. These forward-looking statements include information about possible or assumed future results of our operations or our performance after the merger. Also, when we use any of the words believes, expects, anticipates or similar expressions, we are making forward-looking statements. **Many possible events or factors could affect our future financial results and performance. This could cause our results or performance to differ materially from those expressed in our forward-looking statements. You should consider these important factors when you vote on the merger.** Factors that may cause actual results to differ materially from those contemplated by our forward-looking statements include the following:

our operating costs after the merger may be greater than expected, and our cost savings from the merger may be less than expected, or we may be unable to obtain those cost savings as soon as expected;

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we may be unable to successfully integrate First Capital or we may have more trouble integrating acquired businesses than we expected;

we could lose our key personnel, including the First Capital personnel we will employ as a result of the merger, or spend a greater amount of resources attracting, retaining and motivating them than we have in the past;

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competition among depository and other financial institutions may increase significantly;

changes in the interest rate environment may reduce operating margins;

general economic or business conditions, including acquisition and growth opportunities, may be worse than expected;

legislative or regulatory changes may adversely affect our businesses; and

the continuing war in Iraq, the military deployment in Afghanistan and the war on terrorism, as well as actions taken or to be taken by the United States and other governments as a result of future acts or threats of terrorism.

We have based our forward-looking statements on our current expectations about future events. Although we believe that the expectations reflected in our forward-looking statements are reasonable, we cannot guarantee you that these expectations actually will be achieved. We are under no duty to update any of the forward-looking statements after the date of this joint proxy statement/prospectus to conform those statements to actual results. In evaluating these statements, you should consider various factors, including the risks outlined in the section entitled "Risk Factors Relating to the Merger." You should also consider the cautionary statements contained in Flag's and First Capital's filings with the Securities and Exchange Commission.

**THE SPECIAL MEETINGS**

**General**

**First Capital.** With respect to First Capital shareholders, this document constitutes a proxy statement of First Capital and a prospectus of Flag and is being mailed by First Capital and Flag to First Capital shareholders of record on or about August 18, 2005, together with the notice of the special meeting of shareholders of First Capital and a proxy solicited by First Capital's board of directors for use at the special meeting and at any adjournments or postponements of the meeting.

**Flag.** With respect to Flag shareholders, this document constitutes a proxy statement of Flag and is being mailed by Flag to Flag shareholders of record on or about August 18, 2005, together with the notice of the special meeting of shareholders of Flag and a proxy solicited by Flag's board of directors for use at the special meeting and at any adjournments or postponements of the meeting.

**Meeting Dates, Times and Places and Record Dates**

**First Capital.** The First Capital special meeting will be held at the Country Club of Roswell, 2500 Club Springs Drive, Roswell, Georgia, at 10:00 a.m., local time, on Tuesday, September 20, 2005. Only holders of First Capital common stock of record at the close of business on August 12, 2005 will be entitled to receive notice of and to vote at the special meeting. As of the record date, there were 5,097,502 shares of

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First Capital common stock outstanding and entitled to vote, with each such share entitled to one vote.

**Flag.** The Flag special meeting will be held at its office located at 3475 Piedmont Road, N.E., Suite 550, Atlanta, Georgia, at 1:00 p.m., local time, on Tuesday, September 20, 2005. Only holders of Flag common stock of record at the close of business on July 29, 2005 will be entitled to receive notice of and to vote at the special meeting. As of the record date, there were 8,546,086 shares of Flag common stock outstanding and entitled to vote, with each such share entitled to one vote.

### **Matters to be Considered**

**First Capital.** At the First Capital special meeting, First Capital shareholders will be asked to approve the Agreement and Plan of Merger, dated as of May 26, 2005 by and between First Capital and Flag. Under the

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merger agreement, First Capital will merge with and into Flag and shares of First Capital common stock will be converted into the right to receive shares of Flag common stock. First Capital shareholders may also be asked to consider any other business that properly comes before the special meeting. Finally, First Capital shareholders may be asked to vote on a proposal to adjourn or postpone the special meeting, which could be used to allow more time for soliciting additional votes to approve the merger agreement. Each copy of this proxy statement/prospectus mailed to First Capital shareholders is accompanied by a proxy card for use at the special meeting.

**Flag.** At the Flag special meeting, Flag shareholders will be asked to approve the merger agreement. Flag shareholders may also be asked to consider any other business that properly comes before the special meeting. Finally, Flag shareholders may be asked to vote on a proposal to adjourn or postpone the special meeting, which could be used to allow more time for soliciting additional votes to approve the merger agreement. Each copy of this proxy statement mailed to Flag shareholders is accompanied by a proxy card for use at the special meeting.

### **Vote Required**

**First Capital.** Under Georgia law, approval of the merger agreement requires the affirmative vote of the holders of at least a majority of all of the outstanding shares of First Capital common stock. On the record date, there were approximately 5,079,502 outstanding shares of First Capital common stock, each of which is entitled to one vote at the special meeting. On that date, the directors and executive officers of First Capital and their affiliates beneficially owned a total of approximately 43% of the outstanding shares of First Capital common stock. Each of First Capital's directors and executive officers has agreed, subject to several conditions, to vote his or her shares of First Capital common stock in favor of the merger agreement. Accordingly, we believe it is highly likely that the merger agreement will be approved by First Capital's shareholders. As of the date of this joint proxy statement/prospectus, neither Flag nor any of its affiliates owned any outstanding shares of First Capital common stock. The presence, in person or by proxy, of shares of First Capital common stock representing a majority of First Capital's outstanding shares entitled to vote at the special meeting is necessary in order for there to be a quorum at the special meeting. A quorum must be present in order for the vote on the merger agreement to occur.

**Flag.** Approval of the merger agreement requires the affirmative vote of the holders of at least a majority of the votes cast at the special meeting. On the record date, there were approximately 8,546,086 outstanding shares of Flag common stock, each of which is entitled to one vote at the special meeting. On that date, the directors and officers of Flag and their affiliates beneficially owned a total of approximately 22.8% of the outstanding shares of Flag common stock. Each of Flag's directors and executive officers has agreed, subject to several conditions, to vote his or her shares of Flag common stock in favor of the merger agreement. As of the date of this joint proxy statement/prospectus, neither First Capital nor any of its affiliates owned any outstanding shares of Flag common stock. The presence, in person or by proxy, of shares of Flag common stock representing a majority of Flag's outstanding shares entitled to vote at the special meeting is necessary in order for there to be a quorum at the special meeting. A quorum must be present in order for the vote on the merger agreement to occur.

### **Voting of Proxies**

**First Capital.** Shares of common stock represented by properly executed proxies received at or prior to the First Capital special meeting will be voted at the special meeting in the manner specified by the holders of such shares. Properly executed proxies that do not contain voting instructions will be voted **FOR** approval of the merger agreement, and as determined by a majority of the proxies, as to any other matter that may come before the special meeting, including, among other things, a motion to adjourn or postpone the special meeting to another time for the purpose of soliciting additional proxies or otherwise. However, no proxy with instructions to vote against the merger will be voted in favor of any adjournment or postponement of the special meeting. Any shareholder present in person or by proxy (including broker non-votes, which generally occur when a broker who holds shares in street name for a customer does not have the authority to vote on certain non-routine matters

because its customer has not provided any voting instructions with respect to the matter) at the special meeting who abstains from voting will be counted for purposes of determining whether a quorum exists.

**Because approval of the merger agreement requires the affirmative vote of at least a majority of all the outstanding shares of First Capital common stock entitled to vote at the special meeting, abstentions**



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**and broker non-votes will have the same effect as negative votes. Accordingly, First Capital's board of directors urges its shareholders to complete, date and sign the accompanying proxy card and return it promptly in the enclosed, postage-paid envelope.**

If any other matters are properly presented at the special meeting, the person or persons named in the proxy card enclosed with this joint proxy statement/prospectus and acting thereunder will have discretion to vote on such matters in accordance with their best judgment, unless the proxy indicates otherwise. First Capital has no knowledge of any matters to be presented at the special meeting, other than the matters described in this joint proxy statement/prospectus.

**Flag.** Shares of common stock represented by properly executed proxies received at or prior to the Flag special meeting will be voted at the special meeting in the manner specified by the holders of such shares. Properly executed proxies that do not contain voting instructions will be voted **FOR** approval of the merger agreement, and as determined by a majority of the proxies, as to any other matter that may come before the special meeting, including, among other things, a motion to adjourn or postpone the special meeting to another time for the purpose of soliciting additional proxies or otherwise. However, no proxy with instructions to vote against the merger will be voted in favor of any adjournment or postponement of the special meeting. Any shareholder present in person or by proxy (including broker non-votes) at the special meeting who abstains from voting will be counted for purposes of determining whether a quorum exists.

**Because approval of the merger agreement requires the affirmative vote of at least a majority of the votes cast at the special meeting, abstentions and broker non-votes will have no effect on the outcome of the Flag shareholder vote. Flag's board of directors urges its shareholders to complete, date and sign the accompanying proxy card and return it promptly in the enclosed, postage-paid envelope.**

If any other matters are properly presented at the special meeting, the person or persons named in the proxy card enclosed with this joint proxy statement/prospectus and acting thereunder will have discretion to vote on such matters in accordance with their best judgment, unless the proxy indicates otherwise. Flag has no knowledge of any matters to be presented at the special meeting, other than the matters described in this joint proxy statement/prospectus.

**Revocability of Proxies**

**First Capital.** The grant of a proxy on the enclosed proxy card does not preclude you from voting in person or otherwise revoking a proxy. You may revoke a proxy at any time prior to its exercise by delivering to the secretary of First Capital either a duly executed revocation or a proxy bearing a later date. In addition, you may revoke a proxy prior to its exercise by voting in person at the special meeting. All written notices of revocation and other communications with respect to the revocation of First Capital proxies should be addressed to First Capital Bancorp, Inc., 3320 Holcomb Bridge Road, N.W., Suite A, Norcross, Georgia 30092, Attention: Secretary. Attendance at the special meeting will not in and of itself constitute revocation of a proxy.

**Flag.** The grant of a proxy on the enclosed proxy card does not preclude you from voting in person or otherwise revoking a proxy. You may revoke a proxy at any time prior to its exercise by delivering to the secretary of Flag either a duly executed revocation or a proxy bearing a later date. In addition, you may revoke a proxy prior to its exercise by voting in person at the special meeting. All written notices of revocation and other communications with respect to the revocation of Flag proxies should be addressed to Flag Financial Corporation, 3475 Piedmont Road, N.E., Suite 550, Atlanta, Georgia 30305, Attention: Secretary. Attendance at the special meeting will not in and of itself constitute revocation of a proxy.

**Solicitation of Proxies**

**First Capital.** First Capital will pay all of the costs of soliciting proxies in connection with its special meeting, except that Flag will pay the costs of filing the registration statement with the SEC, of which this joint

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proxy statement/prospectus is a part, and one-half of the costs of printing the registration statement and this joint proxy statement/prospectus. Solicitation of proxies may be made in person or by mail, telephone or facsimile, or other form of communication by directors, officers and employees of First Capital who will not be specially compensated for such solicitation. Nominees, fiduciaries and other custodians will be requested to forward solicitation materials to beneficial owners and to secure their voting instructions, if necessary, and will be reimbursed for the expenses incurred in sending proxy materials to beneficial owners.

**Flag.** Flag will pay all of the costs of soliciting proxies in connection with its special meeting and one-half of the costs of printing the registration statement and this joint proxy statement/prospectus. Solicitation of proxies may be made in person or by mail, telephone or facsimile, or other form of communication by directors, officers and employees of Flag who will not be specially compensated for such solicitation. Nominees, fiduciaries and other custodians will be requested to forward solicitation materials to beneficial owners and to secure their voting instructions, if necessary, and will be reimbursed for the expenses incurred in sending proxy materials to beneficial owners.

### **Recommendations of the Boards of Directors**

**First Capital.** First Capital's board of directors (except for Mr. Blanton who abstained due to a conflict of interest) has approved the merger agreement and the transactions contemplated thereby, believes that the merger is in the best interests of First Capital and its shareholders, and recommends that First Capital shareholders vote **FOR** approval of the merger agreement.

In the course of reaching its decision to approve the merger agreement and the transactions contemplated in the merger agreement, First Capital's board of directors, among other things, consulted with its legal advisors, Troutman Sanders LLP, regarding the legal terms of the merger agreement and with its financial advisor, Burke Capital Group, L.L.C. ( Burke Capital ), as to the fairness, from a financial point of view, of the consideration to be received by the holders of First Capital common stock in the merger. For a discussion of the factors considered by First Capital's board of directors in reaching its conclusion, see Background of and Reasons for the Merger First Capital's Reasons for the Merger.

First Capital shareholders should note that First Capital's directors have certain interests in, and may derive benefits as a result of, the merger that are in addition to their interests as shareholders of First Capital. Specifically, William R. Blanton, First Capital's vice chairman, chief financial officer and chief operating officer, as a non-institutional shareholder, will be entitled to receive a cash payment of approximately \$19.1 million, in lieu of approximately 1,295,602 shares of Flag common stock he would otherwise be entitled to receive as merger consideration. Given that the merger consideration Mr. Blanton will receive is different from other First Capital shareholders, Mr. Blanton abstained from voting to approve the merger and recommending it to shareholders as a result of his conflict of interest. See Terms of the Merger Interests of Employees and Directors of Flag and First Capital in the Merger.

**Flag.** Flag's board of directors has approved the merger agreement and the transactions contemplated thereby, believes that the merger is in the best interests of Flag and its shareholders, and recommends that Flag shareholders vote **FOR** approval of the merger agreement.

In the course of reaching its decision to approve the merger agreement and the transactions contemplated in the merger agreement, Flag's board of directors, among other things, consulted with its legal advisors, Morris, Manning & Martin, LLP, regarding the legal terms of the merger agreement and with its financial advisor, Sandler O'Neill & Partners, L.P. ( Sandler O'Neill ), as to the fairness, from a financial point of view, of the consideration to be paid by Flag to the holders of First Capital common stock in the merger. For a discussion of the factors considered by Flag's board of directors in reaching its conclusion, see Background of and Reasons for the Merger Flag's Reasons for the Merger.

Flag shareholders should note that Flag's directors have certain interests in, and may derive benefits as a result of, the merger that are in addition to their interests as shareholders of Flag. See "Terms of the Merger - Interests of Employees and Directors of Flag and First Capital in the Merger."

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**BACKGROUND OF AND REASONS FOR THE MERGER**

**Background of the Merger**

Over the last five years, a consolidation in the banking industry has occurred. This consolidation has been fueled by, among other things, national and state banking-related legislation that has enabled certain financial institutions to benefit from the economies of scale and greater efficiencies available to combined entities. Financial institutions have increasingly sought suitable combinations as a means of obtaining such benefits.

Senior management of both Flag and First Capital have regularly reviewed with their respective boards of directors the possible benefits of strategic business combinations with other financial institutions. In each case, these reviews have been considered in light of each institution's ongoing evaluation of its available strategies to increase shareholder value and strengthen its franchise in order to better compete in the consolidating market for financial services and products. In addition, both Flag's and First Capital's senior management teams reviewed market conditions with their counterparts at other financial institutions.

In late November 2004, representatives from Burke Capital met with First Capital's board of directors and informed the directors that a regional bank holding company had expressed initial interest in acquiring First Capital. After the presentation by Burke Capital, the First Capital board discussed pursuing a possible transaction and how that would fit with First Capital's long-term strategic plans. After discussion, the First Capital board decided to further pursue a potential transaction in order to maximize shareholder value and engaged Burke Capital to assist them in analyzing and evaluating any proposed transaction. Between December 2004 and early February 2005, senior management of First Capital and representatives of Burke Capital had ongoing discussions with the other interested party regarding a proposed transaction.

In early February 2005, Joseph W. Evans, chairman, president and chief executive officer of Flag, contacted William R. Blanton, vice chairman, chief financial officer and chief operating officer of First Capital to inquire whether First Capital would consider a potential transaction with Flag. Mr. Blanton suggested that Mr. Evans contact H.N. Padgett, Jr., president and chief executive officer of First Capital, to discuss Mr. Evans' ideas for combining the two companies. On February 14, 2005, Mr. Padgett met with Mr. Evans and J. Thomas Wiley, Jr., vice chairman and chief banking officer of Flag, at Flag's offices to discuss the possibility of a strategic merger. Mr. Padgett and Mr. Wiley met again the following day to continue the discussions and to discuss Flag's long-term strategic plans.

Following the meetings with Messrs. Evans and Wiley, on February 16, 2005, Mr. Padgett brought the First Capital board up to date on his discussions with Flag and the continued discussions with the other interested party. The executive committee of First Capital authorized continued discussions with both interested parties regarding a proposed transaction. On the same day, representatives from Sandler O'Neill met with Flag's executives to discuss the structure and pro forma financial impact of a potential transaction between Flag and First Capital.

On February 17, 2005, the Flag board of directors met by conference call to receive a report from Mr. Evans regarding the meetings with First Capital's representatives and to discuss the possibility of a merger with First Capital. During this call, the board authorized Flag's executive management to enter into a non-binding letter of intent with First Capital regarding a merger with First Capital. From this time until March 16, 2005, Mr. Padgett and David R. Hink, chairman of First Capital, had meetings with Mr. Wiley and J. Daniel Speight, vice chairman and chief financial officer of Flag, regarding the structure of any transaction between First Capital and Flag and how such transaction would impact Flag's long-term strategic plans. During this time, senior management of First Capital and representatives of Burke Capital also continued discussions

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with representatives of the other party interested in acquiring First Capital. At the March 16, 2005 meeting of the First Capital board of directors, the First Capital directors were informed of the status of the discussions with the interested parties and authorized management of First Capital to continue negotiations with both parties.

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On March 24, 2005, Messrs. Padget and Hink and representatives of Burke Capital met with Messrs. Evans and Wiley and representatives of Sandler O'Neill, Flag's financial advisor, to discuss the proposed transaction. At this meeting, Flag presented its proposed terms for a merger between the two companies. Following this meeting, the terms proposed by Flag were forwarded to Mr. Blanton for his review.

On March 25, 2005, Flag's board of directors conducted another conference call to discuss the status of negotiations with respect to the merger.

On March 29, 2005, Messrs. Blanton, Hink and Padget met with representatives of Burke Capital to discuss the terms proposed by Flag. Following these discussions, they requested that Burke Capital, on behalf of First Capital, continue to negotiate with representatives of Flag and Sandler O'Neill on the proposed terms. Thereafter, representatives of Burke Capital and Sandler O'Neill, as well as senior management of both Flag and First Capital, met on a number of occasions to discuss various issues with respect to the proposed merger. These discussions focused on the keys terms of any transaction between the parties, including financial terms, transaction structure, management and succession plans and potential integration, transition and regulatory issues. Based on these discussions, on April 1, 2005, Flag delivered to First Capital a non-binding letter of intent regarding the proposed merger.

The executive committee of First Capital's board of directors met on April 5, 2005 to discuss the letter of intent delivered by Flag. At this meeting, representatives of Burke Capital informed the committee that they had shared Flag's proposed terms with the other party interested in pursuing a transaction with First Capital and had been informed by that interested party that they would be unable to match the terms proposed by Flag. Following a lengthy discussion on Flag's proposed terms, the First Capital executive committee authorized Mr. Padget to execute the letter of intent and also authorized management of First Capital to direct Troutman Sanders LLP, as First Capital's legal counsel, to assist management in preparing a definitive merger agreement between First Capital and Flag and further directed management to conduct a due diligence review of Flag's operations.

Between April 1, 2005 and May 25, 2005, representatives of Flag, First Capital, Troutman Sanders, Morris Manning & Martin, LLP, Flag's legal counsel, as well as representatives of Burke Capital and Sandler O'Neill, negotiated the terms of the definitive merger agreement between the parties, and Flag and First Capital also conducted due diligence on their respective operations. In addition, during this time, senior management of Flag and First Capital communicated on a regular basis regarding the potential merger, including the post-closing operations of the combined companies.

On April 27, 2005, representatives of Sandler O'Neill reviewed the terms and financial impact of the merger with the Flag board of directors. After the presentation, the board of directors engaged in a lengthy discussion of the proposed transaction and determined to continue to pursue the potential transaction. On May 17, 2005, the Flag board met again after the Flag annual meeting of shareholders to discuss the merger with First Capital. At this meeting, representatives from Sandler O'Neill presented its oral opinion that the merger consideration in the contemplated transaction with First Capital was fair to Flag from a financial point of view, as of that date and subject to certain assumptions and limitations. Also during this meeting, a representative from Morris, Manning & Martin, LLP, legal counsel to Flag, led the board of directors through a discussion of the terms of the transaction. Following the presentation and discussion, the Flag board of directors approved the merger agreement and recommended its approval by the shareholders of Flag.

On May 25, 2005, the First Capital board of directors met with representatives of Troutman Sanders to discuss the terms of the proposed merger agreement. At this meeting, representatives of Burke Capital provided the board with their analysis of the merger consideration to be paid to the First Capital shareholders. Following a discussion of the terms of the merger agreement, the fairness of the merger consideration to First Capital's shareholders and the other factors discussed below under the heading "First Capital's Reasons for the Merger," the First Capital board concluded, by majority vote, with the exception of Mr. Blanton who abstained from voting as a result of his conflict of interest in the proposed transaction

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(see Terms of the Merger Interests of Employees and Directors of Flag and First Capital in the Merger ), that the merger was fair to the First Capital shareholders and in the best interest of First Capital, approved the merger agreement and recommended its approval by the shareholders of First Capital.



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On May 26, 2005, Flag and First Capital executed the merger agreement and issued a joint press release announcing the proposed merger of the two companies.

**First Capital's Reasons for the Merger**

First Capital's board of directors believes that the merger is fair to, and in the best interest of, First Capital and its shareholders. In reaching its decision to approve the merger agreement, First Capital's board of directors consulted with its management, as well as with its financial and legal advisors, and considered a variety of factors, including the following:

an analysis of the business, operations, financial condition, earnings and prospects of Flag, including the information obtained in First Capital's due diligence review of Flag;

the competitive and regulatory environment for financial institutions generally;

the strategic opportunities presented by a merger between First Capital and Flag based on the belief that the combined organization, with assets greater than \$1.6 billion, would be more attractive to potential customers, employees, purchasers and sellers;

the merger will enable First Capital shareholders (other than shares in excess of 384,000 shares held by any non-institutional shareholder) to exchange their shares of First Capital common stock, in a tax-free transaction, for registered shares of common stock of a public company listed on the Nasdaq National Market;

the belief that the merger will provide greater liquidity for First Capital shareholders by providing a larger public market for their stock, a greater number of shareholders and a larger number of outstanding shares;

the belief that the merger between First Capital and Flag would provide shareholders of First Capital greater benefits than could be obtained through internal growth or the acquisition of another bank;

First Capital will have three of its current directors join the board of directors of Flag;

the belief that the combined entity will provide greater diversification of assets and a deeper pool of experienced management; and

the opinion of Burke Capital that the merger consideration provided in the merger agreement was fair to the shareholders of First Capital, from a financial point of view.

The discussion of the information and factors considered by First Capital's board of directors is not intended to be exhaustive but includes all of the material factors the board considered. In reaching its determination to approve and recommend the merger, First Capital's board of directors did not assign any relative or specific weights to the foregoing factors, and individual directors may have given differing weights to different factors.

**Flag's Reasons for the Merger**

Flag's board of directors believes that the merger is fair to, and in the best interest of, Flag and its shareholders. In reaching its decision to approve the merger agreement, Flag's board of directors consulted with its management, as well as with its financial and legal advisors, and considered a variety of factors, including the following:

the analysis of the business, operations, financial condition, earnings and prospects of First Capital, including the information obtained in Flag's due diligence review of First Capital;

the strategic opportunities presented by a merger between Flag and First Capital;

the complementary nature of Flag's and First Capital's businesses, management and employee cultures and the geographic locations of their respective banks;

the expectation that the rate of earnings growth of the combined company would be greater than Flag could achieve separately;

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the belief that Flag and First Capital share a common vision about the importance of delivering financial performance and shareholder value and that the management and employees of Flag and First Capital possess complementary skills and expertise;

the belief that the risk of successfully combining and integrating Flag and First Capital would be less than the execution risks of other possible strategic alternatives that would be expected to provide benefits to Flag shareholders comparable to those we expect our shareholders to derive from a merger with First Capital;

the opinion of Sandler O'Neill that the merger consideration set forth in the merger agreement was fair to Flag from a financial point of view; and

the fact that, after the merger, First Capital Bank and Flag Bank, on a combined basis, would be one of the largest community banks in the metropolitan Atlanta market.

The discussion of the information and factors considered by Flag's board of directors is not intended to be exhaustive but includes all of the material factors the board considered. In reaching the determination to approve and recommend the merger, Flag's board of directors did not assign any relative or specific weights to the foregoing factors, and individual directors may have given differing weights to different factors.

### **Opinion of First Capital's Financial Advisor**

First Capital retained Burke Capital to act as its financial advisor in connection with a possible business combination. Burke Capital is a nationally recognized investment banking firm whose principal business specialty is financial institutions. In the ordinary course of its investment banking business, Burke Capital is regularly engaged in the valuation of financial institutions and their securities in connection with mergers and acquisitions and other corporate transactions.

Burke Capital acted as financial advisor to First Capital in connection with the proposed merger with Flag and participated in certain of the negotiations leading to the merger agreement. In connection with Burke Capital's engagement, First Capital asked Burke Capital to evaluate the fairness of the merger consideration to First Capital's shareholders from a financial point of view. At the May 25, 2005 meeting of First Capital's board to evaluate the merger, Burke Capital delivered to the board its written opinion that, based upon and subject to various matters set forth in its opinion, the merger consideration was fair to First Capital's shareholders from a financial point of view. At this meeting, the First Capital board voted to approve the merger and subsequently executed the merger agreement on May 26, 2005.

**The full text of Burke Capital's written opinion is attached as Appendix B to this joint proxy statement/prospectus. The opinion outlines matters considered and qualifications and limitations on the review undertaken by Burke Capital in rendering its opinion. The description of the opinion set forth below is qualified in its entirety by reference to the opinion. We urge you to read the entire opinion carefully in connection with your consideration of the proposed merger.**

**Burke Capital's opinion speaks only as of the date of the opinion. The opinion was directed to the First Capital Board and is directed only to the fairness of the merger consideration to First Capital shareholders from a financial point of view. It does not address the underlying business decision of First Capital to engage in the merger or any other aspect of the merger and is not a recommendation to any First Capital shareholder as to how such shareholder should vote at the shareholder meeting with respect to the merger, or any**

**other matter.**

In connection with rendering its May 25, 2005 opinion, Burke Capital reviewed and considered, among other things:

the merger agreement and certain of the schedules thereto;

certain publicly available financial statements and other historical financial information of First Capital that it deemed relevant;

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certain publicly available financial statements and other historical financial information of Flag that it deemed relevant;

projected earnings estimates for First Capital for 2005 prepared by and reviewed with senior management of First Capital and the views of senior management regarding First Capital's business, financial condition, results of operations and future prospects;

the pro forma financial impact of the merger on Flag's ability to complete a transaction from a regulatory standpoint, based on assumptions determined by senior management of First Capital and Burke Capital;

the financial terms of other recent business combinations in the commercial banking industry, to the extent publicly available;

the current market environment generally and the banking environment in particular; and

such other information, financial studies, analyses and investigations and financial, economic and market criteria as it considered relevant.

**First Capital's board of directors did not limit the investigations made or the procedures followed by Burke Capital in giving its opinion.**

In performing its reviews and analyses and in rendering its opinion, Burke Capital assumed and relied upon the accuracy and completeness of all the financial information, analyses and other information that was publicly available or otherwise furnished to, reviewed by or discussed with it and further relied on the assurances of management of First Capital and Flag that they were not aware of any facts or circumstances that would make such information inaccurate or misleading. Burke Capital was not asked to and did not independently verify the accuracy or completeness of such information and it did not assume responsibility or liability for the accuracy or completeness of any of such information. Burke Capital did not make an independent evaluation or appraisal of the assets, the collateral securing assets or the liabilities, contingent or otherwise, of First Capital or Flag or any of their respective subsidiaries, or the ability to collect any such assets, nor was it furnished with any such evaluations or appraisals. Burke Capital is not an expert in the evaluation of allowances for loan losses, and it did not make an independent evaluation of the adequacy of the allowance for loan losses of First Capital or Flag, nor did it review any individual credit files relating to First Capital or Flag. Burke Capital assumed that the respective allowances for loan losses for both First Capital and Flag were adequate to cover such losses and will be adequate on a pro forma basis for the combined entity. In addition, Burke Capital did not conduct any physical inspection of the properties or facilities of First Capital or Flag. Burke Capital is not an accounting firm and it relied on the reports of the independent accountants of First Capital and the Directors of Flag for the accuracy and completeness of the financial statements furnished to it.

Burke Capital's opinion was necessarily based upon market, economic and other conditions as they existed on, and could be evaluated as of, the date of its opinion. Burke Capital assumed, in all respects material to its analysis, that all of the representations and warranties contained in the merger agreement and all related agreements are true and correct, that each party to such agreements will perform all of the covenants required to be performed by such party under such agreements and that the conditions precedent in the merger agreement are not waived. Burke Capital also assumed that there has been no material change in First Capital's and Flag's assets, financial condition, results of operations, business or prospects since the date of the last financial statements made available to them, that First Capital and Flag will remain as going concerns for all periods relevant to its analyses.

In rendering its May 25, 2005 opinion, Burke Capital performed a variety of financial analyses. The following is a summary of the material analyses performed by Burke Capital, but is not a complete description of all the analyses underlying Burke Capital's opinion. The summary

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includes information presented in tabular format. In order to fully understand the financial analyses, these tables must be read together with the accompanying text. The tables alone do not constitute a complete description of the financial analyses. The preparation of a fairness opinion is a complex process involving subjective judgments as to the most appropriate

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and relevant methods of financial analysis and the application of those methods to the particular circumstances. The process, therefore, is not necessarily susceptible to a partial analysis or summary description. Burke Capital believes that its analyses must be considered as a whole and that selecting portions of the factors and analyses considered without considering all factors and analyses, or attempting to ascribe relative weights to some or all such factors and analyses, could create an incomplete view of the evaluation process underlying its opinion. Also, no company included in Burke Capital's comparative analyses described below is identical to First Capital or Flag and no transaction is identical to the merger. Accordingly, an analysis of comparable companies or transactions involves complex considerations and judgments concerning differences in financial and operating characteristics of the companies and other factors that could affect the public trading values or merger transaction values, as the case may be, of First Capital or Flag and the companies to which they are being compared.

The earnings projections used and relied upon by Burke Capital in its analyses were based upon internal projections of First Capital. With respect to all such financial projections and estimates, First Capital's management confirmed to Burke Capital that they reflected the best currently available estimates and judgments of management of the future financial performance of First Capital and Burke Capital assumed for purposes of its analyses that such performance would be achieved. Burke Capital expressed no opinion as to such financial projections or the assumptions on which they were based. The financial projections furnished to Burke Capital by First Capital were prepared for internal purposes only and not with a view towards public disclosure. These projections, as well as the other estimates used by Burke Capital in its analyses, were based on numerous variables and assumptions that are inherently uncertain and, accordingly, actual results could vary materially from those set forth in such projections.

In performing its analyses, Burke Capital also made numerous assumptions with respect to industry performance, business and economic conditions and various other matters, many of which cannot be predicted and are beyond the control of First Capital, Flag and Burke Capital. The analyses performed by Burke Capital are not necessarily indicative of actual values or future results, which may be significantly more or less favorable than suggested by such analyses. Burke Capital prepared its analyses solely for purposes of rendering its opinion and provided such analyses to the First Capital board at the May 25, 2005 meeting. Estimates on the values of companies do not purport to be appraisals or necessarily reflect the prices at which companies or their securities may actually be sold. Such estimates are inherently subject to uncertainty, and actual values may be materially different. Accordingly, Burke Capital's analyses do not necessarily reflect the value of First Capital's common stock or Flag's common stock or the prices at which First Capital or Flag's common stock may be sold at any time.

**Summary of Proposal.** Burke Capital reviewed the financial terms of the proposed transaction whereby the holders of First Capital stock shall be entitled to elect to receive, in exchange for their shares of First Capital common stock, 1.6 shares of Flag common stock. Non-institutional shareholders of First Capital common stock who own more than 384,000 shares will receive cash for those excess shares. Based upon the terms of the merger agreement and Flag's closing stock price of \$15.76 on May 25, 2005, Burke Capital calculated a transaction value of \$134,878,343 or \$25.22 per share of First Capital common stock. Utilizing First Capital's publicly available financial statements as of March 31, 2005, Burke Capital calculated the following ratios:

<b><u>Deal Value Considerations:</u></b>		<b><u>Deal Multiples / Premiums:</u></b>	
Offer Price / Common Share	\$ 25.22	Transaction Value / LTM Net Income	34.81x
Flag Closing Market Price as of May 25, 2005	\$ 15.76	Transaction Value / Book Value	2.34x
Aggregate Value For Common Shares		Transaction Value / Tangible Book Value	
	\$ 128,084,697		2.73x
Aggregate Value for Outstanding Options / Warrants	\$ 6,793,646	Core Deposit Premium	23.25%
<b>Total Transaction Value</b>	<b>\$ 134,878,343</b>	Premium to Closing Market Price	35.00%

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\* Deal multiples based on March 31, 2005 unaudited financial results.



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Burke Capital calculated 5,348,919 fully diluted shares of First Capital common stock outstanding, which was determined using the treasury stock method at the offer price per share. The fully diluted share count is based upon First Capital's 5,079,502 outstanding common shares and 555,672 outstanding options to purchase common shares at a weighted average strike price of \$12.99.

**Comparable Company Analysis.** Burke Capital used publicly available information to compare selected financial information for First Capital and a group of selected financial institutions. The group consisted of First Capital and 24 financial institutions, which Burke Capital refers to as the First Capital Peer Group. The First Capital Peer Group consisted of selected Georgia publicly traded banks with assets between \$250 million and \$1.5 billion. The First Capital Peer Group was comprised of the following institutions:

<u>Bank Holding Company</u>	<u>City</u>	<u>Ticker Symbol</u>	<u>Bank Holding Company</u>	<u>City</u>	<u>Ticker Symbol</u>
ABC Bancorp	Moultrie	ABCB	Habersham Bancorp	Cornelia	HABC
Appalachian Bancshares, Inc.	Ellijay	APAB	Integrity Bancshares, Inc.	Alpharetta	ITYC
CCF Holding Company	Jonesboro	CCFH	NSB Holdings, Inc.	Macon	NSBG
Citizens Bancshares Corporation	Atlanta	CZBS	PAB Bankshares, Inc.	Valdosta	PAB
Colony Bankcorp, Inc.	Fitzgerald	CBAN	Savannah Bancorp, Inc.	Savannah	SAVB
Crescent Banking Company	Jasper	CSNT	Security Bank Corporation	Macon	SBKC
Fidelity Southern Corporation	Atlanta	LION	SouthCrest Financial Group, Inc.	Fayetteville	SCSG
FLAG Financial Corporation	Atlanta	FLAG	Southeastern Banking Corporation	Darien	SEBC
GB&T Bancshares, Inc.	Gainesville	GBTB	Southern Community Bancshares, Inc.	Fayetteville	SNCB
Georgia Bancshares, Inc.	Peachtree City	GABA	Southwest Georgia Financial Corporation	Moultrie	SGB
Georgia Bank Financial Corporation	Augusta	GBFP	Summit Bank Corporation	Atlanta	SBGA
Georgia-Carolina Bancshares, Inc.	Augusta	GECR	WGNB Corp.	Carrollton	WGNB

The analysis calculated the median performance of the First Capital Peer Group, based upon the latest publicly available financial data, to First Capital's March 31, 2005 financial results. The table below sets forth the comparative data.

	<u>Revenues</u>		<u>Earnings</u>				<u>Capital Implications</u>		<u>Asset Quality</u>	
	<u>Net Interest Margin</u>	<u>Noninterest Income/Average Assets</u>	<u>Efficiency</u>	<u>ROAA</u>	<u>ROAE</u>	<u>Pre-Provision, Pre-Tax ROAA</u>	<u>Equity / Assets</u>	<u>Asset Utilization</u>	<u>NPAs/ Total Assets</u>	<u>Reserves / Loans</u>
<b>Peer Group Median</b>	4.15%	0.94%	62.66%	0.90%	11.23%	1.82%	8.26%	93.38%	0.44%	1.30%
<b>First Capital</b>	3.55%	0.23%	66.35%	0.61%	7.73%	1.23%	8.55%	95.95%	0.17%	1.24%

The analysis showed that First Capital's performance is within the range of its peer group.

*Analysis of Selected Merger Transactions.* Burke Capital compared selected pricing multiples and ratios implied by the merger consideration to corresponding merger and acquisition pricing multiples and ratios observed in transactions Burke Capital deemed relevant to the merger. Burke Capital reviewed selected Southeastern bank and thrift merger and acquisition transactions since January 1, 2002 and U.S. bank and thrift merger and acquisition transactions since January 1, 2003 in which the seller had assets between \$500 million

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and \$1 billion. Burke Capital's review showed that the merger consideration represented per share values within the range of the corresponding mean and median values for the selected Southeastern and U.S. merger and acquisition transactions.

***Southeastern Merger Transactions.*** In order to address the specific valuation considerations within the Southeastern markets, Burke Capital selected a group of comparable Southeastern merger and acquisition transactions and compared the pricing multiples to the multiples implied by the merger consideration. Specifically, Burke Capital selected bank and thrift merger and acquisition transactions according to the following criteria:

merger and acquisition transactions announced after January 1, 2002;

all stock and partial cash transactions;

seller located in the Southeast;

seller assets between \$500 million and \$1 billion;

seller ROAA between 0.40% and 1.00%; and

seller located in an MSA market.

Burke Capital selected seven transactions fitting the criteria listed above as being comparable to the proposed merger. The seven comparable transactions selected consisted of the following:

<b>Buyer</b>	<b>State</b>	<b>Seller</b>	<b>State</b>
Peoples Holding Co.	MS	Heritage Financial Holding Corp.	AL
South Financial Group Inc.	SC	Florida Banks Inc.	FL
South Financial Group Inc.	SC	CNB Florida Bancshares Inc.	FL
Colonial BancGroup, Inc.	AL	P.C.B. Bancorp Inc.	FL
Alabama National BanCorp.	AL	Indian River Banking Co.	FL
South Financial Group Inc.	SC	MountainBank Financial Corp.	NC
Synovus Financial Corp.	GA	Community Financial Group Inc.	TN

Burke Capital calculated the multiples of transaction value at announcement to the last 12 months' earnings, book value, tangible book value and book premium to core deposits for each of the seven selected and acquired institutions. Burke Capital then computed high, low, mean, median and quartile multiples and premiums for the transactions. These multiples and premiums were applied to First Capital's publicly available financial statements as of and for the period ended March 31, 2005 and were used to impute a transaction price. As illustrated in the following table, Burke Capital derived an imputed range of values per share of First Capital's common stock of \$18.25 to \$30.58 based upon the median and mean multiples of the selected Southeastern transactions.

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	<b>Median</b>				<b>Flag's Offer</b>
	<b>Multiple</b>	<b>Implied</b>	<b>Mean</b>	<b>Implied</b>	<b>Price for</b>
	<b>Multiple</b>	<b>Value/Share</b>	<b>Multiple</b>	<b>Value/Share</b>	<b>First Capital</b>
Transaction Value / LTM E.P.S.	24.62x	\$ 18.25	25.81x	\$ 19.07	34.73x
Transaction Value / Book Value	2.86x	\$ 30.58	2.75x	\$ 29.48	2.33x
Transaction Value / Tangible Book Value	2.91x	\$ 26.78	2.96x	\$ 27.27	2.73x
Book Premium / Core Deposits	19.48%	\$ 23.04	20.42%	\$ 23.60	23.16%
	Median Value	\$ 24.91		\$ 25.44	
	Mean Value	\$ 24.66		\$ 24.85	<b>\$25.22</b>
	<b>Implied Range</b>	<b>\$ 18.25</b>	<b>&lt;=&gt;</b>	<b>\$ 30.58</b>	

The analysis showed that the merger consideration per share of \$25.22 is within the range of values imputed by the mean and median multiples of the comparable transactions.

**U.S. Merger Transactions.** Burke Capital selected a group of comparable U.S. merger and acquisition transactions and compared the pricing multiples to the multiples implied by the merger consideration.

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Specifically, Burke Capital selected bank and thrift merger and acquisition transactions according to the following criteria:

merger and acquisition transactions announced after January 1, 2003;

all stock and partial cash transactions;

seller located in the U.S.;

seller assets between \$500 million and \$1 billion;

seller ROAA between 0.40% and 1.00%; and

seller located in an MSA market.

Burke Capital selected 14 transactions fitting the criteria listed above as being comparable to the proposed merger. The 14 comparable transactions selected consisted of the following:

<b><u>Buyer</u></b>	<b><u>State</u></b>	<b><u>Seller</u></b>	<b><u>State</u></b>
Willow Grove Bancorp Inc.	PA	Chester Valley Bancorp Inc.	PA
Valley National Bancorp F.N.B. Corp.	NJ PA	NorCrown Bank NSD Bancorp Inc.	NJ PA
Wells Fargo & Co.	CA	First Community Capital Corp.	TX
Peoples Holding Co.	MS	Heritage Financial Holding Corp.	AL
South Financial Group Inc.	SC	Florida Banks Inc.	FL
Provident Bancorp Inc.	NY	Warwick Community Bancorp	NY
South Financial Group Inc.	SC	CNB Florida Bancshares Inc.	FL
Colonial BancGroup Inc.	AL	P.C.B. Bancorp Inc.	FL
Fulton Financial Corp.	PA	Premier Bancorp Inc.	PA
Alabama National BanCorp	AL	Indian River Banking Co.	FL
KNBT Bancorp Inc.	PA	First Colonial Group Inc.	PA
Seacoast Financial Services	MA	Abington Bancorp Inc.	MA
South Financial Group Inc.	SC	MountainBank Financial Corp.	NC

Burke Capital calculated the multiples of transaction value at announcement to the last 12 months earnings, book value, tangible book value and book premium to core deposits for each of the 14 selected and acquired institutions. Burke Capital then computed high, low, mean, median and quartile multiples and premiums for the transactions. These multiples and premiums were applied to First Capital's publicly available financial statements as of and for the period ended March 31, 2005 and were used to impute a transaction price. As illustrated in the following table, Burke Capital derived an imputed range of values per share of First Capital's common stock of \$17.87 to \$30.31 based upon the median and mean multiples of the selected U.S. transactions.

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	<u>Median Multiple</u>	<u>Implied Value/Share</u>	<u>Mean Multiple</u>	<u>Implied Value/Share</u>	<u>Flag's Offer Price for First Capital</u>
Transaction Value / LTM E.P.S.	24.07x	\$ 17.87	26.03x	\$ 19.22	34.73x
Transaction Value / Book Value	2.83x	\$ 30.31	2.79x	\$ 29.88	2.33x
Transaction Value / Tangible Book Value	2.90x	\$ 26.76	3.07x	\$ 28.24	2.73x
Book Premium / Core Deposits	19.59%	\$ 23.11	20.63%	\$ 23.72	23.16%
	Median Value	\$ 24.93		\$ 25.98	
	Mean Value	\$ 24.51		\$ 25.26	<b>\$25.22</b>
	<b>Implied Range</b>	<b>\$ 17.87</b>	<b>&lt;=&gt;</b>	<b>\$ 30.31</b>	

The analysis showed that the merger consideration per share of \$25.22 is within the range of values imputed by the mean and median multiples of the comparable transactions.

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Based upon the forgoing analyses and other investigations and assumptions set forth in its opinion, without giving specific weightings to any one factor or comparison, Burke Capital determined that the transaction consideration was fair from a financial point of view to First Capital shareholders.

For its financial advisory services provided to First Capital, Burke Capital has been paid fees of \$50,000 to date and will be paid an additional fee that will amount to approximately \$1.2 million at the time of the closing of the merger. In addition, First Capital has agreed to indemnify Burke Capital against various liabilities, including any that may arise under the federal securities laws, subject to adjustment based on the actual deal value as of the closing date.

### **Opinion of Flag's Financial Advisor**

By letter dated March 22, 2005, Flag retained Sandler O'Neill to act as its financial advisor in connection with a possible business combination with First Capital. Sandler O'Neill is a nationally recognized investment banking firm whose principal business specialty is financial institutions. In the ordinary course of its investment banking business, Sandler O'Neill is regularly engaged in the valuation of financial institutions and their securities in connection with mergers and acquisitions and other corporate transactions.

Sandler O'Neill acted as financial advisor to Flag in connection with the proposed transaction and participated in certain of the negotiations leading to the execution of a definitive merger agreement on May 26, 2005. At the May 17, 2005 meeting at which Flag's board considered and approved the merger agreement, subject to satisfactory resolution of certain outstanding issues, Sandler O'Neill delivered to the board its oral opinion, that, as of such date, the merger consideration was fair to Flag from a financial point of view. **The full text of Sandler O'Neill's opinion is attached as Appendix C to this joint proxy statement/prospectus. The opinion outlines the procedures followed, assumptions made, matters considered and qualifications and limitations on the review undertaken by Sandler O'Neill in rendering its opinion. The description of the opinion set forth below is qualified in its entirety by reference to the opinion. Sandler O'Neill urges Flag shareholders to read the entire opinion carefully in connection with their consideration of the proposed merger.**

**Sandler O'Neill's opinion speaks only as of the date of the opinion. The opinion was directed to the Flag board and is directed only to the fairness of the merger consideration to Flag from a financial point of view. It does not address the underlying business decision of Flag to engage in the merger or any other aspect of the merger and is not a recommendation to any Flag shareholder as to how such shareholder should vote at the special meeting with respect to the merge or any other matter.**

In connection with rendering its May 17, 2005 opinion, Sandler O'Neill reviewed and considered, among other things:

the merger agreement;

certain publicly available financial statements and other historical financial information of Flag that Sandler O'Neill deemed relevant;

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certain publicly available financial statements and other historical financial information of First Capital that Sandler O'Neill deemed relevant;

an internal budget for Flag for the year ending December 31, 2005 furnished by and reviewed with senior management of Flag and estimates of asset, loan and earnings per share growth for the years thereafter;

internal budgets for First Capital for the years ending December 31, 2005 and 2006 furnished by senior management of First Capital and reviewed with and adjusted downward by senior management of Flag, earnings per share estimates for First Capital for the year ending December 31, 2005 published by I/B/E/S and earnings per share and loan and deposit growth rates, furnished by and reviewed with senior management of Flag;

the pro forma financial impact of the merger on Flag, based on assumptions relating to transaction expenses, purchase accounting adjustments and cost savings furnished by and reviewed with the senior



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managements of Flag and First Capital; and the expected issuance of up to \$30 million in trust preferred securities by Flag;

the publicly reported historical price and trading activity for the common stock of both Flag and First Capital, including a comparison of certain financial and stock market information for Flag and First Capital with similar publicly available information for certain other financial institutions the securities of which are publicly traded;

to the extent publicly available, the financial terms of certain recent business combinations in the commercial banking industry;

the current market environment generally and the banking environment in particular; and

such other information, financial studies, analyses and investigations and financial, economic and market criteria as Sandler O Neill considered relevant.

Sandler O Neill also discussed with certain members of senior management of Flag the business, financial condition, results of operations and prospects of Flag and held similar discussions with the financial advisor of First Capital regarding the business, financial condition, results of operations and prospects of First Capital.

In performing its reviews and analyses and in rendering its opinion, Sandler O Neill relied upon the accuracy and completeness of all the financial and other information that was available to it from public sources, that was provided to Sandler O Neill by Flag or First Capital or their respective representatives or that was otherwise reviewed by Sandler O Neill and has assumed such accuracy and completeness for purposes of rendering this opinion. Sandler O Neill further relied on the assurances of the management of each of Flag and First Capital that they are not aware of any facts or circumstances that would make any of such information inaccurate or misleading. Sandler O Neill has not been asked to undertake, and has not undertaken, an independent verification of any of such information, and Sandler O Neill does not assume any responsibility or liability for the accuracy or completeness thereof. Sandler O Neill did not make an independent evaluation or appraisal of the specific assets, the collateral securing the assets or the liabilities (contingent or otherwise) of Flag or First Capital or any of their subsidiaries, or the collectibility of any such assets, nor has Sandler O Neill been furnished with any such evaluations or appraisals. Sandler O Neill did not make an independent evaluation of the adequacy of the allowance for loan losses of Flag or First Capital nor has Sandler O Neill reviewed any individual credit files relating to Flag or First Capital. Sandler O Neill assumed, with Flag's consent, that the respective allowances for loan losses for both Flag and First Capital are adequate to cover such losses.

The internal budgets and estimates for growth used and relied upon by Sandler O Neill in its analyses for Flag were provided by Flag senior management who confirmed to Sandler O Neill that those budgets and estimates reflected the best currently available estimates and judgments of the future financial performance of Flag. With respect to the internal budgets and growth estimates for First Capital, with Flag's consent, Sandler O Neill used and relied on the budgets provided by the senior management of First Capital as adjusted by Flag's senior management. All projections of transaction costs, purchase accounting adjustments and expected cost savings related to the merger were provided by or reviewed with the senior managements of Flag and First Capital, and those managements confirmed to Sandler O Neill that those projections reflected the best currently available estimates and judgments. Sandler O Neill assumed that the financial performances reflected in all budgets, estimates and projections used in its analyses would be achieved. Sandler O Neill expressed no opinion as to such budgets, estimates or projections or the assumptions on which they were based. Sandler O Neill also assumed that there has been no material change in the assets, financial condition, results of operations, business or prospects of Flag or First Capital since the date of the last financial statements made available to it and that Flag and First Capital will remain as going concerns for all periods relevant to the analyses.

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With respect to the merger agreement, Sandler O'Neill assumed that all of the representations and warranties contained in the merger agreement and all related agreements are true and correct, that each party to such agreements will perform all of the covenants required to be performed by such party under the agreements, that the conditions precedent in the merger agreement are not waived and that the merger will be a tax-free

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reorganization for federal income tax purposes. Finally, with Flag's consent, Sandler O'Neill relied upon the advice received from Flag's legal, accounting and tax advisors as to all legal, accounting and tax matters relating to the merger agreement and the other transactions contemplated by the agreement.

Sandler O'Neill's opinion was necessarily based upon market, economic and other conditions as they existed on, and could be evaluated as of, the date of its opinion. Events occurring after the date hereof could materially affect this opinion. Sandler O'Neill has not undertaken to update, revise, reaffirm or withdraw its opinion or otherwise comment upon events occurring after the date hereof. Sandler O'Neill expressed no opinion as to what the value of Flag's common stock will be when issued to First Capital's shareholders pursuant to the merger agreement or the prices at which the common stocks of Flag or First Capital may trade at any time.

In rendering its May 17, 2005 opinion, Sandler O'Neill performed a variety of financial analyses. The following is a summary of the material analyses performed by Sandler O'Neill, but is not a complete description of all the analyses underlying Sandler O'Neill's opinion. The summary includes information presented in tabular format. **In order to fully understand the financial analyses, these tables must be read together with the accompanying text. The tables alone do not constitute a complete description of the financial analyses.** The preparation of a fairness opinion is a complex process involving subjective judgments as to the most appropriate and relevant methods of financial analysis and the application of those methods to the particular circumstances. The process, therefore, is not necessarily susceptible to a partial analysis or summary description. Sandler O'Neill believes that its analyses must be considered as a whole and that selecting portions of the factors and analyses to be considered without considering all factors and analyses, or attempting to ascribe relative weights to some or all such factors and analyses, could create an incomplete view of the evaluation process underlying its opinion. Also, no company included in Sandler O'Neill's comparative analyses described below is identical to Flag or First Capital, and no transaction is identical to the merger. Accordingly, an analysis of comparable companies or transactions involves complex considerations and judgments concerning differences in financial and operating characteristics of the companies and other factors that could affect the public trading values or merger transaction values, as the case may be, of Flag and First Capital and the companies to which they are being compared.

In performing its analyses, Sandler O'Neill also made numerous assumptions with respect to industry performance, business and economic conditions and various other matters, many of which cannot be predicted and are beyond the control of Flag, First Capital and Sandler O'Neill. The analyses performed by Sandler O'Neill are not necessarily indicative of actual values or future results, which may be significantly more or less favorable than suggested by such analyses. Sandler O'Neill prepared its analyses solely for purposes of rendering its opinion and provided such analyses to the Flag board at the board's May 17, 2005 meeting. Estimates on the values of companies do not purport to be appraisals or necessarily reflect the prices at which companies or their securities may actually be sold. Such estimates are inherently subject to uncertainty, and actual values may be materially different. Accordingly, Sandler O'Neill's analyses do not necessarily reflect the value of Flag's or First Capital's common stock or the prices at which Flag's or First Capital's common stock may be sold at any time.

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**Summary of Proposal.** Sandler O'Neill reviewed the financial terms of the proposed transaction. Using the fixed exchange ratio of 1.6 shares of Flag common stock for each share of First Capital common stock, and the closing price of Flag common stock of \$14.96 on May 13, 2005 for calculating both the stock and cash portion of the consideration, Sandler O'Neill calculated a transaction value of \$23.93 per share. Based upon financial information for First Capital as or for the 12-month period ended March 31, 2005, Sandler O'Neill calculated the following transaction ratios:

**Transaction Multiples**

Offer Price Per Share / LTM EPS	31.1x
Offer Price Per Share / Book Value	210.2%
Offer Price Per Share / Tangible Book Value	242.6%
Tangible Book Premium / Core Deposits (1)	22.3%
Current Market Premium (2)	36.7%

- (1) Core deposits exclude time deposits with a balance over \$100,000.  
(2) Based on First Capital's closing stock price of \$17.50 on May 13, 2005.

The aggregate transaction value was approximately \$127.5 million, based upon the offer price per share of \$23.93, the 5,067,719 First Capital common shares outstanding and the intrinsic value of options to acquire 567,454 shares of First Capital common stock at a weighted-average exercise price of \$12.86.

**Stock Trading History.** Sandler O'Neill reviewed the history of the reported trading prices and volume of Flag's and First Capital's common stock and the relationship between the movements in the price of Flag's common stock and First Capital's common stock to movements in the prices of the Standard & Poor's 500 Index, the Nasdaq Bank Index, the Standard & Poor's Bank Index and the median performance of a composite peer group of publicly traded commercial banks selected by Sandler O'Neill for Flag and First Capital, respectively. The composition of the respective peer groups for Flag and First Capital is discussed under the relevant section under "Comparable Company Analysis" below.

Sandler O'Neill analyzed Flag's common stock for the one-year period ended May 13, 2005. During this period, Flag's common stock generally outperformed each of the indices and the peer group to which it was compared.

**Flag's One Year Stock Performance (May 13, 2004 - May 13, 2005)**

	Beginning Index Value May 13, 2004	Ending Index Value May 13, 2005
Flag	100.00%	120.81%
Flag Peer Group	100.00	109.91
S&P Index	100.00	105.25
Nasdaq Bank Index	100.00	104.56
S&P Bank Index	100.00	108.80

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Sandler O'Neill analyzed First Capital's common stock for the period May 28, 2004 (the closing date of the merger between First Capital and CNB Holdings, Inc.) through May 13, 2005. During this period, First Capital's common stock generally outperformed each of indices and the peer group to which it was compared.

**First Capital's Stock Performance (May 28, 2004 - May 13, 2005)**

	<b>Beginning Index Value</b> <b>May 28, 2004</b>	<b>Ending Index Value</b> <b>May 13, 2005</b>
First Capital	100.00%	116.67%
First Capital Peer Group	100.00	117.00
S&P Index	100.00	102.98
Nasdaq Bank Index	100.00	101.39
S&P Bank Index	100.00	104.18

**Comparable Company Analysis.** Sandler O'Neill also used publicly available information to perform a comparison of selected financial and market trading information for Flag and First Capital, to two different groups of selected financial institutions for Flag and First Capital, respectively.

The Flag peer group consisted of the following publicly traded commercial banks headquartered in Georgia, North Carolina or South Carolina with total assets between \$750 million and \$2.0 billion:

ABC Bancorp	GB&T Bancshares, Inc.
Bank of Granite Corporation	Georgia Bank Financial Corporation
Capital Bank Corporation	LSB Bancshares, Inc.
Colony Bancorp, Inc.	PAB Bankshares, Inc.
Fidelity Southern Corporation	SCBT Financial Corporation
First Bancorp	Security Bank Corporation
First South Bancorp, Inc.	Southern Community Financial Corporation
FNB Corp.	Yadkin Valley Bank and Trust Company
FNB Financial Services Corporation	

The analysis compared publicly available financial and market trading information for Flag and the high, low and median data for the Flag peer group as of and for the 12 months ended March 31, 2005 (or in cases where March data was not available, as of or for the 12 months ended December 31, 2004). The table below sets forth the data for Flag and the median, high and low data for the Flag peer group as of and for the 12 months ended March 31, 2005 (or in cases where March data was not available, as of or for the 12 months ended December 31, 2004), with pricing data as of May 13, 2005.

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	<u>Flag</u>	<u>Peer Group Median Result</u>	<u>Peer Group High Result</u>	<u>Peer Group Low Result</u>
<b>Balance Sheet</b>				
Total Assets ( <i>in thousands</i> )	\$ 840,415	\$ 995,826	\$ 1,687,160	\$ 750,881
Net Loans / Total Assets	73.00%	76.54%	87.62%	64.12%
Gross Loans / Total Deposits	87.25%	97.41%	102.23%	88.63%
Total Borrowings / Total Assets	3.77%	9.30%	18.35%	2.04%
<b>Asset Quality</b>				
Non-performing Assets / Assets	0.80%	0.60%	1.24%	0.21%
Loan Loss Reserve / Gross Loans	1.43%	1.27%	1.80%	1.03%
<b>Capital Adequacy</b>				
Tangible Equity / Tangible Assets	6.01%	7.64%	12.52%	6.02%
Tier 1 Leverage Ratio	7.87%	9.05%	13.85%	7.82%
Tier 1 Risk Based Capital Ratio	10.20%	10.40%	15.97%	8.96%
Total Risk Based Capital Ratio	11.46%	11.97%	17.25%	9.99%
Intangible Assets / Total Equity	29.97%	8.01%	38.46%	0.00%
<b>Profitability</b>				
Net Interest Margin	4.48%	4.16%	4.79%	3.25%
Non-interest Income / Average Assets	1.12%	1.10%	1.80%	0.60%
Fees / Revenues	21.32%	20.74%	32.26%	15.78%
Non-interest Expense / Average Assets	3.83%	2.90%	4.19%	2.36%
Efficiency Ratio	72.85%	62.96%	74.75%	48.46%
Return on Average Assets	0.92%	1.06%	1.66%	0.62%
Return on Average Equity	10.64%	11.06%	20.65%	5.98%
<b>Trading Multiples</b>				
Price / Book Value	181.5%	170.2%	351.9%	120.0%
Price / Tangible Book Value	259.2%	200.0%	379.5%	161.6%
Price / LTM Earnings per Share	18.9x	17.2x	24.8x	14.9x
Price / 2005 Estimated Earnings per Share (1)	N/A	15.2x	17.3x	13.9x
Dividend Payout Ratio	30.38%	36.23%	65.66%	20.81%
Dividend Yield	1.60%	2.15%	3.82%	0.90%
Market Capitalization ( <i>in thousands</i> )	\$ 127,590	\$ 173,475	\$ 304,541	\$ 103,334

(1) Based on I/B/E/S estimates.

Sandler O'Neill also used publicly available information to compare selected financial and market trading information for First Capital and a group of financial institutions selected by Sandler O'Neill. The First Capital peer group consisted of the following publicly traded commercial banks headquartered in Georgia, North Carolina or South Carolina with total assets between \$500 million and \$1 billion:

BNC Bancorp  
 Capital Bank Corporation  
 Colony Bankcorp, Inc.  
 Community Bankshares, Inc.  
 Community Capital Corporation

Gateway Financial Holdings, Inc.  
 Georgia Bank Financial Corporation  
 Integrity Financial Corporation  
 LSB Bancshares, Inc.  
 PAB Bankshares, Inc.

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Cooperative Bankshares, Inc.  
ECB Bancorp, Inc.  
First South Bancorp, Inc.  
FNB Corp.  
FNB Financial Services Corporation

Peoples Bancorp of North Carolina, Inc.  
Savannah Bancorp, Inc.  
Summit Bank Corporation  
Yadkin Valley Bank and Trust Company

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The analysis compared publicly available financial and market trading information for First Capital and the high, low and median data for the First Capital peer group as of and for the 12 months ended March 31, 2005 (or in cases where March data was not available, as of or for the 12 months ended December 31, 2004). The table below sets forth the data for First Capital and the median, high and low data for the First Capital peer group as of and for the 12 months ended March 31, 2005 (or in cases where March data was not available, as of or for the 12 months ended December 31, 2004), with pricing data as of May 13, 2005.

**Comparable Group Analysis**

	<u>First Capital</u>	<u>Peer Group Median Result</u>	<u>Peer Group High Result</u>	<u>Peer Group Low Result</u>
<b>Balance Sheet</b>				
Total Assets ( <i>in thousands</i> )	\$ 673,842	\$ 690,020	\$ 995,826	\$ 501,890
Net Loans / Total Assets	73.30%	76.26%	87.62%	63.31%
Gross Loans / Total Deposits	104.65%	97.30%	115.08%	77.02%
Total Borrowings / Total Assets	18.93%	11.03%	20.12%	2.04%
<b>Asset Quality</b>				
Non-performing Assets / Assets	0.32%	0.43%	1.24%	0.00%
Loan Loss Reserve / Gross Loans	1.24%	1.28%	1.66%	0.92%
<b>Capital Adequacy</b>				
Tangible Equity / Tangible Assets	7.50%	7.56%	9.39%	5.04%
Tier 1 Leverage Ratio	8.46%	8.81%	13.89%	7.82%
Tier 1 Risk Based Capital Ratio	10.22%	10.43%	14.46%	8.96%
Total Risk Based Capital Ratio	11.35%	11.68%	15.40%	9.99%
Intangible Assets / Total Equity	13.36%	7.28%	34.08%	0.00%
<b>Profitability</b>				
Net Interest Margin	3.57%	3.94%	4.79%	3.33%
Non-interest Income / Average Assets	0.23%	0.98%	1.80%	0.64%
Fees / Revenues	6.24%	21.04%	32.26%	15.78%
Non-interest Expense / Average Assets	2.46%	2.94%	4.19%	2.51%
Efficiency Ratio	67.31%	64.16%	77.92%	48.46%
Return on Average Assets	0.61%	0.91%	1.66%	0.31%
Return on Average Equity	7.72%	10.77%	20.65%	3.26%
<b>Trading Multiples</b>				
Price / Book Value	153.7%	173.2%	351.9%	126.7%
Price / Tangible Book Value	177.4%	195.0%	379.5%	126.7%
Price / LTM Earnings per Share	22.7x	17.2x	24.8x	14.4x
Price / 2005 Estimated Earnings per Share (1)	18.8x	14.5x	33.1x	13.1x
Dividend Payout Ratio	0.00%	35.17%	65.66%	9.30%
Dividend Yield	0.00%	2.00%	3.82%	0.22%
Market Capitalization ( <i>in thousands</i> )	\$ 88,685	\$ 111,131	\$ 217,748	\$ 60,271

(1) Based on I/B/E/S estimates.

**Analysis of Selected Merger Transactions.** Sandler O'Neill reviewed 18 nationwide merger transactions announced from January 1, 2004 through May 13, 2005 involving commercial banks with assets between \$500 million and \$1 billion (based on publicly available information when the transactions were announced) as the acquired institution. Sandler O'Neill also reviewed 44 merger transactions with a transaction value



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greater than \$15 million announced during the same period involving commercial banks in the Southeastern United States as the acquired institution. Sandler O'Neill reviewed the following multiples: transaction price at announcement to last 12 months EPS, transaction price to book value per share, transaction price to tangible book value per share,

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and tangible book premium to core deposits and premium to market price and then computed high, low, mean, median multiples and premiums for the transactions. The median multiples were applied to First Capital's financial information as of and for the 12 months ended March 31, 2005. As illustrated in the following tables, Sandler O'Neill derived an imputed range of values per share for First Capital's common stock of \$17.88 to \$30.80 based upon the median multiples for the nationwide transactions and \$21.09 to \$28.41 based upon the median multiples for the Southeast transactions. The implied per share transaction value of the merger as calculated by Sandler O'Neill was \$23.93 per share.

**Transaction Multiples**

	<u>Nationwide Transactions</u>		<u>Southeast Transactions</u>	
	<u>Median Multiple</u>	<u>Implied Value</u>	<u>Median Multiple</u>	<u>Implied Value</u>
Transaction Price/LTM EPS	23.23x	\$ 17.88	30.63x	\$ 23.58
Transaction Price/Book Value	270.56%	\$ 30.80	249.58%	\$ 28.41
Transaction Price/Tangible Book Value	307.65%	\$ 30.34	263.32%	\$ 25.97
Tangible Book Premium/Core Deposits (1)	21.05%	\$ 23.18	19.29%	\$ 22.09
Premium to Market (2)	24.13%	\$ 21.72	20.51%	\$ 21.09

- (1) Core deposits are defined as total deposits less time deposits over \$100,000. The core deposit premium is calculated by taking transaction value, less tangible book value, divided by core deposits.
- (2) Based on First Capital's May 13, 2005 closing price of \$17.50.

**Discounted Dividend Stream and Terminal Value Analysis.** Sandler O'Neill performed an analysis that estimated the future stream of after-tax dividend flows of Flag through December 31, 2009 under various circumstances, assuming Flag's projected dividend stream and that Flag performed in accordance with the 2005 net income projection and earnings per share growth rate projections for 2006 through 2009 provided by management. To approximate the terminal value of Flag common stock at December 31, 2009, Sandler O'Neill applied price to LTM earnings multiples of 14.0x to 24.0x and multiples of tangible book value ranging from 175% to 325%. The dividend income streams and terminal values were then discounted to present values using different discount rates ranging from 9.0% to 15.0% chosen to reflect different assumptions regarding required rates of return of holders or prospective buyers of Flag common stock. As illustrated in the following tables, this analysis indicated an imputed range of values per share for Flag's common stock of \$10.02 to \$21.44 when applying the price/earnings multiples, and \$10.17 to \$23.26 when applying multiples of tangible book value to the current budget. The closing price for Flag's common stock on May 13, 2005 was \$14.96.

**Earnings Per Share Multiples**

<u>Discount Rate</u>	<u>14.0x</u>	<u>16.0x</u>	<u>18.0x</u>	<u>20.0x</u>	<u>22.0x</u>	<u>24.0x</u>
<b>9.00%</b>	\$ 12.83	\$ 14.55	\$ 16.27	\$ 17.99	\$ 19.71	\$ 21.44
<b>10.00%</b>	\$ 12.30	\$ 13.95	\$ 15.60	\$ 17.25	\$ 18.89	\$ 20.54
<b>11.00%</b>	\$ 11.80	\$ 13.38	\$ 14.96	\$ 16.53	\$ 18.11	\$ 19.69
<b>12.00%</b>	\$ 11.32	\$ 12.83	\$ 14.35	\$ 15.86	\$ 17.37	\$ 18.88
<b>13.00%</b>	\$ 10.87	\$ 12.32	\$ 13.77	\$ 15.22	\$ 16.67	\$ 18.11
<b>14.00%</b>	\$ 10.43	\$ 11.82	\$ 13.21	\$ 14.60	\$ 16.00	\$ 17.39
<b>15.00%</b>	\$ 10.02	\$ 11.36	\$ 12.69	\$ 14.02	\$ 15.36	\$ 16.69

Table of ContentsIndex to Financial Statements**Tangible Book Value Per Share Multiples**

<b>Discount Rate</b>	<b>175%</b>	<b>200%</b>	<b>225%</b>	<b>250%</b>	<b>275%</b>	<b>300%</b>	<b>325%</b>
<b>9.00%</b>	\$ 13.01	\$ 14.72	\$ 16.43	\$ 18.13	\$ 19.84	\$ 21.55	\$ 23.26
<b>10.00%</b>	\$ 12.47	\$ 14.11	\$ 15.75	\$ 17.38	\$ 19.02	\$ 20.65	\$ 22.29
<b>11.00%</b>	\$ 11.97	\$ 13.53	\$ 15.10	\$ 16.66	\$ 18.23	\$ 19.80	\$ 21.36
<b>12.00%</b>	\$ 11.48	\$ 12.98	\$ 14.48	\$ 15.99	\$ 17.49	\$ 18.99	\$ 20.49
<b>13.00%</b>	\$ 11.02	\$ 12.46	\$ 13.90	\$ 15.34	\$ 16.78	\$ 18.22	\$ 19.66
<b>14.00%</b>	\$ 10.59	\$ 11.97	\$ 13.35	\$ 14.73	\$ 16.11	\$ 17.49	\$ 18.87
<b>15.00%</b>	\$ 10.17	\$ 11.49	\$ 12.82	\$ 14.14	\$ 15.47	\$ 16.79	\$ 18.11

In addition, Sandler O'Neill performed an analysis that estimated the future stream of after-tax dividend flows of First Capital through December 31, 2009 under various circumstances, assuming First Capital performed in accordance with 2005 and 2006 net income projections and earnings per share growth rate projections for 2007 through 2009 provided by Flag's management. To approximate the terminal value of First Capital common stock at December 31, 2009, Sandler O'Neill applied price/earnings multiples ranging from 14.0x to 24.0x and multiples of tangible book value ranging from 175% to 325%. The income streams and terminal values were then discounted to present values using different discount rates ranging from 9.0% to 15.0% chosen to reflect different assumptions regarding required rates of return of holders or prospective buyers of First Capital common stock. As illustrated in the following tables, this analysis indicated an imputed range of values per share of First Capital common stock of \$13.23 to \$29.24 when applying the price/earnings multiples, and \$15.57 to \$37.29 when applying multiples of tangible book value. The implied per share transaction value of the merger as calculated by Sandler O'Neill was \$23.93 per share.

**Earnings Per Share Multiples**

<b>Discount Rate</b>	<b>14.0x</b>	<b>16.0x</b>	<b>18.0x</b>	<b>20.0x</b>	<b>22.0x</b>	<b>24.0x</b>
<b>9.00%</b>	\$ 17.06	\$ 19.50	\$ 21.93	\$ 24.37	\$ 26.81	\$ 29.24
<b>10.00%</b>	\$ 16.33	\$ 18.67	\$ 21.00	\$ 23.34	\$ 25.67	\$ 28.00
<b>11.00%</b>	\$ 15.65	\$ 17.88	\$ 20.12	\$ 22.35	\$ 24.59	\$ 26.82
<b>12.00%</b>	\$ 14.99	\$ 17.14	\$ 19.28	\$ 21.42	\$ 23.56	\$ 25.71
<b>13.00%</b>	\$ 14.37	\$ 16.43	\$ 18.48	\$ 20.54	\$ 22.59	\$ 24.64
<b>14.00%</b>	\$ 13.79	\$ 15.76	\$ 17.72	\$ 19.69	\$ 21.66	\$ 23.63
<b>15.00%</b>	\$ 13.23	\$ 15.11	\$ 17.00	\$ 18.89	\$ 20.78	\$ 22.67

**Tangible Book Value Per Share Multiples**

<b>Discount Rate</b>	<b>175%</b>	<b>200%</b>	<b>225%</b>	<b>250%</b>	<b>275%</b>	<b>300%</b>	<b>325%</b>
<b>9.00%</b>	\$ 20.08	\$ 22.95	\$ 25.82	\$ 28.69	\$ 31.55	\$ 34.42	\$ 37.29
<b>10.00%</b>	\$ 19.23	\$ 21.97	\$ 24.72	\$ 27.47	\$ 30.22	\$ 32.96	\$ 35.71
<b>11.00%</b>	\$ 18.42	\$ 21.05	\$ 23.68	\$ 26.31	\$ 28.94	\$ 31.58	\$ 34.21
<b>12.00%</b>	\$ 17.65	\$ 20.17	\$ 22.69	\$ 25.22	\$ 27.74	\$ 30.26	\$ 32.78
<b>13.00%</b>	\$ 16.92	\$ 19.34	\$ 21.76	\$ 24.17	\$ 26.59	\$ 29.01	\$ 31.42
<b>14.00%</b>	\$ 16.23	\$ 18.55	\$ 20.86	\$ 23.18	\$ 25.50	\$ 27.82	\$ 30.14
<b>15.00%</b>	\$ 15.57	\$ 17.79	\$ 20.02	\$ 22.24	\$ 24.46	\$ 26.69	\$ 28.91

In connection with its analyses, Sandler O'Neill considered and discussed with the Flag board how the present value analyses would be affected by changes in the underlying assumptions, including variations with respect to net income. Sandler O'Neill noted that the discounted dividend

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stream and terminal value analysis is a widely used valuation methodology, but the results of such methodology are highly dependent upon the numerous assumptions that must be made, and the results thereof are not necessarily indicative of actual values or future results.

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**Pro Forma Merger Analysis.** Sandler O'Neill analyzed certain potential pro forma effects of the merger, assuming the following: (1) the merger closes on September 30, 2005; (2) approximately 84.4% of First Capital shares are exchanged for Flag common stock at a fixed exchange ratio of 1.6x; (3) approximately 15.6% of First Capital shares are exchanged for cash at a price of \$23.93; (4) First Capital stock options are converted into options to purchase Flag common stock, adjusted for the fixed exchange ratio; (5) First Capital's 2005 and 2006 net income projections and earnings per share growth rates for 2007 through 2009 provided by and reviewed with Flag's management; (6) Flag's 2005 budgeted net income and earnings per share growth rate projections for 2006 through 2009 provided by and review with Flag's management; (7) purchase accounting adjustments, charges and transaction costs associated with the merger and cost savings determined by the senior managements of Flag and First Capital; (8) Flag issues \$30 million of trust preferred at closing at a cost of 5.25% per annum. The analyses indicated that for the year ending December 31, 2006 (the first full year of combined operations), the merger would be accretive to Flag's projected earnings per share and, at September 30, 2005 (the assumed closing date of the merger) the merger would be dilutive to Flag's tangible book value per share. The actual results achieved by the combined company may vary from projected results and the variations may be material.

In connection with the merger, Sandler O'Neill will receive from Flag a customary transaction fee, of which \$50,000 has been paid and the balance of which is contingent, and payable, upon closing of the merger. Sandler O'Neill has also received a fee of \$150,000 in connection with rendering its opinion, which fee shall be credited against the fee payable upon closing of the merger. Flag has also agreed to reimburse certain of Sandler O'Neill's reasonable out-of-pocket expenses up to \$15,000 incurred in connection with its engagement and to indemnify Sandler O'Neill and its affiliates and their respective partners, directors, officers, employees, agents and controlling persons against certain expenses and liabilities, including liabilities under securities laws.

Sandler O'Neill may provide investment banking services to Flag in the future and may receive compensation for such services. The services may include raising capital in connection with the merger and/or other services to be performed during the period prior to the closing of the merger.

In the ordinary course of its business as a broker-dealer, Sandler O'Neill may purchase securities from and sell securities to Flag and First Capital and their respective affiliates. Sandler O'Neill may also actively trade the debt and/or equity securities of Flag or First Capital or their respective affiliates for its own account and for the accounts of its customers and, accordingly, may at any time hold a long or short position in such securities.

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**TERMS OF THE MERGER**

The descriptions of the terms and conditions of the merger, the merger agreement and any related documents in this joint proxy statement/prospectus are qualified in their entirety by reference to the copy of the merger agreement attached as Appendix A to this joint proxy statement/prospectus, to the registration statement, of which this joint proxy statement/prospectus is a part, and to the exhibits to the registration statement.

**General**

The merger agreement provides that, if all of the conditions set forth in the merger agreement are satisfied or waived, First Capital will merge with and into Flag, with Flag remaining in existence as the surviving corporation in the merger. First Capital Bank and Capital Financial Software, LLC, each a wholly-owned subsidiary of First Capital, will become wholly-owned subsidiaries of Flag following the merger, and First Capital Bank will be immediately merged with and into Flag Bank. Flag will also assume First Capital's trust subsidiary, First Capital Statutory Trust I, which was created in connection with First Capital's issuance of trust preferred securities.

**Conversion of Stock; Treatment of Options**

**First Capital Common Stock.** At the effective time of the merger, each share of First Capital common stock outstanding generally will be converted into and exchanged for the right to receive 1.6 shares of Flag common stock and cash instead of fractional shares. The exchange ratio is subject to customary adjustments to preserve the relative value of the consideration First Capital shareholders are to receive in the event of stock splits, reverse stock splits or the like before the merger is completed, as described below under **Anti-dilution Adjustments**. Because the exchange ratio is fixed and because the market price of Flag common stock will fluctuate, the value of the shares of Flag common stock that First Capital shareholders will receive at the effective time of the merger may increase or decrease, both before and after the merger.

Any non-institutional First Capital shareholder that would own more than 384,000 shares of Flag common stock following the merger will receive a cash payment, in lieu of shares of Flag common stock over the 384,000 share threshold, equal to the number of such excess shares multiplied by \$14.76 per share, the average closing price of Flag's common stock for the 20 trading days immediately following the public announcement of the merger. As discussed below under **Interests of Employees and Directors of Flag and First Capital in the Merger**, as a result of this provision, William R. Blanton, vice president, chief financial officer and chief operating officer of First Capital, will receive a cash payment of approximately \$19.1 million in the merger.

Any First Capital shareholder who would otherwise have been entitled to receive a fraction of a share of Flag common stock in the merger will receive, in lieu thereof, cash (without interest) in an amount equal to his or her fractional share multiplied by the average closing price of Flag common stock for the 20 trading days immediately preceding the date of the effective time of the merger as reported in *The Wall Street Journal*.

Some shares of First Capital common stock will not be converted in the merger. These include any shares held by Flag, First Capital and their respective subsidiaries, except for shares held on behalf of third parties. Each outstanding share of First Capital common stock owned by Flag, First Capital and their respective subsidiaries will be canceled at the effective time of the merger and will cease to be outstanding.

**Stock Options.** Each outstanding and unexercised option to acquire First Capital common stock granted under First Capital's stock incentive plans will be assumed by Flag, and any right to purchase First Capital common stock under the options shall be converted at the effective time of the merger into rights to purchase Flag common stock, with the following adjustments:

the number of shares of Flag common stock subject to the option will be equal to the product of the number of shares of First Capital common stock subject to the option immediately prior to the effective time of the merger and the exchange ratio; and

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the exercise price per share of Flag common stock subject to the option will be equal to the exercise price under the First Capital option immediately prior to the effective time of the merger divided by the exchange ratio.

Shares of Flag common stock to be issued upon the exercise of First Capital stock options will be timely registered under the Securities Act of 1933 on a registration statement on Form S-8.

**Anti-dilution Adjustments.** If, before the effective time of the merger, the outstanding shares of First Capital common stock or Flag common stock are increased, decreased, changed into or exchanged for a different number or kind of shares or securities as a result of a stock split, stock dividend, recapitalization, reclassification, exchange of shares or similar recapitalization transaction, an appropriate and proportionate adjustment will be made to the exchange ratio.

**Flag Common Stock.** All shares of Flag common stock issued and outstanding immediately before the effective time of the merger will remain issued and outstanding immediately after completion of the merger as shares of common stock of the surviving corporation. They will not be affected by the merger.

**Raising of Additional Capital**

We cannot complete our merger unless we obtain the approval of applicable bank regulatory authorities, including the Federal Reserve and the Georgia Department. We are in the process of preparing and filing applications for approval of the merger with the Federal Reserve and the Georgia Department. In connection with the application, we propose to issue and sell up to \$25,000,000 in trust preferred securities through a trust in an offering to accredited investors that is exempt from the registration requirements of the Securities Act of 1933. The offering of the trust preferred securities by Flag will be subject to the prior approval of the Federal Reserve and the Georgia Department.

In connection with the applications, we also propose to raise at least \$5,000,000 in new capital through the exercise of outstanding warrants to purchase our common stock. The warrants were issued by Flag in connection with a series of private placements of Flag common stock, primarily in 2002, and have a term of 10 years. The warrants were sold to investors in the private placement transactions at a price of \$1.00 per warrant as an inducement for the investors' purchase of Flag common stock in the transactions. Members of Flag's senior management hold some of these warrants. In consideration for the warrant holders' agreement to forfeit the remaining term of the warrants and exercise them in connection with the Merger, we have agreed to adjust the exercise price of the warrants. The following table summarizes the warrants and their year of issuance, original weighted exercise price and adjusted weighted exercise price:

<u>Year of Issuance</u>	<u>Number of Warrants</u>	<u>Original Weighted Exercise Price</u>	<u>Adjusted Weighted Exercise Price</u>
2002	1,236,000	\$ 9.21	\$6.59
2003	12,000	11.50	8.23
2004	6,000	13.01	9.31



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Flag's board of directors established a special committee, consisting of H. Speer Burdette, Quill O. Healey and John D. Houser, none of whom hold any of the warrants, to evaluate and consider whether the terms of the warrant term forfeiture and price adjustment were in the best interests of Flag and its shareholders. After considering the terms and conditions of the warrant term forfeiture and price adjustment and other information which the special committee felt was relevant and consulting with financial and legal experts, the special committee determined that the warrant term forfeiture and price adjustment was in the best interests of Flag and its shareholders. Flag's board of directors ratified the special committee's decision.

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The estimated pro forma capital ratios of the combined company as of June 30, 2005 after giving effect to the capital raising transactions described above and the merger, are as follows:

	<b>Pro Forma for \$30 Million Additional Capital</b>
Tier 1 Leverage Ratio	8.35%
Tier 1 Risk Based Capital Ratio	10.34%
Total Risk Based Capital Ratio	11.55%

Based on these pro forma capital ratios, the combined company will be well capitalized under the Federal Reserve's capital regulations.

**Effective Time of the Merger**

If the merger agreement is approved by the requisite votes of the shareholders of First Capital and Flag and all other required governmental and other consents and approvals are received, and if the other conditions to the obligations of the parties to consummate the merger are satisfied or waived (as permitted), the merger will be consummated and effected on the date and at the time the Articles of Merger reflecting the merger become effective with the Secretary of State of Georgia. Unless otherwise mutually agreed upon in writing by our chief executive officers, we will use our reasonable efforts to cause the effective time of the merger to occur on the last business day of the month in which the last of the following occurs:

the effective date (including expiration of any applicable waiting period) of the last required consent of any regulatory authority having authority over and approving or exempting the merger;

the date on which First Capital shareholders approve the merger agreement;

the date on which Flag shareholders approve the merger agreement; or

a later date if agreed upon in writing by Flag and First Capital.

Assuming satisfaction of all of the conditions to consummation of the merger, the merger is expected to close by the end of the fourth quarter of 2005. Either Flag or First Capital may terminate the merger agreement prior to the effective time, under several circumstances. See Terms of the Merger Conditions to Consummation and Amendment, Waiver and Termination.

**Exchange of Certificates**

Promptly after the effective time of the merger, Flag will cause its exchange agent to mail appropriate transmittal materials to each record holder of First Capital common stock for the exchange for Flag common stock. Risk of loss and title to the certificates will remain with the holder until proper delivery of such certificates to Flag or its exchange agent by former First Capital shareholders. **First Capital shareholders should not surrender their certificates for exchange until they receive a letter of transmittal and instructions from Flag or its exchange agent.** After the effective time of the merger, each holder of shares of First Capital common stock, except holders exercising dissenters' rights, issued and outstanding at the effective time must surrender the certificate or certificates representing their shares to Flag or its exchange agent and will, promptly upon such surrender, receive the consideration they are entitled to under the merger agreement, together with all undelivered dividends or distributions in respect of such shares (without interest). As provided in the merger agreement, each record holder of First Capital common stock shall also receive cash in lieu of any fractional share of Flag common stock to which he or she would be otherwise entitled (without interest). Flag will not be obligated to deliver the consideration to which any former holder of First Capital common stock is entitled until the holder surrenders the certificate or certificates representing his or her shares for exchange. The certificate or

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certificates so surrendered must be duly endorsed as Flag or its exchange agent may require. Neither Flag nor its exchange agent will be liable to a holder of First Capital common stock for any property delivered in good faith to a public official pursuant to any applicable abandoned property, escheat or other law.

After the effective time of the merger (and prior to the surrender of certificates of First Capital common stock to Flag or its exchange agent), record holders of certificates that represented outstanding First Capital common stock immediately prior to the effective time of the merger will have no rights with respect to the certificates other than the right to surrender the certificates and receive in exchange for the certificates a certificate or certificates representing the aggregate number of whole shares of Flag common stock to which the holder is entitled pursuant to the merger agreement, together with a check for the amount (without interest) representing any fractional share.

In the event that any dividend or distribution, the record date for which is on or after the effective time of the merger, is declared by Flag on Flag common stock, no such dividend or other distribution will be delivered to the holder of a certificate representing shares of First Capital common stock immediately prior to the effective time of the merger until such holder surrenders such certificate as set forth above.

In addition, holders of certificates that represented outstanding First Capital common stock immediately prior to the effective time of the merger will be entitled to vote after the effective time of the merger at any meeting of Flag shareholders the number of whole shares of Flag common stock into which such shares are convertible, even if such holder has not surrendered such certificates for exchange as set forth above.

Flag shareholders will not be required to exchange certificates representing their shares of Flag common stock or otherwise take any action after the merger is completed.

### **Important Federal Income Tax Consequences**

The following summarizes certain material federal income tax consequences of the merger to First Capital shareholders. This summary is based on current laws, regulations, rulings and decisions now in effect, all of which are subject to change at any time, possibly with retroactive effect. This summary is not a complete description of all of the tax consequences of the merger and, in particular, may not address federal income tax consequences applicable to you if you are subject to special treatment under federal income tax law, such as rules relating to shareholders who are not citizens or residents of the United States, who are financial institutions, foreign corporations, tax-exempt organizations, insurance companies or dealers in securities, shareholders who acquired their shares pursuant to the exercise of options or similar derivative securities or otherwise as compensation, and shareholders who hold their shares as part of a straddle or conversion transaction. In addition, this summary does not address the tax consequences of the merger under applicable state, local, foreign or estate tax laws. This discussion assumes you hold your shares of First Capital common stock as a capital asset within the meaning of Section 1221 of the Internal Revenue Code of 1986, as amended (the Internal Revenue Code). Each First Capital shareholder should consult with his or her tax advisor about the tax consequences of the merger in light of his or her individual circumstances, including the application of any federal, state, local, foreign or estate tax law.

The merger is intended to constitute a reorganization under Section 368(a) of the Internal Revenue Code. A condition to completing the merger is that, on the closing date, Flag and First Capital receive an opinion from Morris, Manning & Martin, LLP, counsel to Flag, that the merger will qualify as a reorganization within the meaning of Section 368(a) of the Internal Revenue Code. The closing date opinion will be based on customary assumptions and customary representations made by First Capital and Flag. An opinion of counsel represents the counsel's best legal judgment and is not binding on the Internal Revenue Service or any court. If, notwithstanding such opinion of counsel, the merger does not

qualify as a reorganization, the exchange of First Capital common stock for Flag common stock in the merger will be a taxable transaction.

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Neither First Capital nor Flag intends to waive the condition that it receive an opinion that the merger will qualify as a reorganization. If, however, First Capital decides to waive the condition, First Capital will recirculate this document to disclose the waiver and to make all related material disclosures, and will resolicit proxies from the First Capital shareholders.

Provided the merger qualifies as a reorganization, neither First Capital nor Flag will recognize any gain or loss for federal income tax purposes, and the federal income tax consequences to First Capital shareholders will be as follows:

you will not recognize any gain or loss on the exchange of your First Capital common stock for Flag common stock, except to the extent you receive cash instead of shares (including the receipt of cash in instead of a fractional share);

if you receive cash instead of a whole or fractional share of Flag common stock, you will recognize gain or loss equal to the difference between the amount of the cash received and your tax basis allocable to the share or fractional share, and this gain or loss generally will be capital gain or loss;

if you exercise your dissenters' rights under Georgia law and receive payment in cash for the fair value of your shares of First Capital common stock, you will be treated as having exchanged such shares for cash in a redemption subject to Section 302 of the Internal Revenue Code, and you generally will recognize capital gain or loss in such exchange equal to the difference between the cash received and the tax basis of such shares;

your aggregate tax basis for the shares of Flag common stock received for your First Capital common stock will be the same as your aggregate tax basis for the First Capital common stock surrendered in exchange therefor, excluding any basis allocable to a fractional share of Flag common stock for which cash is received;

your holding period for shares of Flag common stock received for your First Capital common stock will include your holding period for the First Capital common stock exchanged for Flag common stock if your shares of First Capital common stock are held as a capital asset within the meaning of Section 1221 of the Internal Revenue Code at the effective time of the merger; and

notwithstanding anything herein to the contrary, you (and any affiliate or person acting on your behalf) may disclose to any and all persons, without limitation of any kind, the transaction's tax treatment and tax structure and all material of any kind (including opinions or other tax analyses) provided to you relating to such tax treatment and tax structure, except to the extent necessary to comply with any applicable federal or state securities laws.

Each First Capital shareholder that receives Flag common stock in the merger will be required to file a statement with his, her or its U.S. federal income tax return setting forth his, her or its basis in the First Capital common stock surrendered and the fair market value of the Flag common stock and cash, if any, received in the merger, and to retain permanent records of these facts relating to the transaction.

**Each First Capital shareholder is urged to consult his or her personal tax and financial advisor as to his or her specific federal income tax consequences, based on his or her own particular status and circumstances, and also as to any state, local, foreign, estate or other tax consequences arising out of the merger.**

**Management and Operations After the Merger**

At the effective time of the merger, First Capital will merge with and into Flag. The directors of Flag in office immediately prior to the effective time will continue as the directors of Flag after the merger. In addition, at the effective time of the merger, three directors of First Capital in office immediately prior to the effective

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time, one of whom will be H.N. Padget, Jr., will be appointed by First Capital and elected as directors of Flag by the Flag board of directors.

The new additional directors from First Capital will be divided among the three classes of Flag's board of directors. In the event any of the three new directors will not serve his or her full term, the remaining new directors appointed by First Capital, by majority vote, will nominate a replacement director to serve out the remaining portion of the term subject to the approval of Flag.

The officers of Flag in office immediately prior to the effective time shall continue to serve as the officers of Flag following the merger. Joseph W. Evans will continue to serve as the chairman, chief executive officer and president of Flag and as the chairman of Flag Bank. J. Thomas Wiley, Jr. will continue to serve as vice chairman and chief banking officer of Flag and as chief executive officer of Flag Bank. Stephen W. Doughty will continue to serve as vice chairman and chief risk management officer of Flag, and J. Daniel Speight will continue to serve as vice chairman, chief financial officer and secretary of Flag.

Mr. Padget will serve as a member of the executive committee of the Flag board of directors, executive vice president of Flag and the president and director of Flag Bank. Steven G. Deaton will serve as executive vice president of Flag Bank. The current directors of Flag Bank will continue to serve as directors of Flag Bank.

**Interests of Employees and Directors of Flag and First Capital in the Merger**

**General.** Some of the employees and directors of Flag and First Capital may be deemed to have interests in the merger in addition to their interests as shareholders of Flag or First Capital generally. These interests include, among others, proposed employee benefits for those who become employees of Flag or a Flag subsidiary after the merger, employment agreements with two of First Capital Bank's current executive officers, the appointment of certain First Capital directors to the board of the combined company, the conversion of outstanding First Capital stock options into rights to purchase Flag common stock and insurance coverage for First Capital's directors and officers, as described below.

**Employee Benefits.** The merger agreement generally provides that Flag will furnish to those employees of First Capital who become employees of Flag or a Flag subsidiary after the effective time of the merger, benefits under employee benefit plans that, when taken as a whole, are substantially similar to those currently provided by Flag and its subsidiaries to their similarly situated employees. Flag may apply any pre-existing condition exclusion or waiting period under any Flag employee health plan for which any employees and/or officers and dependents are covered by the relevant First Capital benefit plans as of the date of the closing, but that portion of any such existing condition exclusion or waiting period will not be enforced to the extent it exceeds in duration the corresponding provision in effect under the First Capital benefit plans immediately prior to the date of the closing. For purposes of participation, vesting and benefit accrual under Flag's employee benefit plans, service with First Capital prior to the effective time of the merger will be treated as service with Flag or its subsidiaries. Flag will credit new Flag employees for amounts paid under First Capital benefit plans for the plan year, including the effective time of the merger, for purposes of applying deductibles, co-payments and out of pocket maximums under the Flag benefit plans.

**Padget Employment Agreement.** As a condition to the closing of the merger, First Capital, First Capital Bank and Mr. Padget will terminate the existing employment agreement upon the closing of the merger, and Flag and Flag Bank will enter into a new employment agreement with Mr. Padget. Pursuant to the new employment agreement, Mr. Padget will serve as executive vice president of Flag and the president of Flag Bank.



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Under the terms of the new employment agreement, Mr. Padget will receive an annual base salary equal to \$180,000 and annual performance bonuses based on the degree of achievement of performance goals to be determined by the compensation committee of the Flag board of directors. Flag will assign to Mr. Padget title to the automobile currently used by Mr. Padget in connection with his duties at First Capital. Mr. Padget will also

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receive, at the effective time of the merger, payments from Flag in the aggregate of \$230,000 as an incentive to enter into this new employment agreement and satisfaction of First Capital's obligations under the previous employment agreement relating to change in control payments. In addition, on January 1, 2006, Mr. Padgett will be eligible, subject to the discretion of Flag's compensation committee, for a bonus up to \$90,000 relating to the success of the merger.

This new employment agreement will have an initial term of one year and will automatically renew each day after the effective date of the merger until either party gives notice of termination, in which event the term of employment will expire on the first anniversary of the 30th day following the date such written notice is received.

The new employment agreement also contains customary provisions regarding termination, and, upon certain events of termination, severance payments and restrictions on competition.

***Deaton Employment Agreement.*** In connection with the merger, First Capital, First Capital Bank and Steven G. Deaton will terminate the existing employment agreement, and Flag and Flag Bank will enter into a new employment agreement with Mr. Deaton. Pursuant to the new employment agreement, Mr. Deaton will serve as executive vice president of Flag Bank.

Under the terms of the new employment agreement, Mr. Deaton will receive an annual base salary equal to \$160,000 and annual performance bonuses based on the degree of achievement of performance goals to be determined by the compensation committee of the Flag board of directors. Mr. Deaton will also receive, at the effective time of the merger, payments from Flag in the aggregate of \$14,400 as an incentive to enter into this new employment agreement and satisfaction of First Capital's obligations under the previous employment agreement relating to change in control payments. In addition, on January 1, 2006, Mr. Deaton will be eligible, subject to the discretion of Flag's compensation committee, for a bonus up to \$100,000 relating to the success of the merger.

This new employment agreement will have an initial term of one year and will automatically renew each day after the effective date of the merger until either party gives notice of termination, in which event the term of employment will expire on the first anniversary of the 30th day following the date such written notice is received.

The new employment agreement also contains customary provisions regarding termination, and, upon certain events of termination, severance payments and restrictions on competition.

***Blanton Non-Compete and Consulting Agreement.*** As a condition to the closing of the merger, Flag and William R. Blanton, a key executive and the largest shareholder of First Capital, will enter into a non-compete and consulting agreement, pursuant to which Mr. Blanton will agree not to compete with Flag or to solicit the employees or customers of Flag, subject to certain exceptions, and to provide technology consulting services for a term of 21 months commencing at the effective time of the merger. Mr. Blanton will not be required to devote more than 16 hours per month (including travel time) to providing the consulting services under this consulting agreement. In consideration for all services rendered by Mr. Blanton to Flag under this consulting agreement, Flag will pay to Mr. Blanton a fee of \$900,000 payable in 21 equal monthly installments of \$42,857.15. Flag has also agreed to reimburse Mr. Blanton for up to \$20,000 in legal expenses incurred by him in connection with the non-compete and consulting agreement.

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In addition, upon the effective time of the merger, Flag will assign to Mr. Blanton title to the automobile, office furniture and laptop computer currently used by Mr. Blanton in connection with his duties at First Capital, and will assign to Mr. Blanton any interest in any life insurance policy it holds on the life of Mr. Blanton, net of any cash value of such policy. The non-compete and consulting agreement also includes customary confidentiality provisions.

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**Good Shepherds Program.** Following the merger, Flag will transfer to William R. Blanton, a key executive and the largest shareholder of First Capital, the software development and deposit and loan production program of First Capital called Good Shepherds. The Good Shepherds program is targeted towards churches and other faith-based organizations, and allows online donations by members of churches and other faith-based organizations and online cash management for the organizations. In connection with the assignment of the program, Flag will transfer to Mr. Blanton its rights in the name Good Shepherds, any deposits developed by the Good Shepherds program outside of metropolitan Atlanta, cash equal to the principal balance of the deposits plus accrued but unpaid interest, and any loans developed by the Good Shepherds program. In consideration of the transfer, Mr. Blanton will pay Flag cash equal to an 8% premium on the principal balance of the deposits developed by the Good Shepherds program as of May 26, 2005, and the principal balance of the loans developed by the Good Shepherds program, plus all accrued interest and other charges.

First Capital and Flag have agreed to permit the continued operation of the Good Shepherds program, including the continued development of the software components of the program and the continuation of the program's marketing initiatives until the completion of the merger, and Mr. Blanton has agreed to reimburse First Capital and Flag for the cost of such operations.

**Merger Cash Payment.** In connection with the merger, Flag will pay cash to any non-institutional First Capital shareholder that would own more than 384,000 shares of Flag common stock following the merger will receive a cash payment, in lieu of shares of Flag common stock over the 384,000 share threshold, equal to the number of such excess shares multiplied by \$14.76 per share, the average closing price of Flag's common stock for the 20 trading days immediately following the public announcement of the merger. William R. Blanton, the vice chairman, chief financial officer and chief operating officer of First Capital, will receive a cash payment of approximately \$19.1 million as a result of this provision.

**Directors.** The directors of Flag in office immediately prior to the effective time will continue as the directors of Flag after the merger. At the effective time of the merger, three directors of First Capital in office immediately prior to the effective time, one of whom shall be H.N. Padgett, Jr., will be appointed by First Capital, subject to Flag's approval, and elected as directors of Flag by the Flag board of directors. The additional directors from First Capital will be divided among the three classes of Flag's board of directors. In the event any of the three new directors will not serve his or her full term prior to the 2006 annual meeting of Flag shareholders, the remaining new directors appointed by First Capital, by majority vote, will nominate a replacement director to serve out the remaining portion of the term subject to the approval of Flag.

**Stock Options.** As described above, each outstanding and unexercised option to acquire First Capital common stock granted under First Capital's stock option and incentive plans will be converted automatically at the effective time of the merger into rights to purchase Flag common stock, with the following adjustments:

the number of shares of Flag common stock subject to the option will be equal to the product of the number of shares of First Capital common stock subject to the option immediately prior to the effective time of the merger and the exchange ratio; and

the exercise price per share of Flag common stock subject to the option will be equal to the exercise price under the First Capital option immediately prior to the effective time of the merger, divided by the exchange ratio.

Shares of Flag common stock to be issued upon the exercise of First Capital stock options will be timely registered under the Securities Act of 1933 on a registration statement on Form S-8.

**Supplemental Retirement Plan.** Ms. Grimes and Messrs. Alford, Deaton, Groce, Hink, Padget and Pond have supplemental retirement agreements with First Capital Bank. Under these agreements, the participants are entitled to receive supplemental retirement benefits from and after their respective retirements at or after age 65

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until death. In the event a participant is terminated, resigns or is removed for any reason other than for cause following a change of control in either First Capital or First Capital Bank, he or she is entitled to receive the benefits promised under the agreements as if they had been continuously employed by First Capital or First Capital Bank until age 65. Consequently, in the event Messrs. Padget and Deaton or any of the directors of First Capital are so terminated, resign or are removed following the merger of First Capital with Flag, they will receive the retirement benefits under the agreements as if they had been continuously employed until age 65. See Management of First Capital Supplemental Retirement Plan.

***Life Insurance Benefits.*** According to the individual split dollar agreements with First Capital, Ms. Grimes and Messrs. Alford, Deaton, Groce, Hink, Padget and Pond are entitled to share in the death benefit proceeds payable under certain life insurance policies owned by First Capital Bank that were purchased in connection with the supplemental retirement agreements. In the event a participant is terminated, resigns or is removed for any reason other than for cause following a change of control in either First Capital or First Capital Bank, he or she becomes 100% vested in the death benefits promised under the agreement. Consequently, in the event Messrs. Padget and Deaton or any of the directors of First Capital are so terminated, resign or are removed following the merger of First Capital with Flag, their beneficiaries will receive the death benefit set forth in the split dollar agreements as if they had died while serving on the board of directors or while employed by First Capital or First Capital Bank, as applicable. See Management of First Capital Life Insurance Benefits.

***Insurance.*** Flag has agreed to provide directors and officers insurance coverage for directors and officers of First Capital, at Flag's election, either (1) by purchasing continuation coverage under First Capital's current policy for directors and officers for a period of not less than three years after the effective time of the merger, or (2) if Flag's current directors and officers policy provides substantially similar coverage as First Capital's current policy, by obtaining coverage under Flag's current policy for First Capital's directors and officers on a prior acts basis for a period not less than three years prior to the effective time of the merger.

**Conditions to Consummation**

The obligations of First Capital and Flag to consummate the merger are subject to the satisfaction or waiver (to the extent permitted) of several conditions, including:

First Capital and Flag shareholders must have approved the merger agreement and the consummation of the merger as and to the extent required by law, First Capital's and Flag's governing corporate instruments and the rules of the National Association of Securities Dealers;

the required regulatory approvals described under Regulatory Matters must have been received, generally without any conditions or restrictions that would, in the reasonable judgment of the board of directors of First Capital or Flag, materially adversely affect the economic or business benefits of the transactions contemplated by the merger agreement so as to render inadvisable the consummation of the merger;

each party must have received all consents (other than those described in the preceding paragraph) required for consummation of the merger and for the prevention of a default under any contract of such party that, if not obtained or made, would reasonably likely have, individually or in the aggregate, a material adverse effect on such party, generally without any conditions or restrictions that would, in the reasonable judgment of the board of directors of First Capital or Flag, materially adversely affect the economic or business benefits of the transactions contemplated by the merger agreement so as to render inadvisable the consummation of the merger;

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no court or regulatory authority may have taken any action that prohibits, restricts or makes illegal the consummation of the transactions contemplated by the merger agreement;

the registration statement registering the shares of Flag common stock to be received by First Capital shareholders, of which this joint proxy statement/prospectus is a part, must have been declared effective

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by the SEC, no stop order suspending the effectiveness of the registration statement may have been issued, no action, suit, proceeding or investigation by the SEC to suspend the effectiveness of the registration statement may have been initiated and be continuing and all necessary approvals under federal and state securities laws relating to the issuance or trading of the shares of Flag common stock issuable pursuant to the merger must have been received;

each party must have received an opinion of Troutman Sanders LLP or Morris, Manning & Martin, LLP to the matters set forth above under **Important Federal Income Tax Consequences** ;

H. N. Padget, Jr. must have entered into an employment agreement with Flag and must have terminated his existing employment agreement with First Capital;

each of the executive officers and directors of each party must have executed and delivered to the other party a support agreement in substantially the form attached to the merger agreement;

William R. Blanton must have entered into a non-compete and consulting agreement with Flag and must have terminated his existing employment agreement with First Capital;

each party's representations and warranties must remain accurate, and each party must have performed all of the agreements and covenants to be performed by it pursuant to the merger agreement and must have delivered certificates confirming satisfaction of the foregoing requirements and certain other matters;

each party must have received an opinion of the other party's counsel, dated the closing date, as to certain matters;

Flag must have received from each affiliate of First Capital an agreement stating, among other things, that he or she will comply with federal securities laws when transferring any shares of Flag common stock received in the merger (see **Resales of Flag Common Stock** ); and

Flag's board of directors must have elected three of the current First Capital directors appointed by First Capital, subject to Flag's approval, as additional new directors of Flag.

No assurances can be provided as to when or if all of the conditions precedent to the merger can or will be satisfied or waived by the appropriate party. As of the date of this joint proxy statement/prospectus, the parties know of no reason to believe that any of the conditions set forth above will not be satisfied. The conditions to consummation of the merger may be waived, in whole or in part, to the extent permissible under applicable law, by the party for whose benefit the condition has been imposed, without the approval of such parties' shareholders.

**Regulatory Matters**

The merger is subject to the prior approval of the Federal Reserve and the Georgia Department. Under these agencies' regulations, they are required, when approving a transaction such as the merger, to take into consideration the financial and managerial resources (including the competence, experience and integrity of the officers, directors and principal shareholders) and future prospects of the existing and proposed institutions and the convenience and needs of the communities to be served. In considering the financial resources and future prospects of the



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existing and proposed institutions, the Federal Reserve and the Georgia Department will, among other things, evaluate the adequacy of the capital level of the parties to the proposed transaction.

We are in the process of preparing and filing applications for approval of the merger with the Federal Reserve and the Georgia Department. In connection with the applications, we propose to issue and sell up to \$25,000,000 in trust preferred securities through a newly formed trust subsidiary of Flag in an offering to accredited investors that is exempt from the registration requirements of the Securities Act of 1933. The offering of the trust preferred securities by Flag will be subject to the prior approval of the Federal Reserve and the Georgia Department.

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In connection with the applications, we also propose to raise at least \$5,000,000 in new capital through the exercise of outstanding warrants to purchase our common stock. The warrants were issued by Flag in connection with a series of private placements of Flag common stock, primarily in 2002, and have a term of 10 years. The warrants were sold to investors in the private placement transactions at a price of \$1.00 per warrant as an inducement for the investors' purchase of Flag common stock in the transactions. Members of Flag's senior management hold some of these warrants. In consideration for the warrant holders' agreement to forfeit the remaining term of the warrants and exercise them in connection with the Merger, we have agreed to adjust the exercise price of the warrants. The following table summarizes the warrants and their year of issuance, original weighted exercise price and adjusted weighted exercise price:

<u>Year of Issuance</u>	<u>Number of Warrants</u>	<u>Original Weighted Exercise Price</u>	<u>Adjusted Weighted Exercise Price</u>
2002	1,236,000	\$ 9.21	\$6.59
2003	12,000	11.50	8.23
2004	6,000	13.01	9.31

Flag's board of directors established a special committee, consisting of H. Speer Burdette, Quill O. Healey and John D. Houser, none of whom hold any of the warrants, to evaluate and consider whether the terms of the warrant term forfeiture and price adjustment were in the best interests of Flag and its shareholders. After considering the terms and conditions of the warrant term forfeiture and price adjustment and other information which the special committee felt was relevant and consulting with financial and legal experts, the special committee determined that the warrant term forfeiture and price adjustment was in the best interests of Flag and its shareholders. Flag's board of directors ratified the special committee's decision.

The merger generally may not be consummated until 30 days after receipt of the Federal Reserve approval, during which time the United States Department of Justice may challenge the merger on antitrust grounds. The commencement of an antitrust action would stay the effectiveness of the Federal Reserve's approval unless a court specifically ordered otherwise. Flag and First Capital believe that the merger does not raise any other significant regulatory concerns.

After the consummation of the merger, we propose to merge Flag Bank and First Capital Bank with Flag Bank remaining as the surviving banking corporation. We cannot complete the proposed bank merger unless we obtain the approval of applicable bank regulatory authorities, including the Federal Deposit Insurance Corporation and the Georgia Department. We are in the process of preparing and filing applications for approval of the bank merger with the Federal Deposit Insurance Corporation and the Georgia Department.

Other than as summarized above, we are not aware of any governmental approvals or actions that may be required for consummation of the merger. Should any other approval or action be required, we currently contemplate that we would seek such approval or action. To the extent that the above summary describes statutes and regulations, it is qualified in its entirety by reference to those particular statutes and regulations. In addition to the approvals and notifications of the regulatory authorities summarized above, we are subject to ongoing supervision, regulation and periodic examination by various federal and state regulatory agencies. Those discussions are qualified in their entirety by the actual language of the laws and regulations, which are subject to change based on possible future legislation and regulatory action.

**Amendment, Waiver and Termination**

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To the extent permitted by law, First Capital and Flag, with the approval of their respective boards of directors, may amend the merger agreement by written agreement at any time without the approval of First Capital shareholders or Flag shareholders. However, after the approval of the merger by First Capital shareholders, no amendment may decrease the consideration to be received without the further approval of First

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Capital shareholders. Similarly, after the approval of the merger by Flag shareholders, no amendment may increase the consideration to be paid by Flag without the further approval of Flag shareholders.

Prior to or at the effective time of the merger, either First Capital or Flag may waive any default in the performance of any term of the merger agreement by the other party, may waive or extend the time for the fulfillment by the other party of any of its obligations under the merger agreement, and may waive any of the conditions precedent to the obligations of such party under the merger agreement, except any condition that, if not satisfied, would result in the violation of an applicable law.

The merger agreement may be terminated, and the merger abandoned, at any time prior to the effective time of the merger, by mutual consent of the boards of directors of First Capital and Flag. In addition, the merger agreement may be terminated, and the merger abandoned, prior to the effective time of the merger by either First Capital or Flag if:

the other party breaches and does not timely cure any representation or warranty contained in the merger agreement;

any consent of any regulatory authority required for consummation of the merger is denied by final nonappealable action of the regulatory authority or if any action taken by the regulatory authority is not appealed within the time limit for appeal, or First Capital shareholders fail to approve the merger agreement at the special meeting;

the merger has not been consummated by March 31, 2006 and the failure to consummate the merger by that date has not been caused by a breach of the terminating party;

any of the conditions precedent to the obligation of the terminating party to consummate the merger cannot be satisfied by March 31, 2006; or

in order to enter into a definitive agreement with respect to a third-party acquisition proposal, the terminating party's board of directors determines prior to the shareholder approval in good faith that such acquisition constitutes a superior proposal and that, after consultation with its advisors, to do otherwise would be inconsistent with its fiduciary duty to the shareholders, in which event the terminating party will pay the termination fee of \$2,000,000 to the other party within 30 business days after the effective date of such termination.

**Conduct of Business Pending the Merger**

Under the merger agreement, each of the parties has agreed, except as otherwise contemplated by the merger agreement or with the prior written consent of the other party, to:

operate its business only in the usual, regular and ordinary course;

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preserve intact its business organizations and assets and maintain its rights and franchises;

use its reasonable efforts to cause its representations and warranties to be correct at all times; and

take no action that would (1) adversely affect the ability of any party to obtain any consents required for the transactions contemplated by the merger agreement without imposition of a condition or restriction that, in the reasonable judgment of the board of directors of First Capital or Flag, would so materially adversely impact the economic or business benefits of the transactions contemplated by the merger agreement as to render inadvisable the consummation of the merger, or (2) adversely affect in any material respect the ability of either party to perform its covenants and agreements under the merger agreement.

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Furthermore, First Capital has agreed in the merger agreement not to take certain actions relating to the operation of their respective businesses pending consummation of the merger without the prior consent of Flag (which consent will not be unreasonably withheld). Such actions include, without limitation:

amending their articles of incorporation, bylaws or other governing corporate instruments;

becoming responsible for any obligation for borrowed money in excess of an aggregate of \$100,000, except in the ordinary course of business consistent with past practices or allowing the imposition of a lien on any stock of their subsidiaries;

acquiring or exchanging (other than exchanges in the ordinary course under employee benefit plans) any shares (or securities convertible into any shares) of capital stock or paying any dividend or making any distribution on any capital stock;

issuing, selling or pledging additional shares of common stock, any stock appreciation rights, any rights to acquire any such stock or any security convertible into such stock;

adjusting or reclassifying any capital stock or issuing or authorizing the issuance of any other securities in respect of, or in substitution for, shares of common stock or their subsidiaries' common stock, or otherwise disposing of or encumbering any asset(s) having a book value in excess of \$100,000, other than in the ordinary course for reasonable and adequate consideration;

acquiring control over any real property, subject to certain exceptions such as foreclosures and acquisitions made in a fiduciary capacity;

purchasing any securities or making any material investments in any person or otherwise acquiring direct or indirect control over any person subject to certain exceptions;

granting any increase in compensation or benefits to employees or officers in excess of 5% on an annual basis (except in accordance with past practice and as previously disclosed, or as required by law), paying any bonus, entering into or amending any severance agreements with officers, or granting any increase in compensation or other benefits to directors (except in accordance with past practice as previously disclosed to the other party);

entering into or amending (unless required by law) any employment contract that does not have the unconditional right to terminate without certain liability;

adopting, subject to certain exceptions, any new employee benefit plan or materially changing any existing plan or program;

making any significant change in tax or accounting methods or systems of internal accounting controls, except for any change required by law or generally accepted accounting principles;

commencing any litigation other than in accordance with past practice or settling any litigation for money damages in excess of \$50,000 or which places material restrictions on operations;

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except in the ordinary course of business, modifying, amending or terminating any material contracts or waiving, releasing or assigning any material rights or claims;

extending credit to any borrower in excess of an aggregate of \$1,000,000;

making any material election with respect to taxes; or

incurring or becoming obligated to incur any expenses exceeding \$100,000, whether capitalized, expended or otherwise other than in the ordinary course of business, excluding any expenses or obligations incurred in connection with the merger.

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Furthermore, Flag has agreed in the merger agreement not to take certain actions relating to the operation of their respective businesses pending consummation of the merger without the prior consent of First Capital (which consent will not be unreasonably withheld). Such actions include, without limitation:

amending their articles of incorporation, bylaws or other governing corporate instruments;

acquiring or exchanging (other than exchanges in the ordinary course under employee benefit plans) any shares (or securities convertible into any shares) of capital stock or paying any dividend or making any distribution on any capital stock;

issuing, selling or pledging additional shares of common stock, any stock appreciation rights, any rights to acquire any such stock or any security convertible into such stock; and

adjusting or reclassifying any capital stock or issuing or authorizing the issuance of any other securities in respect of, or in substitution for, shares of common stock or their subsidiaries' common stock, or otherwise disposing of or encumbering any asset(s) having a book value in excess of \$100,000, other than in the ordinary course for reasonable and adequate consideration.

In addition, each party has agreed that neither it nor any of its affiliates or representatives will: (a) solicit, initiate, or encourage the submission of any acquisition proposal (generally, a tender offer or any proposal for a merger, acquisition, or other business combination), (b) participate in any negotiations regarding, or furnish any information with respect to, an acquisition proposal, (c) withhold, withdraw or modify, in a manner adverse to the party, the approval or recommendation by such party's board of directors of this merger agreement, or (d) approve, recommend or enter into any agreement with respect to any acquisition proposal. However, prior to the approval of the merger agreement by shareholders, each party may take the above mentioned actions in connection with an unsolicited bona fide acquisition proposal, after giving five business days prior written notice to the other party, to the extent that such party's board of directors determines in good faith (after consultation with its advisors) that such acquisition proposal is a superior proposal with more favorable terms from a financial point of view, and that to do otherwise would be inconsistent with its fiduciary duty to its shareholders. Furthermore, such party's board of directors may, in the case of (d), terminate the merger agreement; provided, however, that any party shall have caused its financial and legal advisors to negotiate in good faith with the other party during such five business days to adjust the terms of the merger agreement as would enable any party to proceed with the merger on such adjusted terms. In the merger agreement, each party also agreed to immediately cease and terminate any negotiations with any other parties with respect to any ongoing acquisition proposal.

### **Expenses and Fees**

The merger agreement provides that each party will be responsible for its own direct costs and expenses incurred in connection with the negotiation and consummation of the transactions contemplated by the merger agreement, except that Flag will pay the filing fee in connection with the registration statement and this joint proxy statement/prospectus and one-half of the printing costs incurred in connection with printing the registration statement and this joint proxy statement/prospectus.

### **Accounting Treatment**



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The merger will be accounted for using the purchase method of accounting for financial reporting purposes. Flag and First Capital have determined that the merger will be accounted for as an acquisition by Flag of First Capital. In identifying Flag as the acquiring entity, the companies took into account the relative outstanding share ownership, the composition of the governing body of the combined entity and the designation of certain senior management positions. Under purchase accounting, the assets and liabilities of an acquired company as of the effective time of the acquisition are recorded at their respective fair values and added to those of the acquiring company. Financial statements issued after consummation of an acquisition accounted for as a purchase would reflect such values and would not be restated retroactively to reflect the historical financial position or results of operations of the acquired company.

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**Resales of Flag Common Stock**

The shares of Flag common stock to be issued to First Capital shareholders in the merger have been registered under the Securities Act of 1933 (the Securities Act). Such shares may be traded freely and without restriction by those shareholders not deemed to be affiliates of First Capital or Flag as that term is defined under the Securities Act. Any subsequent transfer of such shares, however, by any person who is an affiliate of First Capital at the time the merger is submitted for a vote or consent of the shareholders of First Capital will, under existing law, require either:

the further registration under the Securities Act of the shares of Flag common stock to be transferred;

compliance with Rule 145 promulgated under the Securities Act (permitting limited sales under certain circumstances); or

the availability of another exemption from registration.

An affiliate of First Capital, as defined by the rules promulgated pursuant to the Securities Act, is a person who directly, or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with First Capital. First Capital has agreed that it will use its reasonable efforts to cause each person or entity that is an affiliate for purposes of complying with Rule 145 to enter into a written agreement relating to such restrictions on sale or other transfer.

**Dissenters' Appraisal Rights**

Any First Capital shareholder who desires to dissent from the merger and receive the fair value of his or her common stock in cash may do so upon complying with the provisions of Sections 14-2-1301 through 14-2-1332 of the Georgia Business Corporation Code. As a result of exceptions under the Georgia Business Corporation Code, however, shareholders of Flag are not entitled to the dissenters' appraisal rights in connection with the merger. The following is a summary of those sections and is qualified in its entirety by the copy of the sections attached to this joint proxy statement/prospectus as Appendix D, which is incorporated by reference herein.

Georgia law provides that any dissenting shareholder desiring to object to the merger and receive payment in cash for his or her shares of common stock must deliver, prior to the vote by his or her company's shareholders on the merger agreement, written notice of his or her intent to demand payment for his or her shares of common stock if the merger is completed. A First Capital shareholder should mail or deliver such notice to First Capital Bancorp, Inc., Attention: Corporate Secretary, 3320 Holcomb Bridge Road, N.W., Suite A, Norcross, Georgia 30092. The demand must be in addition to, and separate from, any proxy or vote against the merger. Any dissenting shareholder must not vote in favor of the merger agreement.

If the merger agreement is approved by First Capital and Flag shareholders, within ten days after the vote of First Capital's shareholders, First Capital will send by mail a written notice, known as a dissenters' notice, to each shareholder who filed a written notice of his or her intent to dissent and who has not voted in favor of the merger agreement. The dissenters' notice will:

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state where demand for payment must be sent, and set a date by which the company must receive the payment demand, which date may not be fewer than 30 nor more than 60 days after the date of the dissenters' notice;

specify where and when share certificates must be deposited, or, in the case of uncertificated shares, the restrictions on the transfer of the uncertificated shares after the payment demand is received by the company; and

be accompanied by a copy of Sections 14-2-1301 through 14-2-1332 of the Georgia Business Corporation Code.

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The dissenters' notice is to be sent to each dissenting shareholder at his or her address as it appears in First Capital's stock transfer books or at such address as the dissenting shareholder supplies by notice to First Capital. Any dissenting shareholder who fails to demand payment or deposit share certificates where required by the date set in the dissenters' notice will no longer be entitled to payment for his or her shares of common stock under Georgia law.

Within ten days after the later of (1) the effective time of the merger, or (2) the receipt of a demand for payment from a shareholder, First Capital must make a written offer of payment to each dissenting shareholder who demanded payment and deposited certificates as required, in the amount First Capital estimates to be the fair value of the dissenting shareholder's shares, plus any accrued interest from the effective time of the merger. Such offer of payment must be accompanied by:

First Capital's financial statements as of the end of a fiscal year ending not more than 16 months before the date of payment, and the latest available interim financial statements of First Capital;

a statement of First Capital's estimate of the fair value of its shares;

an explanation of how the interest was calculated;

a statement of the dissenter's right to demand payment under Section 14-2-1327 of the Georgia Business Corporation Code; and

a copy of Sections 14-2-1301 through 14-2-1332 of the Georgia Business Corporation Code.

If the shareholder accepts First Capital's offer by written notice to First Capital within 30 days after its offer, or is deemed to have accepted such offer by failure to respond within 30 days, payment for his or her shares will be made within 60 days after the making of the offer or the effective time of the merger, whichever is later. If the merger is not completed within 60 days after the date set for demanding payment and depositing share certificates, First Capital shall return the deposited certificates and release the transfer restrictions imposed on uncertificated shares. If the merger is later consummated, First Capital must send a new dissenters' notice and repeat the payment demand procedure.

Within 30 days after First Capital's offer, any dissenting shareholder who believes that First Capital's offer is less than the fair value of his or her shares, or who believes the interest due has been incorrectly calculated, may, in writing, notify his or her company of his or her estimate of the fair value of the shares or interest due. If the shareholder's demand for payment remains unsettled, First Capital must commence a proceeding within 60 days after receiving the payment demand and petition the Superior Court located in the county where First Capital is headquartered to determine the fair value of the shares and the accrued interest. The court may appoint one or more persons as appraisers to receive evidence and recommend a decision on the fair value of the shares. Each dissenting shareholder whose demand remains unsettled will be made a party to the proceeding and will be entitled to judgment for the amount the court finds to be the fair value of the shareholder's shares, plus interest to the date of judgment.

The court shall assess the costs of the appraisal proceeding against First Capital. However the court may assess costs against all or some of the dissenters, in amounts the court finds equitable, to the extent the court finds the dissenters acted arbitrarily, vexatiously, or not in good faith in demanding payment for their shares. The court may also assess fees and attorney's expenses against any party the court finds to have acted arbitrarily, vexatiously, or not in good faith with respect to the rights provided by Georgia law.

No action by any dissenter to enforce dissenters' rights may be brought more than three years after the effective time of the merger, regardless of whether notice of the merger and the right to dissent was given by the applicable company in accordance with Georgia law.

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**UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL INFORMATION**

The following unaudited pro forma condensed combined financial information and explanatory notes present how the combined financial statements of Flag and First Capital may have appeared had the businesses actually been combined at the beginning of the period presented. The unaudited pro forma condensed combined financial information shows the impact of the merger of Flag and First Capital on the companies respective historical financial positions and results of operations under the purchase method of accounting with Flag treated as the acquirer. Under this method of accounting, the assets and liabilities of First Capital will be recorded by Flag at their estimated fair values as of the date the merger is completed. The unaudited pro forma condensed combined financial information combines the historical financial information of Flag and First Capital as of and for the six months ended June 30, 2005 and for the year ended December 31, 2004. The unaudited pro forma condensed combined balance sheet as of June 30, 2005 assumes the merger was completed on that date. The unaudited pro forma condensed combined statements of income give effect to the merger as if the merger had been completed on January 1, 2004 and January 1, 2005, respectively.

The merger agreement was announced on May 26, 2005 and provides for each outstanding share of First Capital common stock to be converted into the right to receive 1.6 shares of Flag common stock other than shares beneficially owned by Flag, First Capital or any non-institutional First Capital shareholder who owns in excess of 384,000 of the issued and outstanding pro forma shares of Flag common stock. The unaudited pro forma condensed combined financial information has been derived from and should be read in conjunction with the historical consolidated financial statements and the related notes of both Flag and First Capital, which are incorporated in this document by reference or appear elsewhere in this document. See [Where You Can Find More Information](#) on page 110 and [Financial Statements of First Capital Bancorp, Inc. and Subsidiaries](#) on page F-1.

The unaudited pro forma condensed combined financial information is presented for illustrative purposes only and does not indicate the financial results of the combined companies had the companies actually been combined at the beginning of each period presented and had the impact of possible revenue enhancements, expense efficiencies, asset dispositions and share repurchases, among other factors, been considered. In addition, as explained in more detail in the accompanying notes to the unaudited pro forma condensed combined financial information, the allocation of the purchase price reflected in the pro forma condensed combined financial information is subject to adjustment.

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## Flag Financial Corporation/First Capital Bancorp, Inc.

## Pro Forma Condensed Combined Balance Sheet

(Unaudited)

The following unaudited pro forma condensed combined balance sheet combines the historical balance sheets of Flag and First Capital assuming the companies had been combined on June 30, 2005, on a purchase accounting basis.

	June 30, 2005			
	Flag Historical	First Capital Historical	Pro Forma Adjustments	Pro Forma Combined
	(Dollars in Thousands, Except Share Data)			
<b>Assets</b>				
Cash and due from banks	\$ 13,720	\$ 20,826	\$ 10,804(a)	\$ 45,350
Federal funds sold	6,378	3,422		9,800
Interest-bearing deposits in banks	18,958	1,278		20,236
Investment securities	123,138	129,667	46(b)	252,851
Restricted equity securities		6,916		6,916
Mortgage loans held for sale	9,106			9,106
Loans, net	638,947	489,775		1,128,722
Premises and equipment	13,558	1,144		14,702
Goodwill	20,324	7,411	71,878(c)	99,613
Core deposit intangible	683	953	6,015(d)	7,651
Other assets	17,697	13,422	322(e)	31,441
<b>Total Assets</b>	<b>\$ 862,509</b>	<b>\$ 674,814</b>	<b>\$ 89,065</b>	<b>\$ 1,626,388</b>
<b>Liabilities</b>				
Deposits:				
Non-interest-bearing deposits	\$ 56,859	\$ 102,927	\$	\$ 159,786
Interest-bearing deposits	683,944	367,320		1,051,264
Total deposits	740,803	470,247		1,211,050
Federal Home Loan Bank advances	25,000	117,371	263(f)	142,634
Federal funds purchased and securities sold under repurchase agreements	1,156	16,273		17,429
Other borrowings	1,600			1,600
Junior subordinated debentures	14,433	6,392	24,872(g)	45,697
Other liabilities	7,128	4,955	8,352(h)	20,435
<b>Total liabilities</b>	<b>790,120</b>	<b>615,238</b>	<b>33,487</b>	<b>1,438,845</b>
<b>Stockholders Equity</b>				

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Common stock	10,097	5,228	2,372(i)	17,697
Additional paid-in capital	28,296	36,567	70,987(i)	135,850
Retained earnings	47,751	19,876	(19,876)(i)	47,751
Accumulated other comprehensive loss	(251)	(612)	612(i)	(251)
Unearned ESOP shares		(240)	240(i)	
Less treasury stock	(13,504)	(1,243)	1,243(i)	(13,504)
<b>Total shareholders equity</b>	<u>72,389</u>	<u>59,576</u>	<u>55,578</u>	<u>187,543</u>
<b>Total liabilities and stockholders equity</b>	<u>\$ 862,509</u>	<u>\$ 674,814</u>	<u>\$ 89,065</u>	<u>\$ 1,626,388</u>
Shares outstanding	8,546,086	5,079,502	2,520,148(i)	16,145,736



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## Flag Financial Corporation/First Capital Bancorp, Inc.

## Pro Forma Condensed Combined Statement of Income

(Unaudited)

The following preliminary unaudited pro forma condensed combined statement of income combines the historical statements of income of Flag and First Capital assuming the companies had been combined on January 1, 2005, on a purchase accounting basis.

	For the Six Months Ended June 30, 2005			
	Flag Historical	First Capital Historical	Pro Forma Adjustments	Pro Forma Combined
	(Dollars in Thousands, Except Share and Per Share Data)			
Interest income	\$ 26,851	\$ 19,109	\$ 116 (j)	\$ 46,076
Interest expense	9,025	6,409	544 (k)	15,978
Net interest income	17,826	12,700	(428)	30,098
Provision for loan losses	375	300		675
Net interest income after provision for loan losses	17,451	12,400	(428)	29,423
Non-interest income	5,194	746		5,940
Non-interest expense	16,539	9,029	570 (l)	26,138
Earnings before provision for income taxes	6,106	4,117	(998)	9,225
Provision for income taxes	1,973	1,526	(379)(m)	3,120
Net earnings	\$ 4,133	\$ 2,591	\$ (619)	\$ 6,105
Basic earning per share	\$ 0.48	\$ 0.52		\$ 0.38
Diluted earnings per share	\$ 0.45	\$ 0.50		\$ 0.36
Shares				
Basic	8,526,428	5,026,021	2,573,629 (n)	16,126,078
Diluted	9,249,683	5,217,473	2,496,881 (o)	16,964,037

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## Flag Financial Corporation/First Capital Bancorp, Inc.

## Pro Forma Condensed Combined Statement of Income

(Unaudited)

The following preliminary unaudited pro forma condensed combined statement of income combines the historical statements of income of Flag and First Capital assuming the companies had been combined on January 1, 2004, on a purchase accounting basis.

	For the Year Ended December 31, 2004			
	Flag Historical	First Capital Historical	Pro Forma Adjustment	Pro Forma Combined
	(Dollars in Thousands, Except Share and Per Share Data)			
Interest income	\$ 42,621	\$ 29,624	\$ 123(j)	\$ 72,368
Interest expense	12,057	11,191	954(k)	24,202
Net interest income	30,564	18,433	(831)	48,166
Provision for loan losses	1,845	1,325		3,170
Net interest income after provision for loan losses	28,719	17,108	(831)	44,996
Non-interest income	11,468	1,094		12,562
Non-interest expense	29,509	13,235	1,269(l)	44,013
Earnings before provision for income taxes	10,678	4,967	(2,100)	13,545
Provision for income taxes	3,310	1,755	(798)(m)	4,267
Net earnings	\$ 7,368	\$ 3,212	\$ (1,302)	\$ 9,278
Basic earning per share	\$ 0.88	\$ 0.83		\$ 0.58
Diluted earnings per share	\$ 0.82	\$ 0.80		\$ 0.56
Shares				
Basic	8,396,047	3,868,748	3,730,902(n)	15,995,697
Diluted	8,981,620	3,994,990	3,718,018(o)	16,694,628

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**NOTES TO THE UNAUDITED PRO FORMA CONDENSED COMBINED**

**FINANCIAL INFORMATION**

**(Unaudited)**

- (a) Represents the net proceeds from the proposed trust preferred offering by Flag of \$24.9 million and the proceeds from warrant exercises by Flag warrant holders of 768,049 warrants at a price of \$6.51 per warrant (or \$5.0 million in the aggregate), less the cash paid to First Capital shareholders of \$19.1 million.
- (b) Represents the fair value adjustment for securities held-to-maturity.
- (c) Represents the write-off of First Capital goodwill of \$7.4 million and the recording of \$79.3 million in goodwill as a result of the merger.
- (d) Represents the write-off of First Capital core deposit intangible of \$953,000 and the recording of \$7.0 million in core deposit intangible as a result of the merger (the estimated core deposit intangible is based on industry averages for premiums recently paid on deposits).
- (e) Represents \$50,000 in debt issuance costs related to the proposed trust preferred offering by Flag and \$272,000 deferred tax asset resulting from change of control provisions of the deferred compensation arrangements for First Capital.
- (f) Represents the fair value adjustment for Federal Home Loan Bank advances.
- (g) Represents the fair value adjustment of \$128,000 relating to First Capital junior subordinated debentures and assumed the proposed issuance of \$25 million of trust preferred securities by Flag to help fund the transaction and increase its regulatory capital.
- (h) Represents the net deferred income taxes of \$2.6 million relating to purchase accounting adjustments, \$5.0 million of transaction costs, net of the tax benefit relating to the merger, including \$2.4 million of personnel related costs, \$1.8 million of professional expenses and \$851,000 of conversion costs, and \$716,000 to adjust deferred compensation for change of control vesting provisions of the deferred compensation arrangements for First Capital.
- (i) Represents the elimination of First Capital equity accounts, issuance of 6.8 million of Flag common shares in the merger at an estimated fair value of \$103.9 million (based on the average closing price of Flag common stock for the 10 days before and the 10 days after the merger announcement of \$15.14, a reasonable estimate of the value of the Flag common stock), the recording of \$6.2 million in additional paid-in capital relating to the fair value of First Capital stock options, and the exercise of 768,049 warrants by Flag warrant holders at a price of \$6.51 per warrant.
- (j) Represents the earnings on \$10.8 million net cash (\$24.9 million trust preferred offering and the proceeds from the issuance of 768,049 shares of common stock upon the exercise of warrants of \$5.0 million, less the cash paid to First Capital shareholders of \$19.1 million) assuming an investment in overnight federal funds and the amortization of purchase accounting adjustment for held-to-maturity securities (12 year straight line amortization).
- (k)

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Represents the amortization of purchase accounting adjustments for Federal Home Loan Bank advances (4 year straight line amortization) and junior subordinated debentures (27 year straight line amortization) as well as interest expense related to the proposed \$25 million trust preferred offering by Flag (using 3 month LIBOR rate at period end plus 1.50%).

- (l) Represents the amortization of purchase accounting adjustments for the core deposit intangible (10 year sum of the years digit amortization) and debt issuance costs of \$50,000 related to the proposed \$25 million trust preferred offering by Flag (30 year straight line amortization).
- (m) Represents the net tax effect, at 38%, related to the amortization of purchase accounting adjustments, interest income from overnight investments and interest expense from the proposed trust preferred offering by Flag.
- (n) Represents issuance of 6.8 million shares of Flag common stock in the merger, the elimination of First Capital weighted average basic shares, and the exercise of 768,049 warrants by Flag warrant holders.
- (o) Represents issuance of 6.8 million shares of Flag common stock in the merger, conversion of First Capital options to Flag options in the merger, elimination of First Capital weighted average dilutive shares, and the issuance of 768,049 shares of common stock upon the exercise of warrants by Flag warrant holders.

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**INFORMATION ABOUT FLAG**

**General**

Flag is a bank holding company headquartered in Atlanta, Georgia and is registered under the Bank Holding Company Act of 1956, as amended (the BHC Act ). Flag is the sole shareholder of Flag Bank and was incorporated under the laws of the State of Georgia on February 9, 1993.

As a bank holding company, Flag facilitates Flag Bank's abilities to serve its customers' requirements for financial services. The holding company structure provides greater financial and operating flexibility than is available to Flag Bank. For example, Flag may assist Flag Bank in maintaining its required capital ratios by borrowing money and contributing the proceeds of the debt to Flag Bank as primary capital. Flag provides several services through divisions of Flag Bank including mortgage services through Flag Mortgage, investment and insurance services through Flag Financial Services and payroll processing through Payroll Solutions.

As of June 30, 2005, Flag had total assets of \$862.5 million, total deposits of \$740.8 million, shareholders' equity of \$72.4 million and net loans of \$638.9 million.

The principal office of Flag is located at 3475 Piedmont Road, N.E., Suite 550, Atlanta, Georgia 30305, telephone number (404) 760-7700.

**Flag Bank**

Flag Bank is a state bank organized under the laws of the State of Georgia with locations in the following cities and counties in Georgia: Atlanta (Fulton County, DeKalb County and Cobb County), Unadilla (Dooly County), Vienna (Dooly County), Montezuma (Macon County), Buena Vista (Marion County), LaGrange (Troup County), Hogansville (Troup County), Jonesboro (Clayton County), Duluth (Gwinnett County), Columbus (Muscookee County), Macon (Bibb County), Newnan (Coweta County) and Warner Robins (Houston County). Flag Bank was originally chartered in 1931 as Citizens Bank and became a wholly owned subsidiary of Flag through a series of acquisitions commencing in 1998.

Flag Bank's business consists primarily of attracting deposits from the general public and, with these and other funds, offering a broad range of banking products and services, including residential mortgage loans, consumer loans, commercial loans, commercial real estate loans, residential construction loans, securities investments and other services. Flag Bank's principal sources of income are interest and fees collected on loans, including fees received for originating and selling loans and for servicing loans sold to others, and, to a lesser extent, interest and dividends collected on other investments and service charges on deposit accounts.

For more information about Flag's business, reference is made to Flag's Annual Report on Form 10-K for the year ended December 31, 2004, which is incorporated by reference into this proxy statement/prospectus. See "Where You Can Find More Information."

**INFORMATION ABOUT FIRST CAPITAL**

**General**

First Capital is a bank holding company headquartered in Norcross, Georgia and is registered under the BHC Act. First Capital was incorporated under the laws of the State of Georgia on November 5, 1997, and is the sole shareholder of First Capital Bank and Capital Financial Software, LLC.

On May 28, 2004, First Capital, which was then known as CNB Holdings, Inc., acquired the former First Capital Bancorp, Inc. ( Old FCBI ) through the merger (the May 2004 merger ) of Old FCBI with and into

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First Capital. First Capital was the surviving company of the May 2004 merger. On December 31, 2004, First Capital changed its name from CNB Holdings, Inc. to First Capital Bancorp, Inc. First Capital's stock ticker symbol changed to FCBX.OB effective January 18, 2005.

As a result of the May 2004 merger, First Capital Bank and Capital Financial Software, LLC, which were wholly owned subsidiaries of Old FCBI, became wholly owned subsidiaries of First Capital. Additionally, as a result of the May 2004 merger, First Capital assumed Old FCBI's obligations under the First Capital Statutory Trust, I, which was created in connection with Old FCBI's issuance of trust preferred securities. On November 15, 2004, however, First Capital merged its two wholly owned banking subsidiaries, First Capital Bank and Chattahoochee National Bank, with First Capital Bank surviving the bank merger.

In addition, First Capital operates Capital Financial Software, LLC, which markets and sells a proprietary software package used by bankruptcy trustees to monitor and track the disposition of Chapter 7 bankruptcy cases.

As of June 30, 2005, First Capital had total assets of \$674.8 million, total deposits of \$470.2 million, shareholders' equity of \$59.6 million and net loans of \$489.8 million.

First Capital's executive office is located at 3320 Holcomb Bridge Road, N.W., Suite A, Norcross, Georgia 30092, and its telephone number at such location is (770) 921-6400.

**First Capital Bank**

First Capital Bank is a state-chartered commercial bank located in Norcross, Georgia, with its primary market consisting of the metropolitan Atlanta area. First Capital Bank operates five locations in Norcross, Alpharetta, Duluth and Cumming, Georgia. First Capital Bank is a full service commercial bank that offers a broad range of banking products and services, including commercial, real estate, residential mortgage, SBA loans and consumer loans, cash management and other services.

First Capital Bank's business consists primarily of attracting deposits from the general public and, with these and other funds, offering a broad range of banking products and services, including residential mortgage loans, consumer loans, commercial loans, commercial real estate loans, residential construction loans, securities investments and other services. First Capital Bank's principal sources of income are interest and fees collected on loans, including fees received for originating and selling loans and for servicing loans sold to others, and, to a lesser extent, interest and dividends collected on other investments and service charges on deposit accounts.

*Loan Approval and Review.* First Capital Bank's loan approval policies provide for various levels of officer lending authority. When the amount of aggregate loans to a single borrower exceeds that individual officer's lending authority, the loan request is considered and approved by an officer with a higher lending limit or the loan committee. First Capital Bank makes loans to directors or executive officers of First Capital Bank after approval by the board of directors of First Capital Bank, on terms not more favorable than would be available to entities otherwise unaffiliated with First Capital Bank.

*Lending Limits.* First Capital Bank's lending activities are subject to a variety of lending limits imposed by state and federal law. Differing limits apply based on the type of loan and the nature of the borrower, including the borrower's other loan relationships with First Capital Bank. In general, however, First Capital Bank is able to loan to any one borrower a maximum amount equal to either 15% of First Capital Bank's capital and surplus or 25% of its capital and surplus if the amount that exceeds 15% is fully secured by good collateral and other ample security.

*Credit Risks.* The principal economic risk associated with each category of loans that First Capital Bank makes is the creditworthiness of the borrower. Borrower creditworthiness is affected by general economic conditions and the strength of the relevant business market segment.



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*Real Estate Loans.* First Capital Bank makes commercial real estate loans, construction and acquisition and development loans, and residential real estate loans. These loans include commercial loans in which First Capital Bank takes a security interest in real estate out of an abundance of caution and not as the principal collateral for the loan, but exclude home equity loans, which are classified as consumer loans.

*Commercial Real Estate.* First Capital Bank focuses on diversifying its portfolio across different property types. Accordingly, its commercial real estate portfolio includes loans secured by warehouses, office buildings, land, extended stay properties, assisted living properties retail office and service properties, self storage properties, apartments, condominiums, industrial properties, and restaurants. Commercial real estate loan terms generally are limited to five years or less, although payments may be structured on a longer amortization basis. Interest rates may be fixed or adjustable, but generally are not fixed for a period exceeding 60 months. First Capital Bank normally charges an origination fee on these loans. Risks associated with commercial real estate loans include fluctuations in the value of real estate, new job creation trends, tenant vacancy rates and the quality of the borrower's management. First Capital Bank attempts to limit its risk by analyzing borrowers' cash flow and collateral value on an ongoing basis.

*Construction and Acquisition and Development Loans.* First Capital Bank's construction and acquisition and development loans are diversified over a mix of commercial, single family and multi-family developments. Construction loans are generally made with a term of approximately 12 months, and interest is paid monthly. Acquisition and development loans are generally made with a term of approximately 24 months, and interest is paid monthly. The ratio of the loan principal to the value of the collateral as established by independent appraisal generally does not exceed 80%. Loans on developments or properties that have not been pre-sold by the builder are also based on the builder/borrower's financial strength and cash flow position, as well as the financial strength and reputation of the builder in case of an acquisition and development loan. Loan proceeds are disbursed based on the percentage of completion and only after an experienced construction lender or engineer has inspected the project. Risks associated with construction loans include fluctuations in the value of real estate and new job creation trends.

*Residential Real Estate.* First Capital Bank's residential real estate loans consist of residential first and second mortgage loans. The majority of First Capital Bank's residential real estate loans are five-one adjustable rate mortgages. The interest rate on these loans is fixed for the first five years, then is adjusted on the fifth anniversary of the loan and each anniversary thereafter based on the index specified in the loan documentation. As a result, First Capital Bank limits its exposure to long-term interest rate risks that are typically associated with residential real estate loans. Residential real estate loans are made consistent with First Capital Bank's loan policy and with the ratio of the loan principal to the value of collateral as established by independent appraisal not to exceed 80%. These loan-to-value ratios are designed to compensate for fluctuations in real estate market value and to minimize losses that could result from a downturn in the residential real estate market.

*Commercial Loans.* First Capital Bank's commercial loans include working capital loans, accounts receivable and inventory financing and equipment financing. The terms of these loans vary by purpose and by type of underlying collateral, if any. First Capital Bank typically makes equipment loans for a term of five years or less at fixed or variable rates, with the loan fully amortized over the term. Equipment loans generally are secured by the financed equipment, and the ratio of the loan principal to the value of the financed equipment or other collateral is generally 70% or less. Loans to support working capital typically have terms not exceeding one year and usually are secured by accounts receivable, inventory or personal guarantees of the principals of the business. For loans secured by accounts receivable or inventory, principal is typically repaid as the assets securing the loan are converted into cash, and for loans secured with other types of collateral, principal is typically due at maturity. The quality of the commercial borrower's management and its ability both to evaluate properly changes in the supply and demand characteristics affecting its markets for products and services and to respond effectively to such changes are significant factors in a commercial borrower's creditworthiness.

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*Consumer Loans.* First Capital Bank also makes, to a lesser extent, a variety of loans to individuals for personal, family and household purposes, including secured and unsecured installment and term loans, home equity loans and lines of credit. Consumer loan repayments depend upon the borrower's financial stability and are more likely to be adversely affected by divorce, job loss, illness and personal hardships. Because many consumer loans are secured by depreciable assets such as boats, cars and trailers, these loans are typically amortized over the useful life of the asset.

First Capital Bank also originates mortgage loans for sale into the secondary market. First Capital Bank limits interest rate risk and credit risk on these loans by locking the interest rate for each loan with the secondary investor and receiving the investor's underwriting approval prior to originating the loan.

*Investments.* In addition to loans, First Capital Bank makes other investments primarily in obligations of the United States or obligations guaranteed as to principal and interest by the United States, other taxable securities and other obligations of states and municipalities. First Capital Bank also engages in federal funds transactions with its principal correspondent banks and acts as both a buyer and seller of funds depending on the cost of funds.

*Deposits.* First Capital Bank offers certificates of deposit, commercial checking and money market accounts and personal checking and money market accounts. Additionally, First Capital Bank offers cash management services to its commercial customers.

*Asset and Liability Management.* The goal of First Capital Bank's asset and liability management policy is to effectively utilize all sources of funds, including liabilities, capital and off balance sheet items, to minimize principal risk, interest rate risk and funding risk while providing an optimum and stable net interest margin, a profitable after-tax return on assets and return on equity and adequate liquidity. The asset and liability management committee conducts these management functions within the framework of written loan and investment policies that First Capital Bank has adopted. Wide and frequent fluctuations in market interest rates, coupled with an objective of achieving reasonable net interest margin, make a relatively balanced rate sensitivity position a desirable goal. The committee attempts to achieve this goal by monitoring the rate sensitivity gap position. The gap is the difference between rate sensitive assets and rate sensitive liabilities as a percentage of total assets.

*Capital Financial Software.* Capital Financial Software, LLC was formed in 1997 to provide proprietary software to bankruptcy trustees. The software is designed to allow bankruptcy trustees to monitor and track the disposition of Chapter 7 bankruptcy cases while assisting the trustees in processing information that must be periodically submitted to bankruptcy courts. Its software product, ProClaim, is fully developed and is being marketed to both financial institutions and bankruptcy trustees throughout the United States.

*Other Banking Services.* Other bank services include cash management services, travelers checks, direct deposit of payroll and social security checks and automatic drafts for various accounts. First Capital Bank is associated with a shared network of automated teller machines that may be used by First Capital Bank's customers throughout Georgia and other states. First Capital Bank also offers MasterCard and VISA credit card services through The Banker's Bank, Atlanta, Georgia, as its agent. In addition, First Capital Bank offers Internet banking and corporate cash management services.

First Capital Bank also offers to its targeted commercial customers a courier service that will pick up non-cash deposits and minimal cash deposits of up to \$200 from the customer's place of business and deliver it to First Capital Bank. First Capital Bank believes that this is an important service for its customers because First Capital Bank currently has only two full-service locations. First Capital Bank has contracted

with a third-party courier service that has been approved by the Georgia Public Service Commission for bank-related work.

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#### **Employees**

First Capital has 109 full-time equivalent employees. Employees of First Capital enjoy a variety of employee benefit programs, including a 401(k) plan, various comprehensive medical, accident and group life insurance plans and paid vacations. First Capital considers its relations with its employees to be excellent.

#### **Market Area and Competition**

First Capital operates in North Atlanta, and its primary market area is the Atlanta metropolitan statistical area ( Atlanta MSA ). The Atlanta MSA continues to experience significant economic and population growth, providing a market with a vibrant economy that is supported by a well-balanced industrial and manufacturing base.

The banking business is highly competitive, and the profitability of First Capital Bank depends principally upon First Capital Bank's ability to compete in its market area. First Capital Bank competes with other commercial and savings banks, savings and loan associations, credit unions, finance companies, mutual funds, asset-based non-bank lenders and certain other non-financial institutions. First Capital Bank has been able to compete effectively with other financial institutions by establishing long-term customer relationships and building customer loyalty, emphasizing technology and customer service and providing products and services designed to address the specific needs of its customers.

#### **Supervision and Regulation**

Both First Capital and First Capital Bank are subject to extensive state and federal banking regulations that impose restrictions on and provide for general regulatory oversight of their operations. These laws generally are intended to protect depositors and not shareholders. The following discussion describes the material elements of the regulatory framework that applies to First Capital and First Capital Bank.

**First Capital.** Because First Capital owns all of the capital stock of First Capital Bank, it is a bank holding company under the BHC Act. As a result, First Capital is primarily subject to the supervision, examination and reporting requirements of the BHC Act and the regulations of the Federal Reserve. As a bank holding company located in Georgia, the Georgia Department also regulates and monitors all significant aspects of First Capital's operations.

*Acquisitions of Banks.* The BHC Act requires every bank holding company to obtain the Federal Reserve's prior approval before:

acquiring direct or indirect ownership or control of any voting shares of any bank if, after the acquisition, the bank holding company will directly or indirectly own or control more than 5% of the bank's voting shares;

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acquiring all or substantially all of the assets of any bank; or

merging or consolidating with any other bank holding company.

Additionally, the BHC Act provides that the Federal Reserve may not approve any of these transactions if it would result in or tend to create a monopoly or, substantially lessen competition or otherwise function as a restraint of trade, unless the anti-competitive effects of the proposed transaction are clearly outweighed by the public interest in meeting the convenience and needs of the community to be served. The Federal Reserve is also required to consider the financial and managerial resources and future prospects of the bank holding companies and banks concerned and the convenience and needs of the community to be served. The Federal Reserve's consideration of financial resources generally focuses on capital adequacy, which is discussed below.

Under the BHC Act, if adequately capitalized and adequately managed, First Capital, or any other bank holding company located in Georgia, may purchase a bank located outside of Georgia. Conversely, an adequately

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capitalized and adequately managed bank holding company located outside of Georgia may purchase a bank located inside Georgia. In each case, however, restrictions may be placed on the acquisition of a bank that has only been in existence for a limited amount of time or will result in specified concentrations of deposits. Currently, Georgia law prohibits acquisitions of banks that have been chartered for less than three years. Because First Capital Bank has been incorporated for more than three years, this limitation does not apply to First Capital.

*Change in Bank Control.* Subject to various exceptions, the BHC Act and the Change in Bank Control Act, together with related regulations, require the Federal Reserve approval prior to any person or company acquiring control of a bank holding company. Control is conclusively presumed to exist if an individual or company acquires 25% or more of any class of voting securities of the bank holding company. Control is rebuttably presumed to exist if a person or company acquires 10% or more, but less than 25%, of any class of voting securities and either:

the bank holding company has registered securities under Section 12 of the Securities Exchange Act of 1934 (the Exchange Act ), or

no other person owns a greater percentage of that class of voting securities immediately after the transaction.

First Capital common stock is registered under Section 12 of the Exchange Act. The regulations also provide a procedure for challenging the rebuttable presumption of control.

*Permitted Activities.* A bank holding company is generally permitted under the BHC Act to engage in or acquire direct or indirect control of more than 5% of the voting shares of any company engaged in the following activities:

banking or managing or controlling banks; and

any activity that the Federal Reserve determines to be so closely related to banking as to be a proper incident to the business of banking.

Activities that the Federal Reserve has found to be so closely related to banking as to be a proper incident to the business of banking include:

factoring accounts receivable;

making, acquiring, brokering or servicing loans and usual related activities;

leasing personal or real property;

operating a non-bank depository institution, such as a savings association;

trust company functions;

financial and investment advisory activities;

conducting discount securities brokerage activities;

underwriting and dealing in government obligations and money market instruments;

providing specified management consulting and counseling activities;

performing selected data processing services and support services;

acting as agent or broker in selling credit life insurance and other types of insurance in connection with credit transactions; and

performing selected insurance underwriting activities.

Despite prior approval, the Federal Reserve may order a bank holding company or its subsidiaries to terminate any of these activities or to terminate its ownership or control of any subsidiary when it has reasonable cause to believe that the bank holding company's continued ownership, activity or control constitutes a serious risk to the financial safety, soundness or stability of it or any of its bank subsidiaries.

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In addition to the permissible bank holding company activities listed above, a bank holding company may qualify and elect to become a financial holding company, permitting the bank holding company to engage in activities that are financial in nature or incidental or complementary to financial activity. The BHC Act expressly lists the following activities as financial in nature:

lending, trust and other banking activities;

insuring, guaranteeing or indemnifying against loss or harm, or providing and issuing annuities, and acting as principal, agent or broker for these purposes in any state;

providing financial, investment or advisory services;

issuing or selling instruments representing interests in pools of assets permissible for a bank to hold directly;

underwriting, dealing in or making a market in securities;

other activities that the Federal Reserve may determine to be so closely related to banking or managing or controlling banks as to be a proper incident to managing or controlling banks;

foreign activities permitted outside of the United States if the Federal Reserve has determined them to be usual in connection with banking operations abroad;

merchant banking through securities or insurance affiliates; and

insurance company portfolio investments.

To qualify to become a financial holding company, First Capital Bank and any other depository institution subsidiary of First Capital must be well capitalized and well managed and must have a Community Reinvestment Act rating of at least satisfactory. Additionally, First Capital must file an election with the Federal Reserve to become a financial holding company and must provide the Federal Reserve with 30 days' written notice prior to engaging in a permitted financial activity. While First Capital meets the qualification standards applicable to financial holding companies, First Capital has not elected to become a financial holding company.

*Support of Subsidiary Institutions.* Under Federal Reserve policy, First Capital is expected to act as a source of financial strength for First Capital Bank and to commit resources to support First Capital Bank. This support may be required at times when, without this Federal Reserve policy, First Capital might not be inclined to provide it. In addition, any capital loans made by First Capital to First Capital Bank will be repaid only after First Capital Bank's deposits and various other obligations are repaid in full. In the unlikely event of First Capital's bankruptcy, any commitment by it to a federal bank regulatory agency to maintain the capital of First Capital Bank will be assumed by the bankruptcy trustee and entitled to a priority of payment.



**First Capital Bank.** First Capital Bank is subject to extensive state and federal banking regulations that impose restrictions on and provide for general regulatory oversight of its operations. These laws are generally intended to protect depositors and not shareholders. The following discussion describes the material elements of the regulatory framework that applies to First Capital Bank.

Because First Capital Bank is a commercial bank chartered under the laws of the State of Georgia, it is primarily subject to the supervision, examination and reporting requirements of the FDIC and the Georgia Department. The FDIC and Georgia Department regularly examine First Capital Bank's operations and have the authority to approve or disapprove mergers, the establishment of branches and similar corporate actions. Both regulatory agencies have the power to prevent the continuance or development of unsafe or unsound banking practices or other violations of law. Additionally, First Capital Bank's deposits are insured by the FDIC to the maximum extent provided by law. First Capital Bank is also subject to numerous state and federal statutes and regulations that affect its business, activities and operations.

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*Branching.* Under current Georgia law, First Capital Bank may open branch offices throughout Georgia with the prior approval of the Georgia Department. In addition, with prior regulatory approval, First Capital Bank may acquire branches of existing banks located in Georgia. First Capital Bank and any other national or state-chartered bank generally may branch across state lines by merging with banks in other states if allowed by the laws of the applicable foreign state. Georgia law, with limited exceptions, currently permits branching across state lines through interstate mergers.

Under the Federal Deposit Insurance Act, states may opt-in and allow out-of-state banks to branch into their state by establishing a new start-up branch in the state. Currently, Georgia has not opted-in to this provision. Therefore, interstate merger is the only method through which a bank located outside of Georgia may branch into Georgia. This provides a limited barrier of entry into the Georgia banking market, which protects First Capital Bank from an important segment of potential competition. However, because Georgia has elected not to opt-in, First Capital Bank's ability to establish a new start-up branch in another state may be limited. Many states that have elected to opt-in have done so on a reciprocal basis, meaning that an out-of-state bank may establish a new start-up branch only if its home state has also elected to opt-in. Consequently, until Georgia changes its election, the only way First Capital Bank will be able to branch into states that have elected to opt-in on a reciprocal basis will be through interstate merger.

*Prompt Corrective Action.* The FDIC Improvement Act of 1991 establishes a system of prompt corrective action to resolve the problems of undercapitalized financial institutions. Under this system, the federal banking regulators have established five capital categories (well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized) in which all institutions are placed. The federal banking agencies have also specified by regulation the relevant capital levels for each of the other categories. At December 31, 2004, First Capital Bank qualified for the well-capitalized category.

Federal banking regulators are required to take various mandatory supervisory actions and are authorized to take other discretionary actions with respect to institutions in the three undercapitalized categories. The severity of the action depends upon the capital category in which the institution is placed. Generally, subject to a narrow exception, the banking regulator must appoint a receiver or conservator for an institution that is critically undercapitalized.

An institution that is categorized as undercapitalized, significantly undercapitalized or critically undercapitalized is required to submit an acceptable capital restoration plan to its appropriate federal banking agency. A bank holding company must guarantee that a subsidiary depository institution meets its capital restoration plan, subject to various limitations. The controlling holding company's obligation to fund a capital restoration plan is limited to the lesser of 5% of an undercapitalized subsidiary's assets at the time it became undercapitalized or the amount required to meet regulatory capital requirements. An undercapitalized institution is also generally prohibited from increasing its average total assets, making acquisitions, establishing any branches or engaging in any new line of business, except under an accepted capital restoration plan or with FDIC approval. The regulations also establish procedures for downgrading an institution to a lower capital category based on supervisory factors other than capital.

*FDIC Insurance Assessments.* The FDIC has adopted a risk-based assessment system for insured depository institutions that takes into account the risks attributable to different categories and concentrations of assets and liabilities. The system assigns an institution to one of three capital categories: (1) well capitalized; (2) adequately capitalized; and (3) undercapitalized. These three categories are substantially similar to the prompt corrective action categories described above, with the undercapitalized category including institutions that are undercapitalized, significantly undercapitalized and critically undercapitalized for prompt corrective action purposes. The FDIC also assigns an institution to one of three supervisory subgroups based on a supervisory evaluation that the institution's primary federal regulator provides to the FDIC and information that the FDIC determines to be relevant to the institution's financial condition and the risk posed to the deposit insurance funds. Assessments range from 0 to 27 cents per \$100 of deposits, depending on the institution's capital group and



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supervisory subgroup. In addition, the FDIC imposes assessments to help pay off the \$780 million in annual interest payments on the \$8 billion financing corporation bonds issued in the late 1980s as part of the government rescue of the thrift industry.

The FDIC may terminate its insurance of deposits if it finds that the institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC.

*Community Reinvestment Act.* The Community Reinvestment Act requires that, in connection with examinations of financial institutions within their respective jurisdictions, the Federal Reserve or the FDIC shall evaluate the record of each financial institution in meeting the credit needs of its local community, including low and moderate-income neighborhoods. These facts are also considered in evaluating mergers, acquisitions and applications to open a branch or facility. Failure to adequately meet these criteria could impose additional requirements and limitations on First Capital and First Capital Bank. Additionally, First Capital must publicly disclose the terms of various Community Reinvestment Act-related agreements.

*Other Regulations.* Interest and other charges collected or contracted for by First Capital Bank are subject to state usury laws and federal laws concerning interest rates. For example, under the Soldiers and Sailors Civil Relief Act of 1940, a lender is generally prohibited from charging an annual interest rate in excess of 6% on any obligation for which the borrower is a person on active duty with the United States military.

First Capital Bank's loan operations are also subject to federal laws applicable to credit transactions, such as the:

federal Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;

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

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

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

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

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

In addition to the federal and state laws noted above, the Georgia Fair Lending Act ( GAFLA ) imposes restrictions and procedural requirements on most mortgage loans made in Georgia, including home equity loans and lines of credit. On August 5, 2003, the Office of the Comptroller of the Currency (the OCC ) issued a formal opinion stating that the entirety of GAFLA is preempted by federal law for national banks and their operating subsidiaries. GAFLA contains a provision that preempts GAFLA as to state banks in the event that the OCC preempts GAFLA as to

national banks. Therefore, First Capital Bank is exempt from the requirements of GAFLA.

The deposit operations of First Capital Bank are subject to:

the Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records; and

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the Electronic Funds Transfer Act and Regulation E issued by the Federal Reserve to implement that act, which govern automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services.

**Capital Adequacy.** First Capital and First Capital Bank are required to comply with the capital adequacy standards established by the Federal Reserve (in the case of First Capital) and the FDIC (in the case of First Capital Bank). The Federal Reserve has established a risk-based and a leverage measure of capital adequacy for bank holding companies. First Capital Bank is also subject to risk-based and leverage capital requirements adopted by the FDIC, which are substantially similar to those adopted by the Federal Reserve for bank holding companies.

The risk-based capital standards are designed to make regulatory capital requirements more sensitive to differences in risk profiles among banks and bank holding companies, to account for off-balance-sheet exposure, and to minimize disincentives for holding liquid assets. Assets and off-balance-sheet items, such as letters of credit and unfunded loan commitments, are assigned to broad risk categories, each with appropriate risk weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance-sheet items.

The minimum guideline for the ratio of total capital to risk-weighted assets is 8%. Total capital consists of two components, Tier 1 Capital and Tier 2 Capital. Tier 1 Capital generally consists of common stock, minority interests in the equity accounts of consolidated subsidiaries, noncumulative perpetual preferred stock, and a limited amount of qualifying cumulative perpetual preferred stock, less goodwill and other specified intangible assets. Tier 1 Capital must equal at least 4% of risk-weighted assets. Tier 2 Capital generally consists of subordinated debt, other preferred stock and a limited amount of loan loss reserves. The total amount of Tier 2 Capital is limited to 100% of Tier 1 Capital. At December 31, 2004 First Capital's ratio of total capital to risk-weighted assets was 11.29% and its Tier 1 Capital to risk-weighted assets was 10.17%.

In addition, the Federal Reserve has established minimum leverage ratio guidelines for bank holding companies. These guidelines provide for a minimum ratio of Tier 1 Capital to average assets, less goodwill and other specified intangible assets, of 3% for bank holding companies that meet specified criteria, including having the highest regulatory rating and implementing the Federal Reserve's risk-based capital measure for market risk. All other bank holding companies generally are required to maintain a leverage ratio of at least 4%. At December 31, 2004, First Capital's leverage ratio was 8.43%. The guidelines also provide that bank holding companies experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels without reliance on intangible assets. The Federal Reserve considers the leverage ratio and other indicators of capital strength in evaluating proposals for expansion or new activities.

Failure to meet capital guidelines could subject a bank or bank holding company to a variety of enforcement remedies, including issuance of a capital directive, the termination of deposit insurance by the FDIC, a prohibition on accepting brokered deposits, and certain other restrictions on its business. As described above, significant additional restrictions can be imposed on FDIC-insured depository institutions that fail to meet applicable capital requirements.

**Payment of Dividends.** First Capital is a legal entity separate and distinct from First Capital Bank. The principal sources of the First Capital's cash flow, including cash flow to pay dividends to its shareholders, are dividends that First Capital Bank pays to its sole shareholder, First Capital. Statutory and regulatory limitations apply to First Capital Bank's payment of dividends. If, in the opinion of the federal banking regulator, First Capital Bank were engaged in or about to engage in an unsafe or unsound practice, the federal banking regulator could require, after notice and a hearing, that it stop or refrain from engaging in the questioned practice. The federal banking agencies have indicated that paying dividends that deplete a depository institution's capital base to an inadequate level would be an unsafe and unsound banking practice. Under the FDIC Improvement Act of 1991, a



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depository institution may not pay any dividends if payment would cause it to become undercapitalized or if it already is undercapitalized. Moreover, the federal agencies have issued policy statements that provide that bank holding companies and insured banks should generally only pay dividends out of current operating earnings.

The Georgia Department also regulates First Capital Bank's dividend payments and must approve dividend payments that would exceed 50% of First Capital Bank's net income for the prior year. First Capital's payment of dividends may also be affected or limited by other factors, such as the requirement to maintain adequate capital above regulatory guidelines.

***Restrictions on Transactions with Affiliates.*** First Capital and First Capital Bank are subject to the provisions of Section 23A of the Federal Reserve Act. Section 23A places limits on the amount of:

a bank's loans or extensions of credit to affiliates;

a bank's investment in affiliates;

assets a bank may purchase from affiliates, except for real and personal property exempted by the Federal Reserve;

loans or extensions of credit made by a bank to third parties collateralized by the securities or obligations of affiliates; and

a bank's guarantee, acceptance or letter of credit issued on behalf of an affiliate.

The total amount of the above transactions is limited in amount, as to any one affiliate, to 10% of a bank's capital and surplus and, as to all affiliates combined, to 20% of a bank's capital and surplus. In addition to the limitation on the amount of these transactions, each of the above transactions must also meet specified collateral requirements. First Capital Bank must also comply with other provisions designed to avoid the taking of low-quality assets.

First Capital and First Capital Bank are also subject to the provisions of Section 23B of the Federal Reserve Act, which, among other things, prohibits an institution from engaging in the above transactions with affiliates unless the transactions are on terms substantially the same, or at least as favorable to the institution or its subsidiaries, as those prevailing at the time for comparable transactions with nonaffiliated companies.

First Capital Bank is also subject to restrictions on extensions of credit to its executive officers, directors, principal shareholders and their related interests. These extensions of credit (1) must be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with third parties and (2) must not involve more than the normal risk of repayment or present other unfavorable features.



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**Privacy.** Financial institutions are required to disclose their policies for collecting and protecting confidential information. Customers generally may prevent financial institutions from sharing nonpublic personal financial information with nonaffiliated third parties except under narrow circumstances, such as the processing of transactions requested by the consumer or when the financial institution is jointly sponsoring a product or service with a nonaffiliated third party. Additionally, financial institutions generally may not disclose consumer account numbers to any nonaffiliated third party for use in telemarketing, direct mail marketing or other marketing to consumers.

**Consumer Credit Reporting.** On December 4, 2003, President Bush signed the Fair and Accurate Credit Transactions Act, amending the federal Fair Credit Reporting Act (the FCRA ). These amendments to the FCRA (the FCRA Amendments ) became effective in 2004.

The FCRA Amendments include, among other things:

requirements for financial institutions to develop policies and procedures to identify potential identity theft and, upon the request of a consumer, place a fraud alert in the consumer's credit file stating that the consumer may be the victim of identity theft or other fraud;

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for entities that furnish information to consumer reporting agencies (which would include First Capital Bank), requirements to implement procedures and policies regarding the accuracy and integrity of the furnished information and regarding the correction of previously furnished information that is later determined to be inaccurate; and

a requirement for mortgage lenders to disclose credit scores to consumers.

The FCRA Amendments also prohibit a business that receives consumer information from an affiliate from using that information for marketing purposes unless the consumer is first provided a notice and an opportunity to direct the business not to use the information for such marketing purposes (the opt-out ), subject to certain exceptions. First Capital does not share consumer information among its affiliated companies for marketing purposes, except as allowed under exceptions to the notice and opt-out requirements. Because no affiliate of First Capital is currently sharing consumer information with any other affiliate of First Capital for marketing purposes, the limitations on sharing of information for marketing purposes do not have a significant impact on First Capital.

**Anti-Terrorism and Money Laundering Legislation.** First Capital Bank is subject to the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act (the USA PATRIOT Act ), the Bank Secrecy Act, and rules and regulations of the Office of Foreign Assets Control (the OFAC ). These statutes and related rules and regulations impose requirements and limitations on specified financial transactions and account relationships, intended to guard against money laundering and terrorism financing. First Capital Bank has established a customer identification program pursuant to Section 326 of the USA PATRIOT Act and the Bank Secrecy Act, and otherwise has implemented policies and procedures to comply with the foregoing rules.

**Proposed Legislation and Regulatory Action.** New regulations and statutes are regularly proposed that contain wide-ranging proposals for altering the structures, regulations and competitive relationships of financial institutions operating or doing business in the United States. First Capital cannot predict whether or in what form any proposed regulation or statute will be adopted or the extent to which its business may be affected by any new regulation or statute.

**Effect of Governmental Monetary Policies.** First Capital s earnings are affected by domestic economic conditions and the monetary and fiscal policies of the United States government and its agencies. The Federal Reserve s monetary policies have had, and are likely to continue to have, an important impact on the operating results of commercial banks through its power to implement national monetary policy in order, among other things, to curb inflation or combat a recession. The monetary policies of the Federal Reserve affect the levels of bank loans, investments and deposits through its control over the issuance of United States government securities, its regulation of the discount rate applicable to member banks and its influence over reserve requirements to which member banks are subject. First Capital cannot predict the nature or impact of future changes in monetary and fiscal policies.

### **Legal Proceedings**

There are no material pending legal proceedings to which First Capital or any of its subsidiaries is a party or of which any of their properties are subject; nor are there material proceedings known to First Capital to be contemplated by any governmental authority; nor are there material proceedings known to First Capital, pending or contemplated, in which any director, officer or affiliate or any principal security holder of First Capital, or any associate of any of the foregoing is a party or has an interest adverse to First Capital or its subsidiaries.



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First Capital's principal executive office is located at 3320 Holcomb Bridge Road, N.W., Suite A, Norcross, Georgia 30092. As shown in the table below, First Capital Bank has two full-service banking locations and three loan production offices. First Capital leases all of its office space.

Executive office and full-service bank branch	3320 Holcomb Bridge Road., N.W., Suite A, Norcross, Georgia 30092
Full-service bank branch	7855 North Point Pkwy., Alpharetta, Georgia 30022
Loan production office	3802 Satellite Blvd., Suite 100, Duluth, Georgia 30096
Loan production office	327 Dahlonega Street, Suite 604A, Cumming, Georgia 30040
Loan production office	3625 Brookside Pkwy., Alpharetta, Georgia 30022

**Market Price and Dividends**

The common stock of First Capital trades on the Over the Counter Bulletin Board ( OTC BB ) under the symbol FCBX.OB. The market for First Capital's common stock is limited due to its relatively low trading volume. The following table sets forth, for the periods indicated, the quarterly high and low bid price of the common stock of First Capital reported by the OTC BB. Prices reflect inter-dealer prices without retail mark-up, mark-down or commissions and may not necessarily represent actual transactions.

	2005	
	High	Low
Third Quarter (through August 11, 2005)	\$ 24.10	\$ 22.55
Second Quarter	\$ 24.00	\$ 16.65
First Quarter	\$ 22.00	\$ 19.90

	2004	
	High	Low
Fourth Quarter	\$ 20.99	\$ 16.35
Third Quarter	\$ 16.85	\$ 15.25
Second Quarter	\$ 16.25	\$ 13.75
First Quarter	\$ 17.50	\$ 15.35

	2003	
	High	Low

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Fourth Quarter	\$ 17.50	\$ 14.55
Third Quarter	\$ 14.65	\$ 10.50
Second Quarter	\$ 13.00	\$ 9.00
First Quarter	\$ 9.55	\$ 8.35

Historically, First Capital has not paid any dividends. First Capital's future dividend policy will depend on First Capital's earnings, capital requirements, financial condition and other factors considered relevant by the First Capital board of directors.

The principal source of First Capital's cash flow, including cash flow to pay dividends to its shareholders, is dividends that First Capital Bank pays to First Capital. Statutory and regulatory limitations apply to First Capital Bank's payment of dividends to First Capital, as well as to First Capital's payment of dividends to its shareholders. For a complete discussion of restrictions on dividends, see [Supervision and Regulation Payment of Dividends](#) above.

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**FIRST CAPITAL MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL  
CONDITION AND RESULTS OF OPERATIONS**

The purpose of the following discussion is to address information relating to the financial condition and results of operations of First Capital that may not be readily apparent from a review of the consolidated financial statements and notes thereto, which begins on page F-1 of this joint proxy statement/prospectus. This discussion should be read in conjunction with information provided in First Capital's consolidated financial statements and accompanying footnotes. Unless otherwise noted, the discussion of net interest income in this financial review is presented on a taxable equivalent basis to facilitate performance comparisons among various taxable and tax-exempt assets.

In the May 2004 merger, CNB Holdings, Inc. acquired all of the outstanding common stock of First Capital Bancorp, Inc. ( Old FCBI ). For accounting purposes, the acquisition has been treated as a recapitalization of Old FCBI, with Old FCBI as the acquirer (reverse acquisition). The historical financial statements prior to May 28, 2004 are those of Old FCBI. The discussion of financial condition and results of operations for the year ended December 31, 2004, include seven months of operations of the combined company and five months of operations of the Old FCBI. The results of operations for the quarter and six months ended June 30, 2004 include one month of operations of the combined company and two months, with respect to the quarter ended June 30, 2004, and five months with respect to the six months ended June 30, 2004, of operations of the Old FCBI. The results of operations for the year ended December 31, 2003 include only the operations of Old FCBI.

**Results of Operations**

***Three-Month Period Ended June 30, 2005***

Net income for the three months ended June 30, 2005 totaled \$1,281,000, or \$.25 per basic and \$.25 per fully diluted share, compared to net income of \$344,000, or \$.11 per basic and \$.10 per fully diluted share, for the same period in 2004.

Net interest income (the difference between the interest earned on interest-earning assets and the interest paid on interest-bearing liabilities) is the single largest component of First Capital's revenue. First Capital actively manages this revenue source to provide an optimal level of revenue while balancing interest rate, credit and liquidity risks. Since market forces and economic conditions beyond First Capital's control determine interest rates, the ability to generate net interest income depends upon First Capital's ability to maintain an adequate spread between the rate paid on interest-bearing liabilities and the rate earned on interest-earning assets. Net interest income totaled \$6,371,000 for the three months ended June 30, 2005, an increase of \$2.5 million or 65%, over the same period in 2004.

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Presented below are various components of assets and liabilities, interest income and expense as well as their yield/cost for the three months ended June 30, 2005 and 2004.

	<b>Three-Month Period Ended June 30,</b>					
	<b>2005</b>			<b>2004</b>		
	<b>Average Balances (1)</b>	<b>Income/ Expense</b>	<b>Yields/ Rates</b>	<b>Average Balances (1)</b>	<b>Income/ Expense</b>	<b>Yields/ Rates</b>
	(Dollars in Thousands)					
Federal funds sold and interest-bearing deposits	\$ 4,545	\$ 31	2.74%	\$ 5,976	\$ 17	1.14%
Securities (2)	142,754	1,500	4.21	130,384	1,409	4.33
Loans, net of deferred fees (3)(4)	497,243	8,137	6.56	393,964	5,353	5.45
<b>Total interest-earning assets</b>	<b>644,542</b>	<b>9,668</b>	<b>6.02%</b>	<b>530,324</b>	<b>6,779</b>	<b>5.13%</b>
Unrealized losses on securities	(1,147)			(841)		
Allowance for loan losses	(6,249)			(4,104)		
Cash and due from banks	17,361			10,171		
Other assets	22,637			9,152		
<b>Total</b>	<b>\$ 677,144</b>			<b>\$ 544,702</b>		
Transaction and money market deposits	\$ 130,673	\$ 372	1.14%	\$ 103,302	\$ 189	0.73%
Time deposits	230,780	1,687	2.93	219,853	1,435	2.62
Federal funds purchased and securities sold under repurchase agreements	15,806	119	3.02	4,433	19	1.72
Other borrowings	124,021	975	3.15	121,101	1,132	3.75
Subordinated debentures	6,392	144	9.04	6,392	144	9.04
<b>Total interest-bearing liabilities</b>	<b>507,672</b>	<b>3,297</b>	<b>2.60%</b>	<b>455,081</b>	<b>2,919</b>	<b>2.57%</b>
Non interest-bearing demand deposits	105,097			55,486		
Other liabilities	5,411			2,652		
Stockholders' equity	58,964			31,483		
<b>Total</b>	<b>\$ 677,144</b>			<b>\$ 544,702</b>		
<b>Net interest income</b>		<b>\$ 6,371</b>			<b>\$ 3,860</b>	
Net interest spread			3.42%			2.56%
Net interest margin			3.96%			2.92%

(1) Average balances are daily averages.

(2) Securities available for sale are reported at amortized cost.

(3) Loans include nonaccrual loans.

(4) Interest and fees on loans includes fees of \$308,000 and \$253,000 for the three month periods ended June 30, 2005 and 2004, respectively.

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The increase in net interest income was driven mainly by loan growth. Average loans for the second quarter of 2005 increased \$103.3 million, or 26% over the same period in 2004. The significant growth in First Capital's loan portfolio includes the impact of the May 2004 merger.

For the three months ended June 30, 2005 and 2004, the average yield on interest-earning assets was 6.02% and 5.13%, respectively. Average interest-earning assets grew \$114.2 million, or 22%, quarter over quarter. In addition to growth in the loan portfolio, average investment securities increased \$12.4 million, or 9%, quarter over quarter. Growth in investment securities was due mainly to the impact of the May 2004 merger. The 89 basis point improvement in yield was mainly the result of Federal Reserve action to raise short-term rates during 2005 and the second half of 2004.



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The growth in interest-earning assets was funded by both interest-bearing and non interest-bearing sources. Average interest-bearing liabilities for the second quarter of 2005 increased \$52.6 million, or 12%, over the same period in 2004. \$38.3 million of the growth in interest-bearing liabilities was attributable to interest-bearing deposits and \$14.3 million to other borrowings, which include primarily FHLB advances. Average non interest-bearing demand deposits increased \$49.6 million, or 89%, from the second quarter of 2004 to the second quarter of 2005. The impact of the May 2004 merger is included in these growth figures. The rate paid on average interest-bearing liabilities was 2.60% for the second quarter of 2005, compared to 2.57% for the same period in 2004. Increased funding by low cost interest-bearing sources including transaction and money market deposits and federal funds purchased mitigated the effect of higher rates paid on interest-bearing funds. Average interest-bearing transaction and money market deposits grew \$27.4 million or 27%, quarter over quarter, and provided 26% of total interest-bearing funding during the second quarter of 2005, compared to 23% for the same period in 2004. Use of federal funds purchased and securities sold under repurchase agreements also increased, from 1% of total interest-bearing funding to 3%.

As reflected in the table above, the net interest margin was 3.96% for the second quarter of 2005, compared to 2.92% for the same period in 2004. This improvement was the combined result of several factors: 1) increased volumes; 2) a 89 basis point increase in the average yield on interest-earning assets compared to only a three basis point increase in the average cost of interest-bearing liabilities; and 3) substantial growth in non interest-bearing funding sources. On average, 16% of interest-earning assets were funded by non interest-bearing sources for the second quarter of 2005, compared to 10% during the same period in 2004. Prime rate increases of 125 basis points during 2004 and 100 basis points during the first half of 2005 had a larger and more immediate impact on loans than deposits.

Total other income for the quarter ended June 30, 2005 was \$353,000, an increase of \$144,000 or 69% from the same period in 2004. Loan servicing fee income, mortgage origination fees, and gains on sales of loans were the biggest components of this \$353,000, representing \$138,000, \$70,000 and \$69,000 of the total, respectively. Loan servicing fees grew \$63,000, from \$75,000 for the second quarter of 2004. The majority of loan servicing income was earned on a \$20 million loan portfolio purchased in March of 2004. Mortgage origination fees grew \$28,000, quarter over quarter. First Capital began originating mortgages as a line of business following the May 2004 merger. Income from gains on sales of loans for the second quarter 2005 was earned on the sale of three SBA loans.

Total non interest expenses increased \$1,827,000 to \$4,579,000 for the quarter ended June 30, 2005 compared to \$2,752,000 for the same period in 2004. Salaries and other compensation expense, which is the most significant portion of non interest expense, also represented the most significant increase, growing \$952,000, or 55%, quarter over quarter. Salaries and other compensation expense increased as a result of the May 2004 merger and from the addition of new employees in business development groups and support functions. Overall, the number of full-time equivalent employees grew from 97 at June 30, 2004, to 105 at June 30, 2005.

The second major category of non interest expense, net occupancy and equipment, increased \$243,000, or 113%, quarter over quarter. During 2004, First Capital leased additional space in the Norcross office and opened two loan production offices. Two additional locations were also added as part of the May 2004 merger.

The last major category of non interest expense, other expense, increased \$632,000, or 78%, quarter over quarter. Within the other expense category, the largest increases occurred in professional fees, business development, postage and courier services, and data processing. Professional fees, which include legal, accounting, consulting and loan review expenses, were up \$182,000, or 217%, to \$266,000 for the second quarter of 2005 from \$84,000 for the same period in 2004. Legal fees for research and public filings accounted for the majority of this increase. Business development expenses were \$250,000 for the second quarter of 2005, compared to \$135,000 for the same period in 2004, an increase of \$115,000 or 85%. The higher expenses were in support of deposit gathering initiatives. Postage and courier services, and data processing expense increased to support deposit gathering initiatives and because of the greater number of accounts serviced and products offered



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following the May 2004 merger. Postage and courier services were \$98,000 for the second quarter of 2005, compared to \$14,000 for the same period in 2004, an increase of \$84,000 or 600%. Data processing expense was \$140,000 for the second quarter of 2005, compared to \$74,000 for the same period in 2004, an increase of \$66,000 or 89%.

The effective tax rate was 35.8% for the three months ended June 30, 2005 and 33.5% for the three months ended June 30, 2004.

***Six-Month Period Ended June 30, 2005***

Net income for the six months ended June 30, 2005 totaled \$2,591,000, or \$.52 per basic and \$.50 per fully diluted share, compared to net income of \$1,047,000, or \$.39 per basic and \$.38 per fully diluted share, for the same period in 2004.

Net interest income totaled \$12,700,000 for the six months ended June 30, 2005, an increase of \$5,659,000, or 80%, over the same period in 2004.

Presented below are various components of assets and liabilities, interest income and expense as well as their yield/cost for the six months ended June 30, 2005 and 2004.

	Six-Month Period Ended June 30,					
	2005			2004		
	Average Balances  (1)	Income/ Expense	Yields/ Rates	Average Balances  (1)	Income/ Expense	Yields/ Rates
	(Dollars in Thousands)					
Federal funds sold and interest-bearing deposits	\$ 3,661	\$ 47	2.59%	\$ 6,437	\$ 34	1.06%
Securities (2)	141,554	2,977	4.24	123,165	2,643	4.30
Loans, net of deferred fees (3)(4)	499,133	16,085	6.50	359,929	9,631	5.37
<b>Total interest-earning assets</b>	<b>644,348</b>	<b>19,109</b>	<b>5.98%</b>	<b>489,531</b>	<b>12,308</b>	<b>5.04%</b>
Unrealized gains (losses) on securities	(729)			(364)		
Allowance for loan losses	(6,178)			(3,722)		
Cash and due from banks	16,042			9,030		
Other assets	21,276			6,999		
<b>Total</b>	<b>\$ 674,759</b>			<b>\$ 501,474</b>		

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Transaction and money market deposits	\$ 126,776	\$ 675	1.07%	\$ 92,125	\$ 337	0.73%
Time deposits	234,169	3,266	2.81	203,180	2,735	2.70
Federal funds purchased and securities sold under repurchase agreements	20,166	281	2.81	4,107	31	1.51
Other borrowings	122,259	1,899	3.13	116,128	1,876	3.24
Subordinated debentures	6,392	288	9.09	6,392	288	9.04
	<u>509,762</u>	<u>6,409</u>		<u>421,932</u>	<u>5,267</u>	
Total interest-bearing liabilities			2.54%			2.50%
Non interest-bearing demand deposits	102,079			51,166		
Other liabilities	4,509			2,042		
Stockholders' equity	58,409			26,334		
	<u>\$ 674,759</u>			<u>\$ 501,474</u>		
Net interest income		<u>\$ 12,700</u>			<u>\$ 7,041</u>	
Net interest spread			3.44%			2.54%
Net interest margin			3.97%			2.88%

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- (1) Average balances are daily averages.
- (2) Securities available for sale are reported at amortized cost.
- (3) Loans include nonaccrual loans.
- (4) Interest and fees on loans includes fees of \$837,000 and \$454,000 for the periods ended June 30, 2005 and 2004, respectively.

The increase in net interest income was driven mainly by loan growth. Average loans for the six-month period ended June 30, 2005 increased \$139.2 million, or 39% over the same period in 2004. The significant growth in First Capital's loan portfolio includes the impact of the May 2004 merger and the purchase of a \$20 million loan portfolio in March of 2004.

For the six months ended June 30, 2005 and 2004, the average yield on interest-earning assets was 5.98% and 5.04%, respectively, and average interest-earning assets grew \$154.8 million, or 32%. In addition to growth in the loan portfolio, average investment securities increased \$18.4 million, or 15% for the same periods. Growth in investment securities was due mainly to the impact of the May 2004 merger. The 94 basis point improvement in yield was mainly the result of Federal Reserve action to raise short-term rates during 2005 and the second half of 2004.

The growth in interest-earning assets was funded by both interest-bearing and non interest-bearing sources. Average interest-bearing liabilities for the six-month period ended June 30, 2005 increased \$87.8 million, or 21%, over the same period in 2004. \$65.6 million of the growth in interest-bearing liabilities was attributable to interest-bearing deposits and \$22.2 million to other borrowings, which include primarily FHLB advances. Average non interest-bearing demand deposits increased \$50.9 million, or 100%, from the six-month period ended June 30, 2004 to the same period in 2005. The impact of the May 2004 merger is included in these growth figures. The rate paid on average interest-bearing liabilities was 2.54% for the first half of 2005, compared to 2.50% for the same period in 2004. Increased funding by low cost interest-bearing sources including transaction and money market deposits and federal funds purchased mitigated the effect of higher rates paid on interest-bearing funds. Average interest-bearing transaction and money market deposits grew \$34.7 million or 38%, period over period, and provided 25% of total interest-bearing funding during the first quarter of 2005, compared to 22% for the same period in 2004. Use of federal funds purchased and securities sold under repurchase agreements also increased, from 1% of total interest-bearing funding to 4%.

As reflected in the table above, the net interest margin was 3.97% for the first half of 2005, compared to 2.88% for the same period in 2004. This improvement was the combined result of several factors: 1) increased volumes; 2) a 94 basis point increase in the average yield on interest-earning assets compared to only a four basis point increase in the average cost of interest-bearing liabilities; and 3) substantial growth in non interest-bearing funding sources. On average, 16% of interest-earning assets were funded by non interest-bearing sources for the first half of 2005, compared to 11% during the same period in 2004. Prime rate increases of 125 basis points during 2004 and 100 basis points during the first half of 2005 had a larger and more immediate impact on loans than deposits.

Total other income for the six-month period ended June 30, 2005 was \$746,000, an increase of \$446,000 or 149% from the same period in 2004. Loan servicing fee income, other income, gains on sales of loans, and mortgage origination fees were the biggest components of this \$446,000, representing \$294,000, \$150,000, \$130,000 and \$107,000 respectively. Loan servicing fees grew \$203,000, from \$91,000 for the first six months of 2004. The majority of loan servicing income was earned on the \$20 million loan portfolio purchased in March of 2004. Other income consisted primarily of license fee income generated First Capital's Capital Financial Software subsidiary. The First Capital recognized \$110,000 in license fee income during the six-month period in 2005, compared to \$74,000 during the same period in 2004, an increase of \$26,000. The higher license fee income was due to growth in deposits managed by bankruptcy trustees who are the end users of this subsidiary's software product. 2005 income from gains on sales of loans was earned on the sale of seven SBA loans.

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Mortgage origination fees grew \$65,000, for the six-month period in 2005 over the same period in 2004. First Capital began originating mortgages as a line of business following the May 2004 merger.

Total non interest expenses increased \$4,145,000 to \$9,029,000 for the six-month period ended June 30, 2005 compared to \$4,884,000 for the same period in 2004. Salaries and other compensation expense, which is the most significant portion of non interest expense, also represented the most significant increase, growing \$2,436,000, or 81%, period over period. Salaries and other compensation expense increased as a result of the May 2004 merger and from the addition of new employees in business development groups and support functions. Overall, the number of full-time equivalent employees grew from 97 at June 30, 2004, to 105 at June 30, 2005.

The second major category of non-interest expense, net occupancy and equipment, increased \$513,000, or 136%, period over period. During 2004, First Capital leased additional space in the Norcross office and opened two loan production offices. Two additional locations were also added as part of the May 2004 merger.

The last major category of non-interest expense, other expense, increased \$1,196,000, or 80%, period over period. Within the other expense category, the largest increases occurred in professional fees, business development, data processing, ACH credit card processing and amortization of the core deposit intangible. Professional fees, which include legal, accounting, consulting and loan review expenses, were up \$247,000, or 133%, to \$433,000 for the first half of 2005 from \$186,000 for the same period in 2004. Legal fees for research and public filings accounted for the majority of this increase. Business development expenses were \$451,000 for the first half of 2005, compared to \$274,000 for the same period in 2004, an increase of \$177,000 or 65%. The higher expenses were in support of deposit gathering initiatives. Data processing expense was \$277,000 for the first half of 2005, compared to \$137,000 for the same period in 2004, an increase of \$140,000 or 102%. ACH credit card processing expense was \$175,000 for the first half of 2005, compared to \$15,000 for the same period in 2004, an increase of \$160,000 or 1067%. Both data processing and ACH credit card processing increased to support deposit gathering initiatives and because of the greater number of accounts serviced and products offered following the May 2004 merger. Core deposit intangible amortization was \$148,000 for the first half of 2005, compared to \$25,000 for the same period in 2004 and resulted from the May 2004 merger.

The effective tax rate was 37.1% for the six months ended June 30, 2005 and 34.9% for the six months ended June 30, 2004.

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*General.* Net income for 2004 totaled \$3,212,000, an increase of \$1,652,000 or 106% from 2003 earnings of \$1,560,000. Diluted earnings per share were \$.80 for 2004, compared to \$.65 for 2003, an increase of 23%. The 2004 earnings were influenced by the May 2004 merger.

*Net Interest Income.* Net interest income (the difference between the interest earned on interest-bearing assets and the interest paid on interest-bearing liabilities) is the single largest component of First Capital's revenue. First Capital actively manages this revenue source to provide an optimal level of revenue while balancing interest rate, credit and liquidity risks. Since market forces and economic conditions beyond First Capital's control determine interest rates, the ability to generate net interest income depends upon First Capital's ability to maintain an adequate spread between the rate paid on interest-bearing liabilities and the rate earned on interest-earning assets. Net interest income totaled \$18,433,000 for 2004, an increase of \$9,275,000, or 101% over 2003.

Presented below are various components of assets and liabilities, interest income and expense as well as their yield/cost for 2004 and 2003.

	Years Ended December 31,					
	2004			2003		
	Average Balances (1)	Income/ Expense	Yields/ Rates	Average Balances (1)	Income/ Expense	Yields/ Rates
	(Dollars in Thousands)					
Federal funds sold and interest-bearing deposits	\$ 5,653	\$ 72	1.27%	\$ 2,467	\$ 28	1.13%
Securities (2)	138,415	5,996	4.33	109,088	4,256	3.90
Loans, net of deferred fees (3)(4)	413,972	23,556	5.69	277,642	15,271	5.50
<b>Total interest-earning assets</b>	<b>558,040</b>	<b>29,624</b>	<b>5.31%</b>	<b>389,197</b>	<b>19,555</b>	<b>5.02%</b>
Unrealized gains (losses) on securities	(331)			51		
Allowance for loan losses	(4,748)			(3,379)		
Cash and due from banks	10,077			5,550		
Other assets	13,923			4,698		
<b>Total</b>	<b>\$ 576,961</b>			<b>\$ 396,117</b>		
Transaction and money market deposits	\$ 103,981	\$ 834	.80%	\$ 69,394	\$ 520	.75%
Time deposits	231,844	6,011	2.59	180,613	5,934	3.29
Federal funds purchased, securities sold under repurchase agreements, and other borrowings	129,729	3,771	2.91	99,328	3,368	3.39
Subordinated debt	6,392	575	9.00	6,392	575	9.00
<b>Total interest-bearing liabilities</b>	<b>471,946</b>	<b>11,191</b>	<b>2.37%</b>	<b>355,727</b>	<b>10,397</b>	<b>2.92%</b>

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Non interest-bearing demand deposits	60,515	19,141
Other liabilities	3,314	1,950
Stockholders equity	41,186	19,299
	<u>          </u>	<u>          </u>
Total	\$ 576,961	\$ 396,117
	<u>          </u>	<u>          </u>
Net interest income	18,433	9,158
	<u>          </u>	<u>          </u>
Net interest spread	2.94%	2.10%
Net interest margin	3.30%	2.35%

- (1) Average balances are daily averages.
- (2) Securities available for sale are reported at amortized cost.
- (3) Loans include nonaccrual loans and are net of deferred fees.
- (4) Interest and fees on loans includes fees of \$1,384,000 and \$849,000 for the periods ended December 31, 2004 and 2003, respectively.



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The increase in net interest income was driven mainly by loan growth. Average loans increased \$136.3 million, or 49%, over 2003. The significant growth in First Capital's loan portfolio was the result of the May 2004 merger, which accounted for \$103.0 million of the net growth, and the purchase of a \$20 million loan portfolio.

Average interest-earning assets grew \$168.8 million, or 43%, year over year. In addition to growth in the loan portfolio, investment securities increased \$29.3 million, or 27%, year over year. Growth in investment securities was due mainly to the May 2004 merger, which accounted for \$38.4 million of the net growth. The rate earned on average interest-earning assets was 5.31% for 2004, compared to 5.02% for 2003. The 29 basis point improvement was mainly the result of Federal Reserve action to raise short-term rates during the second half of 2004.

The growth in interest-earning assets was funded by both interest-bearing and non interest-bearing sources. Average interest-bearing liabilities increased \$116.2 million, or 33%, from 2003 to 2004. Of this growth, \$85.8 million was attributable to interest-bearing deposits and \$30.4 million to other borrowings, which include primarily FHLB advances. Non interest-bearing demand deposits increased \$41.4 million, or 216%, on average from 2003 to 2004. Interest-bearing and non interest-bearing deposits acquired in the May 2004 merger were \$103.6 million and \$12.8 million, respectively. The rate paid on average interest-bearing liabilities was 2.37% for 2004, compared to 2.92% for 2003. First Capital benefited from term deposits and FHLB advances attained at historically low rates before the Federal Reserve action and from increased funding by non interest-bearing sources. Non interest bearing sources represented 11% of total funding on average in 2004, compared to 5% in 2003.

As reflected in the table above, the net interest margin was 3.30% for 2004, compared to 2.35% for 2003. This improvement was the combined result of increased volumes and favorable rate movements for both assets and liabilities. Prime rate increases of 125 basis points during 2004 had a larger and more immediate impact on loans than deposits. In addition, there was significant growth in non interest-bearing deposits during the year. This growth in non interest-bearing deposits is the result of First Capital's deposit gathering programs. First Capital expects that the growth in non interest-bearing deposits will continue to improve its net interest margin.

*Provision for Loan Losses.* The provision for loan losses was \$1,325,000 in 2004, compared with \$100,000 in 2003. The provision as a percentage of average loans was .32% for 2004 and .04% for 2003. The ratio of net loan charge-offs / (recoveries) to average outstanding loans for 2004 was 0%, compared with .05% for 2003. In 2004, First Capital had no charge-offs and recoveries of \$2,000. In 2003, First Capital charged off loans totaling \$150,000 and had no recoveries. The allowance for loan losses as a percentage of gross loans was 1.24% as of December 31, 2004, compared to 1.08% as of December 31, 2003. Even though First Capital incurred no losses in 2004, First Capital still made additions to the reserve to adequately fund the allowance related to loan growth and to compensate for the cyclical nature of the real estate market. As of December 31, 2004, 92% of the loan portfolio was secured by real estate. Management of First Capital considers the allowance for loan losses to be adequate to absorb possible future losses.

*Non Interest Income.* Total non interest income for the year ended December 31, 2004 was \$1,094,000, an increase of \$766,000, or 234%, from \$328,000 in 2003. The biggest components of non interest income and the year over year increase were gains on sale of loans, loan servicing fee income and mortgage origination fees. Gains on sale of loans were \$363,000 in 2004, compared to none in 2003. Loan-servicing fee income was \$248,000, an increase of \$243,000 from 2003. Mortgage origination fee income was \$157,000, compared to none in 2003. All of these increases are the result of new lines of business acquired in the May 2004 merger. Losses on sales of securities of \$32,000 were recognized in 2004, compared to \$28,000 in losses recognized in 2003. Losses in both years resulted from sales of lower quality trust preferred issues. The main components of other income were license fee income generated from First Capital's Capital Financial Software subsidiary and income from bank owned life insurance. In 2004, First Capital recognized income from license fees of \$163,000 and income from bank owned life insurance of \$86,000, compared to \$229,000 and none, respectively, in 2003. The decrease in license fee income was due to a decline in the bankruptcy deposits of trustees in financial institutions serviced by the software subsidiary. Bank owned life insurance was acquired as part of the May 2004 merger.



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*Non Interest Expense.* Total non interest expense was \$13,235,000 in 2004, compared to \$6,938,000 in 2003, an increase of \$6,297,000, or 91%. In general, non interest expense increased to support First Capital's growth. The following table represents the components of non interest expense for the years ended December 31, 2004 and 2003.

	<u>2004</u>	<u>2003</u>	<u>Change</u> <u>2004-2003</u>
<b>(Dollars in Thousands)</b>			
Salaries and other compensation	\$ 8,120	\$ 4,392	85%
Net occupancy and equipment expense	1,142	575	99
Other expense (1)	3,973	1,971	102
<b>Total non interest expense</b>	<b>\$ 13,235</b>	<b>\$ 6,938</b>	<b>91%</b>
<hr/>			
(1) Other expense:			
Professional fees	\$ 657	\$ 230	186%
Business development	535	320	67
Data processing	349	192	82
Travel and meals expense	258	217	19
Postage and courier services	223	103	117
Regulatory expense	186	83	124
Lockbox processing	181	36	403
Insurance-directors and officers	178	96	85
Amortization of core deposit intangible	172		100
Loan origination expense	170	95	79
Other operating expenses	1,064	599	78
<b>Total other expense</b>	<b>\$ 3,973</b>	<b>\$ 1,971</b>	<b>102%</b>

Salaries and other compensation, which is the most significant portion of other expense, also represented the most significant increase, growing by \$3,728,000, or 85%, year over year. Salaries and other compensation increased as a result of the May 2004 merger and from the addition of new employees in business development groups and support functions. Overall, the number of full-time equivalent employees more than doubled from 51 at December 31, 2003, to 104 at December 31, 2004.

The second major category of non interest expense, net occupancy and equipment, increased \$567,000, or 99%, year over year. During 2004, First Capital leased additional space in the Norcross office and opened two loan production offices. Two more locations were added as part of the May 2004 merger.

The last major category of non interest expense, other expense, increased \$2,002,000, or 102%, year over year. Within the other expense category, the largest increase occurred in professional fees, which include legal, accounting, consulting and loan review expenses. Professional fees were up \$427,000, or 186%, year over year. During 2004, professional fees were incurred in connection with the \$20 million loan portfolio purchased in March, merger-related issues, and company growth in general. Business development and lockbox processing expenses increased in support of deposit gathering initiatives. Data processing expense increased to support deposit gathering initiatives and because of the greater number of accounts serviced and products offered following the May 2004 merger. Also contributing to the increase in other expense was the

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\$172,000 in amortization expense for the core deposit intangible asset that resulted from the May 2004 merger.

*Income Taxes.* Income tax expense was \$1,755,000 for 2004, compared to \$889,000 for 2003. The effective tax rates for 2004 and 2003 were 35.3% and 36.3%, respectively.

*Rate/Volume Analysis of Net Interest Income.* The following table describes the extent to which changes in interest rates and changes in volume of interest-earning assets and interest-bearing liabilities have affected First Capital's interest income and interest expense during the year. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (1) change in volume (change in

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volume multiplied by old rate); (2) change in rate (change in rate multiplied by old volume); and (3) a combination of change in rate and change in volume. The changes in interest income and interest expense attributable to both volume and rate have been allocated proportionately on a consistent basis to the change due to volume and the change due to rate.

	2004 compared to 2003		
	increase (decrease)		
	due to changes in		
	Rate	Volume	Total
	(Dollars in Thousands)		
<b>Interest-earning assets:</b>			
Federal funds sold and interest-bearing deposits	\$ 3	\$ 40	\$ 43
Securities	507	1,234	1,741
Loans, net of deferred fees	545	7,740	8,285
<b>Total interest income</b>	<b>1,055</b>	<b>9,014</b>	<b>10,069</b>
<b>Interest-bearing liabilities:</b>			
Transaction and money market deposits	39	275	314
Time deposits	(1,402)	1,480	78
Other borrowings	(528)	930	402
Subordinated debt			
<b>Total interest expense</b>	<b>(1,891)</b>	<b>2,685</b>	<b>794</b>
<b>Increase in net interest income</b>	<b>\$ 2,946</b>	<b>\$ 6,329</b>	<b>\$ 9,275</b>

**Financial Condition**

Management of First Capital continuously monitors the financial condition of First Capital Bank in order to protect depositors, protect retained earnings and increase current and future earnings. Further discussion of significant items affecting First Capital Bank's financial condition is provided in detail below.

***June 30, 2005***

On June 30, 2005 total assets were \$674.8 million, compared to \$658.2 million on December 31, 2004, an increase of \$16.6 million, or 3%. Most of this growth occurred in net loans, which increased \$11.2 million, or 2% from \$478.6 million on December 31, 2004 to \$489.8 million on June 30, 2005.

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On June 30, 2005 total liabilities were \$615.2 million, compared to \$601.4 million on December 31, 2004, an increase of \$13.8 million, or 2%. Deposits increased \$11.5 million, or 3%, and federal funds purchased and securities sold under repurchase agreements increased \$5.1 million, or 45%, from December 31, 2004 to June 30, 2005. Non-interest bearing demand deposits grew from \$77.3 million, or 17% of total deposits on December 31, 2004, to \$102.9 million or 22% of total deposits on June 30, 2005.

On June 30, 2005, total stockholders' equity was \$59.6 million, compared to \$56.8 million on December 31, 2004, an increase of \$2.8 million, or 5%. The increase in stockholders' equity was primarily due to the retention of net income of \$2.6 million for the six months ended June 30, 2005.

*Allowance for Loan Losses.* The allowance for loan losses as of June 30, 2005 was \$6.3 million. The allowance for loan losses, as a percentage of total gross loans, at June 30, 2005 was 1.3%, as compared to 1.2% at December 31, 2004. First Capital's provision for loan losses decreased by \$550,000 during the six months ended June 30, 2005 as compared to the same period in 2004. The reduction in provision reflects a slower loan growth and minimal net charge-offs of \$7,421 in 2005. During the fourth quarter of 2004, a review of First Capital's loan portfolio by an independent firm was conducted. The purpose of this review, which is conducted regularly, was to assess the risk in the loan portfolio and to determine the adequacy of the allowance for loan losses. The review included analyses of historical performance, the level of non-conforming and rated loans, loan

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volume and activity, review of loan files and consideration of economic conditions and other pertinent information. First Capital plans to continue engaging, on an annual basis, an independent firm to review its loan portfolio. In addition to the independent reviews, First Capital's regulators also conduct annual examinations of the loan portfolio. Upon completion, the regulator presents its report of findings to First Capital's board of directors and management. Information provided from these independent sources, together with information provided by management and other information known to the First Capital's board of directors, is utilized by the board of directors to monitor, on a quarterly basis, the loan portfolio. Specifically, First Capital's board of directors attempts to identify risks inherent in the loan portfolio (e.g., problem loans, potential problem loans and loans to be charged off), assess the overall quality and collectibility of the loan portfolio, and determine amounts of the allowance for loan losses and the provision for loan losses to be reported based on the results of their review.

Management of First Capital considers the allowance for loan losses to be adequate; however, there can be no assurance that charge-offs in future periods will not exceed the allowance for loan losses or that additional provisions of the allowance will not be required.

The following table summarizes the allowance for loan losses for the six-month periods ended June 30, 2005 and 2004.

	<u>2005</u>	<u>2004</u>
	(Dollars in thousands)	
<b>Average amount of loans outstanding</b>	\$ 499,133	\$ 360,881
<b>Allowance for loan losses balance, beginning of period</b>	\$ 6,049	\$ 3,306
<b>Less charge-offs</b>		
Commercial loans		
Real estate loans		
Consumer loans	(10)	
<b>Total charge-offs</b>	(10)	
<b>Plus recoveries</b>		
Commercial loans	2	
Real estate loans	1	
Consumer loans		
<b>Total recoveries</b>	3	
<b>Net charge-offs</b>	(7)	
<b>Plus provision for loan losses</b>	300	850
<b>Plus amount acquired in business combination</b>		1,416
<b>Allowance for loan losses balance, end of period</b>	6,342	\$ 5,572
<b>Net charge-offs to average loans</b>	0.0014%	%

The following table is a summary of nonaccrual, past due and restructured debt.

	June 30, 2005		
	Past Due		
	Nonaccrual	90 Days	Restructured
	Loans	Still Accruing	Debt
	(Dollars in thousands)		
Real estate loans	\$ 160	\$	\$
Commercial loans	1,284		
Consumer loans			
<b>Total</b>	<b>\$ 1,444</b>	<b>\$</b>	<b>\$</b>



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	June 30, 2004		
	Past Due		
	Nonaccrual	90 Days	Restructured
	Loans	Still Accruing	Debt
	(Dollars in thousands)		
Real estate loans	\$ 691	\$	\$
Commercial loans	900		
Consumer loans			
<b>Total</b>	<b>\$ 1,591</b>	<b>\$</b>	<b>\$</b>

Accrual of interest is discontinued on a loan when management determines, upon consideration of economic and business factors affecting collection efforts, that collection of interest is doubtful. The \$1.4 million in nonaccrual loans at June 30, 2005 included \$1.4 million in SBA loans, of which SBA guaranteed \$1.0 million, and \$100,000 in loans secured by real estate. Therefore, First Capital's exposure to losses is considered minimal.

Loans classified for regulatory purposes as loss, doubtful, substandard, or special mention that have not been included in the table above do not represent or result from trends or uncertainties which management reasonably expects will materially impact future operating results, liquidity or capital resources. These classified loans do not represent material credits about which management is aware of any information that causes management to have serious doubts as to the ability of such borrowers to comply with their loan repayment terms, except as noted above.

*Liquidity and Sources of Capital.* Liquidity involves First Capital's ability to maintain adequate cash flows to fund operations and meet obligations and other commitments on a timely and cost-effective basis. While the desired level of liquidity will vary depending upon a variety of factors, management's primary goal is to maintain a sufficient level of liquidity in all expected economic environments. Daily monitoring of the sources and uses of funds is necessary to maintain a position that meets these requirements.

First Capital's primary sources of liquidity are customer deposits, other borrowings, loan repayments and securities available for sale. If additional funding sources are needed, First Capital has access to federal funds lines at correspondent banks and borrowings from the Federal Reserve discount window. Additionally, First Capital Bank is a member of the Federal Home Loan Bank of Atlanta, which provides access to FHLB lending sources. Lines of credit with the FHLB totaling \$269.9 million were available on June 30, 2005, of which \$117.4 million was outstanding. First Capital also had federal funds back-up lines of credit totaling \$37.5 million, of which \$14.0 million was outstanding on June 30, 2005.

As of June 30, 2005, First Capital Bank was considered to be well capitalized as defined in the Federal Deposit Insurance Corporation Improvement Act and based on regulatory minimum capital requirements. First Capital's and First Capital Bank's actual capital ratios are presented in the following table.

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	<u>Actual</u>	<u>For Capital Adequacy Purposes</u>	<u>To Be Well Capitalized</u>
<b>As of June 30, 2005</b>			
Total Capital to Risk Weighted Assets:			
Consolidated	11.74%	8%	N/A
First Capital Bank	11.48%	8%	10%
Tier I Capital to Risk Weighted Assets:			
Consolidated	10.57%	4%	N/A
First Capital Bank	10.31%	4%	6%
Tier I Capital to Average Assets:			
Consolidated	8.62%	4%	N/A
First Capital Bank	8.42%	4%	5%

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First Capital not aware of any other known trends, events or uncertainties, other than the effect of events as described above, that will have or that are reasonably likely to have a material effect on its liquidity, capital resources or operations. First Capital is not aware of any current recommendations by the regulatory authorities, which, if they were implemented, would have such an effect, except as noted above.

*Off-Balance Sheet Arrangements.* First Capital's financial statements do not reflect various commitments and contingent liabilities that arise in the normal course of business. These off-balance sheet financial instruments include commitments to extend credit and standby letters of credit. These financial instruments are included in the financial statements when funds are distributed or the instruments become payable. First Capital uses the same credit policies in making commitments as it does for on-balance-sheet instruments. First Capital's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit, standby letters of credit and credit card commitments is represented by the contractual amount of those instruments. At June 30, 2005, First Capital had outstanding commitments to extend credit of approximately \$189.6 million and outstanding standby letters of credit of approximately \$3.8 million.

***December 31, 2004***

As of December 31, 2004, total assets were \$658.2 million, an increase of 50% over December 31, 2003 total assets of \$439.4 million. Over the same period, loans net of deferred fees and allowance for loan losses grew 58% to \$478.6 million from \$302.7 million, total deposits grew 57% to \$458.7 million from \$292.5 million, and other borrowings increased 14% to \$120.5 million from \$105.8 million. The resulting loan to deposit ratio was 106% at December 31, 2004, compared to 105% at December 31, 2003. The ratio of loans to total funding was 81% at December 31, 2004, compared to 73% at December 31, 2003. Total funding includes deposits, federal funds purchased, securities sold under repurchase agreements, and other borrowings.

*Loan Portfolio.* The following table presents various categories of loans contained in First Capital's loan portfolio for the fiscal years ended December 31, 2004 and 2003, and the total amount of all loans for such periods.

	<b>December 31,</b>	
	<b>2004</b>	<b>2003</b>
	<b>(Dollars in Thousands)</b>	
<b>Type of Loan</b>		
Real estate-construction	\$ 180,898	\$ 126,656
Real estate-mortgage	264,849	161,530
Commercial	39,076	18,242
Other	1,570	347
	<b>486,393</b>	<b>306,775</b>
Less: Deferred loan fees and costs	(1,774)	(736)
Less: Allowance for possible loan losses	(6,049)	(3,306)
<b>Loans, net</b>	<b>\$ 478,570</b>	<b>\$ 302,733</b>

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The following is a presentation of the contractual maturities of loans as of December 31, 2004:

	Maturity by Years			Total
	One or Less	One to Five	Over Five	
(Dollars in Thousands)				
<b>Type of Loans</b>				
Real estate construction	\$ 133,016	\$ 41,879	\$ 6,003	\$ 180,898
Real estate mortgage	52,410	111,333	101,106	264,849
Commercial	17,110	8,196	13,770	39,076
Other	693	698	179	1,570
<b>Total</b>	<b>\$ 203,229</b>	<b>\$ 162,106</b>	<b>\$ 121,058</b>	<b>\$ 486,393</b>

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For the above loans, the following table represents the interest rate structure for loans maturing over one year:

	<b>(Dollars in Thousands)</b>
Fixed rate	\$ 75,833
Floating rate	207,331
<b>Total</b>	<b>\$ 283,164</b>

Information with respect to nonaccrual, past due, restructured and other problem loans at December 31, 2004 and 2003 is as follows:

	<b>December 31,</b>	
	<b>2004</b>	<b>2003</b>
	<b>(Dollars in Thousands)</b>	
Nonaccrual loans	\$ 1,629	\$ 155
Loans contractually past due 90 days or more as to interest or principal payments and still accruing		
Restructured loans		
Loans, now current about which there are serious doubts as to the ability of the borrower to comply with loan repayment terms		
Interest income that would have been recorded on nonaccrual and restructured loans under original terms	83	34
Interest income that was recorded on nonaccrual and restructured loans	7	28

As of December 31, 2004, there were no loans classified for regulatory purposes as doubtful, substandard or special mention that (1) represent or result from trends or uncertainties that management reasonably expects will materially impact future operating results, liquidity or capital resources, or (2) represent material credits about which management is aware of any information that causes it to have serious doubts as to the ability of such borrowers to comply with the loan repayment terms. There are no loans for which known information about possible credit problems of borrowers causes management to have serious doubts as to the ability of such borrowers to comply with the present loan repayment terms.

Accrual of interest is discontinued on a loan when management determines upon consideration of economic and business factors affecting collection efforts that collection of interest is doubtful.

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*Summary of Loan Loss Experience.* An analysis of First Capital's loan loss experience is furnished in the following table for the years indicated.

	Years Ended December 31,	
	2004	2003
	(Dollars in Thousands)	
Balance at beginning of year	\$ 3,306	\$ 3,356
Charge-offs:		
Real estate construction		150
Real estate mortgage		
Commercial		
Other loans		
Total		150
Recoveries:		
Real estate construction		
Real estate mortgage	2	
Commercial		
Other loans		
Total	2	
Net charge-offs / (recoveries)	(2)	150
Additions charged to operations	1,325	100
Allowance acquired in business combination	1,416	
Balance at end of year	\$ 6,049	\$ 3,306
Ratio of net charge-offs / (recoveries) during the year to average loans outstanding	0%	0.05%

First Capital does not currently allocate its allowance for loan losses by major loan types due to its lack of loss history in these major loan types. First Capital, instead, uses its risk rating system to allocate its allowance for loan losses. The risk-rated loans were grouped by major loan types for purposes of this presentation.

Factors considered in determining the adequacy of the unallocated component of the allowance for loan losses include First Capital's heavy concentration in real estate loans, the continued strong growth in the real estate loan portfolio, the large increase in commercial and industrial loans, and the economic environment in general. These factors are tempered by the diversification within First Capital's real estate portfolio, the continuing positive performance within the local real estate market, the experience level of First Capital's lenders and strong credit culture. The uncertain economic outlook at the end of 2004 prompted the larger unallocated reserve.



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The allowance for loan losses was allocated as follows:

	December 31,			
	2004		2003	
	Percent		Percent of	
	of loans		loans in	
	in each		each	
	category		category	
	to total		to total	
	Allowance		Allowance	
	Amount	loans	Amount	loans
	_____	_____	_____	_____
	(Dollars in Thousands)			
Real estate construction	\$ 1,619	37.2	\$ 1,318	41.3
Real estate mortgage	2,304	54.5	1,802	52.7
Commercial	494	8.0	173	5.9
Other loans	13	0.3	2	0.1
Unallocated	1,619		11	
	_____	_____	_____	_____
	\$ 6,049	100.0	\$ 3,306	100.0
	_____	_____	_____	_____

Real estate mortgage loans included the remaining balance (\$27.9 million) of the combined \$30 million loan portfolio purchased in March 2004, for which there were no reserves represented in First Capital's allowance for loan losses. At December 31, 2004, there was a separate cash reserve for these loans of \$3.8 million in First Capital Bank that was provided by the seller of the portfolio. First Capital Bank's reserve analysis suggests a need of only \$535,000 in reserves. A portion of the cash reserves is refundable to the seller at the end of five years if First Capital Bank has not incurred losses in excess of the reserve balance.

*Investments.* As of December 31, 2004, investment securities comprised approximately 22% of First Capital's assets, compared to 27% as December 31, 2003. The following table shows the carrying value of First Capital's securities.

	2004	2003
	_____	_____
	(Dollars in Thousands)	
Securities available for sale:		
U.S. Treasury notes and obligations of U.S. government agencies	\$ 39,130	\$ 23,299
Mortgage-backed securities	82,637	65,105
Other debt securities	6,833	12,090
Equity securities	2,040	2,208



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Total securities available for sale	\$ 130,640	\$ 102,702
Securities held to maturity:		
Mortgage-backed securities	\$ 6,571	\$ 9,832
Other	250	250
Total securities held to maturity	\$ 6,821	\$ 10,082
Restricted equity securities:	\$ 6,818	\$ 6,194
Total investment securities	\$ 144,279	\$ 118,978

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The carrying values of debt securities available-for-sale and held-to-maturity, as of December 31, 2004, are shown below by contractual maturity. Actual maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	<b>Maturity By Years</b>				
	<b>One or Less</b>	<b>One to Five</b>	<b>Five to Ten</b>	<b>Over Ten</b>	<b>Total</b>
<b>(Dollars in Thousands)</b>					
<b>Securities available for sale:</b>					
U.S. Treasury notes and obligations of U.S. government agencies	\$ 4,024	\$ 28,830	\$ 6,276	\$	\$ 39,130
Mortgage-backed securities		5,359	22,609	54,669	82,637
Other debt securities	1,248		2,500	3,085	6,833
<b>Total securities available for sale</b>	<b>\$ 5,272</b>	<b>\$ 34,189</b>	<b>\$ 31,385</b>	<b>\$ 57,754</b>	<b>\$ 128,600</b>
<b>Weighted average yield (1)</b>	<b>3.97%</b>	<b>3.50%</b>	<b>4.66%</b>	<b>4.58%</b>	<b>4.29%</b>
<b>Securities held to maturity:</b>					
Mortgage-backed securities	\$	\$	\$	\$ 6,571	\$ 6,571
Other debt securities		250			250
<b>Total securities held to maturity</b>	<b>\$</b>	<b>\$ 250</b>	<b>\$</b>	<b>\$ 6,571</b>	<b>\$ 6,821</b>
<b>Weighted average yield (1)</b>		<b>3.75%</b>		<b>5.00%</b>	<b>4.95%</b>

(1) Based on amortized cost.

*Deposits.* Total deposits averaged \$396.3 million in 2004, compared to \$269.1 million in 2003, an increase of \$127.2 million or 47%. On average, non interest-bearing demand deposits increased \$41.4 million or 216%, interest-bearing transaction accounts increased \$34.6 million or 50%, and time deposits increased \$51.2 million or 28% from 2003.

The following table indicates the scheduled maturities of time deposits of \$100,000 and greater at December 31, 2004:

	<b>(Dollars in Thousands)</b>
Three months or less	\$ 30,046
Three to six months	19,142
Six to twelve months	37,120
Over one year	48,454
<b>Total</b>	<b>\$ 134,762</b>

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First Capital Bank had brokered deposits of \$75.0 million on December 31, 2004. Included in brokered deposits is \$72.6 million of time deposits of \$100,000 and greater, which are included in the above maturity schedule.

At December 31, 2004, First Capital Bank had no deposit relationships that represented concentrations.

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*Return on Equity and Assets.* Returns on average assets and average equity for fiscal years ended December 31, 2004 and 2003 are presented below.

	<b>December 31,</b>	
	<b>2004</b>	<b>2003</b>
Return on average assets	0.56%	0.39%
Return on average equity	7.80%	8.08%
Average equity to average assets ratio	7.14%	4.87%
Dividend payout ratio	0%	15.36%

*Interest Rate Risk Management.* The objective of interest rate risk management is to identify and manage the sensitivity of earnings to changing interest rates, in order to achieve First Capital's overall financial goals. The inherent maturity and repricing characteristics of First Capital's day-to-day lending and deposit activities create a naturally asset-sensitive structure. By monitoring the level of rate sensitive assets to rate sensitive liabilities, First Capital manages the sensitivity of earnings to changes in interest rates within its established policy guidelines. The asset/liability management committee oversees the interest rate risk management process and approves policy guidelines.

In analyzing interest rate sensitivity, First Capital compares its forecasted net interest income to several different interest rate scenarios using a rate simulation model. These forecasts are based upon a number of assumptions for each scenario, including balance sheet growth rates, repricing characteristics and prepayment rates. In addition to a flat rate and a most likely scenario, First Capital regularly analyzes the potential impact of other more extreme scenarios using historical periods of rapid rate changes. While the interest rate sensitivity modeling assumes that management takes no action, First Capital regularly assesses the viability of strategies to reduce unacceptable risks to earnings and implement such strategies when First Capital believes those actions are prudent.

Interest rate sensitivity is a function of the repricing characteristics of First Capital's assets and liabilities. These repricing characteristics are the time frames within which the interest-earning assets and interest-bearing liabilities are subject to changes in interest rates at maturity, replacement or repricing during the life of the instruments. Interest rate sensitivity management focuses on the maturity structure of assets and liabilities and their repricing characteristics during periods of change in market interest rates. Effective interest rate sensitivity management seeks to minimize the impact of interest rate fluctuations on the net interest margin. Interest rate sensitivity is measured as the difference between assets and liabilities that are subject to repricing at various time horizons: within three months, three to 12 months, one to five years, over five years, and on a cumulative basis. The differences are known as interest rate sensitivity gaps.

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The interest rate sensitivity position at year-end 2004 is presented in the following table. The difference between rate sensitive assets and rate sensitive liabilities, or the interest rate sensitivity gap, is shown at the bottom of the table. The table does not necessarily indicate the impact of general interest rate movements on the net interest margin because various assets and liabilities that reprice within the same period may in fact, reprice at different times within such period and at different rates. Repricing rates are also subject to competitive pressures.

	Interest Sensitivity Periods				Total
	Within Three Months	After Three Months But Within One Year	After One Year But Within Five Years	After Five Years	
(Dollars in Thousands)					
<b>INTEREST-EARNING ASSETS</b>					
Interest-bearing deposits	\$ 665	\$ 570	\$ 238	\$	\$ 1,473
Federal funds sold	375				375
Securities (1)	10,015	10,863	52,738	70,656	144,272
Loans	296,453	71,410	101,662	16,868	486,393
<b>Total interest-bearing assets</b>	<b>\$ 307,508</b>	<b>\$ 82,843</b>	<b>\$ 154,638</b>	<b>\$ 87,524</b>	<b>\$ 632,513</b>
<b>INTEREST-BEARING LIABILITIES</b>					
Interest-bearing demand and savings	\$ 132,593	\$	\$	\$	\$ 132,593
Time deposits	58,106	104,171	86,459		248,736
Federal funds purchased and repurchase agreements	11,210				11,210
Other borrowings	78,488		6,000	42,392	126,880
<b>Total interest-bearing liabilities</b>	<b>\$ 280,397</b>	<b>\$ 104,171</b>	<b>\$ 92,459</b>	<b>\$ 42,392</b>	<b>\$ 519,419</b>
Interest sensitivity gap	\$ 27,111	\$ (21,328)	\$ 62,179	\$ 45,132	
Cumulative interest sensitivity gap	\$ 27,111	\$ 5,783	\$ 67,962	\$ 113,094	
Interest sensitivity gap ratio	109.7%	79.5%	167.3%	206.5%	
Cumulative interest sensitivity gap ratio	109.7%	101.5%	114.2%	121.8%	

(1) Securities at amortized cost.

As evidenced by the table above, at year-end 2004, First Capital was within its target range of 80% to 120% for the cumulative interest rate sensitivity gap ratio in the one year horizon. A positive interest sensitivity gap corresponds to a gap ratio greater than 100%, and a negative interest sensitivity gap corresponds to a gap ratio less than 100%. During a period of rising interest rates, a negative gap would tend to affect net interest income adversely, while a positive gap would tend to increase net interest income. Conversely, during a period of falling interest rates, a negative gap would tend to increase net interest income, while a positive gap would tend to affect net interest income adversely. With respect to First Capital, an increase in interest rates would result in higher earnings while a decline in interest rates would reduce income in all periods. This, however, assumes that all other factors affecting income remain constant.

*Liquidity Risk Management.* The primary objectives of asset/liability management are to provide adequate liquidity to meet the needs of customers and to maintain an optimal balance between interest-sensitive assets and interest-sensitive liabilities, so that First Capital can also meet the expectations of its stockholders as market interest rates change. Liquidity risk involves the risk of being unable to fund assets, as well

as the risk of not being able to meet unexpected cash needs. Active management and planning are necessary to ensure First Capital maintains the ability to fund operations cost-effectively and to meet current and future potential obligations such as loan commitments and unexpected deposit outflows.

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Funding sources primarily include customer-based core deposits, purchased funds, collateralized borrowings and cash flows from operations. Cash flows from operations are a significant component of liquidity risk management and consider both deposit maturities and the scheduled cash flows from loan and investment maturities and payments. Deposits are First Capital's primary source of liquidity. The stability of this funding source is affected by returns available to customers on alternative investments, the quality of customer service levels and competitive forces.

First Capital purchases funds on an unsecured basis in the federal funds and national certificate of deposit markets. In addition, First Capital routinely uses loans and securities in its portfolio as collateral for secured borrowings. In the event of severe market disruptions, First Capital has access to secured borrowings through the Federal Reserve Bank. Providing funding under current agreements may result in the forgoing more profitable lending and investing opportunities because of funding constraints.

Below are the pertinent liquidity balances and ratios for the years ended December 31, 2004 and December 31, 2003.

	<u>2004</u>	<u>2003</u>
	<b>(Dollars in Thousands)</b>	
Cash and due from banks	\$ 13,753	10,255
Federal fund sold and other investments	\$ 375	1,844
Securities	\$ 144,279	118,978
CDs \$100,000 and greater to total deposits ratio	29%	37%
Loan to deposit ratio	106%	105%
Loan to total funding (deposits plus borrowings)	81%	73%
Brokered deposits	\$ 75,010	65,516

The following table sets forth certain information about contractual cash obligations as of December 31, 2004.

	<b>Payments Due after December 31, 2004</b>				
	<b>Total</b>	<b>1 Year or Less</b>	<b>1 - 3 Years</b>	<b>4 - 5 Years</b>	<b>After 5 Years</b>
	<b>(Dollars in Thousands)</b>				
Subordinated debt	\$ 6,392	\$	\$	\$	\$ 6,392
Federal Home Loan Bank advances	120,488		12,012	71,982	36,494
Operating leases	1,768	455	651	662	
Total contractual cash obligations	\$ 128,648	\$ 455	\$ 12,663	\$ 72,644	\$ 42,886

*Off-Balance Sheet Arrangements.* The financial statements do not reflect various commitments and contingent liabilities that arise in the normal course of business. These off-balance sheet financial instruments include commitments to extend credit, standby letters of credit and credit card commitments. Such financial instruments are included in the financial statements when funds are distributed or the instruments become payable. First Capital's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit, standby letters of credit and credit card commitments is represented by the contractual amount of those instruments. First Capital uses the same credit policies in making such commitments as First Capital does for on-balance sheet instruments. Although these amounts do not

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necessarily represent future cash requirements, a summary of First Capital's commitments as of December 31, 2004 and December 31, 2003 is as follows:

	<u>2004</u>	<u>2003</u>
	<b>(Dollars in Thousands)</b>	
Commitments to extend credit	\$ 179,788	\$ 96,585
Financial standby letters of credit	50	210
Other standby letters of credit	4,672	3,085
Total	\$ 184,510	\$ 99,880



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*Capital Adequacy.* There are two primary measures of capital adequacy for banks and bank holding companies: (1) risk-based capital guidelines, and (2) the leverage ratio.

The risk-based capital guidelines measure the amount of a bank's required capital in relation to the degree of risk perceived in its assets and its off-balance sheet items. Note that under the risk-based capital guidelines, capital is divided into two tiers. Tier 1 capital consists of common stockholders' equity, non-cumulative and cumulative (bank holding companies only) perpetual preferred stock and minority interest. Goodwill is subtracted from the total. Tier 2 capital consists of the allowance for loan losses, hybrid capital instruments, term subordinated debt and intermediate term preferred stock. To be adequately capitalized, banks are required to maintain a minimum total risk-based capital ratio of 8.0%, with at least 4.0% consisting of Tier 1 capital.

The second measure of capital adequacy is the leverage ratio. The leverage ratio is computed by dividing Tier 1 capital into total average assets. The table below illustrates regulatory capital ratios for First Capital Bank and First Capital at December 31, 2004:

	<b>December 31, 2004</b>	<b>Minimum regulatory requirement</b>
	<u>                    </u>	<u>                    </u>
<b>First Capital Bank</b>		
Tier 1 capital	10.08%	4.0%
Tier 2 capital	1.12%	
	<u>                    </u>	<u>                    </u>
Total risk-based capital ratio	11.20%	8.0%
	<u>                    </u>	<u>                    </u>
Leverage ratio	8.37%	4.0%
	<u>                    </u>	<u>                    </u>
<b>First Capital consolidated</b>		
Tier 1 capital	10.17%	4.0%
Tier 2 capital	1.12%	
	<u>                    </u>	<u>                    </u>
Total risk-based capital ratio	11.29%	8.0%
	<u>                    </u>	<u>                    </u>
Leverage ratio	8.43%	4.0%
	<u>                    </u>	<u>                    </u>

First Capital believes that the above ratios indicate that the capital positions of First Capital Bank and First Capital are sound and that both are well positioned for future growth.

**Critical Accounting Estimates**

First Capital has adopted various accounting policies that govern the application of accounting principles generally accepted in the United States and general practices within the banking industry in the preparation of its financial statements. First Capital's significant accounting policies are

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described in the notes to the audited financial statements beginning on page F-10 of this joint proxy statement/prospectus. Certain accounting policies require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates. Estimates and assumptions are reviewed periodically, and the effects of revisions are reflected in the consolidated financial statements in the period they are determined to be necessary.

*Allowance for Loan Losses.* The allowance for loan losses is established through provisions for loan losses charged to operations. The provision for loan losses charged to operations is based upon management's judgment of the amount necessary to maintain the allowance at a level adequate to absorb probable losses. Loans are charged against the allowance for loan losses when management believes that the collection of principal is unlikely. Subsequent recoveries are added to the allowance. Management's evaluation of the adequacy of the allowance for loan losses is based on a formal analysis which assesses the risk within the loan portfolio. This

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analysis includes consideration of loan concentrations, historical performance, level of non-performing loans, current economic conditions and review of certain individual loans. Because First Capital's loan portfolio is mainly secured by real estate, management of First Capital has continued to augment the allowance for loan losses because of the cyclical nature of the real estate market.

The allowance for loan losses consists of two main components: the allocated and unallocated allowances. Both components of the allowance are available to cover inherent losses in the portfolio. The allocated component of the allowance is determined using a loan loss allocation method used by regulators and industry consultants. First Capital uses a risk rating system for its loans as shown below.

<b>Risk</b>	
<b>Rating</b>	<b>Definition</b>
0	Exceptional
1	Above average
2	Quality
3	Satisfactory
4	Acceptable - merits attention
5	Watch - special mention
6	Substandard
7	Doubtful - collection questionable
8	Loss

*Goodwill.* First Capital's growth over the past year has been enhanced significantly by the May 2004 merger. For purchase acquisitions, First Capital is required to record the assets acquired, including identified intangible assets and liabilities assumed at their fair value, which involves estimates based on third-party valuations, such as appraisals, or internal valuations based on discounted cash flow analyses or other valuation techniques. The determination of the useful lives of intangible assets is subjective as is the appropriate amortization period for such intangible assets. In addition, purchase acquisitions typically result in recording goodwill, which is subject to ongoing periodic impairment tests based on the fair value of net assets acquired compared to the carrying value of goodwill. If for any future period First Capital determines that there has been impairment in the carrying value of its goodwill balances, First Capital will record a charge to its earnings, which could have a material adverse effect on its net income.

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**MANAGEMENT OF FIRST CAPITAL**

**Board of Directors**

The members of the board of directors of First Capital are divided into three classes, with the members of each class serving three-year terms. The shareholders of First Capital elect one class annually. First Capital's board of directors presently consists of 12 members.

The following table sets forth for each director of First Capital: (1) the person's name; (2) his or her age at December 31, 2004; (3) the year he or she was first elected as a director of First Capital; and (4) his or her positions with First Capital, other than as a director, and his or her recent business experience for the past five years.

There are no family relationships between any of the directors, executive officers and significant employees of First Capital and First Capital Bank.

*Patricia Rhodes Grimes*, age 56, has been a director of First Capital since 1998. Ms. Grimes has extensive senior-level banking experience. At Trust Company of Georgia (now SunTrust Bank), Ms. Grimes served as group vice president and assistant manager of systems and programming. Additionally, Ms. Grimes served as senior vice president and manager of the Applications Systems Division with SunTrust Service Corporation, a subsidiary of SunTrust Banks, Inc. Ms. Grimes retired from SunTrust Service Corporation in 1992. Ms. Grimes is a graduate of the University of Georgia, where she has served on the MIS Advisory Board and is currently president-elect of the advisory board for the Franklin College of Arts and Sciences.

*Jon A. Pond*, age 57, has been a director of First Capital since 1988. Mr. Pond has been the president of Pond & Company, an engineering and architectural services company, since 1987. Mr. Pond holds a professional engineer license as well as a professional land surveyor license. Mr. Pond serves on the compensation/governance committee of First Capital.

*Joe E. McCart*, age 63, has been a director of First Capital since May 2004. Mr. McCart is an insurance agent and serves as president of Joe McCart Insurance Agency, Inc., a general insurance agency founded in 1971 and located in Duluth, Georgia. Mr. McCart is a member of the compensation/governance committee of First Capital.

*Richard T. Smith*, age 58, has been a director of First Capital since May 2004. Mr. Smith is a partner in and serves as president of the law firm Richard T. Smith, PC. In addition, Mr. Smith also serves as vice president of Vista Title Company. Mr. Smith is a member of the compensation/governance committee of First Capital.

*William R. Blanton*, age 57, has been a director of First Capital since May 2004 and serves vice chairman, chief financial officer and chief operating officer of First Capital. Mr. Blanton also serves as chief financial officer and chief operating officer of First Capital Bank. From 1989

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until the May 2004 merger, Mr. Blanton also served as president and chief executive officer of one of First Capital Bank's predecessors. Mr. Blanton is chairman of the executive committee of First Capital. Mr. Blanton is the managing member and a shareholder of Terrazza Realty Investments. Mr. Blanton is also the managing member and sole shareholder of Terrazza Realty Advisors, LLC and a one-half owner of Cinc Systems, LLC, an accounting software company.

*David R. Hink*, age 56, has been a director of First Capital since 1998. Mr. Hink is chairman of First Capital and First Capital Bank. Mr. Hink has been the managing principal of Strategic Solutions Resources, LLC, a strategy development and merger and acquisition consulting firm, since December 1996. Mr. Hink also serves as chief executive officer of Southern Retirement Services, an assisted living and senior care company, as chief financial officer and a director of Cenergie, a fuel cell manufacturing company, as vice chairman and director of Enercom, a software company and as a director of Cobb Energy, an energy utility and services company. Mr. Hink is a member of the executive committee of First Capital.

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*H.N. Padget, Jr.*, age 48, has been a director of First Capital since 1998. Mr. Padget is the president and chief executive officer of First Capital and First Capital Bank. Prior to the May 2004 merger, Mr. Padget served as president and chief executive officer of one of First Capital Bank's predecessors. Mr. Padget has been a banker in metropolitan Atlanta for over 25 years and has served in various management positions throughout his career. Mr. Padget is a member of the executive committee of First Capital.

*Edgar H. Sims, Jr.*, age 63, has been a director of First Capital since May 2004. Mr. Sims is a partner in the law firm McKenna Long & Aldridge, LLP, located in Atlanta, Georgia. Mr. Sims is a member of the audit committee of First Capital.

*C. Dan Alford*, age 44, has been a director of First Capital since 1998. Mr. Alford has served as the chief financial officer of Allied Utility Network LLC, a consultant to the utility industry, since February 1998. From 1989 to 1998, Mr. Alford served in various capacities, including executive vice president and chief operating officer, of A&C Enercom, Inc. from 1996 to 1997. Mr. Alford has also served as general manager of national operations for the Commercial & Industrial Division of Virginia Electric Power Company. Mr. Alford is the chairman of the audit committee of First Capital.

*William H. Groce, Jr.*, age 68, has been a director of First Capital since 1998. Mr. Groce is a retired executive from BellSouth Telecommunications. Mr. Groce held various positions at BellSouth Telecommunications throughout his career, which began in 1958, including executive assistant to the president of BellSouth Telecommunications and secretary to its board of directors from 1988 until his retirement in 1994. Mr. Groce is the chairman of the compensation/ governance committee of First Capital.

*Theodore J. LaVallee, Sr.*, age 68, has been a director of First Capital since May 2004. Mr. LaVallee was president and part owner of S&L Mortgage Corp., a mortgage banking company, until its sale in 1989, when he retired from S&L Mortgage Corp. Since 1996, Mr. LaVallee has also served in various capacities with S&L Mortgage & Investments, Inc., an Atlanta real estate firm, most recently as president. Mr. LaVallee is a member of the executive committee of First Capital.

*Neil H. Strickland*, age 68, has been a director of First Capital since May 2004. Mr. Strickland has served as president of Strickland General Agency, Inc., a property and casualty wholesale insurance agency in Duluth, Georgia, since it was founded in 1967. Mr. Strickland is a member of the audit committee of First Capital.

**Other Executive Officers and Significant Employees**

*Steven G. Deaton*, age 41, is executive vice president, commercial lending of First Capital Bank. Prior to joining one of First Capital Bank's predecessors in 2000, Mr. Deaton held numerous management positions with SouthTrust Bank of Georgia.

*J. Donald Tate*, age 59, is executive vice president, senior credit officer of First Capital Bank. Mr. Tate joined one of First Capital Bank's predecessors in 1998 and has 35 years of banking experience in the lending, credit and audit/collateral monitoring fields. Prior to joining one of First Capital Bank's predecessors, Mr. Tate held positions at Bank of America, National Bank of Georgia/First American Bank and National Bank of Commerce.

*Gary A. Thornton*, age 42, is executive vice president, treasurer and senior investment officer of First Capital Bank. Mr. Thornton joined one of First Capital Bank's predecessors in 2003 and has 18 years of experience in bank portfolio management and fixed income investing. Prior to joining one of First Capital Bank's predecessors, Mr. Thornton held positions at Wachovia Bank, N.A., Regions Financial Corp. and First National Bank of Gainesville.

*Henry G. Vick*, age 59, is executive vice president, real estate lending with First Capital Bank. Prior to joining one of First Capital Bank's predecessors in 2003, Mr. Vick held positions at Bank South Mortgage, Bank of America and First Horizon Mortgage.

**Table of Contents****Index to Financial Statements****Executive Compensation**

The following table sets forth a summary of compensation paid to or accrued on behalf of the chief executive officer and the other persons designated as executive officers of First Capital during 2004 whose combined salary and bonus exceeded \$100,000 for services rendered during 2004 (collectively, the named executive officers). Information as to perks received by these executive officers is omitted because the amounts received by each officer does not exceed the lesser of \$50,000 or 10% of his combined salary and bonus for a given year.

Name and Principal Position	Fiscal Year	Annual Compensation		Long Term Compensation Awards	All Other Compensation \$(1)
		Salary (\$)	Bonus (\$)	Securities Underlying Options (#)	
H. N. Padget, Jr. President and Chief Executive Officer	2004	168,035	109,000	0	59,199
	2003	151,668		0	39,827
	2002	143,500		0	9,750
William R. Blanton Vice Chairman, Chief Financial Officer and Chief Operating Officer	2004	106,375(2)	148,800	0	21,538
Steven G. Deaton Executive Vice President, Commercial Lending of First Capital Bank	2004	150,577	101,400	23,000(3)	45,612
	2003	146,106		0	29,614
	2002	124,000	12,932	0	8,001

(1) Consists of the following amounts for the individuals and years indicated:

		Split Dollar Death Benefit	Earned Retirement Benefit	401(k) Plan Matching Contribution	ESOP Allocation
H.N. Padget, Jr.	2004	\$ 297	\$ 35,915	\$ 2,341	\$ 19,646
	2003	377	33,862	1,744	3,844
	2002	225	4,940	*	4,585
William R. Blanton	2004	\$ 0	\$ 0	\$ 2,250	\$ 19,288
Steven G. Deaton	2004	\$ 167	\$ 25,510	\$ 2,289	\$ 19,646
	2003	223	24,103	1,593	3,695
	2002	141	3,458	*	4,402



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The split dollar death benefit represents the individual's reportable income for the death benefit described in Life Insurance Benefits below, while the earned retirement benefit represents the annual retirement benefit earned under the retirement plan described in Supplemental Retirement Plan below. The 401(k) plan contribution represents matching funds contributed by First Capital to the individual's account under the 401(k) plan, and the ESOP allocation represents the fair market value of the shares of common stock contributed to the individual's ESOP account by First Capital, measured as of December 31 of the applicable year.

- \* Specific information for 2002 is not available and therefore is not reflected in the table above. These amounts are comparable to the amounts reflected for 2004 and 2003.
- (2) Mr. Blanton did not become an executive officer of First Capital until May 28, 2004. As a result, the amount shown reflects only the salary he received from First Capital after that date. See Employment Agreements below for additional information regarding his annual salary and the terms of his employment.
- (3) See Option Grants in Last Fiscal Year below for the terms of these options.

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The following table provides details regarding stock options granted during 2004 to the named executive officers.

Name	Date of Grant	Securities Underlying Options Granted (#)	% of Total Options		Expiration Date
			Granted to Employees in Fiscal Year	Exercise or Base Price (\$/Sh)	
H.N. Padget, Jr.					
William R. Blanton					
Steven G. Deaton	4/30/04	4,000(1)	2.2	15.00	4/30/14
	7/09/04	4,000(2)	2.2	15.50	7/09/14
	8/18/04	15,000(3)	8.3	16.60	8/18/14

(1) The indicated options are fully vested.

(2) The options vest in one-third annual increments beginning on the first anniversary of the date of grant.

(3) The options vest in one-third annual increments beginning on the first anniversary of the date of grant.

**Aggregated Option Exercises in Last Fiscal Year and Fiscal Year-End Option Values**

None of the named executive officers exercised any options in 2004. The following table reports their respective option holdings and values at the end of 2004, based on a market value of \$20.60 per share for the common stock at December 31, 2004.

Name	Number of Securities		Value of Unexercised	
	Underlying Unexercised		In-the-Money Options	
	Options at Fiscal Year-End		Exercisable	Unexercisable
	Exercisable	Unexercisable	Exercisable	Unexercisable
H.N. Padget, Jr.	44,000	0	\$ 484,400	\$ 0
William R. Blanton	0	0	\$ 0	\$ 0
Steven G. Deaton	10,500	19,000	\$ 106,790	\$ 80,400

**Employment Agreements**

**H.N. Padget, Jr.** In early 2005, First Capital and First Capital Bank entered into an amended and restated employment agreement with H.N. Padget, Jr. regarding Mr. Padget's employment as president and chief executive officer of First Capital and First Capital Bank. The employment agreement currently provides that Mr. Padget's annual base salary rate is \$180,000. Mr. Padget's employment agreement provides that for fiscal 2005 he will be entitled to receive a cash bonus based upon attainment of specified target levels of return on earnings and certain strategic initiatives established by the Compensation Committee. Pursuant to the employment agreement, First Capital furnishes an automobile for Mr. Padget's use as well as reimbursement of country club membership dues. Further, the employment agreement provides for reimbursement of disability insurance premiums at a monthly rate of \$158 and reimbursement of medical, hospitalization and term life insurance premiums at a monthly rate of \$600. The period of employment under the employment agreement continues until the earlier of January 31, 2006 or any earlier termination of the employment. In the event that Mr. Padget's employment is terminated (1) by First Capital without cause, or (2) at Mr. Padget's election, upon First Capital and First Capital Bank's breach of any material provision of the employment agreement, then, in either case, First Capital will be required to pay Mr. Padget, as termination compensation, an amount equal to 12 months of existing base salary plus the cost of medical, hospitalization and term life insurance. If First Capital and First Capital Bank terminate Mr. Padget's employment without cause following a change of control, First Capital will be required to pay Mr. Padget an amount equal to three times the highest annual base salary and cost of medical, hospitalization and term life insurance coverages for the fiscal year during the term in which those costs were highest. Mr. Padget is subject to restrictive covenants protecting confidential information and prohibiting the solicitation of customers and employees during his term of employment and, in most situations, for specified periods following his term of employment.

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As part of the proposed merger with Flag, Mr. Padgett's current employment agreement will be terminated and he will enter into a new employment agreement with Flag. See "Terms of the Merger - Interests of Employees and Directors of Flag and First Capital in the Merger - Padgett Employment Agreement."

**William R. Blanton.** In May 2004, First Capital entered into an employment agreement with William R. Blanton regarding Mr. Blanton's employment as vice chairman, chief operating officer and chief financial officer of First Capital and First Capital Bank. The agreement terminated by its terms on December 31, 2004, although Mr. Blanton has continued to be employed by First Capital in the same capacity. Under the employment agreement, Mr. Blanton was entitled to an annual base salary equal to \$145,000 per year, subject to normal annual increases, provided that Mr. Blanton's salary shall at no time trail the base salary of the chief executive officer of First Capital by more than \$10,000. Based on this provision, Mr. Blanton's base salary was increased during 2004 to \$170,000 following a salary increase for Mr. Padgett to the annual salary reflected in the Summary Compensation Table. The agreement also provided that Mr. Blanton was entitled to receive annual incentive compensation based on criteria established by the Board of Directors of First Capital. Pursuant to the employment agreement, First Capital furnished an automobile for Mr. Blanton's use as well as country club membership dues. In addition, Mr. Blanton was entitled to receive cash bonuses when and as necessary to permit Mr. Blanton to pay the premiums necessary to maintain an existing life insurance policy with a \$5,000,000 death benefit. The period of employment under the employment agreement was to continue until the earlier of December 31, 2004 or the termination of the employment as follows: (1) at the election of First Capital and First Capital Bank for cause; (2) at Mr. Blanton's election, upon First Capital Bank's and First Capital's breach of any material provision of the employment agreement; or (3) upon Mr. Blanton's death or disability. In the event that Mr. Blanton's employment was terminated (1) by First Capital without cause, or (2) by Mr. Blanton as a result of a breach of the agreement by First Capital or First Capital Bank, First Capital would be required to pay Mr. Blanton, as termination compensation, an amount equal to six months of existing base salary plus medical, hospitalization and term life insurance. In addition, in the event of a change of control of First Capital or First Capital Bank, First Capital would be required to pay Mr. Blanton an amount equal to three times his then current annual compensation, including salary, bonuses and perquisites. In the event that Mr. Blanton's employment was terminated for any reason, Mr. Blanton would be prohibited from competing with First Capital Bank or soliciting its customers or employees within the geographic area set forth in the employment agreement for a period of six months after the date of termination.

As part of the proposed merger with Flag, Mr. Blanton has agreed to enter into a non-compete and consulting agreement with Flag. See "Terms of the Merger - Interests of Employees and Director of Flag and First Capital in the Merger - Blanton Non-compete and Consulting Agreement."

**Steven G. Deaton.** In April 2005, First Capital and First Capital Bank entered into an amended and restated employment agreement with Steven G. Deaton regarding Mr. Deaton's employment as Executive Vice President and Senior Lending Officer of First Capital and First Capital Bank. The employment agreement currently provides that Mr. Deaton's annual base salary rate is \$160,000. Mr. Deaton's employment agreement provides that for fiscal 2005 he will be entitled to receive a cash bonus based upon attainment of specified target levels of return on earnings and certain strategic initiatives established by the Compensation Committee. Pursuant to the employment agreement, First Capital furnishes Mr. Deaton with an automobile allowance as well as reimbursement of country club membership dues. The period of employment under the employment agreement continues until the earlier of December 31, 2005 or any earlier termination of the employment. In the event that Mr. Deaton's employment is terminated (1) by First Capital without cause, or (2) at Mr. Deaton's election, upon First Capital and First Capital Bank's breach of any material provision of the employment agreement, then, in either case, First Capital will be required to pay Mr. Deaton, as termination compensation, an amount equal to 12 months of existing base salary plus medical, hospitalization and term life insurance. If First Capital and First Capital Bank terminate Mr. Deaton's employment without cause following a change of control, First Capital will be required to pay Mr. Deaton an amount equal to 12 months of his existing annual base salary. Mr. Deaton is subject to restrictive covenants protecting confidential information and prohibiting the solicitation of customers and employees during his term of employment and for specified periods following his term of employment.

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As part of the proposed merger with Flag, Mr. Deaton's current employment agreement will be terminated and he will enter into a new employment agreement with Flag. See "Terms of the Merger - Interest of Employees and Director of Flag and First Capital in the Merger - Deaton Employment Agreement."

### **Supplemental Retirement Plan**

Ms. Grimes and Messrs. Alford, Deaton, Groce, Hink, Padget and Pond have supplemental retirement agreements with First Capital Bank. Under these agreements, the participants are entitled to receive supplemental retirement benefits from and after their respective retirements at or after age 65 until death. In the event any of the participants are terminated, resign or are removed prior to age 65 for any reason other than cause, some or all of the benefits become payable, depending upon the circumstances of the departure and whether the participant is an executive officer or serves only as a director. Under the terms of these agreements, in the event any of the participants are terminated, resign or are removed for any reason other than for cause following the merger with Flag, which constitutes a change of control of First Capital and First Capital Bank, he or she is entitled to receive the benefits promised under the agreements as if they had been continuously employed by First Capital or First Capital Bank until age 65. The amount of each participant's retirement benefits is determined by various formulae tied to the after-tax income attributable to specified insurance contracts, as described by the terms of the participant's agreement. Those terms vary depending upon whether the participant is an executive officer or serves only as a director.

In addition to the supplemental retirement benefits provided under these agreements, Messrs. Padget and Deaton are entitled to defer up to 25% of their compensation each year and each of the directors of First Capital is entitled to defer up to 100% of his or her compensation each year. Any amounts deferred are credited with earnings equal to 150% of the average after-tax yield of a one-year Treasury bill. None of the eligible participants described above has participated in this deferral benefit.

### **Life Insurance Benefits**

Ms. Grimes and Messrs. Alford, Deaton, Groce, Hink, Padget and Pond are entitled to share in the death benefit proceeds payable under certain life insurance policies owned by First Capital Bank that were purchased as a means of facilitating the discharge of the obligations incurred under the supplemental retirement agreements. These arrangements are reflected by individual split dollar agreements, each of which provides for the payment of up to 90% of the death benefit proceeds from the policy or policies insuring the life of the participant, less cash surrender value, to the beneficiary or beneficiaries designated by the participant. The death benefits are not payable if the participant's service is terminated for cause, and only a portion of the death benefit proceeds otherwise payable is due if the participant terminates, resigns or is removed from service before death. The portion payable depends upon a participant's number of years of service with First Capital Bank and whether he or she is an executive officer or serves only as a director. Service prior to the implementation of the plan counts only for directors. First Capital Bank pays all premiums due under these policies. In the event a participant is terminated, resigns or is removed for any reason other than for cause following a change of control in either First Capital or First Capital Bank, he or she becomes 100% vested in the death benefits promised under the agreement. Consequently, in the event Messrs. Padget and Deaton or any of the directors of First Capital are so terminated, resign or are removed following the merger with Flag, their beneficiaries will receive the death benefit set forth in the split dollar agreements as if they had died while serving on the board of directors or while employed by First Capital or First Capital Bank, as applicable.

### **Director Fees**

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Prior to July 1, 2004, First Capital paid directors a fee of \$500 for each board of directors meeting attended and \$150 for each committee meeting attended. In addition, the chairman of the board received an additional \$500 for each board meeting attended and the chairman of each of First Capital's committee received an additional \$150 for each committee meeting attended.

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Effective as of July 1, 2004, the chairman of the board receives a retainer of \$60,000 per year, while other directors are paid a retainer of \$15,000 per year. Committee chairs receive an additional \$5,000 annual retainer. All retainer amounts are paid in quarterly increments.

As an alternative to the deferrals to which directors are entitled under the supplemental retirement plan described above, First Capital also has in place a directors' deferral plan, which allows each of First Capital Bank's directors to defer either 50% or 100% of his or her directors' fees and then have this deferred compensation invested in either First Capital's common stock or a variety of mutual funds. A participant's benefits are generally paid upon the person's resignation or removal from office. As of December 31, 2004, First Capital had recorded a deferred compensation liability of \$413,810 under this plan.

**Certain Relationships and Related Transactions**

Since January 1, 2003, First Capital and First Capital Bank have extended loans from time to time to certain of their directors, their associates, affiliates and members of the immediate families of the directors and executive officers of First Capital and First Capital Bank. These loans are made in compliance with applicable laws and regulations and in the ordinary course of business on substantially the same terms, including interest rates, collateral and repayment terms, as those prevailing at the time for comparable transactions with persons not affiliated with First Capital or First Capital Bank, and do not involve more than the normal risk of collectibility or present other unfavorable features.

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**SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT  
OF FIRST CAPITAL**

The following table sets forth information with respect to the beneficial ownership, as of June 24, 2005, of shares of First Capital common stock by (1) each person known by First Capital to be the beneficial owner of more than 5% of First Capital's issued and outstanding common stock, (2) each of First Capital's directors, (3) each of First Capital's named executive officers, and (4) all directors and named executive officers of First Capital as a group. Except as noted below, First Capital believes that each of the persons listed has sole investment and voting power with respect to the shares included in the table.

The information contained in this table reflects beneficial ownership as determined in accordance with Rule 13d-3 under the Securities Exchange Act of 1934. Information with respect to beneficial ownership is based upon information furnished by each owner. With respect to certain of the individuals listed in the table and the aggregate number of shares held by the directors and named executive officers as a group, the number of shares indicated includes shares that the individual has the right to acquire on or before October 11, 2005 (60 days from August 12, 2005), through the exercise of options. Under the SEC's rules, a person is also deemed to be the beneficial owner of any securities owned by such person's spouse, children or relatives living in the same household. Accordingly, more than one person may be deemed to be a beneficial owner of the same securities.

<u>Name of Beneficial Owner</u>	<u>Amount and Nature of Beneficial Ownership</u>	<u>Percent of Class</u>
C. Dan Alford	29,646 <sup>(1)</sup>	*
William R. Blanton	1,049,751 <sup>(2)</sup>	20.7
Patricia Rhodes Grimes	35,291 <sup>(3)</sup>	*
William H. Groce, Jr.	69,109 <sup>(4)</sup>	1.4
David R. Hink	42,003 <sup>(5)</sup>	*
Theodore J. LaVallee, Sr.	76,748 <sup>(6)</sup>	1.5
Joe E. McCart	181,686 <sup>(7)</sup>	3.6
H.N. Padget, Jr.	83,334 <sup>(8)</sup>	1.6
Jon A. Pond	47,630 <sup>(9)</sup>	*
Edgar H. Sims, Jr.	162,014	3.2
Richard T. Smith	232,364 <sup>(10)</sup>	4.6
Neil H. Strickland	167,163 <sup>(11)</sup>	3.3
Steven G. Deaton	43,225 <sup>(12)</sup>	*
<b>All Directors and Executive Officers as a Group (16 persons):</b>	<b>2,336,501<sup>(13)</sup></b>	<b>44.4</b>

\* Represents holdings of less than 1%.

(1) Includes 10,000 shares issuable upon the exercise of stock options that may be exercised within 60 days of August 12, 2005.

(2) Includes 421,543 shares held jointly with Mr. Blanton's spouse and 946 shares held in First Capital's ESOP.



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- (3) Includes 12,500 shares issuable upon the exercise of stock options that may be exercised within 60 days of August 12, 2005.
- (4) Includes 10,108 shares held by Mr. Groce's spouse and 15,000 shares issuable upon the exercise of stock options that may be exercised within 60 days of August 12, 2005.
- (5) Includes 15,000 shares issuable upon the exercise of stock options that may be exercised within 60 days of August 12, 2005.
- (6) Includes 13,481 shares held by Mr. LaVallee's spouse and 1,001 shares held by S&L Mortgage & Investments, of which Mr. LaVallee is President.

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- (7) Includes 85,528 shares held jointly with Mr. McCart's spouse.
- (8) Includes 2,760 shares held by Mr. Padgett's 401(k), 1,690 shares held in First Capital's ESOP and 44,000 shares issuable upon the exercise of stock options that may be exercised within 60 days of August 12, 2005. Also includes an aggregate of 6,000 shares held by Mr. Padgett's children and as to which Mr. Padgett disclaims beneficial ownership.
- (9) Includes an aggregate of 2,596 shares held by two of Mr. Pond's children, as to which he has sole voting power. Also includes 15,000 shares issuable upon the exercise of stock options that may be exercised within 60 days of August 12, 2005.
- (10) All shares are held by Mr. Smith's spouse.
- (11) Includes 1,130 shares held by Mr. Strickland's spouse and 23,524 shares held by SCSC, Inc. in which Mr. Strickland owns a controlling interest.
- (12) Includes 4,817 shares held by Mr. Deaton's 401(k), 1,661 shares held in First Capital's ESOP and 16,833 shares issuable upon the exercise of stock options that may be exercised within 60 days of August 12, 2005.
- (13) Includes 182,318 shares issuable upon the exercise of stock options that may be exercised within 60 days of August 12, 2005.

**COMPARATIVE RIGHTS OF FIRST CAPITAL SHAREHOLDERS AND FLAG SHAREHOLDERS**

The following is a comparison of certain rights of First Capital shareholders and those of Flag shareholders. Certain significant differences in the rights of First Capital shareholders and those of Flag shareholders arise from differing provisions of First Capital's and Flag's respective governing corporate instruments.

The following summary does not purport to be a complete statement of the provisions affecting, and differences between, the rights of First Capital shareholders and those of Flag shareholders. The identification of specific provisions or differences is not meant to indicate that other equally or more significant differences do not exist. This summary is qualified in its entirety by reference to the Georgia Business Corporation Code and to the respective governing corporate instruments of First Capital and Flag, to which First Capital shareholders are referred.

**Authorized Capital Stock**

**First Capital.** First Capital is authorized to issue 10,000,000 shares of common stock, \$1.00 par value per share, of which 5,079,502 shares are outstanding as of the record date, and is authorized to issue 10,000,000 shares of preferred stock, no par value, of which no shares are issued and outstanding as of the date of this joint proxy statement/prospectus. As of the date of this joint proxy statement/prospectus, 773,000 shares of First Capital common stock were reserved for issuance under the First Capital Bancorp, Inc. 1998 Incentive Plan, 1994 Stock Option Plan and 1998 Non-qualified Stock Option Plan. First Capital's articles of incorporation do not provide that shareholders have a preemptive right to acquire authorized and unissued shares of First Capital.

Under First Capital's bylaws, each shareholder is entitled to one vote for each share of stock owned. A majority of First Capital's outstanding shares entitled to vote, represented in person or by proxy, constitutes a quorum. A majority of the shares represented and entitled to vote at a meeting of shareholders is sufficient to take action on a matter, unless otherwise provided by applicable law, the articles of incorporation or bylaws. As allowed under Georgia law, action required or permitted to be taken at a shareholders' meeting may be taken without a meeting if a consent in writing setting forth the action to be taken is signed by those persons who

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would be entitled to vote at a meeting those shares having voting power to cast at least the minimum number of votes necessary to authorize the action at a meeting at which all shares entitled to vote were present and voted.

**Flag.** Flag is authorized to issue 20,000,000 shares of common stock, \$1.00 par value per share, of which 8,546,086 shares are issued and outstanding as of the date of this joint proxy statement/prospectus, and is authorized to issue 10,000,000 shares of preferred stock, no par value, of which no shares are issued as of the date of this joint proxy statement/prospectus. As of the date of this joint proxy statement/prospectus, 1,079,156 shares of Flag were reserved for possible issuance upon the exercise of outstanding stock options under the Flag employee incentive plan, approximately 108,081 shares were reserved for issuance under the director incentive plan and approximately 1,264,000 shares were reserved for issuance under warrants. Flag's articles of incorporation do not provide that shareholders have a preemptive right to acquire authorized and unissued shares of Flag common stock.

Flag common stock is not divided into classes, and Flag has no classes or series of capital stock issued or outstanding other than Flag common stock. Under Flag's bylaws, the holders of a majority of the stock issued and outstanding and entitled to vote, present in person or represented by proxy, shall constitute a quorum for the transaction of business at all meetings of the shareholders except as otherwise provided by statute or by Flag's articles of incorporation or bylaws. If a quorum is present, action on a matter is approved if the votes cast favoring the action exceed the votes cast opposing the action, unless otherwise provided by applicable law, the articles of incorporation or bylaws. As allowed under Georgia law, action required or permitted to be taken at a shareholders' meeting may be taken without a meeting if the action is taken by all of the shareholders entitled to vote by means of one or more written consents signed by all of the shareholders entitled to take action.

**Amendments to Articles of Incorporation and Bylaws**

**First Capital.** Under Georgia law, amendment of a corporation's articles of incorporation generally requires approval by a majority of the votes entitled to be cast on the amendment by each voting group entitled to vote on the amendment. First Capital's articles of incorporation provide that amendments to the provisions regarding the classified board, the removal of directors, the factors the board of directors may consider when evaluating a tender offer or merger, the amendment of First Capital's bylaws, and the limitations on the liability of directors requires the affirmative vote of the holders of two-thirds of the issued and outstanding shares of First Capital voting together as a single class, unless two-thirds of the directors then in office approve the change, in which case, a majority of the votes entitled to be cast on the amendment is sufficient.

First Capital's board of directors has the power to alter, amend or repeal First Capital's bylaws or adopt new bylaws, subject to the power of shareholders to make, amend, alter, change or repeal the bylaws by the affirmative vote of the holders of two-thirds of the issued and outstanding shares of First Capital entitled to vote on the matter.

**Flag.** Under Georgia law, amendment of a corporation's articles of incorporation generally requires approval by a majority of the votes entitled to be cast on the amendment by each voting group entitled to vote on the amendment. Flag's articles of incorporation provide that the provisions regarding the approval required for certain business combinations may only be changed by the affirmative vote of at least two-thirds of the issued and outstanding shares of the corporation entitled to vote thereon at any regular or special meeting of the shareholders, and notice of the proposed change must be contained in the notice of the meeting, unless two-thirds of certain continuing directors approve the proposed amendment. Flag's articles of incorporation also provide that the provisions regarding the election, term and removal of Flag Directors may only be amended or rescinded by the affirmative vote of the holders of at least two-thirds of the issued and outstanding shares of Flag entitled to vote in an election of directors or at any regular or special meeting of the shareholders, and notice of any proposed change must be contained in the notice of the meeting, unless two-thirds of the directors then serving approve the proposed amendment.



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Flag's bylaws generally provide that the bylaws may be made, amended or repealed by the Flag board of directors unless Flag's articles of incorporation or the Georgia Business Corporation Code reserve the power to amend or repeal the bylaws exclusively to the shareholders in whole or in part, or the shareholders, in amending or repealing a particular bylaw, provide expressly that Flag's board of directors may not amend or repeal that bylaw. Neither Flag's articles of incorporation nor bylaws expressly permit the Flag shareholders to make, alter or rescind any bylaws. Any amendment of the provisions in Flag's bylaws relating to the number of directors of Flag requires the affirmative vote of two-thirds of all directors then in office or the affirmative vote of the holders of two-thirds of the issued and outstanding shares of Flag entitled to vote at any regular or special meeting of the shareholders called for that purpose. Unless two-thirds of the directors then serving approve, the provisions in Flag's bylaws relating to the removal of Flag directors by the Flag shareholders may only be amended or rescinded by the affirmative vote of the holders of at least two-thirds of the issued and outstanding shares of Flag entitled to vote in an election of directors or at any regular or special meeting of the shareholders, and notice of any proposed change must be contained in the notice of the meeting.

### **Board of Directors and Absence of Cumulative Voting**

**First Capital.** First Capital's bylaws provide for a board of directors having not less than five nor more than 25 members, the precise number to be fixed by resolution of the shareholders or the board of directors. First Capital's board of directors currently has 12 members. Each director, except in the case of death, resignation or retirement, disqualification or removal, shall serve until his successor shall have been elected and qualified. First Capital's articles of incorporation provide for a classified board of directors, with the directors divided into three classes as nearly equal in number as possible. Directors are elected for three year terms by the affirmative vote of a majority of the shares represented at First Capital's annual meeting of shareholders.

First Capital's articles of incorporation and bylaws do not provide for cumulative voting for the election of directors. When a vacancy occurs among the directors, the remaining members of the board of directors must continue to act and may appoint a director to fill such vacancy at any regular meeting of the board of directors, or at a special meeting called for that purpose.

**Flag.** Flag's bylaws generally provide that the number of directors constituting the Flag board of directors shall consist of not fewer than six and not more than 12 members. The board of directors fixes the precise number of directors. Flag currently has nine directors.

Flag's articles of incorporation and bylaws provide for a classified board of directors, with the directors divided into three classes as nearly equal in number as possible. Directors are elected for three year terms by the affirmative vote of a majority of the shares represented at Flag's annual meeting of shareholders.

Flag's bylaws provide that in the event of a vacancy on the Flag board of directors, including any vacancy created by reason of an increase in the number of directors, such vacancy may be filled by the shareholders of Flag, the Flag board of directors, or, if the directors remaining in office constitute fewer than a quorum of the board of directors, by affirmative vote of a majority of the remaining directors. Flag shareholders do not have cumulative voting rights with respect to the election of directors. All elections for directors are decided by a plurality of the votes cast by the shares entitled to vote in the election at a meeting at which a quorum is present.

### **Removal of Directors**

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**First Capital.** Under First Capital's articles of incorporation, the entire board of directors or any individual may be removed from office (1) without cause by the affirmative vote of the holders of two-thirds of the issued and outstanding shares of each class of capital stock and two-thirds of the total shares entitled to vote at an election of directors, or (2) with cause only by the affirmative vote of a majority of the issued and outstanding shares of each class of capital stock and a majority of the total shares entitled to vote at an election of directors. The board of directors may remove a director from office if the director is adjudicated as incompetent by a court,

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if the director is convicted of a felony, if the director does not, within 60 days after the director's election, accept the office in writing or by attendance at a meeting of the board of directors and fulfill any other requirements for holding the office of director, or if the director fails to attend regular meetings of the board of directors for six consecutive meetings without having been excused by the board of directors.

**Flag.** Under Flag's articles of incorporation and bylaws, the entire board or any individual director may be removed from office, but only for cause (defined as final conviction of a felony, request or demand for removal by any bank regulatory authority having jurisdiction over Flag, or breach of fiduciary duty involving personal profit). Such removal must be effected by the affirmative vote of the holders of a majority of the outstanding shares of Flag.

### **Indemnification of Directors and Officers**

**First Capital.** The Georgia Business Corporation Code provides for the indemnification of directors and officers of Georgia corporations against expenses, judgments, fines and settlements in connection with litigation. Under these provisions, indemnification is available if it is determined that the proposed indemnitee acted in good faith and reasonably believed (1) in the case of conduct in his or her official capacity, that such conduct was in the best interests of the corporation, (2) in all other cases, that such conduct was at least not opposed to the best interests of the corporation, and (3) with respect to any criminal action or proceeding, that the individual had no reasonable cause to believe his or her conduct was unlawful. To the extent that a proposed indemnitee has been successful on the merits or otherwise in defense of any action, suit or proceeding (or any claim, issue or matter therein), he or she must be indemnified against expenses (including attorney fees) actually and reasonably incurred by him or her in connection therewith.

Under the Georgia Business Corporation Code, indemnification permitted in connection with a proceeding by or in the right of the corporation is limited to reasonable expenses incurred in connection with the proceeding. A corporation may not indemnify a director or officer in connection with a proceeding in which he or she was adjudged liable on the basis that a personal benefit was improperly received.

First Capital's bylaws provide that First Capital may indemnify any person who was, is or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative, arbitrative or investigative (other than an action by or in right of the corporation), by reason of the fact that he or she is or was a director, officer, employee or agent of First Capital, or is or was serving at the request of First Capital as a director, officer, employee or agent of another corporation or of a partnership, joint venture, trust or other enterprise, against expenses (including attorney's fees), judgments, fines, and amounts paid in settlement, in accordance with Georgia law. First Capital may not indemnify a person in the case of a claim, issue, or matter as to which a person has been adjudged to be liable on the basis that personal benefit was improperly received by him, or her, whether or not involving action in his or her official capacity. To the extent that a director, officer, employee or agent of First Capital has been successful, on the merits or otherwise, in the defense of any proceeding to which he or she was a party, or in defense of any claim, issue, or matter therein, because he or she is or was a director, officer, employee or agent of the corporation, the corporation must indemnify the director, officer, employee, or agent against reasonable expenses incurred by him or her.

Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, officers and controlling persons of First Capital pursuant to the foregoing provisions, or otherwise, we have been advised that in the opinion of the SEC, such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by us of expenses incurred or paid by a director, officer or controlling person of the First Capital in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, we will, unless in the opinion of our counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act and will be



governed by the final adjudication of such issue.

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Any indemnification must be in accordance with the rules and regulations of the Federal Reserve.

*Flag*. The provisions of the Georgia Business Corporation Code regarding indemnification of officers and directors are also applicable to Flag. Flag's articles of incorporation and bylaws generally provide that any director who is deemed eligible will be indemnified against liability and other expenses incurred in a proceeding which is initiated against such person by reason of his serving as a director, to the fullest extent authorized by the Georgia Business Corporation Code; provided, however, that Flag will not indemnify any director for any liability or expenses incurred by such director:

for any appropriation, in violation of his duties, of any business opportunity of Flag;

for any acts or omissions which involve intentional misconduct or a knowing violation of law;

for the types of liability set forth in Section 14-2-832 of the Georgia Business Corporation Code or successor provisions; or

for any transaction from which the director derives an improper personal benefit.

Flag's articles of incorporation and bylaws provide for the advancement of expenses to its directors at the outset of a proceeding, upon the receipt from such director of the written affirmation and repayment promise required by Section 14-2-856 of the Georgia Business Corporation Code, the purchase of insurance by Flag against any liability of the director arising from his duties and actions as a director, the survival of such indemnification to the director's heirs, executors and administrators, and the limitation of a director's liability to the corporation itself. The indemnification provisions state that they are non-exclusive, and shall not impair any other rights to which those seeking indemnification or advancement of expenses may be entitled. Flag's bylaws also provide for similar indemnification of the officers of Flag. Flag's bylaws provide that shareholders are entitled to notification of any indemnification granted to the directors.

Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, officers and controlling persons of Flag pursuant to the foregoing provisions, or otherwise, we have been advised that in the opinion of the SEC, such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by us of expenses incurred or paid by a director, officer or controlling person of the Flag in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, we will, unless in the opinion of our counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act and will be governed by the final adjudication of such issue.

Any indemnification must be in accordance with the rules and regulations of the Federal Reserve.

**Special Meetings of Shareholders**

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**First Capital.** First Capital's bylaws provide that a special meeting of shareholders, unless otherwise prescribed by law, may be called for any purpose at any time by the president, and must be called by the president or the secretary when so directed by the board of directors, at the request in writing by any two or more directors, or at the request in writing by shareholders owning, in the aggregate, not less than two-thirds of the outstanding shares of First Capital entitled to vote in an election of directors.

**Flag.** Flag's bylaws provide that a special meetings of shareholders may be called at any time by a majority of the entire board of directors of Flag, the chairman of the board, the president, or, upon delivery to Flag's secretary of a signed and dated written request setting out the purpose or purposes for the meeting by the holders of a majority of the votes entitled to be cast on any issue proposed to be considered at the proposed special meeting.

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**Mergers, Share Exchanges and Sales of Assets**

Georgia law generally prohibits a business combination between a Georgia corporation and an interested shareholder (generally the beneficial owner of 10% or more of the corporation's voting stock) within five years after the person or entity becomes an interested shareholder, unless (1) prior to the person or entity becoming an interested shareholder, the business combination or the transaction pursuant to which such person or entity became an interested shareholder shall have been approved by the corporation's board of directors, (2) upon consummation of the transaction in which the interested shareholder became such, the interested shareholder holds at least 90% of the corporation's voting stock (excluding insider shares held by persons who are both officers and directors and shares held by certain employee benefit plans), or (3) after the shareholder becomes an interested shareholder, he or she acquires additional shares resulting in ownership of at least 90% of the outstanding voting common stock and obtains the approval of the holders of a majority of the remaining shares, excluding insider shares as described above.

Georgia law also provides for certain voting rules and fair price requirements concerning business combinations with interested shareholders. This provision is designed to protect shareholders of Georgia corporations against the inequities of certain tactics which have been utilized in hostile takeover attempts. Under the fair price provisions, business combinations with interested shareholders (generally, a person who beneficially owns 10% or more of the corporation's voting shares) must meet one of three criteria designed to protect minority shareholders: (1) the transaction must be unanimously approved by the continuing directors of the corporation (generally, directors who served prior to the time the interested shareholder acquired 10% ownership and who are unaffiliated with the interested shareholder); (2) the transaction must be approved by two-thirds of the continuing directors and a majority of shares held by shareholders other than the interested shareholders; or (3) the terms of the transaction must meet specified fair pricing criteria and certain other tests which are intended to assure that all shareholders receive a fair price and equivalent consideration for their shares regardless at which point in time they sell to the acquiring party.

The business combination and fair price requirements under Georgia law are not applicable to any Georgia corporation unless they are specifically incorporated in the bylaws of the corporation.

**First Capital.** First Capital's articles of incorporation and bylaws specifically incorporate the business combinations with interested shareholders and fair price provisions of Georgia law, and thus these requirements are applicable to First Capital. Additionally, other provisions of First Capital's articles of incorporation and bylaws may have the effect of preventing, discouraging, or delaying any change of control of First Capital. The board of directors of First Capital may, if it deems it advisable, oppose a tender or other offer for First Capital's securities, whether the offer is in cash or in the securities of a corporation or otherwise. When considering whether to oppose an offer, the board of directors may, but is not legally obligated to, consider any pertinent issues; including, but not limited to: (1) whether the offer price is acceptable based on the historical and present operating results or financial condition of the corporation; (2) whether a more favorable price could be obtained for First Capital's securities in the future; (3) the impact which an acquisition of First Capital would have on the employees, depositors and customers of First Capital and its subsidiaries and the communities which they serve; (4) the reputation and business practices of the offeror and its management and affiliates; (5) the value of the securities, if any, that the offeror is offering in exchange for First Capital's securities, based on an analysis of the worth of First Capital as compared to the offeror or any other entity whose securities are being offered; and (6) any antitrust or other legal or regulatory issues that are raised by the offer.

If the board of directors determines that an offer should be rejected, it may take any lawful action to accomplish its purpose including, but not limited to, any or all of the following: (1) advising shareholders not to accept the offer; (2) litigation against the offeror; (3) filing complaints with governmental and regulatory authorities; (4) acquiring First Capital's securities; (5) selling or otherwise issuing authorized but unissued securities of First Capital or treasury stock or granting options or rights with respect thereto; (6) acquiring a company to create an antitrust or other regulatory problem for the offeror; and (7) soliciting a more favorable offer from another individual entity.



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**Flag.** Flag's bylaws specifically incorporates only the fair price provisions of Georgia laws, and thus these voting and fair price requirements are applicable to Flag and to any business combination approved or recommended by the board of directors of Flag. In addition, Flag's articles of incorporation generally require the affirmative vote of the holders of at least two-thirds of all the issued and outstanding shares (other than shares held by an interested stockholder) of Flag common stock entitled to vote to approve a business combination with an interested stockholder (basically, a 10% or more stockholder of Flag), unless:

two-thirds of the directors of Flag approve a memorandum of understanding with the interested stockholder regarding the business combination prior to the date such stockholder became an interested stockholder, or

the business combination is unanimously approved by certain continuing directors of Flag.

### **Shareholder Rights to Examine Books and Records**

Georgia law provides that a shareholder is entitled to inspect and copy certain books and records (such as the corporation's articles of incorporation or bylaws) upon written demand at least five days before the date on which he or she wishes to inspect such books and records. A shareholder is entitled to inspect certain other documents (such as minutes of the meetings of the board of directors, accounting records and the record of shareholders of the corporation) provided that (1) such inspection must occur during regular business hours at a reasonable location determined by the corporation, and (2) any such demand for inspection will only be permitted if (a) the demand for inspection is made in good faith or made for a proper purpose, (b) the shareholder describes with particularity his or her purpose for the inspection and the documents he or she wishes to inspect, (c) the records requested for inspection are directly connected to the stated purpose, and (d) the records are to be used only for the stated purpose.

The bylaws of both Flag and First Capital provide that the board of directors has the power to determine which accounts and books of the corporation, if any, will be open to the inspection of shareholders, except such as may by law be specifically open to inspection, and the board of directors has the power to fix reasonable rules and regulations not in conflict with the applicable law for the inspection of accounts and books which by law or by determination of the board of directors are open to inspection, and shareholders' rights in this respect are restricted and limited accordingly. The provisions of the Georgia Business Corporation Code regarding shareholder inspection rights are also applicable to both Flag and First Capital.

### **Dividends**

**First Capital.** First Capital's bylaws provide that the board of directors may declare dividends upon the outstanding shares of the corporation at any regular or special meeting and the dividends may be paid in cash or property only out of the unreserved and unrestricted retained earnings of the corporation, or out of the unreserved and unrestricted net earnings of the current fiscal year, computed to the date of declaration of the dividend, or the next preceding fiscal year. Under Georgia law, First Capital's board of directors may declare dividends on First Capital common stock unless doing so would cause First Capital to be unable to pay its debts as they come due in the usual course of business, or First Capital's total assets to be less than the sum of its total liabilities plus the amount needed to satisfy any dissolution preferences.

The ability of First Capital to pay distributions to First Capital shareholders depends, however, to a large extent upon the amount of dividends its bank subsidiary, which is subject to restrictions imposed by regulatory authorities, pay to First Capital. In addition, the Federal Reserve could

oppose a distribution by First Capital if it determined that such a distribution would harm First Capital's ability to support its bank subsidiary.

**Flag.** Flag's bylaws provide that the board of directors may declare dividends upon the outstanding shares of the corporation at any regular or special meeting, as long as the Board of Directors complies with the requirements of the Georgia Business Corporation Code and the applicable rules and regulations of any relevant

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regulatory authorities. Such dividends may be paid in cash, property, or shares of Flag's capital stock. Under Georgia law, Flag's board of directors may declare dividends on Flag common stock unless doing so would cause Flag to be unable to pay its debts as they come due in the usual course of business, or Flag's total assets to be less than the sum of its total liabilities plus the amount needed to satisfy any dissolution preferences. Like First Capital, since Flag is a bank holding company, the ability of Flag to pay distributions to Flag shareholders depends to a large extent upon the amount of dividends its bank subsidiaries may provide to it under their regulatory guidelines and the Federal Reserve will permit.

**EXPERTS**

The consolidated financial statements of Flag and its subsidiaries as of December 31, 2004 and 2003, and for each of the years in the three-year period ended December 31, 2004, and management's assessment of the effectiveness of internal control over financial reporting as of December 31, 2004 included in Flag's Annual Report on Form 10-K for the year ended December 31, 2004 have been incorporated in this proxy statement/prospectus by reference, in reliance on the reports of Porter Keadle Moore, LLP, independent registered public accounting firm, given on the authority of said firm as experts in accounting and auditing.

The consolidated financial statements of First Capital as of December 31, 2004 and 2003, and for each of the two years ended December 31, 2004 included in this joint proxy statement/prospectus have been audited by Mauldin & Jenkins, LLC, independent registered public accounting firm, as stated in their report appearing herein and have been so included in reliance upon the report of such firm given upon the authority of said firm as experts in accounting and auditing.

**LEGAL MATTERS**

The legality of the shares of Flag common stock being offered hereby is being passed upon for Flag by Morris, Manning & Martin, LLP, Atlanta, Georgia, as counsel for Flag. Morris, Manning & Martin, LLP will also opine as to certain federal income tax consequences of the merger. See Terms of the Merger Important Federal Income Tax Consequences. Certain additional legal matters relating to the merger are being passed upon for Flag by Morris, Manning & Martin, LLP and for First Capital by Troutman Sanders LLP, Atlanta, Georgia.

**SHAREHOLDER PROPOSALS AND OTHER MATTERS**

Any shareholder proposal intended for inclusion in Flag's proxy statement for next year's annual meeting of shareholders must be received at the principal offices of Flag not later than November 10, 2005. In addition, the proxy solicited by Flag's management for that meeting will confer discretionary authority upon the management to vote on any such shareholder proposal presented at that meeting unless Flag is provided with notice of such proposal by November 10, 2005.

Under Georgia law, only business within the purpose or purposes described in the Notice of Special Meeting may be conducted at either of the special meetings.





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**WHERE YOU CAN FIND MORE INFORMATION**

Flag has filed a registration statement on Form S-4 with the SEC to register the issuance of Flag common stock to First Capital shareholders in the merger. This joint proxy statement/prospectus is a part of that registration statement and constitutes a prospectus of Flag and a proxy statement of each of Flag and First Capital for their respective special meetings. As allowed by SEC rules, this joint proxy statement/prospectus does not contain all the information you can find in the registration statement or the exhibits to the registration statement.

Flag and First Capital file reports, proxy statements, and other information with the SEC. You may inspect or copy these materials at the Public Reference Room at the SEC at Room 1580, 100 F. Street, N.E., Washington, D.C. 20549. For a fee, you may also obtain copies of these materials by writing to the Public Reference Section of the Commission at 100 F. Street, N.E. Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the SEC public reference room. Flag's and First Capital's public filings are also available to the public from commercial document retrieval services and at the Internet web site maintained by the SEC at <http://www.sec.gov>.

The SEC allows Flag to incorporate by reference information into this joint proxy statement/prospectus. This means that Flag can disclose important information to you by referring you to another document filed separately with the SEC. The information incorporated by reference is considered to be a part of this joint proxy statement/prospectus, except for any information that is superseded by information that is included directly in this joint proxy statement/prospectus or in other later-filed documents that are incorporated by reference. The information incorporated by reference contains important information about our companies and their financial condition.

The following documents filed with the SEC by Flag are incorporated by reference into this joint proxy statement/prospectus.

Flag filings with the SEC:

Annual Report on Form 10-K for the year ended December 31, 2004;

Definitive Proxy Statement, filed on April 20, 2005;

Quarterly Reports on Form 10-Q filed on May 10, 2005 and August 8, 2005;

Current Reports on Form 8-K filed on January 27, 2005, April 28, 2005, June 1, 2005, June 6, 2005, July 21, 2005 and July 22, 2005; and

The description of Flag common stock contained in Form 8-A, filed under Section 12 of the Exchange Act, as declared effective by the SEC on March 1, 1994, including any amendment or report filed for the purpose of updating such description.

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All documents and reports filed by Flag with the SEC pursuant to Section 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act between the date of this joint proxy statement/prospectus and the date of the special meeting are incorporated by reference into this joint proxy statement/prospectus. These documents include periodic reports, such as annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, as well as proxy statements.

Flag has supplied all information contained or incorporated by reference in this joint proxy statement/prospectus relating to Flag, as well as all pro forma financial information, and First Capital has supplied all relevant information relating to First Capital.

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Documents incorporated by reference are available from Flag without charge, excluding any exhibits to those documents, unless the exhibit is specifically incorporated by reference as an exhibit in this joint proxy statement/prospectus. You can obtain documents incorporated by reference in this joint proxy statement/prospectus by requesting them in writing or by telephone from Flag at the following address:

Flag Financial Corporation

3475 Piedmont Road, N.E., Suite 550

Atlanta, Georgia 30305

(404) 760-7700

Attention: Lisa G. Lane

In order to receive timely delivery of the documents in advance of the special meeting of shareholders, you must request such information no later than September 15, 2005. If you request any incorporated documents from Flag or First Capital, the appropriate company will mail them to you by first class mail, or another equally prompt means, within one business day after your request is received.

When deciding how to cast your vote, you should rely only on the information contained or incorporated by reference in this joint proxy statement/prospectus. We have not authorized anyone to give any information or make any representation about the merger or the companies that is different from, or in addition to, that contained in this joint proxy statement/prospectus or in any of the materials that have been incorporated into this joint proxy statement/prospectus. Therefore, if anyone distributes this type of information, you should not rely upon it.

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**FIRST CAPITAL BANCORP, INC. AND SUBSIDIARIES**

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**Table of Contents****Index to Financial Statements****FIRST CAPITAL BANCORP, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****(UNAUDITED)**

	<b>June 30, 2005 (Unaudited)</b>	<b>December 31, 2004</b>
(\$ in thousands)		
<b>ASSETS</b>		
Cash and due from banks	\$ 20,826	\$ 13,753
Interest-bearing deposits in banks	1,278	1,473
Federal funds sold and overnight investments	3,422	375
	<hr/>	<hr/>
Cash and cash equivalents	25,526	15,601
Investment securities:		
Securities available for sale, at fair value	123,709	130,640
Securities held to maturity, at cost (fair values of \$6,004 and \$6,975, respectively)	5,958	6,821
Restricted equity securities, at cost	6,916	6,818
Loans, net	489,775	478,570
Premises and equipment, net	1,144	1,056
Goodwill	7,411	6,681
Core deposit intangible	953	1,101
Other assets	13,422	10,947
	<hr/>	<hr/>
Total assets	\$ 674,814	\$ 658,235
<b>LIABILITIES</b>		
Deposits:		
Non interest-bearing demand	\$ 102,927	\$ 77,341
Interest-bearing demand and money market	138,730	132,515
Savings	51	79
Time deposits of \$100,000 or more	128,630	134,762
Other time deposits	99,909	113,974
	<hr/>	<hr/>
Total deposits	470,247	458,671
Federal funds purchased and securities sold under repurchase agreements	16,273	11,210
Other borrowings	117,371	120,488
Other liabilities	4,955	4,660
Subordinated debentures	6,392	6,392
	<hr/>	<hr/>
Total liabilities	615,238	601,421
<b>STOCKHOLDERS EQUITY</b>		
Preferred stock; no par value; 10,000,000 shares authorized; no shares issued and outstanding	5,228	5,170

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Common stock; \$1 par value; 10,000,000 shares authorized; 5,228,311 and 5,170,000 shares issued, respectively		
Surplus	36,567	35,902
Treasury stock, 148,809 and 142,888 shares, respectively	(1,243)	(1,122)
Unearned ESOP shares	(240)	(400)
Retained earnings	19,876	17,285
Accumulated other comprehensive loss	(612)	(21)
	<hr/>	<hr/>
Total stockholders' equity	59,576	56,814
	<hr/>	<hr/>
Total liabilities and stockholders' equity	\$ 674,814	\$ 658,235
	<hr/>	<hr/>

See notes to the consolidated financial statements.

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## FIRST CAPITAL BANCORP, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF INCOME

(UNAUDITED)

	FOR THE THREE-MONTH PERIOD ENDED		FOR THE SIX-MONTH PERIOD ENDED	
	JUNE 30,		JUNE 30,	
	(\$ in thousands except per share data)		(\$ in thousands except per share data)	
	2005	2004	2005	2004
<b>Interest Income:</b>				
Loans and leases, including fees	\$ 8,137	\$ 5,353	\$ 16,085	\$ 9,631
<b>Investment securities:</b>				
U.S. Treasury and government agencies	426	256	793	436
Mortgage-backed securities	892	863	1,812	1,619
Other investments	182	290	372	588
Interest-bearing deposits in banks	7	6	14	8
Federal funds sold and overnight investments	24	11	33	26
<b>Total interest income</b>	<b>9,668</b>	<b>6,779</b>	<b>19,109</b>	<b>12,308</b>
<b>Interest expense:</b>				
Interest-bearing demand, money market and savings	372	189	675	337
Time deposits of \$100,000 or more	908	828	1,731	1,648
Other time deposits	779	607	1,535	1,087
Federal funds purchased, securities sold under repurchase agreements and other borrowings	1,238	1,295	2,468	2,195
<b>Total interest expense</b>	<b>3,297</b>	<b>2,919</b>	<b>6,409</b>	<b>5,267</b>
<b>Net interest income</b>	<b>6,371</b>	<b>3,860</b>	<b>12,700</b>	<b>7,041</b>
Provision for loan losses	150	800	300	850
<b>Net interest income after provision for loan losses</b>	<b>6,221</b>	<b>3,060</b>	<b>12,400</b>	<b>6,191</b>
<b>Non interest income:</b>				
Service charges on deposit accounts	17	21	39	36
Loan servicing fee income	138	75	294	91
Mortgage origination fees	70	42	107	42
Gain on sale of loans, net	69	13	130	32
Net gain on sale of securities available for sale	21		26	
Other income	38	58	150	99



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Total non interest income	353	209	746	300
<b>Non interest expense:</b>				
Salaries and other compensation expense	2,675	1,723	5,442	3,006
Net occupancy and equipment expense	458	215	891	378
Other expense	1,446	814	2,696	1,500
Total non interest expense	4,579	2,752	9,029	4,884
Income before income taxes	1,995	517	4,117	1,607
Income tax expense	714	173	1,526	560
Net income	\$ 1,281	\$ 344	\$ 2,591	\$ 1,047
Basic earnings per share	\$ .25	\$ .11	\$ .52	\$ .39
Fully diluted earnings per share	\$ .25	\$ .10	\$ .50	\$ .38
Cash dividends per common share	\$	\$	\$	\$

See notes to the consolidated financial statements.

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## FIRST CAPITAL BANCORP, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(UNAUDITED)

	FOR THE		FOR THE	
	THREE-MONTH		SIX-MONTH	
	PERIOD ENDED		PERIOD ENDED	
	JUNE 30,		JUNE 30,	
	2005	2004	2005	2004
Net income	\$ 1,281	\$ 344	\$ 2,591	\$ 1,047
Other comprehensive income (loss):				
Unrealized holding gains (losses) arising during period, net of tax	472	(1,232)	(571)	(1,308)
Reclassification adjustment for gains realized in net income, net of tax	(14)		(17)	
Unrealized gains on cash flow hedges, net of tax	(19)	(3)	(3)	(3)
Other comprehensive income (loss)	439	(1,235)	(591)	(1,311)
Comprehensive income (loss)	\$ 1,720	\$ (891)	\$ 2,000	\$ (264)

See notes to the consolidated financial statements.

Table of ContentsIndex to Financial Statements**FIRST CAPITAL BANCORP, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS****(UNAUDITED)**

	<b>FOR THE</b>	
	<b>SIX-MONTH</b>	
	<b>PERIOD ENDED</b>	
	<b>JUNE 30,</b>	
	<b>2005</b>	<b>2004</b>
	<u>          </u>	<u>          </u>
<b>OPERATING ACTIVITIES:</b>		
Net income	\$ 2,591	\$ 1,047
Adjustments to reconcile net income to net cash provided by operating activities:		
Net (accretion) amortization of securities	(129)	9
Depreciation and amortization	482	132
Net gain on sale of other real estate owned		(9)
Net gain on sale of securities available for sale	(26)	
Net gain on sale of premises and equipment	(8)	
Provision for loan losses	300	850
Net (increase) decrease in other assets	(2,079)	773
Net increase (decrease) in other liabilities	680	(2,340)
	<u>          </u>	<u>          </u>
Net cash provided by operating activities	1,811	462
	<u>          </u>	<u>          </u>
<b>INVESTING ACTIVITIES:</b>		
Proceeds from calls and maturities of securities available for sale	5,250	2,020
Principal repayments from mortgage-backed securities	13,756	15,326
Purchases of securities available for sale	(16,515)	(16,856)
Redemption (purchases) of restricted equity securities	(128)	9
Proceeds from sale of securities available for sale	4,568	
Net increase in loans	(12,143)	(52,826)
Net cash acquired in business combination		6,527
Proceeds from the sale of other real estate owned		1,086
Purchases of premises and equipment	(422)	(327)
Proceeds from sale of premises and equipment	8	
	<u>          </u>	<u>          </u>
Net cash used in investing activities	(5,626)	(45,041)
	<u>          </u>	<u>          </u>
<b>FINANCING ACTIVITIES:</b>		
Net increase in deposits	11,577	48,573
Net increase (decrease) in federal funds purchased and securities sold under repurchase agreements	5,063	(8,312)
Net increase (decrease) in Federal Home Loan Bank advances	(3,117)	5,288
Net decrease in other borrowings		(4,000)

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Proceeds from rights offering		14,887
Sale (purchase) of treasury stock	(121)	34
Proceeds from exercise of stock options	338	278
	<u>          </u>	<u>          </u>
Net cash provided by financing activities	13,740	56,748
	<u>          </u>	<u>          </u>
Net increase in cash and cash equivalents	9,925	12,169
Cash and cash equivalents, beginning of period	15,601	12,098
	<u>          </u>	<u>          </u>
Cash and cash equivalents, end of period	\$ 25,526	\$ 24,267
	<u>          </u>	<u>          </u>

See notes to the consolidated financial statements.

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**FIRST CAPITAL BANCORP, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

**NOTE 1 BASIS OF PRESENTATION**

The accompanying unaudited consolidated financial statements for First Capital Bancorp, Inc. and subsidiaries (the Company or First Capital ) have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions for Form 10-QSB. Accordingly, they do not include all the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the three and six month periods ended June 30, 2005 are not necessarily indicative of the results that may be expected for the year ending December 31, 2005. These financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-KSB for the year ended December 31, 2004.

At June 30, 2005, the Company had one wholly-owned bank subsidiary, First Capital Bank, and two wholly-owned non-bank subsidiaries, Capital Financial Software, LLC, a limited liability company which markets and provides support of its software used by bankruptcy trustees and First Capital Statutory Trust I, a grantor trust formed to issue cumulative trust preferred securities.

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, with all significant intercompany accounts and transactions eliminated in consolidation.

**NOTE 2 MERGER WITH FIRST CAPITAL BANCORP, INC.**

On May 28, 2004, CNB Holdings, Inc. acquired the former First Capital Bancorp, Inc. ( old FCBI ) through the merger (the Merger ) of old FCBI with and into CNB Holdings, Inc. ( CNB ).

As a result of the merger, First Capital Bank and Capital Financial Software, LLC, which were wholly owned subsidiaries of old FCBI, became wholly owned subsidiaries of CNB. Additionally, as a result of the Merger, CNB assumed old FCBI's obligations under the First Capital Statutory Trust I, which was created in connection with old FCBI's issuance of trust preferred securities. Chattahoochee National Bank also continued to be a wholly owned subsidiary of CNB after the Merger. On November 15, 2004, CNB merged (the Bank Merger ) its two wholly owned banking subsidiaries, First Capital Bank and Chattahoochee National Bank, with First Capital Bank surviving the Bank Merger. On December 31, 2004, CNB changed its name to First Capital Bancorp, Inc.

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For accounting purposes, the acquisition has been treated as a recapitalization of old FCBI with old FCBI as the acquirer (reverse acquisition). The historical financial statements prior to May 28, 2004 are those of old FCBI. The discussion of financial condition and results of operations for the quarter ended June 30, 2004 include one month of operations for CNB Holdings and three months of operations of old FCBI. Similarly, the discussion of financial condition and results of operations for the six months ended June 30, 2004 include one month of operations for CNB Holdings and six months of operations of old FCBI. The discussion of financial condition and results of operations for the three months and six months ended June 30, 2005 are those of the combined Company.

The aggregate purchase price was \$16,035,052. The purchase price was determined based on the average market price of CNB Holdings, Inc.'s common stock over the two-day period before and after the terms of the acquisition were agreed to and announced.

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Table of ContentsIndex to Financial Statements**FIRST CAPITAL BANCORP, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(UNAUDITED)**

The \$1,273,676 core deposit intangible asset has a weighted-average life of approximately 4.3 years. The core deposit intangible asset is being amortized over the weighted average life using the straight-line method, which is not materially different than the interest method. Of the \$7,356,090 of goodwill that was assigned to CNB, none is expected to be deductible for income tax purposes.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition. The Company obtained third-party valuations of the core deposit intangible and other fair value adjustments.

Cash, due from banks, Federal funds sold and overnight investments	\$ 6,526,621
Securities available-for-sale	36,872,956
Restricted equity securities	1,506,000
Derivative	31,986
Loans	102,995,192
Premises and equipment	124,085
Core deposit intangible	1,273,676
Goodwill	7,356,090
Other assets	8,068,128
	<hr/>
Total assets acquired	\$ 164,754,734
	<hr/>
Deposits	116,397,828
Other borrowings	26,986,639
Other liabilities	5,335,215
	<hr/>
Total liabilities assumed	\$ 148,719,682
	<hr/>
Net assets acquired	\$ 16,035,052
	<hr/>

**NOTE 3 MERGER WITH FLAG FINANCIAL CORPORATION**

On May 26, 2005, First Capital Bancorp, Inc. and Flag Financial Corporation (Nasdaq: FLAG) entered into a definitive agreement for Flag Financial Corporation to acquire First Capital Bancorp, Inc. Subject to regulatory and shareholder approval, the transaction is expected to close in the fourth quarter of 2005.





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## FIRST CAPITAL BANCORP, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

## NOTE 4 EARNINGS PER COMMON SHARE

Earnings per share is computed by dividing net income available to common stockholders by the weighted average number of shares outstanding during the period.

Presented below is a summary of the components used to calculate basic and diluted earnings per common share.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2004	2005	2004
<b>Basic Earnings Per Share:</b>				
Weighted average common shares outstanding	5,043,097	3,204,247	5,026,021	2,698,149
Net income	\$ 1,281,045	\$ 343,573	\$ 2,590,572	\$ 1,046,898
Basic earnings per share	\$ 0.25	\$ 0.11	\$ 0.52	\$ 0.39
<b>Diluted Earnings Per Share:</b>				
Weighted average common shares outstanding	5,043,097	3,204,247	5,026,021	2,698,149
Net effect of the assumed exercise of stock options based on the treasury stock method using average market prices for the year	161,978	59,179	171,501	49,866
Shares held by rabbi trust	19,951	9,533	19,951	9,533
Total weighted average common shares and common stock equivalents outstanding	5,225,026	3,272,959	5,217,473	2,757,548
Net income as reported	\$ 1,281,045	\$ 343,573	\$ 2,590,572	\$ 1,046,898
Diluted earnings per share	\$ 0.25	\$ 0.10	\$ 0.50	\$ 0.38



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## FIRST CAPITAL BANCORP, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

## NOTE 5 STOCK COMPENSATION PLANS

The Company has two stock-based employee compensation plans for granting options to directors and employees. The Company accounts for those plans under the recognition and measurement principles of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations. No stock-based employee compensation cost is reflected in net income, as all options granted under those plans had an exercise price equal to the market value of the underlying stock on the date of grant. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS Statement No. 123, *Accounting for Stock-Based Compensation*, to stock-based employee compensation.

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2005	2004	2005	2004
Net income, as reported	\$ 1,281,045	\$ 343,573	\$ 2,590,572	\$ 1,046,898
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards	23,830	9,971	38,941	25,082
Pro forma net income	\$ 1,257,215	\$ 333,602	\$ 2,551,631	\$ 1,021,816
Earnings per share:				
Basic as reported	\$ 0.25	\$ 0.11	\$ 0.52	\$ 0.39
Basic pro forma	0.25	0.10	0.51	0.38
Fully diluted as reported	0.25	0.10	0.50	0.38
Fully diluted pro forma	0.24	0.10	0.49	0.37

## NOTE 6 RECENT ACCOUNTING STANDARDS

## Stock-Based Compensation

In December 2004, the Financial Accounting Standards Board ( FASB ) published FASB Statement No. 123 (revised 2004), *Share-Based Payment* ( FAS 123(R) or the Statement ). FAS 123(R) requires that the compensation cost relating to share-based payment transactions,

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including grants of employee stock options, be recognized in financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. FAS 123(R) covers a wide range of share-based compensation arrangements including stock options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. FAS 123(R) is a replacement of FASB Statement No. 123, *Accounting for Stock-Based Compensation*, and supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and its related interpretive guidance.

The effect of the Statement will be to require the Company to measure the cost of employee services received in exchange for stock options based on the grant-date fair value of the award, and to recognize the cost over the period the employee is required to provide services for the award. FAS 123(R) permits entities to use any option-pricing model that meets the fair value objective in the Statement. The Company will be required to apply FAS 123(R) as of the beginning of its first interim period that begins after December 15, 2005.

The Company has not yet completed its study of the transition methods or made any decisions about how it will adopt FAS 123(R). The impact of this Statement on the Company in fiscal 2005 and beyond will depend upon various factors, among them being First Capital's future compensation strategy. The pro forma compensation costs presented in the table above and in prior filings for the Company have been calculated using

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**FIRST CAPITAL BANCORP, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(UNAUDITED)**

a Black-Scholes option pricing model and may not be indicative of amounts which should be expected in future years. No decisions have been made as to which option-pricing model is most appropriate for the Company for future awards.

**NOTE 7 RECLASSIFICATION OF CERTAIN INCOME AND EXPENSES**

Certain income and expenses on the statements of income for periods prior to June 30, 2005 have been reclassified, with no effect on net income or earnings per common share, to be consistent with the classifications adopted for the periods ended December 31, 2004.

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**REPORT OF INDEPENDENT REGISTERED**

**PUBLIC ACCOUNTING FIRM**

**To the Board of Directors**

**First Capital Bancorp, Inc. and Subsidiaries**

**Norcross, Georgia**

We have audited the accompanying consolidated balance sheets of **First Capital Bancorp, Inc. (formerly CNB Holdings, Inc.) and Subsidiaries** as of December 31, 2004 and 2003, and the related consolidated statements of income, comprehensive income, stockholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of First Capital Bancorp, Inc. and Subsidiaries as of December 31, 2004 and 2003, and the results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

/s/ Mauldin & Jenkins, LLC

Atlanta, Georgia

March 16, 2005

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**Table of Contents****Index to Financial Statements****FIRST CAPITAL BANCORP, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****DECEMBER 31, 2004 AND 2003**

	<u>2004</u>	<u>2003</u>
<b>ASSETS</b>		
Cash and due from banks	\$ 13,753,147	\$ 10,254,667
Interest-bearing deposits in banks	1,473,000	
Federal funds sold and overnight investments	375,415	1,843,663
	<u>15,601,562</u>	<u>12,098,330</u>
Cash and cash equivalents	15,601,562	12,098,330
Investment securities:		
Securities available for sale, at fair value	130,640,056	102,701,593
Securities held to maturity, at cost (fair values of \$6,974,861 and \$10,301,655, respectively)	6,821,208	10,082,040
Restricted equity securities, at cost	6,817,600	6,193,900
Loans, net	478,570,341	302,733,270
Premises and equipment, net	1,056,360	337,316
Goodwill	6,680,887	
Core deposit intangible	1,101,291	
Other assets	10,945,586	5,214,467
	<u>658,234,891</u>	<u>439,360,916</u>
Total assets	\$ 658,234,891	\$ 439,360,916
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Liabilities:		
Deposits:		
Non interest-bearing demand	\$ 77,341,063	\$ 28,729,963
Interest-bearing demand and money market	132,514,627	76,284,719
Savings	78,655	
Time deposits of \$100,000 or more	134,762,440	107,914,494
Other time deposits	113,973,818	79,607,181
	<u>458,670,603</u>	<u>292,536,357</u>
Total deposits	458,670,603	292,536,357
Federal funds purchased and securities sold under repurchase agreements	11,209,688	12,165,000
Other borrowings	120,488,314	105,829,900
Other liabilities	4,660,255	1,839,533
Subordinated debentures	6,392,000	6,392,000
	<u>601,420,860</u>	<u>418,762,790</u>
Total liabilities	601,420,860	418,762,790
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, no par value, 10,000,000 shares authorized; no shares issued and outstanding		
Common stock; \$1 par value; 10,000,000 shares authorized; 5,170,000 and 217 shares issued, respectively	5,170,000	217

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Surplus	<b>35,901,761</b>	6,579,220
Treasury stock, 142,888 and -0- shares, respectively	<b>(1,122,018)</b>	
Unearned ESOP shares	<b>(399,998)</b>	
Retained earnings	<b>17,285,267</b>	14,073,464
Accumulated other comprehensive loss	<b>(20,981)</b>	(54,775)
	<hr/>	<hr/>
Total stockholders' equity	<b>56,814,031</b>	20,598,126
	<hr/>	<hr/>
Total liabilities and stockholders' equity	<b>\$ 658,234,891</b>	\$ 439,360,916
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See Notes to Consolidated Financial Statements.

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## FIRST CAPITAL BANCORP, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF INCOME

## YEARS ENDED DECEMBER 31, 2004 AND 2003

	<u>2004</u>	<u>2003</u>
Interest income:		
Loans and leases, including fees	\$ 23,556,292	\$ 15,271,139
Investment securities:		
U.S. Treasury and government agencies	1,203,821	806,152
Mortgage-backed securities	3,706,231	2,131,500
Other investments	1,086,309	1,318,436
Interest-bearing deposits in banks	21,772	
Federal funds sold and overnight investments	49,609	28,035
Total interest income	<u>29,624,034</u>	<u>19,555,262</u>
Interest expense:		
Interest-bearing demand, money market and savings	834,277	520,027
Time deposits of \$100,000 or more	3,303,640	3,540,055
Other time deposits	2,707,412	2,393,624
Federal funds purchased, securities sold under repurchase agreements and other borrowings	4,345,880	3,943,285
Total interest expense	<u>11,191,209</u>	<u>10,396,991</u>
Net interest income	18,432,825	9,158,271
Provision for loan losses	1,325,000	100,000
Net interest income after provision for loan losses	<u>17,107,825</u>	<u>9,058,271</u>
Non interest income:		
Service charges on deposit accounts	91,540	76,384
Loan servicing fee income	248,008	5,176
Mortgage origination fees	157,089	
Gain on sale of loans, net	363,130	
Net loss on sale of securities available for sale	(32,040)	(28,237)
Other income	265,808	274,766
Total non interest income	<u>1,093,535</u>	<u>328,089</u>
Non interest expense:		
Salaries and other compensation expense	8,119,552	4,391,729
Net occupancy and equipment expense	1,141,523	574,750
Other expense	3,973,724	1,971,253
Total non interest expense	<u>13,234,799</u>	<u>6,937,732</u>

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Income before income taxes	<b>4,966,561</b>	2,448,628
Income tax expense	<b>1,754,758</b>	888,515
Net income	<b>\$ 3,211,803</b>	\$ 1,560,113
Basic earnings per share	<b>\$ 0.83</b>	\$ 0.72
Diluted earnings per share	<b>\$ 0.80</b>	\$ 0.65

See Notes to Consolidated Financial Statements.

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Table of ContentsIndex to Financial Statements**FIRST CAPITAL BANCORP, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****YEARS ENDED DECEMBER 31, 2004 AND 2003**

	<u>2004</u>	<u>2003</u>
Net income	<u>\$ 3,211,803</u>	<u>\$ 1,560,113</u>
Other comprehensive income (loss):		
Unrealized holding gains (losses) arising during period, net of tax (benefit) of \$19,946 and \$(201,523), respectively	40,507	(358,265)
Reclassification adjustment for losses realized in net income, net of tax benefits of \$11,534 and \$10,165, respectively	20,506	18,072
Unrealized losses on cash flow hedges, net of tax benefits of \$15,310	<u>(27,219)</u>	
Other comprehensive income (loss)	<u>33,794</u>	<u>(340,193)</u>
Comprehensive income	<u>\$ 3,245,597</u>	<u>\$ 1,219,920</u>

See Notes to Consolidated Financial Statements.

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**FIRST CAPITAL BANCORP, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**

**YEARS ENDED DECEMBER 31, 2004 AND 2003**

<u>Common Stock</u>	<u>Surplus</u>	<u>Treasury Stock</u>	<u>Unearned ESOP Shares</u>	<u>Retained Earnings</u>	<u>Accumulated Other</u>
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