BANC CORP
Form 10-Q
August 09, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC

# FORM 10-Q

(Mark One)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2004

OR

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

FOR THE TRANSITION PERIOD FROM __________________ TO __________________

Commission File number 0-25033

The Banc Corporation
(Exact Name of Registrant as Specified in its Charter)

| Delaware | 63-1201350 |
| --- | --- |
| (State or Other Jurisdiction of Incorporation) | (IRS Employer Identification No.) |

17 North 20th Street, Birmingham, Alabama 35203
(Address of Principal Executive Offices)

(205) 327-3600
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [X] No [ ]

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes [X] No [ ]

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| Class | Outstanding as of June 30, 2004 |
| --- | --- |
| Common stock, $.001 par value | 17,729,062 |

PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

THE BANC CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(DOLLARS IN THOUSANDS)

| | JUNE 30, 2004 (UNAUDITED) | DE |
|---|---|---|
| ASSETS | | |
| Cash and due from banks | $ 26,048 | $ |
| Interest bearing deposits in other banks | 16,795 | |
| Federal funds sold | 18,000 | |
| Investment securities available for sale | 200,357 | |
| Mortgage loans held for sale | 3,610 | |
| Loans, net of unearned income | 889,371 | |
| Less: Allowance for loan losses | (20,180) | |
| Net loans | 869,191 | |
| Premises and equipment, net | 58,375 | |
| Accrued interest receivable | 5,454 | |
| Stock in FHLB and Federal Reserve Bank | 10,243 | |
| Other assets | 79,963 | |
| TOTAL ASSETS | $ 1,288,036 | $ |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Deposits | | |
| Noninterest-bearing | $ 89,854 | $ |
| Interest-bearing | 874,024 | |
| TOTAL DEPOSITS | 963,878 | |
| Advances from FHLB | 156,090 | |
| Other borrowed funds | 15,155 | |
| Long-term debt | 1,820 | |
| Subordinated debentures | 31,959 | |
| Accrued expenses and other liabilities | 19,000 | |
| TOTAL LIABILITIES | 1,187,902 | |
| Stockholders' Equity | | |
| Preferred stock, par value $.001 per share; authorized 5,000,000 shares; shares issued 62,000 at June 30, 2004 and December 31, 2003 | - | |
| Common stock, par value $.001 per share; authorized 25,000,000 shares; shares issued 18,025,932 and 18,018,202, respectively; outstanding 17,729,062 and 17,694,595, respectively | 18 | |
| Surplus - preferred | 6,193 | |
| - common | 68,437 | |
| Retained Earnings | 30,925 | |
| Accumulated other comprehensive loss | (2,594) | |
| Treasury stock, at cost | (430) | |

| | | |
|---|---|---|
| Unearned ESOP stock | (1,866) | |
| Unearned restricted stock | (549) | |
| TOTAL STOCKHOLDERS' EQUITY | 100,134 | |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | $ 1,288,036 | $ |

See Notes to Condensed Consolidated Financial Statements.

THE BANC CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)
(AMOUNTS IN THOUSANDS, EXCEPT PER SHARE DATA)

| | THREE MONTHS ENDED JUNE 30, | | SIX MON JUN |
|---|---|---|---|
| | 2004 | 2003 | 2004 |
| INTEREST INCOME | | | |
| Interest and fees on loans | $ 13,691 | $ 19,682 | $ 27,258 |
| Interest on investment securities | | | |
| Taxable | 2,109 | 822 | 3,822 |
| Exempt from Federal income tax | 26 | 67 | 41 |
| Interest on federal funds sold | 41 | 96 | 75 |
| Interest and dividends on other investments | 231 | 186 | 396 |
| Total interest income | 16,098 | 20,853 | 31,592 |
| INTEREST EXPENSE | | | |
| Interest on deposits | 4,505 | 6,152 | 8,782 |
| Interest on other borrowed funds | 1,456 | 2,220 | 3,122 |
| Interest on subordinated debentures | 626 | 632 | 1,252 |
| Total interest expense | 6,587 | 9,004 | 13,156 |
| NET INTEREST INCOME | 9,511 | 11,849 | 18,436 |
| Provision for loan losses | - | 725 | - |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES | 9,511 | 11,124 | 18,436 |
| NONINTEREST INCOME | | | |
| Service charges and fees on deposits | 1,397 | 1,656 | 2,788 |
| Mortgage banking income | 383 | 1,185 | 787 |
| Gain on sale of securities | 37 | 637 | 428 |
| Gain on sale of branch | - | - | 739 |
| Other income | 982 | 1,283 | 1,825 |
| TOTAL NONINTEREST INCOME | 2,799 | 4,761 | 6,567 |

| | | | |
|---|---|---|---|
| NONINTEREST EXPENSES | | | |
| Salaries and employee benefits | 5,871 | 6,371 | 11,457 |
| Occupancy, furniture and equipment expense | 2,094 | 2,277 | 4,052 |
| Other | 3,202 | 3,793 | 6,804 |
| TOTAL NONINTEREST EXPENSES | 11,167 | 12,441 | 22,313 |
| Income before income taxes | 1,143 | 3,444 | 2,690 |
| INCOME TAX EXPENSE | 79 | 940 | 398 |
| NET INCOME | $ 1,064 | $ 2,504 | $ 2,292 |
| BASIC NET INCOME PER COMMON SHARE | $ 0.05 | $ 0.14 | $ 0.12 |
| DILUTED NET INCOME PER COMMON SHARE | $ 0.05 | $ 0.14 | $ 0.11 |
| WEIGHTED AVERAGE COMMON SHARES OUTSTANDING | 17,578 | 17,472 | 17,569 |
| WEIGHTED AVERAGE COMMON SHARES OUTSTANDING, ASSUMING DILUTION | 18,487 | 17,884 | 18,532 |

See Notes to Condensed Consolidated Financial Statements.

THE BANC CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOW (UNAUDITED)
(DOLLARS IN THOUSANDS)

| | SIX MONTHS ENDE JUNE 30, | |
|---|---|---|
| | 2004 | 200 |
| NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES | $ 5,028 | $ (21 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Net increase in interest bearing deposits in other banks | (4,926) | |
| Net increase in federal funds sold | (18,000) | (14 |
| Proceeds from sales of securities available for sale | 71,720 | 22 |
| Proceeds from maturities of investment securities available for sale | 36,105 | 28 |
| Purchases of investment securities available for sale | (161,819) | (73 |
| Net (increase) decrease in loans | (39,344) | 9 |
| Purchases of premises and equipment | (2,222) | (1 |
| Net cash paid in branch sale | (6,626) | (31 |
| Other investing activities | (6,744) | |
| Net cash used by investing activities | (131,856) | (61 |

| | | |
|---|---|---|
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Net increase in deposit accounts | 82,144 | 71 |
| Net increase (decrease) in FHLB advances and other borrowed funds | 39,326 | |
| Proceeds received on long term debt | - | 2 |
| Payments made on long term debt | (105) | |
| Proceeds from sale of common stock | 49 | |
| Proceeds from sale of preferred stock | - | 6 |
| Cash dividends paid | (217) | |
| Net cash provided by financing activities | 121,197 | 79 |
| Net decrease in cash and due from banks | (5,631) | (3 |
| Cash and due from banks at beginning of period | 31,679 | 45 |
| CASH AND DUE FROM BANKS AT END OF PERIOD | $ 26,048 | $ 41 |

See Notes to Condensed Consolidated Financial Statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions for Form 10-Q, and, therefore, do not include all information and footnotes necessary for a fair presentation of financial position, results of operations and cash flows in conformity with generally accepted accounting principles. For a summary of significant accounting policies that have been consistently followed, see Note 1 to the Consolidated Financial Statements included in Form 10-K for the year ended December 31, 2003 as filed with the Securities and Exchange Commission ("SEC"). It is management's opinion that all adjustments, consisting of only normal and recurring items necessary for a fair presentation, have been included. Operating results for the three and six-month periods ended June 30, 2004, are not necessarily indicative of the results that may be expected for the year ending December 31, 2004.

The statement of financial condition at December 31, 2003, has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

Note 2 - Recent Accounting Pronouncements

In November 2002, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" (FIN 45). FIN 45 requires certain guarantees to be recorded at fair value. In general, FIN 45 applies to contracts or indemnification agreements that contingently require the guarantor to make payments to the guaranteed party based on changes in an underlying that is related to an asset, liability, or an equity security of the guaranteed party. The initial recognition and measurement provisions of FIN 45 are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. On January 1, 2003, the Corporation began recording a liability and an offsetting asset for the fair value of any standby letters of

credit issued by the Corporation beginning January 1, 2003. The impact of this new accounting standard was not material to the financial condition or results of operations of the Corporation. FIN 45 also requires new disclosures, even when the likelihood of making any payments under the guarantee is remote. These disclosure requirements were effective for financial statements of interim or annual periods ending after December 15, 2002.

The Corporation, as part of its ongoing business operations, issues financial guarantees in the form of financial and performance standby letters of credit. Standby letters of credit are contingent commitments issued by the Corporation generally to guarantee the performance of a customer to a third party. A financial standby letter of credit is a commitment by the Corporation to guarantee a customer's repayment of an outstanding loan or debt instrument. In a performance standby letter of credit, the Corporation guarantees a customer's performance under a contractual nonfinancial obligation for which it receives a fee. The Corporation has recourse against the customer for any amount it is required to pay to a third party under a standby letter of credit. Revenues are recognized ratably over the life of the standby letter of credit. At June 30, 2004, the Corporation had standby letters of credit outstanding with maturities ranging from less than one year to four years. The maximum potential

amount of future payments the Corporation could be required to make under its standby letters of credit at June 30, 2004 was $17.1 million which represents the Corporation's maximum credit risk. At June 30, 2004, the Corporation had no significant liabilities and receivables associated with standby letters of credit agreements entered into subsequent to December 31, 2002 as a result of the Corporation's adoption of FIN 45 at January 1, 2003. Standby letters of credit agreements entered into prior to January 1, 2003, have a carrying value of zero. The Corporation holds collateral to support standby letters of credit when deemed necessary.

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51" ("FIN 46"). FIN 46 addresses whether business enterprises must consolidate the financial statements of entities known as "variable interest entities". A variable interest entity is defined by FIN 46 to be a business entity which has one or both of the following characteristics: (1) the equity investment at risk is not sufficient to permit the entity to finance its activities without additional support from other parties, which is provided through other interests that will absorb some or all of the expected losses at the entity; and (2) the equity investors lack one or more of the following essential characteristics of a controlling financial interest: (a) direct or indirect ability to make decisions about the entity's activities through voting rights or similar rights, (b) the obligation to absorb the expected losses of the entity if they occur, which makes it possible for the entity to finance its activities, or (c) the right to receive the expected residual returns of the entity if they occur, which is the compensation for risk of absorbing expected losses.

In previous financial statements, the Corporation had consolidated two trusts through which it had issued trust preferred securities ("TPS") and reported the TPS as "guaranteed preferred beneficial interests in the Corporation's subordinated debentures" in the statements of financial condition. In December 2003, the FASB issued a revision to FIN 46 to clarify certain provisions which affected the accounting for TPS. As a result of the provisions in revised FIN 46, the trusts have been deconsolidated, with the Corporation accounting for its investment in the trusts as assets, its subordinated debentures as debt, and the interest paid thereon as interest expense. The Corporation had always classified the TPS as debt and the dividends as interest but eliminated its common stock investment and dividends received from the trust. FIN 46 permits and encourages restatement of prior period results, and accordingly, all financial statements

presented have been adjusted to give effect to the revised provisions of FIN 46. While these changes had no effect on previously reported net interest margin, net income or earnings per share, they increased total interest income and interest expense, as well as total assets and total liabilities. (See Note 8)

In December 2003, the American Institute of Certified Public Accountants ("AICPA") issued Statement of Position 03-3 ("SOP 03-3"), "Accounting for Certain Loans or Debt Securities Acquired in a Transfer." SOP 03-3 addresses accounting for differences between contractual cash flows and cash flows expected to be collected from an investor's initial investment in loans or debt securities (loans) acquired in a transfer if those differences are attributable, at least in part, to credit quality. It includes such loans acquired in purchase business combinations and applies to all nongovernmental entities, including not-for-profit organizations. SOP 03-3 does not apply to loans originated by the entity. SOP 03-3 limits the yield that may be accepted (accretable yield) to the excess of the investor's estimate of undiscounted expected principal, interest, and other cash flows (cash flows expected at acquisition to be collected) over the investor's initial investment in the loan. SOP 03-3 requires that the excess of contractual cash flows over cash flows expected to be collected (nonaccretable difference) not be recognized as an adjustment of yield, loss accrual, or valuation allowance. SOP 03-3 prohibits investors from displaying accretable yield and nonaccretable difference in the balance sheet. Subsequent increases in cash flows expected to be collected generally should be recognized prospectively through adjustment of the loan's yield over its remaining life. Decreases in cash flows expected to be collected should be recognized as impairment. SOP 03-3 prohibits "carrying over" or creation of valuation allowances in the initial accounting of all loans ac-

quired in a transfer that are within the scope of SOP 03-3. The prohibition of the valuation allowance carryover applies to the purchase of an individual loan, a pool of loans, a group of loans, and loans acquired in a purchase business combination. SOP 03-3 is effective for loans acquired in fiscal years beginning after December 15, 2004. The changes required by SOP 03-3 are not expected to have a material impact on results of operations, financial position, or liquidity of the Corporation.

In March 2004, the SEC issued Staff Accounting Bulletin ("SAB") 105, "Application of Accounting Principles to Loan Commitments", which addresses certain issues regarding the accounting for and disclosure of loan commitments relating to the origination of mortgage loans that will be held for resale. Such commitments are considered derivatives under the provisions of Statement of Financial Accounting Standard ("SFAS") No. 133, as amended by SFAS No. 149, and are therefore required to be recorded at fair value. SAB 105 stipulates that in recording those commitments no consideration should be given to any expected future cash flows related to the associated servicing of the future loan. SAB 105 further stipulates that no other internally-developed intangible assets, such as customer relationship intangibles, should be recorded as part of the loan commitment derivative. SAB 105 requires disclosure of accounting policies for loan commitment derivatives, including methods and assumptions used to estimate fair value and any associated economic hedging strategies. The provisions of SAB 105 were effective for loan commitment derivatives that were entered into after March 31, 2004. The provisions of SAB 105 did not have a material impact on results of operations, financial position, or liquidity of the Corporation.

Note 3 - Branch Sales

On February 6, 2004, the Corporation's banking subsidiary sold its Morris, Alabama branch, which had assets of approximately $1,037,000 and liabilities of $8,217,000. The Corporation realized a $739,000 pre-tax gain on the sale.

In August 2003, the Corporation sold seven branches of The Bank, known as the Emerald Coast branches of The Bank, serving the markets from Destin to Panama City, Florida for a $46,800,000 deposit premium. These branches had assets of approximately $234,000,000 and liabilities of $209,000,000. The Corporation realized a $46,018,000 pre-tax gain on the sale.

On March 13, 2003, the Corporation's banking subsidiary sold its Roanoke, Alabama branch, which had assets of approximately $9,800,000 and liabilities of $44,672,000. The Corporation realized a $2,246,000 pre-tax gain on the sale.

Note 4 - Segment Reporting

The Corporation has two reportable segments, the Alabama Region and the Florida Region. The Alabama Region consists of operations located throughout the state of Alabama. The Florida Region consists of operations located in the eastern panhandle region of Florida. The Corporation's reportable segments are managed as separate business units because they are located in different geographic areas. Both segments derive revenues from the delivery of financial services. These services include commercial loans, mortgage loans, consumer loans, deposit accounts and other financial services.

The Corporation evaluates performance and allocates resources based on profit or loss from operations. There are no material intersegment sales or transfers. Net interest revenue is used as the basis for performance evaluation rather than its components, total interest revenue and total interest expense. The accounting policies

used by each reportable segment are the same as those discussed in Note 1 to the Consolidated Financial Statements included in the Form 10-K for the year ended December 31, 2003. All costs have been allocated to the reportable segments. Therefore, combined amounts agree to the consolidated totals (in thousands).

| | Alabama Region | Florida Region | Combined |
|---|---|---|---|
| Three months ended June 30, 2004 | | | |
| Net interest income | $ 6,886 | $ 2,625 | $ 9,511 |
| Provision for loan losses | 984 | (984) | - |
| Noninterest income(1) | 2,467 | 332 | 2,799 |
| Noninterest expense(2) | 8,743 | 2,424 | 11,167 |
| Income tax (benefit) expense | (377) | 456 | 79 |
| Net income | 3 | 1,061 | 1,064 |
| Total assets | 1,063,265 | 224,771 | 1,288,036 |
| Three months ended June 30, 2003 | | | |
| Net interest income | $ 6,736 | $ 5,113 | $ 11,849 |
| Provision for loan losses | (275) | 1,000 | 725 |
| Noninterest income(1) | 4,015 | 746 | 4,761 |
| Noninterest expense(2) | 8,563 | 3,878 | 12,441 |
| Income tax expense | 648 | 292 | 940 |
| Net income | 1,815 | 689 | 2,504 |
| Total assets | 948,506 | 492,595 | 1,441,101 |

| | | | |
|---|---|---|---|
| Six months ended June 30, 2004 | | | |
| Net interest income | $ 13,213 | $ 5,223 | $ 18,436 |
| Provision for loan losses | 1,956 | (1,956) | - |
| Noninterest income(1) | 5,865 | 702 | 6,567 |
| Noninterest expense(2) | 17,412 | 4,901 | 22,313 |
| Income tax (benefit)expense | (481) | 879 | 398 |
| Net income | 191 | 2,101 | 2,292 |
| Six months ended June 30, 2003 | | | |
| Net interest income | $ 12,825 | $ 10,401 | $ 23,226 |
| Provision for loan losses | 831 | 1,094 | 1,925 |
| Noninterest income(1) | 8,757 | 1,648 | 10,405 |
| Noninterest expense(2) | 16,141 | 7,730 | 23,871 |
| Income tax expense | 1,334 | 983 | 2,317 |
| Net income | 3,276 | 2,242 | 5,518 |

(1) See Note 3 concerning branch sales. Also, in January 2004, certain loans was transferred from the Florida segment to the Corporation's special assets department which is included in the Alabama segment.

(2) Noninterest expense for the Alabama region includes all expenses for the holding company, which have not been prorated to the Florida region.

Note 5 - Net Income Per Share

The following table sets forth the computation of basic and diluted net income per common share (in thousands, except per share amounts):

| | Three Months Ended June 30 | | Six Months Ended June 30 | |
|---|---|---|---|---|
| | 2004 | 2003 | 2004 | 2003 |
| Numerator: | | | | |
| Net income | $ 1,064 | $ 2,504 | $ 2,292 | $ 5,518 |
| Less preferred dividends | 217 | - | 217 | - |
| For basic and diluted, net income applicable to common stock | $ 847 | $ 2,504 | $ 2,075 | $ 5,518 |
| Denominator: | | | | |
| For basic, weighted average common shares outstanding | 17,578 | 17,472 | 17,569 | 17,461 |
| Effect of dilutive stock options, restricted stock and convertible preferred | 909 | 412 | 963 | 290 |
| Weighted average common shares outstanding, assuming dilution | 18,487 | 17,884 | 18,532 | 17,751 |
| Basic net income per common share | $ .05 | $ .14 | $ .12 | $ .32 |
| Diluted net income per common share | $ .05 | $ .14 | $ .11 | $ .31 |

Note 6 - Comprehensive Income (Loss)

Total comprehensive income (loss) was $(1,879,000) and $(122,000), respectively, for the three and six-month periods ended June 30, 2004, and $2,474,000 and $5,323,000 respectively, for the three and six-month periods ended June 30, 2003. Total comprehensive income (loss) consists of net income (loss) and the unrealized gain or loss on the Corporation's available for sale securities portfolio arising during the period.

Note 7 - Income Taxes

The primary difference between the effective tax rate and the federal statutory rate in 2004 and 2003 is due to certain tax-exempt income and rehabilitation tax credits on the Corporation's headquarters, the John A. Hand building.

Note 8 - Junior Subordinated Debentures

The Corporation has sponsored two trusts, TBC Capital Statutory Trust II ("TBC Capital II") and TBC Capital Statutory Trust III ("TBC Capital III"), of which 100% of the common equity is owned by the Corporation. The trusts were formed for the purpose of issuing Corporation-obligated mandatory redeemable trust preferred securities to third-party investors and investing the proceeds from the sale of such trust preferred securities solely in junior subordinated debt securities of the Corporation (the debentures). The debentures held by each trust are the sole assets of that trust. Distributions on the trust preferred securities issued by each trust are payable semi-annually at a rate per annum equal to the interest rate being earned by the trust on the debentures held by that trust. The trust preferred securities are subject to mandatory redemption, in whole or in part, upon repayment of the debentures. The Corporation has entered into agreements which, taken collectively, fully and unconditionally guarantee the trust preferred securities subject to the terms of each of the guarantees. The debentures held by the TBC Capital II and TBC Capital III capital trusts are first redeemable, in whole or in part, by the Corporation on September 7, 2007 and July 25, 2006, respectively.

As a result of applying the provisions of FIN 46, governing when an equity interest should be consolidated, the Corporation was required to deconsolidate these subsidiary trusts from its financial statements in the fourth quarter of 2003. The deconsolidation of the net assets and results of operations of the trusts had virtually no impact on the Corporation's financial statements or liquidity position, since the Corporation continues to be obligated to repay the debentures held by the trusts and guarantees repayment of the trust preferred securities issued by the trusts. The consolidated debt obligation related to the trusts increased from $31,000,000 to $31,959,000 upon deconsolidation, with the difference representing the Corporation's common ownership interest in the trusts.

The trust preferred securities held by the trusts qualify as Tier 1 capital for the Corporation under Federal Reserve Board guidelines.

Consolidated debt obligations related to subsidiary trusts holding solely debentures of the Corporation follow:

| | June 30, 2004 | December 31, 2003 |
|---|---|---|

| | | |
|---|---|---|
| | (In thousands) | |
| 10.6% junior subordinated debentures owed to TBC Capital Statutory Trust II due September 7, 2030 | $ 15,464 | $ 15,464 |
| 6-month LIBOR plus 3.75% junior subordinated debentures owed to TBC Capital Statutory Trust III due July 25, 2031 | 16,495 | 16,495 |
| Total junior subordinated debentures owed to unconsolidated subsidiary trusts | $ 31,959 | $ 31,959 |

As of June 30, 2004 and December 31, 2003, the interest rate on the $16,495,000 subordinated debentures was 4.96% and 4.90%, respectively.

Currently, the Corporation must obtain regulatory approval prior to paying any dividends on these trust preferred securities. The Federal Reserve approved the timely payment of our semi-annual distributions on our trust preferred securities in January, March and July, 2004.

Note 9 - Stockholders' Equity

In September of 2000, the Corporation's board of directors approved a stock buyback plan in an amount not to exceed $10,000,000. As of June 30, 2004, there were 65,448 shares held in treasury at a cost of $430,000.

On April 1, 2002, the Corporation issued 157,000 shares of restricted common stock to certain directors and key employees pursuant to the Second Amended and Restated 1998 Stock Incentive Plan. Under the Restricted Stock Agreements, the shares of restricted stock may not be sold or assigned in any manner for a five-year period that began on April 1, 2002. During this restricted period, the participant is eligible to receive dividends and exercise voting privileges. The restricted stock also has a corresponding vesting period with one-third vesting at the end of each of the third, fourth and fifth years. The restricted stock was issued at $7.00 per share, or $1,120,000, and is classified as a contra-equity account, "Unearned restricted stock", in stockholders' equity. During 2003, 15,000 shares of this restricted common stock were forfeited. Restricted shares outstanding as of June 30, 2004 were 142,500 and the remaining amount in the unearned restricted stock account is $549,000. This balance is being amortized as expense as the stock is earned during the restricted period. The amounts of restricted shares are included in the diluted earnings per share calculation, using the treasury stock method, until the shares vest. Once vested, the shares become outstanding for basic earnings per share. For the periods ended June 30, 2004 and 2003, the Corporation has recognized $100,000 and $112,000, respectively, in restricted stock expense.

The Corporation adopted a leveraged employee stock ownership plan (the "ESOP") effective May 15, 2002, that covers all eligible employees that have attained the age of twenty-one and have completed a year of service. As of June 30, 2004, the ESOP has been internally leveraged with 273,400 shares of the Corporations' common stock purchased in the open market and classified as a contra-equity account, "Unearned ESOP shares", in stockholders' equity.

On January 29, 2003, the ESOP trustees finalized a $2,100,000 promissory note to reimburse the Corporation for the funds used to leverage the ESOP. The unreleased shares and a guarantee of the Corporation secure the promissory note, which has been classified as long-term debt on the Corporation's statement of

financial condition. As the debt is repaid, shares are released from collateral based on the proportion of debt service. Principal payments on the debt are $17,500 per month for 120 months. The interest rate is adjusted annually to the Wall Street Journal prime rate. Released shares are allocated to eligible employees at the end of the plan year based on the employee's eligible compensation to total compensation. The Corporation recognizes compensation expense during the period as the shares are earned and committed to be released. As shares are committed to be released and compensation expense is recognized, the shares become outstanding for basic and diluted earnings per share computations. The amount of compensation expense reported by the Corporation is equal to the average fair value of the shares earned and committed to be released during the period. Compensation expense that the Corporation recognized during the periods ended June 30, 2004, and 2003, was $98,000 and $55,000, respectively. The ESOP shares as of June 30, 2004 were as follows:

| | June 30, 2004 |
|---|---|
| Allocated shares | 28,628 |
| Estimated shares committed to be released | 13,350 |
| Unreleased shares | 231,422 |
| Total ESOP shares | 273,400 |
| Fair value of unreleased shares | $1,520,000 |

The Corporation has established a stock incentive plan for directors and certain key employees that provide for the granting of restricted stock and incentive and nonqualified options to purchase up to 2,500,000 shares of the Corporation's common stock. The compensation committee of the Board determines the terms of the restricted stock and options granted.

All options granted have a maximum term of ten years from the grant date, and the option price per share of options granted cannot be less than the fair market value of the Corporation's common stock on the grant date.

The Corporation has adopted the disclosure-only provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (Statement 123) which allows an entity to continue to measure compensation costs for those plans using the intrinsic value-based method of accounting prescribed by APB Opinion No. 25, "Accounting for Stock Issued to Employees." The Corporation has elected to follow APB Opinion 25 and related interpretations in accounting for its employee stock options. Accordingly, compensation cost for fixed and variable stock-based awards is measured by the excess, if any, of the fair market price of the underlying stock over the amount the individual is required to pay. Compensation cost for fixed awards is measured at the grant date, while compensation cost for variable awards is estimated until both the number of shares an individual is entitled to receive and the exercise or purchase price are known (measurement date). No option-based employee compensation cost is reflected in net income, as all options granted had an exercise price equal to the market value of the underlying common stock on the date of grant. The pro forma information below was determined as if the Corporation had accounted for its employee stock options under the fair value method of Statement 123. For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting

period. The Corporation's pro forma information follows (in thousands except earnings per share information):

| | For the three-months ended | | For the six-months ended | |
|---|---|---|---|---|
| | June 30, 2004 | June 30, 2003 | June 30, 2004 | June 30, 2003 |
| Net income: | | | | |
| As reported | $ 1,064 | $ 2,504 | $ 2,292 | $ 5,518 |
| Pro forma | 666 | 2,321 | 1,787 | 5,156 |
| Earnings per common share: | | | | |
| As reported | $ .05 | $ .14 | $ .12 | $ .32 |
| Pro forma | .03 | .13 | .09 | .30 |
| Diluted earnings per common share: | | | | |
| As reported | $ .05 | $ .14 | $ .11 | $ .31 |
| Pro forma | .02 | .13 | .08 | .29 |

The fair value of the options granted was based upon the Black-Scholes pricing model. The Corporation used the following weighted average assumptions for:

| | June 30 | |
|---|---|---|
| | 2004 | 2003 |
| Risk free interest rate | 4.69% | 3.33% |
| Volatility factor | .41 | .34 |
| Weighted average life of options | 7.00 | 7.00 |
| Dividend yield | 0.00 | 0.00 |

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

### Basis of Presentation

The following is a discussion and analysis of our June 30, 2004 consolidated financial condition and results of operations for the three and six-month periods ended June 30, 2004 and 2003. All significant intercompany accounts and transactions have been eliminated. Our accounting and reporting policies conform to generally accepted accounting principles.

This information should be read in conjunction with our unaudited consolidated financial statements and related notes appearing elsewhere in this report and the audited consolidated financial statements and related notes and "Management's Discussion and Analysis of Financial Condition and Results of Operations", appearing in our Annual Report on Form 10-K for the year ended December 31, 2003.

### Overview

Our principal subsidiary is The Bank, an Alabama-chartered financial institution

headquartered in Birmingham, Alabama which operates 26 banking offices in Alabama and the eastern panhandle of Florida. Other subsidiaries include TBC Capital Statutory Trust II ("TBC Capital II"), a Connecticut statutory trust, TBC Capital Statutory Trust III ("TBC Capital III"), a Delaware business trust, and Morris Avenue Management Group, Inc. ("MAMG"), an Alabama corporation, all of which are wholly owned. TBC Capital II and TBC Capital III are unconsolidated special purpose entities formed solely to issue cumulative trust preferred securities. MAMG is a real estate management company that manages our headquarters, our branch facilities and certain other real estate owned by The Bank.

Our total assets were $1.288 billion at June 30, 2004, an increase of $116.4 million, or 9.94% from $1.172 billion as of December 31, 2003. Our total loans, net of unearned income were $889 million at June 30, 2004, an increase of $32 million, or 3.78% from $857 million as of December 31, 2003. Our total deposits were $964 million at June 30, 2004, an increase of $74 million, or 8.31% from $890 million as of December 31, 2003. Our total stockholders' equity remained level at $100 million at June 30, 2004 and December 31, 2003.

In March 2003, we sold our branch in Roanoke, Alabama, which had assets of approximately $9.8 million and liabilities of $44.7 million. We realized a $2.3 million pre-tax gain on the sale. In August 2003, we sold seven branches of The Bank, known as the Emerald Coast branches of The Bank, serving the markets from Destin to Panama City, Florida, for a $46.8 million deposit premium. These branches had assets of approximately $234 million and liabilities of $209 million. We realized a $46.0 million pre-tax gain on the sale. On February 6, 2004, we sold our Morris, Alabama branch, which had assets of approximately $1.0 million and liabilities of $8.2 million, for a $739,000 pre-tax gain. Because of the impact of these sales on our interest-bearing deposits and our loan portfolio, as well as the impact of the gains on sale on our net income, there are variations in the comparability between 2004 and 2003 of our financial position and results of operations. Where appropriate, we have tried to quantify these effects in the discussion that follows.

In January of 2004, we transferred the majority of our nonperforming loans and approximately $7 million of other problem loans to our special assets department. Approximately $41.0 million in loans were transferred along with the related allowance for loan loss of $9.8 million. This department is staffed with nine employees,

and is managed by our special assets executive, who has over 18 years of experience in dealing with special assets. By segregating these relationships, we believe we can better monitor and control our collection efforts. Segregating these relationships also allows us to accurately monitor the performance of our individual branches on an ongoing basis without the influence of these nonperforming and problem relationships. Management is vigorously pursuing appropriate collection efforts and expects the nonperforming and problem relationships to decline over the next six months.

Management reviews the adequacy of the allowance for loan losses on a quarterly basis. The provision for loan losses represents the amount determined by management necessary to maintain the allowance for loan losses at a level capable of absorbing inherent losses in the loan portfolio. Management's determination of the adequacy of the allowance for loan losses, which is based on the factors and risk identification procedures discussed in the following pages, requires the use of judgments and estimates that may change in the future. Changes in the factors used by management to determine the adequacy of the allowance or the availability of new information could cause the allowance for loan losses to be increased or decreased in future periods. In addition, bank regulatory agencies, as part of their examination process, may require that

additions or reductions be made to the allowance for loan losses based on their judgments and estimates.

Results of Operations

Our net income for the three-month period ended June 30, 2004 (second quarter of 2004), was $1.1 million compared to $2.5 million for the three-month period ended June 30, 2003 (second quarter of 2003), a decrease of $1.4 million. Our basic and diluted net income per share was $.05 for the second quarter of 2004, which represents a $.09 decrease from $.14 per share for the second quarter of 2003.

Our net income for the six-month period ended June 30, 2004 (first six months of 2004) was $2.3 million compared to $5.5 million for the six-month period ended June 30, 2003 (first six months of 2003), a decrease of $3.2 million. Basic net income per share was $.12 and diluted net income per share was $.11 for the first six months of 2004, which represents a $ .20 decrease from $.32 and $.31 per share for the first six months of 2003. Return on average assets, on an annualized basis, was .37% for the first six months of 2004 compared to .78% for the first six months of 2003. Return on average stockholders' equity, on an annualized basis, was 4.59% for the first six months of 2004 compared to 13.97% for the first six months of 2003. Book value per common share was $5.30 at June 30, 2004 compared to $5.31 at December 31, 2003. Tangible book value per common share at June 30, 2004 and December 31, 2003 was $4.59.

The decrease in net income during the first and second quarters of 2004 compared to the first and second quarters of 2003 is the result of a decline in our net interest margin and other noninterest income offset by a decline in the provision for loan losses and other noninterest expenses. The reasons underlying these declines are discussed in the following paragraphs.

Net interest income is the difference between the income earned on interest-earning assets and interest paid on interest-bearing liabilities used to support such assets. Net interest income decreased $2.3 million, or 19.7% to $9.5 million for the second quarter of 2004 from $11.8 million for the second quarter of 2003. Net interest income decreased primarily due to a $4.8 million or 22.8% decrease in total interest income offset by a $2.4 million, or 26.8% decrease in total interest expense. The decline in total interest income is primarily due to a $275 million decline in the average volume of loans, which is primarily the result of the sale of certain branches during 2003.

The decline in total interest expense is primarily attributable to a 45-basis point decline in the average interest rate paid on interest-bearing liabilities and a $164 million decline in the volume of average interest-bearing liabilities. The decline in the average interest-bearing liabilities is due to the decline in deposit volume related to the sale of certain branches during 2003. The average rate paid on interest-bearing liabilities was 2.47% for the second quarter of 2004 compared to 2.92% for the second quarter of 2003. Our net interest spread and net interest margin were 3.31% and 3.42%, respectively, for the second quarter of 2004, compared to 3.53% and 3.67% for the second quarter of 2003.

Average interest-earning assets for the second quarter of 2004 decreased $178 million, or 13.7% to $1.121 billion from $1.299 billion in the second quarter of 2003. This decrease in average interest-earning assets was offset by a $164 million, or 13.3%, decrease in average interest-bearing liabilities to $1.071 billion for the second quarter of 2004 from $1.235 billion for the second quarter of 2003. Average interest-earning assets and liabilities decreased due to the sale of certain branches during 2003. The ratio of average interest-earning assets to average interest-bearing liabilities was 104.7% and

105.2% for the second quarters of 2004 and 2003, respectively. Average interest-bearing assets produced a taxable equivalent yield of 5.78% for the second quarter of 2004 compared to 6.45% for the second quarter of 2003. The 67-basis point decline in the yield was partially offset by a 45-basis point decline in the average rate paid on interest-bearing liabilities.

Net interest income decreased $4.8 million, or 20.6% to $18.4 million for the first six months of 2004 from $23.2 million for the first six months of 2003. The decrease in net interest income was primarily due to a $10.2 million, or 24.4% decrease in total interest income offset by a $5.4 million, or 29.2% decrease in total interest expense. The decline in total interest income is primarily due to a $287 million decline in the average volume of loans, which is primarily the result of the sale of certain branches during 2003.

The decline in total interest expense is primarily attributable to a 50-basis point decline in the average interest rate paid on interest-bearing liabilities and a $194 million decline in the volume of average interest-bearing liabilities. The decline in the average interest-bearing liabilities is primarily due to the decline in deposit volume related to the sale of certain branches during 2003. The average rate paid on interest-bearing liabilities was 2.53% for the first six months of 2004 compared to 3.03% for the first six months of 2003. Our net interest spread and net interest margin were 3.28% and 3.39%, respectively, for the first six months of 2004, compared to 3.46% and 3.61%, respectively, for the first six months of 2003.

Average interest-earning assets for the first six months of 2004 decreased $206 million, or 15.8% to $1.095 billion from $1.301 billion in the first six months of 2003. This decrease in average interest-earning assets was offset by a $194 million, or 15.7%, decrease in average interest-bearing liabilities to $1.044 billion for the first six months of 2004 from $1.238 billion for the first six months of 2003. Average interest-earning assets and liabilities decreased due to the sale of certain branches during 2003. The ratio of average interest-earning assets to average interest-bearing liabilities was 104.9% and 105.1% for the first six months of 2004 and 2003, respectively. Average interest-bearing assets produced a taxable equivalent yield of 5.81% for the first six months of 2004 compared to 6.49% for the first six months of 2003. The 68-basis point decline in the yield was offset by a 50-basis point decline in the average rate paid on interest-bearing liabilities.

Average Balances, Income, Expense and Rates. The following table depicts, on a taxable equivalent basis for the periods indicated, certain information related to our average balance sheet and our average yields on assets and average costs of liabilities. Average yields are calculated by dividing income or expense by the average balance of the corresponding assets or liabilities. Average balances have been calculated on a daily basis.

| | THREE MONTHS ENDED JUNE | | | |
|---|---|---|---|---|
| | 2004 | | | |
| | AVERAGE BALANCE | INCOME/ EXPENSE | YIELD/ RATE | AVERAG BALANC |
| | | | (Dollars in thousa | |
| ASSETS | | | | |
| Interest-earning assets: | | | | |
| Loans, net of unearned income(1)......... | $ 869,376 | $ 13,691 | 6.33% | $ 1,144 |

| | | | | |
|---|---|---|---|---|
| Investment securities | | | | |
| Taxable | 183,643 | 2,109 | 4.62 | 60 |
| Tax-exempt(2) | 2,744 | 39 | 5.72 | 6 |
| Total investment securities | 186,387 | 2,148 | 4.64 | 66 |
| Federal funds sold | 17,670 | 41 | 0.93 | 32 |
| Other investments | 47,945 | 231 | 1.94 | 55 |
| Total interest-earning assets | 1,121,378 | 16,111 | 5.78 | 1,299 |
| Noninterest-earning assets: | | | | |
| Cash and due from banks | 30,783 | | | 34 |
| Premises and equipment | 58,129 | | | 61 |
| Accrued interest and other assets | 83,443 | | | 71 |
| Allowance for loan losses | (23,308) | | | (28 |
| Total assets | $ 1,270,425 | | | $ 1,437 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | | |
| Interest-bearing liabilities: | | | | |
| Demand deposits | $ 258,926 | 813 | 1.26 | $ 298 |
| Savings deposits | 28,987 | 11 | 0.15 | 35 |
| Time deposits | 578,039 | 3,681 | 2.56 | 693 |
| Other borrowings | 173,170 | 1,456 | 3.38 | 174 |
| Subordinated debentures | 31,959 | 626 | 7.88 | 31 |
| Total interest-bearing liabilities | 1,071,081 | 6,587 | 2.47 | 1,234 |
| Noninterest-bearing liabilities: | | | | |
| Demand deposits | 87,153 | | | 114 |
| Accrued interest and other liabilities | 11,643 | | | 6 |
| Stockholders' equity | 100,548 | | | 81 |
| Total liabilities and stockholders' equity | $ 1,270,425 | | | $ 1,437 |
| Net interest income/net interest spread | | 9,524 | 3.31% | |
| Net yield on earning assets | | | 3.42% | |
| Taxable equivalent adjustment: | | | | |
| Investment securities(2) | | 13 | | |
| Net interest income | | $ 9,511 | | |

(1) Nonaccrual loans are included in loans, net of unearned income. No adjustment has been made for these loans in the calculation of yields.

(2) Interest income and yields are presented on a fully taxable equivalent basis using a tax rate of 34 percent.

The following table sets forth, on a taxable equivalent basis, the effect that the varying levels of our interest-earning assets and interest-bearing liabilities and the applicable rates have had on the changes in net interest income for the three months ended June 30, 2004 and 2003.

| | THREE MONTHS ENDED JUNE 30 (1) 2004 VS 2003 | | |
|---|---|---|---|
| | | CHANGES DUE TO | |
| | INCREASE (DECREASE) | RATE | VOLUME |
| | (Dollars in thousands) | | |
| Increase (decrease) in: | | | |
| Income from interest-earning assets: | | | |
| Interest and fees on loans................ | $ (5,991) | $(1,532) | $ (4,459) |
| Interest on securities: | | | |
| Taxable.............................. | 1,287 | (144) | 1,431 |
| Tax-exempt.......................... | (63) | (12) | (51) |
| Interest on federal funds................. | (55) | (18) | (37) |
| Interest on other investments............. | 45 | 75 | (30) |
| Total interest income................ | (4,777) | (1,631) | (3,146) |
| Expense from interest-bearing liabilities: | | | |
| Interest on demand deposits.................. | 100 | 204 | (104) |
| Interest on savings deposits................. | (17) | (13) | (4) |
| Interest on time deposits.................... | (1,730) | (903) | (827) |
| Interest on other borrowings................. | (764) | (744) | (20) |
| Interest subordinated debentures............. | (6) | (6) | - |
| Total interest expense............... | (2,417) | (1,462) | (955) |
| Net interest income.................. | $ (2,360) | $ (169) | $ (2,191) |

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(1) The change in interest income and interest expense due to both rate and volume has been allocated to rate and volume changes in proportion to the relationship of the absolute dollar amounts of the changes in each.

The following table depicts, on a taxable equivalent basis for the periods indicated, certain information related to our average balance sheet and our average yields on assets and average costs of liabilities. Average yields are calculated by dividing income or expense by the average balance of the corresponding assets or liabilities. Average balances have been calculated on a daily basis.

| | SIX MONTHS ENDED JUNE 30, | | | |
|---|---|---|---|---|
| | 2004 | | | |
| | AVERAGE BALANCE | INCOME/ EXPENSE | YIELD/ RATE | AVERAGE BALANCE |
| | | | (Dollars in thousands) | |

| | | | | |
|---|---|---|---|---|
| ASSETS | | | | |
| Interest- earning assets: | | | | |
| Loans, net of unearned income(1) | $ 863,800 | $ 27,258 | 6.35% | $1,150,899 |
| Investment securities | | | | |
| Taxable | 170,639 | 3,822 | 4.50 | 54,081 |
| Tax-exempt(2) | 2,030 | 62 | 6.14 | 7,158 |
| Total investment securities | 172,669 | 3,884 | 4.52 | 61,239 |
| Federal funds sold | 16,055 | 75 | 0.94 | 33,895 |
| Other investments | 42,257 | 396 | 1.88 | 54,655 |
| Total interest-earning assets | 1,094,781 | 31,613 | 5.81 | 1,300,688 |
| Noninterest-earning assets: | | | | |
| Cash and due from banks | 29,002 | | | 33,650 |
| Premises and equipment | 58,076 | | | 61,108 |
| Accrued interest and other assets | 82,192 | | | 72,267 |
| Allowance for loan losses | (24,396) | | | (33,278) |
| Total assets | $1,239,655 | | | $1,434,435 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | | |
| Interest-bearing liabilities: | | | | |
| Demand deposits | $ 248,361 | 1,494 | 1.21 | $ 293,391 |
| Savings deposits | 29,692 | 24 | 0.16 | 35,725 |
| Time deposits | 561,091 | 7,264 | 2.60 | 702,254 |
| Other borrowings | 172,606 | 3,122 | 3.64 | 174,777 |
| Subordinated debentures | 31,959 | 1,252 | 7.88 | 31,959 |
| Total interest-bearing liabilities | 1,043,709 | 13,156 | 2.53 | 1,238,106 |
| Noninterest-bearing liabilities: | | | | |
| Demand deposits | 84,200 | | | 110,180 |
| Accrued interest and other liabilities | 11,419 | | | 6,508 |
| Stockholders' equity | 100,327 | | | 79,641 |
| Total liabilities and stockholders' equity | $1,239,655 | | | $1,434,435 |
| Net interest income/net interest spread | | 18,457 | 3.28% | |
| Net yield on earning assets | | | 3.39% | |
| Taxable equivalent adjustment: | | | | |
| Investment securities(2) | | 21 | | |
| Net interest income | | $ 18,436 | | |

(1) Nonaccrual loans are included in loans, net of unearned income. No adjustment has been made for these loans in the calculation of yields.

(2) Interest income and yields are presented on a fully taxable equivalent basis using a tax rate of 34 percent.

The following table sets forth, on a taxable equivalent basis, the effect that the varying levels of our interest-earning assets and interest-bearing liabilities and the applicable rates have had on changes in net interest income for the six months ended June 30, 2004 and 2003.

| | SIX MONTHS ENDED JUNE 30 (1) 2004 VS 2003 | | |
|---|---|---|---|
| | | CHANGES DUE TO | |
| | INCREASE (DECREASE) | RATE | VOLUME |
| | (Dollars in thousands) | | |
| Increase (decrease) in: | | | |
| Income from interest-earning assets: | | | |
| Interest and fees on loans................ | $ (12,268) | $(3,082) | $ (9,186) |
| Interest on securities: | | | |
| Taxable.............................. | 2,282 | (95) | 2,377 |
| Tax-exempt........................... | (179) | (22) | (157) |
| Interest on federal funds................. | (124) | (35) | (89) |
| Interest on other investments............. | 14 | 60 | (46) |
| Total interest income................ | (10,275) | (3,174) | (7,101) |
| Expense from interest-bearing liabilities: | | | |
| Interest on demand deposits.................. | 87 | 188 | (101) |
| Interest on savings deposits................. | (45) | (35) | (10) |
| Interest on time deposits.................... | (4,166) | (2,115) | (2,051) |
| Interest on other borrowings................. | (1,284) | (1,230) | (54) |
| Interest subordinated debentures............. | (16) | (16) | - |
| Total interest expense............... | (5,424) | (3,208) | (2,216) |
| Net interest income.................. | $ (4,851) | $ 34 | $ (4,885) |

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(1) The change in interest income and interest expense due to both rate and volume has been allocated to rate and volume changes in proportion to the relationship of the absolute dollar amounts of the changes in each.

Noninterest income. Noninterest income decreased $1.9 million or 41.2% to $2.8 million for the second quarter of 2004 from $4.7 million for the second quarter of 2003, primarily due to a decrease in mortgage banking income and gains on sales of securities. Mortgage banking income decreased $802,000, or 67.7% to $383,000 in the second quarter of 2004 from $1.2 million in the second quarter of 2003. The decline in mortgage banking income is the result of the lessening demand for refinancing that has occurred in 2004 and the sale of the Emerald Coast branches. Gains on sales of securities decreased $600,000 to $37,000, in the second quarter of 2004 from $637,000 in the second quarter of 2003.

Noninterest income decreased $3.8 million, or 36.9% to $6.6 million for the first six months of 2004 from $10.4 million for the first six months of 2003, primarily due to the $2.2 million gain we realized in 2003 on the sale of our

Roanoke branch. This decrease was partially offset by a $739,000 gain we realized on the sale of our Morris branch during 2004. Service charges on deposits decreased $491,000, or 15.0%, to $2.8 million in the first six months of 2004 from $3.3 million in the first six months of 2003. Mortgage banking income decreased $1.3 million, or 61.8% to $787,000 in the first six months of 2004 from $2.1 million in the first six months of 2003. Gains on sales of securities decreased $235,000, to $428,000 in the first six months of 2004 from $663,000 in the first six months of 2003. The decline in service charges is related to the decline in deposit accounts, which resulted from the sale of certain branches during 2003. The decline in mortgage banking income is the result of the lessening demand for refinancing that has occurred in 2004 and the sale of the Emerald Coast branches.

Noninterest expense. Noninterest expense decreased $1.2 million, or 10.2% to $11.2 million for second quarter of 2004 from $12.4 million for the second quarter of 2003. Salaries and benefits decreased $500,000, or 7.85% to $5.9 million for the second quarter of 2004 from $6.4 million for the second quarter of 2003. Occupancy and furniture and equipment expenses decreased $183,000, or 8.04% to $2.1 million for the second quarter of 2004

from $2.3 million for the second quarter of 2003. All other noninterest expenses decreased $591,000, or 15.6% to $3.2 million for the second quarter of 2004 from $3.8 million for the second quarter of 2003.

Noninterest expense decreased $1.6 million, or 6.53% to $22.3 million for first six months of 2004 from $23.9 million for the first six months of 2003. Salaries and benefits decreased $1.2 million, or 9.7% to $11.5 million for the first six months of 2004 from $12.7 million for the first six months of 2003. Occupancy and furniture and equipment expenses decreased $233,000, or 5.44% to $4.1 million for the first six months of 2004 from $4.3 million for the first six months of 2003. All other noninterest expenses decreased $93,000, or 1.35% to $6.8 million for the first six months of 2004 from $6.9 million for the first six months of 2003. During the first six months of 2004, we incurred approximately $2.8 million in certain expenses, including $913,000 for the special asset department related to increased foreclosure and repossession activity, $301,000 in valuation write-downs, $626,000 in legal fees, $437,000 in audit and accounting fees and $825,000 in FDIC premiums. Management does not expect these expenses to be at these levels in the future. FDIC premiums for the same period last year were $91,000. Our FDIC premiums for the remaining six-month period ending December 31, 2004 are expected to be approximately $210,000. The expenses incurred by the special assets department reflect the increased activity in this area, which has produced significant recoveries in the first six months of 2004.

Income tax expense. Our income tax expense was $79,000 for the second quarter of 2004, compared to $940,000 for the second quarter of 2003 and $398,000 for the first six months of 2004, compared to $2.3 million for the first six months of 2003. The primary difference in the effective rate and the federal statutory rate (34%) for the three and six-month periods ended June 30, 2004 is due to certain tax-exempt income from investments and insurance policies and rehabilitation tax credits on our headquarters, the John A. Hand building.

Provision for Loan Losses. The provision for loan losses represents the amount determined by management necessary to maintain the allowance for loan losses at a level capable of absorbing inherent losses in the loan portfolio. Management reviews the adequacy of the allowance on a quarterly basis. The allowance for loan loss calculation is segregated into various segments that include classified loans, loans with specific allocations and pass rated loans. A pass rated loan is generally characterized by a very low to average risk of default and is a loan in which management perceives there is a minimal risk of loss.

Loans are rated using an eight-point scale, with loan officers having the primary responsibility for assigning the risk ratings and for the timely reporting of changes in the risk ratings. These processes, and the assigned risk ratings, are subject to review by our internal loan review function and senior management. Based on the assigned risk ratings, the criticized and classified loans in the portfolio are segregated into the following regulatory classifications: Special Mention, Substandard, Doubtful or Loss. Generally, regulatory reserve percentages are applied to these categories to estimate the amount of loan loss allowance, adjusted for previously mentioned risk factors. Impaired loans are reviewed specifically and separately under Statement of Financial Accounting Standards ("SFAS") No. 114 to determine the appropriate reserve allocation. Management compares the investment in an impaired loan against the present value of expected cash flows discounted at the loan's effective interest rate, the loan's observable market price, or the fair value of the collateral if the loan is collateral dependent, to determine the specific reserve allowance. Reserve percentages assigned to non-rated loans are based on historical charge-off experience adjusted for other risk factors. To evaluate the overall adequacy of the allowance to absorb losses inherent in our loan portfolio, management considers historical loss experience based on volume and types of loans, trends in classifications, volume and trends in delinquencies and nonaccruals, economic conditions and other pertinent information. Based on future evaluations, additional provision for loan losses may be necessary to maintain the allowance for loan losses at an appropriate level. See "Financial Condition - Allowance for Loan Losses" for additional discussion.

As a result of the collection of certain classified loans of approximately $6.0 million in the first quarter of 2004, increased recoveries of charged-off loans of $2.03 million for the first six months of 2004 and an adjustment to the risk factors related to 1-4 family residential loans in the second quarter of 2004, no provision for loan losses was posted for the second quarter or first six months of 2004, a $1.9 million provision for loan losses was posted for the first six months of 2003. In addition, over one-half of our loan growth during the first six-months is related to a single credit with a very low risk rating that was originated in the second quarter and is fully secured by marketable securities. During the first six months of 2004, we had net charged-off loans totaling $5.0 million compared to net charged-off loans of $7.0 million in the first six months of 2003. The net amount of charged-off loans during the first six months of 2004 was covered by specific and standard allocations of allowance for loan losses which had been provided in previous periods. The annualized ratio of net charged-off loans to average loans was 1.16% in the first six months of 2004 compared to 1.23% for the first six months of 2003 and 2.21% for the year 2003. The allowance for loan losses totaled $20.2 million, or 2.27% of loans, net of unearned income at June 30, 2004 compared to $25.2 million, or 2.94% of loans, net of unearned income at December 31, 2003. See "Financial Condition - Allowance for Loan Losses" for additional discussion.

## Financial Condition

Total assets were $1.288 billion at June 30, 2004, an increase of $116 million, or 9.94% from $1.172 billion as of December 31, 2003. Average total assets for the first six months of 2004 totaled $1.240 billion, which was supported by average total liabilities of $1.140 billion and average total stockholders' equity of $100 million.

Short-term liquid assets. Our short-term liquid assets (cash and due from banks, interest-bearing deposits in other banks and federal funds sold) increased $17.3 million, or 39.7%, to $60.8 million at June 30, 2004 from $43.5 million at December 31, 2003. This increase resulted primarily from excess funds invested in federal funds sold and interest-bearing deposits at the Federal Home Loan Bank ("FHLB"). These excess funds were attributable primarily to an increase in

deposits. These deposits were invested in short-term liquid assets primarily to improve our liquidity position and position us for future investment and loan growth. At June 30, 2004, our short-term liquid assets comprised 4.7% of total assets, compared to 3.7% at December 31, 2003. We continually monitor our liquidity position and will increase or decrease our short-term liquid assets as necessary.

Investment Securities. Total investment securities increased $58.8 million, or 41.5% to $200.4 million at June 30, 2004, from $141.6 million at December 31, 2003. Mortgage-backed securities, which comprised 15.6% of the total investment portfolio at June 30, 2004, decreased $11.1 million, or 26.2%, to $31.2 million from $42.3 million at December 31, 2003. Investments in U.S. Treasury and agency securities, which comprised 66.2% of the total investment portfolio at June 30, 2004, increased $60.2 million, or 83.0%, to $132.7 million from $72.5 million at December 31, 2003. The increase in our agency securities improved our liquidity, and we expect that our investment in these securities will provide reasonable returns over a five- to six-year period. The total investment portfolio at June 30, 2004 comprised 17.6% of all interest-earning assets compared to 13.8% at December 31, 2003 and produced an average taxable equivalent yield of 4.6% for the second quarter of 2004 compared to 5.6% for the second quarter of 2003 and 4.5% for the first six months of 2004 compared to 5.9% for the first six months of 2003.

Loans. Loans, net of unearned income, totaled $889.4 million at June 30, 2004, an increase of 3.8%, or $32.5 million from $856.9 million at December 31, 2003. Mortgage loans held for sale totaled $3.6 million at June 30, 2004, a decrease of $2.8 million from $6.4 million at December 31, 2003. Average loans, including mortgage loans held for sale, totaled $863.8 million for the first six months of 2004 compared to $1.151 billion for the

first six months of 2003. Average loans, including mortgage loans held for sale, totaled $869.4 million for the second quarter of 2004 compared to $1.145 billion for the second quarter of 2003. Loans, net of unearned income, comprised 78.1% of interest-earning assets at June 30, 2004, compared to 83.6% at December 31, 2003. Mortgage loans held for sale comprised .3% of interest-earning assets at June 30, 2004, compared to .6% at December 31, 2003. The loan portfolio produced an average yield of 6.3% for the second quarter and first six months of 2004 compared to 6.9% for the second quarter and first six months of 2003. This decline in yield was substantially offset by basis point declines of 45 and 50 in the average cost of the funds for the second quarter and first six months of 2004, respectively, that support our loan portfolio. The following table details the distribution of our loan portfolio by category as of June 30, 2004 and December 31, 2003:

DISTRIBUTION OF LOANS BY CATEGORY

| | JUNE 30,2004 | | DECEMBER 31,2003 | |
|---|---|---|---|---|
| | AMOUNT | PERCENT OF TOTAL | AMOUNT | PERCE OF TOTA |
| Commercial and industrial........................ | $ 147,411 | 16.5% | $142,072 | 16. |
| Real estate-- construction and land development... | 163,666 | 18.4 | 147,917 | 17. |
| Real estate -- mortgage | | | | |
| Single-family................................ | 250,020 | 28.1 | 231,064 | 27. |
| Commercial.................................... | 255,398 | 28.7 | 250,032 | 29. |

| | | | | |
|---|---|---|---|---|
| Other | 28,740 | 3.2 | 31,645 | 3. |
| Consumer | 38,088 | 4.3 | 46,201 | 5. |
| Other | 7,154 | .8 | 8,923 | 1. |
| Total loans | 890,477 | 100.0% | 857,854 | 100. |
| Unearned income | (1,106) | | (913) | |
| Allowance for loan losses | (20,180) | | (25,174) | |
| Net loans | $ 869,191 | | $831,767 | |

Deposits. Noninterest-bearing deposits totaled $89.9 million at June 30, 2004, an increase of 4.4%, or $3.8 million from $86.1 million at December 31, 2003. Noninterest-bearing deposits comprised 9.3% of total deposits at June 30, 2004, compared to 9.7% at December 31, 2003. Of total noninterest-bearing deposits $66.5 million, or 74% were in our Alabama branches while $23.3 million, or 26% were in our Florida branches.

Interest-bearing deposits totaled $874.0 million at June 30, 2004, an increase of 8.7%, or $70.2 million from $803.8 million at December 31, 2003. Interest-bearing deposits averaged $839.1 million for the first six months of 2004 compared to $1.031 billion for the first six months of 2003, a decrease of $192.2 million, or 18.6%. Our average interest-bearing deposits for the second quarter of 2004 totaled $866.0 million compared to $1.028 billion for the second quarter of 2003, a decrease of $162.1 million, or 15.8%.

The average rate paid on all interest-bearing deposits during the first six months of 2004 was 2.1% compared to 2.5% for the first six months of 2003 and 2.1% for the second quarter of 2004 compared to 2.4% for the second quarter of 2003. Of total interest-bearing deposits $650.3 million, or 74.4% were in the Alabama branches while $223.7 million, or 25.6% were in the Florida branches.

Borrowings. Advances from the Federal Home Loan Bank ("FHLB") totaled $156.1 million at June 30, 2004 and $121.1 million at December 31, 2003. Borrowings from the FHLB were used primarily to fund growth in the loan portfolio and have a weighted average rate of approximately 3.35% at June 30, 2004, which has decreased from 4.60% at December 31, 2003. The advances are secured by FHLB stock, agency securities and a blanket lien on certain residential real estate loans and commercial loans.

Junior Subordinated Debentures. We have sponsored two trusts, TBC Capital Statutory Trust II ("TBC Capital II") and TBC Capital Statutory Trust III ("TBC Capital III"), of which we own 100% of the common securities. The trusts were formed for the purpose of issuing mandatory redeemable trust preferred securities to third-party investors and investing the proceeds from the sale of such trust preferred securities solely in our junior subordinated debt securities (the debentures). The debentures held by each trust are the sole assets of that trust. Distributions on the trust preferred securities issued by each trust are payable semi-annually at a rate per annum equal to the interest rate being earned by the trust on the debentures held by that trust. The trust preferred securities are subject to mandatory redemption, in whole or in part, upon repayment of the debentures. We have entered into agreements which, taken collectively, fully and unconditionally guarantee the trust preferred securities subject to

the terms of each of the guarantees. The debentures held by the TBC Capital II and TBC Capital III capital trusts are first redeemable, in whole or in part, by us on September 7, 2007 and July 25, 2006, respectively.

As a result of applying the provisions of FIN 46, governing when an equity interest should be consolidated, we were required to deconsolidate these subsidiary trusts from our financial statements in the fourth quarter of 2003. The deconsolidation of the net assets and results of operations of the trusts had virtually no impact on our financial statements or liquidity position, since we continue to be obligated to repay the debentures held by the trusts and guarantee repayment of the trust preferred securities issued by the trusts. The consolidated debt obligation related to the trusts increased from $31,000,000 to $31,959,000 upon deconsolidation, with the difference representing our common ownership interest in the trusts.

The trust preferred securities held by the trusts qualify as Tier 1 capital under Federal Reserve Board guidelines.

Consolidated debt obligations related to subsidiary trusts holding solely our debentures follow:

| | June 30, 2004 | December 31, 200 |
|---|---|---|
| | (In thousands) | |
| 10.6% junior subordinated debentures owed to TBC Capital Statutory Trust II due September 7, 2030 | $ 15,464 | $ 15,464 |
| 6-month LIBOR plus 3.75% junior subordinated debentures owed to TBC Capital Statutory Trust III due July 25, 2031 | 16,495 | 16,495 |
| Total junior subordinated debentures owed to unconsolidated subsidiary trusts | $ 31,959 | $ 31,959 |

As of June 30, 2004 and December 31, 2003, the interest rate on the $16,495,000 subordinated debentures was 4.96% and 4.90%, respectively.

Currently, we must obtain regulatory approval prior to paying any dividends on these trust preferred securities. The Federal Reserve approved the timely payment of our semi-annual distributions on our trust preferred securities in January, March and July, 2004.

Allowance for Loan Losses. We maintain an allowance for loan losses within a range we believe is adequate to absorb estimated losses inherent in the loan portfolio. We prepare a quarterly analysis to assess the risk in the loan portfolio and to determine the adequacy of the allowance for loan losses. Generally, we estimate the allowance using specific reserves for impaired loans, and other factors, such as historical loss experience based on volume and types of loans, trends in classifications, volume and trends in delinquencies and non-accruals, economic conditions and other pertinent information. The level of allowance for loan losses to net loans will vary depending on the quarterly analysis.

We manage and control risk in the loan portfolio through adherence to credit standards established by the board of directors and implemented by senior management. These standards are set forth in a formal loan policy, which establishes loan underwriting and approval procedures, sets limits on credit concentration and enforces regulatory requirements. In addition, we have engaged

Credit Risk Management, LLC, an independent loan review firm, to supplement our existing independent loan review function.

Loan portfolio concentration risk is reduced through concentration limits for borrowers, collateral types and geographical diversification. Concentration risk is measured and reported to senior management and the board of directors on a regular basis.

The allowance for loan loss calculation is segregated into various segments that include classified loans, loans with specific allocations and pass rated loans. A pass rated loan is generally characterized by a very low to average risk of default and is a loan in which management perceives there is a minimal risk of loss. Loans are rated using an eight-point scale with the loan officer having the primary responsibility for assigning risk ratings and for the timely reporting of changes in the risk ratings. These processes, and the assigned risk ratings, are subject to review by the internal loan review function and senior management. Based on the assigned risk ratings, the criticized and classified loans in the portfolio are segregated into the following regulatory classifications: Special Mention, Substandard, Doubtful or Loss. Generally, regulatory reserve percentages are applied to these categories to estimate the amount of loan loss allowance required, adjusted for previously mentioned risk factors.

Pursuant to SFAS No. 114, impaired loans are specifically reviewed loans for which it is probable that we will be unable to collect all amounts due according to the terms of the loan agreement. Impairment is measured by comparing the recorded investment in the loan with the present value of expected future cash flows discounted at the loan's effective interest rate, at the loans observable market price or at the fair value of the collateral if the loan is collateral dependent. A valuation allowance is provided to the extent that the measure of the impaired loans is less than the recorded investment. A loan is not considered impaired during a period of delay in payment if the ultimate collectibility of all amounts due is expected. Larger groups of homogenous loans such as consumer installment and residential real estate mortgage loans are collectively evaluated for impairment.

Reserve percentages assigned to pass rated homogeneous loans are based on historical charge-off experience adjusted for current trends in the portfolio and other risk factors.

As stated above, risk ratings are subject to independent review by the internal loan review, which also performs ongoing, independent review of the risk management process. The risk management process includes underwriting, documentation and collateral control. Loan review is centralized and independent of the lending function. The loan review results are reported to the Audit Committee of our board of directors and senior management. We have also established a centralized loan administration services department to serve our entire bank. This department will provide standardized oversight for compliance with loan approval authorities and bank lending policies and procedures, as well as centralized supervision, monitoring and accessibility.

The following table summarizes certain information with respect to our allowance for loan losses and the composition of charge-offs and recoveries for the periods indicated.

SUMMARY OF LOAN LOSS EXPERIENCE

SIX-MONTH

| | PERIOD ENDED JUNE 30, 2004 | YEAR ENDED DECEMBER 31, 2003 |
|---|---|---|
| | (Dollars in thousands) | |
| Allowance for loan losses at beginning of period . | $ 25,174 | $ 27,266 |
| Allowance of (branch sold) acquired bank .......... | - | (102) |
| Charge-offs: | | |
| Commercial and industrial ...................... | 2,252 | 10,823 |
| Real estate -- construction and land development | 241 | 630 |
| Real estate -- mortgage | | |
| Single-family ............................ | 287 | 1.505 |
| Commercial ............................... | 3,015 | 6,696 |
| Other .................................... | 40 | 1,187 |
| Consumer ....................................... | 1,154 | 3,092 |
| Other .......................................... | 32 | 517 |
| Total charge-offs ...................... | 7,021 | 24,450 |
| Recoveries: | | |
| Commercial and industrial ...................... | 556 | 554 |
| Real estate -- construction and land development . | 1 | 23 |
| Real estate -- mortgage | | |
| Single-family ............................ | 337 | 23 |
| Commercial ............................... | 381 | 49 |
| Other .................................... | 52 | 48 |
| Consumer ....................................... | 320 | 282 |
| Other .......................................... | 380 | 6 |
| Total recoveries ....................... | 2,027 | 985 |
| Net charge-offs ................................. | 4,994 | 23,465 |
| Provision for loan losses ....................... | - | 20,975 |
| Allowance for loan losses at end of period ........ | $ 20,180 | $ 25,174 |
| Loans at end of period, net of unearned income .... | $ 889,371 | $ 856,941 |
| Average loans, net of unearned income ............ | 863,800 | 1,063,451 |
| Ratio of ending allowance to ending loans ......... | 2.27% | 2.94% |
| Ratio of net charge-offs to average loans (1) ..... | 1.16% | 2.21% |
| Net charge-offs as a percentage of: | | |
| Provision for loan losses ...................... | - | 111.87% |
| Allowance for loan losses (1) .................. | 49.77% | 93.21% |
| Allowance for loan losses as a percentage of nonperforming loans ......................... | 86.32% | 78.59% |

(1)Annualized.

At June 30, 2004, the allowance for loan losses as a percentage of loans, net of unearned income was 2.27% compared to 2.94% as of December 31, 2003. The allowance for loan losses as a percentage of nonperforming loans increased to 86.32% at June 30, 2004 from 78.59% at December 31, 2003 due to a decrease in nonperforming loans of $8.6 million (See "Financial Condition - Nonperforming loans" below).

Net charge-offs were $5.0 million for the first six months of 2004. Net charge-offs to average loans on an annualized basis totaled 1.16% for the first six months of 2004. Net commercial loan charge-offs totaled $1.7 million, or 34.0% of total net charge-off loans for the first six months of 2004 compared to

43.8% of total net charge-off loans for the year 2003. Net commercial real estate loan charge-offs totaled $2.6 million, or 52.7% of total net charge-off loans for the first six months of 2004 compared to 28.3% of total net charge-off loans for the year 2003. Net consumer loan charge-offs totaled $834,000, or 16.7% of total net charge-off loans for the first six months of 2004 compared to 12% of total net charge-off loans for the year 2003. Net commercial real estate loan charge-offs as a percentage of total net charge-offs were higher in the first six months of 2004 because of continued foreclosure activity on certain commercial real estate loans on which estimated losses had been provided to the allowance for loan losses during 2003.

Nonperforming Loans. In January of 2004, we transferred the majority of our nonperforming loans and approximately $7.0 million of other problem loans to our special assets department. Approximately $41.0 million in loans were transferred with the related allowance for loan loss of $9.8 million. This department is staffed with nine employees and is managed by our special assets executive, who has over 18 years of experience in dealing with special assets. By segregating these relationships, we believe we can better monitor and control our collection efforts. Segregating these relationships also allows us to accurately monitor the performance of our individual branches on an ongoing basis without the influence of these nonperforming and problem relationships. Management is vigorously pursuing appropriate collection efforts and expects the nonperforming and problem relationships to decline over the next six months.

Nonperforming loans decreased $8.6 million to $23.4 million as of June 30, 2004 from $32.0 million as of December 31, 2003. As a percentage of net loans, nonperforming loans decreased from 3.74% at December 31, 2003 to 2.63% at June 30, 2004. The decrease in nonperforming loans resulted primarily from collections, charge-offs and the transfer of certain loans to other real estate and foreclosed assets. Other real estate and foreclosed assets increased $1.0 million to $7.0 million at June 30, 2004 from $6.0 million at December 31, 2003. The following table represents our nonperforming loans for the dates indicated.

NONACCRUAL, PAST DUE AND RESTRUCTURED LOANS

| | JUNE 30, 2004 | | |
|---|---|---|---|
| | OPERATING BRANCHES | SPECIAL ASSETS | TOT |
| | | (Dollars in Th | |
| Nonaccrual............................................ | $ 4,746 | $ 17,101 | $ 21 |
| Past due (contractually past due 90 days or more)........... | 1,338 | 131 | 1 |
| Restructured .................................................. | 63 | -- | |
| | $ 6,147 | $ 17,232 | $ 23 |
| Loans, net of unearned ........................................ | $863,183 | $ 26,188 | $ 889 |
| Nonperforming loans as a percent of loans | .71% | 65.80% | |

Loans past due 30 days or more, net of non-accruals, improved to .84% at June 30, 2004 from 2.28% at December 31, 2003. Exclusive of the loans in the special assets portfolio, loans past due more than 30 days, net of non-accruals, were ..75%.

The following is a summary of nonperforming loans by category for the dates shown:

| | JUNE 30 2004 | DECEMBER 31, 2003 |
|---|---|---|
| | (Dollars in thousands) | |
| Commercial and industrial | $ 6,105 | $11,621 |
| Real estate -- construction and land development | 1,635 | 1,735 |
| Real estate -- mortgages | | |
| Single-family | 4,744 | 5,472 |
| Commercial | 12,378 | 10,238 |
| Other | 262 | 162 |
| Consumer | 395 | 465 |
| Other | -- | 201 |
| Total nonperforming loans | $23,379 | $32,034 |

A delinquent loan is placed on nonaccrual status when it becomes 90 days or more past due and management believes, after considering economic and business conditions and collection efforts, that the borrower's financial condition is such that the collection of interest is doubtful. When a loan is placed on nonaccrual status, all interest which has been accrued on the loan during the current period but remains unpaid is reversed and deducted from earnings as a reduction of reported interest income; any prior period accrued and unpaid interest is reversed and charged against the allowance for loan losses. No additional interest income is accrued on the loan balance until the collection of both principal and interest becomes reasonably certain. When a problem loan is finally resolved, there may ultimately be an actual write-down or charge-off of the principal balance of the loan to the allowance for loan losses, which may necessitate additional charges to earnings.

Impaired Loans. At June 30, 2004, the recorded investment in impaired loans totaled $21.1 million with approximately $7.3 million in allowance for loan losses specifically allocated to impaired loans. This represents a decrease of $4.3 million from $25.4 million at December 31, 2003. A significant portion of our impaired loans have been transferred to our special assets department. The following is a summary of impaired loans and the specifically allocated allowance for loan losses by category as of June 30, 2004:

| | OPERATING BRANCHES | | SPECIAL ASSETS | |
|---|---|---|---|---|
| | OUTSTANDING BALANCE | SPECIFIC ALLOWANCE | OUTSTANDING BALANCE | SPECIFI ALLOWAN |
| Commercial and industrial | $ 2,825 | $ 1,719 | $ 4,099 | $ 1,43 |
| Real estate -- construction and land development | 392 | 67 | 1,037 | 22 |
| Real estate -- mortgages | | | | |
| Single-family | 611 | 55 | 1,271 | 40 |
| Commercial | 1,904 | 454 | 8,719 | 2,93 |
| Other | 143 | 24 | 78 | 3 |

| | | | | |
|---|---|---|---|---|
| Total ............................. | $ 5,875 | $ 2,319 | $15,204 | $ 5,01 |

Potential Problem Loans. In addition to nonperforming loans, management has identified $1.4 million in potential problem loans as of June 30, 2004. Potential problem loans are loans where known information about possible credit problems of the borrowers causes management to have doubts as to the ability of such borrowers to comply with the present repayment terms and may result in disclosure of such loans as nonperforming. Approximately $325,000 or 22% of the potential problem loans are part of the portfolio that was transferred to our special assets department in January, 2004. Overall, $907,000 or 63% of our potential problem loans are secured by real estate. Management has allocated in allowance for loan losses approximately $322,000 to absorb any losses that may result from these loans.

Stockholders Equity. Our total stockholders' equity remained level at $100 million at June 30, 2004 and December 31, 2003. Net income of $2.3 million increased stockholders' equity during the first six months of 2004 but was offset by a $2.4 million unrealized loss on available for sale investment securities. As of June 30, 2004 we had 18,025,932 shares of common stock issued and 17,729,062 outstanding. In September of 2000, our board of directors approved a stock buyback plan in an amount not to exceed $10,000,000. As of June 30, 2004, there were 65,448 shares held in treasury at a cost of $430,000.

On April 1, 2002, we issued 157,500 shares of restricted common stock to certain directors and key employees pursuant to the Second Amended and Restated 1998 Stock Incentive Plan. Under the Restricted Stock Agreements, the stock may not be sold or assigned in any manner for a five-year period that began on April 1, 2002. During this restricted period, the participant is eligible to receive dividends and exercise voting privileges. The restricted stock also has a corresponding vesting period with one-third vesting at the end of each of the third, fourth and fifth years. The restricted stock was issued at $7.00 per share, or $1,120,000, and classified as a contra-equity account, "Unearned restricted stock", in stockholders' equity. During 2003, 15,000 shares of this restricted common stock were forfeited. Restricted shares outstanding as of June 30, 2004 were 142,500 and the remaining amount in the unearned restricted stock account is $549,000. This balance is being amortized as expense as the stock is earned during the restricted period. The amounts of restricted shares are included in the diluted earnings per share calculation, using the treasury stock method, until the shares vest. Once vested, the shares become outstanding for basic earnings per share. For the periods ended June 30, 2004 and 2003, we recognized $100,000 and $112,000, respectively, in restricted stock expense.

We adopted a leveraged employee stock ownership plan (the "ESOP") effective May 15, 2002, that covers all eligible employees who are at least 21 years old and have completed a year of service. As of June 30, 2004, the ESOP has been internally leveraged with 273,400 shares of our common stock purchased in the open market and classified as a contra-equity account, "Unearned ESOP shares", in stockholders' equity.

On January 29, 2003, the ESOP trustees finalized a $2,100,000 promissory note to reimburse us for the funds used to leverage the ESOP. The unreleased shares and our guarantee secure the promissory note, which has been classified as long-term debt on our statement of financial condition. As the debt is repaid, shares are released from collateral based on the proportion of debt service. Principal payments on the debt are $17,500 per month for 120 months. The interest rate is adjusted annually to the Wall Street Journal prime rate. Released shares are allocated to eligible employees at the end of the plan year based on the

employee's eligible compensation to total compensation. We recognize compensation expense during the period as the shares are earned and committed to be released. As shares are committed to be released and compensation expense is recognized, the shares become outstanding for basic and diluted earnings per share computations. The amount of compensation expense we report is equal to the average fair value of the shares earned and committed to be released during the period. Compensation expense that we recognized during the periods ended June 30, 2004 and 2003 was $98,000 and $55,000, respectively. The ESOP shares as of June 30, 2004, were as follows:

| | June 30, 2004 |
|---|---|
| Allocated shares | 28,628 |
| Estimated shares committed to be released | 13,350 |
| Unreleased shares | 231,422 |
| Total ESOP shares | 273,400 |
| Fair value of unreleased shares | $ 1,520,000 |

Regulatory Capital. The table below represents our and our subsidiary's regulatory and minimum regulatory capital requirements at June 30, 2004 (dollars in thousands):

| | ACTUAL | | FOR CAPITAL ADEQUACY PURPOSES | | T C |
|---|---|---|---|---|---|
| | AMOUNT | RATIO | AMOUNT | RATIO | AMO |
| Total Risk-Based Capital | | | | | |
| Corporation | $133,251 | 13.46% | $79,214 | 8.00% | $ 99 |
| The Bank | 126,716 | 12.95 | 78,279 | 8.00 | 97 |
| Tier 1 Risk-Based Capital | | | | | |
| Corporation | 119,704 | 12.09 | 39,607 | 4.00 | 59 |
| The Bank | 114,387 | 11.69 | 39,139 | 4.00 | 58 |
| Leverage Capital | | | | | |
| Corporation | 119,704 | 9.51 | 50,325 | 4.00 | 62 |
| The Bank | 114,387 | 9.16 | 49,929 | 4.00 | 62 |

Liquidity

Our principal sources of funds are deposits, principal and interest payments on loans, federal funds sold and maturities and sales of investment securities. In addition to these sources of liquidity, we have access to purchased funds from several regional financial institutions and from the Federal Home Loan Bank under a blanket floating lien on certain commercial loans and residential real

estate loans. Also, we have established certain repurchase agreements with a large financial institution. While scheduled loan repayments and maturing investments are relatively predictable, interest rates, general economic conditions and competition primarily influence deposit flows and early loan payments. Management places constant emphasis on the maintenance of adequate liquidity to meet conditions that might reasonably be expected to occur. Management believes it has established sufficient sources of funds to meet its anticipated liquidity needs.

Forward-Looking Statements

The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements made by us or on our behalf. Some of the disclosures in this Quarterly Report on Form 10-Q, including, among others, any statements preceded by, followed by, or which include, the words "may," "could," "should," "will," "would," "hope," "might," "believe," "expect," "anticipate," "estimate," "intend," "plan," "assume" or similar expressions constitute forward-looking statements.

These forward-looking statements are based upon and include, implicitly and explicitly, our assumptions with respect to our beliefs, plans, objectives, goals, expectations, anticipations, estimates, intentions, financial condition, results of operations, future performance and business, including our expectations and estimates with respect to our revenues, expenses, earnings, return on equity, return on assets, efficiency ratio, asset quality and other financial data and capital and performance ratios.

Although we believe that the expectations underlying our forward-looking statements are reasonable, these statements involve risks and uncertainties that are subject to change based on various important factors (some of which are beyond our control). The following factors, among others, could cause our financial performance to differ materially from what is reflected in our forward-looking statements: the strength of the United States

economy in general and the strength of the regional and local economies in which we conduct operations; the effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System; inflation, interest rate, market and monetary fluctuations; our ability to successfully integrate the assets, liabilities, customers, systems and management we acquire or merge into our operations; our timely development of new products and services in a changing environment, including the features, pricing and quality compared to the products and services of our competitors; the willingness of users to substitute competitors' products and services for our products and services; the impact of changes in financial services policies, laws and regulations, including laws, regulations and policies concerning taxes, banking, securities and insurance, and the application thereof by regulatory bodies; our ability to resolve any legal proceeding on acceptable terms and its effect on our financial condition or results of operations; technological changes; changes in consumer spending and savings habits; and regulatory, legal or judicial proceedings.

If one or more of the factors affecting our forward-looking information and statements proves incorrect, then our actual results, performance or achievements could differ materially from those expressed in, or implied by, forward-looking information and statements contained in this report. Therefore, we caution you not to place undue reliance on our forward-looking statements.

We do not intend to update our forward-looking information and statements, whether written or oral, to reflect change. All forward-looking information and statements attributable to us are expressly qualified by these cautionary

statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

There have been no material changes in our quantitative and qualitative disclosures about market risk as of June 30, 2004 from those presented in our Annual Report on Form 10-K for the year ended December 31, 2003.

The information set forth under the caption "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations-Market Risk-Interest Rate Sensitivity" included in our Annual Report on Form 10-K for the year ended December 31, 2003, is hereby incorporated herein by reference.

ITEM 4. CONTROLS AND PROCEDURES

CEO AND CFO CERTIFICATIONS

Appearing as exhibits to this report are Certifications of our Chief Executive Officer ("CEO") and our Chief Financial Officer ("CFO"). The Certifications are required to be made by Rule 13a - 14 of the Securities Exchange Act of 1934, as amended. This Item contains the information about the evaluation that is referred to in the Certifications, and the information set forth below in this Item 4 should be read in conjunction with the Certifications for a more complete understanding of the Certifications.

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

We conducted an evaluation (the "Evaluation") of the effectiveness of the design and operation of our disclosure controls and procedures under the supervision and with the participation of our management, including our CEO and CFO. Based upon that Evaluation, our CEO and CFO have concluded that, as of the end of the period covered by this report, our disclosure controls and procedures are effective to ensure that material information relating to The Banc Corporation and its subsidiaries is made known to management, including the CEO and CFO, particularly during the period when our periodic reports are being prepared. There have not been any changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities and Exchange Act of 1934, as amended) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

While we are a party to various legal proceedings arising in the ordinary course of business, we believe that there are no proceedings threatened or pending against us at this time that will individually, or in the aggregate, materially

adversely affect our business, financial condition or results of operations. We believe that we have strong claims and defenses in each lawsuit in which we are involved. While we believe that we should prevail in each lawsuit, there can be no assurance that the outcome of any pending or future litigation, either individually or in the aggregate, will not have a material adverse effect on our financial condition or our results of operations.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

On June 15, 2004, our Annual Meeting of Stockholders was held at which shares of common stock represented at the Annual Meeting were voted in favor of the directors listed below as follows:

| Director | For | Against | Withheld |
|---|---|---|---|
| 1. James R. Andrews, M.D. | 13,453,708 | - | 171,818 |
| 2. David R. Carter | 13,342,256 | - | 283,270 |
| 3. James Mailon Kent, Jr. | 13,325,460 | - | 300,066 |
| 4. Ronald W. Orso, M.D. | 13,453,908 | - | 171,618 |
| 5. Larry D. Striplin, Jr. | 13,217,181 | - | 408,345 |
| 6. James A. Taylor | 13,341,960 | - | 283,566 |

In addition to the directors elected at the meeting, the following individuals will continue to serve as directors until the end of their respective terms:

Jerry M. Smith
Marie Swift
K. Earl Durden
Thomas E. Jernigan, Jr.
Randall E. Jones
Michael E. Stephens
W. T. Campbell, Jr.
Roger Barker
James A. Taylor, Jr.
Harold Ripps

In addition, shares of common stock represented at the Annual Meeting were voted in favor of the amendment to the Second Amended and Restated 1998 Stock Incentive Plan of The Banc Corporation to increase the number of shares reserved for awards under the Plan as follows:

| For | Against | Abstain | Nonvotes | Broker Withheld |
|---|---|---|---|---|
| 7,062,070 | 770,700 | 87,751 | 5,705,005 | - |

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibit:

31.01 Certification of principal executive officer pursuant to Rule 13a-14(a).

31.02 Certification of principal financial officer pursuant to 13a-14(a).

32.01 Certification of principal executive officer pursuant to 18 U.S.C. Section 1350.

32.02 Certification of principal financial officer pursuant to 18 U.S.C. Section 1350.

(b) Reports on Form 8-K:

We furnished a Current Report on Form 8-K dated June 14, 2004 under Items 4 and 7 of Form 8-K containing the following Exhibits:

Exhibit (16) - 1 Letter, dated June 14, 2004, from Ernst & Young LLP to the Securities and Exchange Commission.

Exhibit (16) - 2 Letter, dated June 14, 2004, from Ernst & Young LLP to David R. Carter, Chief Financial Officer, The Banc Corporation

We furnished a Current Report on Form 8-K dated August 2, 2004 under Items 7 and 12 of Form 8-K containing as an Exhibit a press release dated August 2, 2004.

SIGNATURES

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

The Banc Corporation
(Registrant)

Date: August 9, 2004 By: /s/ James A. Taylor, Jr.

James A. Taylor, Jr.
President and Chief Operating Officer

Date: August 9, 2004 By: /s/ David R. Carter

David R. Carter
Executive Vice President and Chief Financial Officer
(Principal Accounting Officer)