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COLONIAL BANCGROUP INC
Form 10-Q
November 14, 2001

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTER ENDED SEPTEMBER 30, 2001

COMMISSION FILE NUMBER 1-13508

THE COLONIAL BANCGROUP, INC.
(Exact name of registrant as specified in its charter)

DELAWARE

63-0661573

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer Identification No.)

One Commerce Street
Montgomery, Alabama 36104

(Address of principle executive offices)

(334) 240-5000

(Registrant's telephone number)

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 and (2) has been subject to the filing requirements for at least the past 90 days.

YES NO

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

| Class | Outstanding at October 31, 2001 |
|---|---------------------------------|
| ----- Common Stock, \$2.50 Par Value | ----- 115,202,034 |

THE COLONIAL BANCGROUP, INC.
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CAUTIONARY STATEMENT PURSUANT TO SAFE HARBOR PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995:

This report contains "forward-looking statements" within the meaning of the federal securities laws. The forward-looking statements in this report are subject to risks and uncertainties that could cause actual results to differ materially from those expressed in or implied by the statements. Factors that may cause actual results to differ materially from those contemplated by such forward-looking statements include, among other things, the following possibilities: (i) deposit attrition, customer loss, or revenue loss in the ordinary course of business; (ii) increases in competitive pressure in the banking industry; (iii) changes in the interest rate environment which reduce margins; (iv) costs or difficulties related to the integration of the institutions and businesses recently acquired or to be acquired by BancGroup are greater than expected; (v) general economic conditions, either nationally or regionally, that are less favorable than expected, resulting in, among other things, a deterioration in credit quality, (vi) changes which may occur in the regulatory environment; (vii) a significant rate of inflation or deflation; and (viii) changes in the securities markets. When used in this Report, the words "believes," "estimates," "plans," "expects," "should," "may," "might," "outlook," and "anticipates," and similar expressions as they relate to BancGroup (including its subsidiaries), or its management are intended to identify forward-looking statements.

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THE COLONIAL BANGROUP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CONDITION
(Unaudited)
(Dollars in thousands, except per share amounts)

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| | September 30, 2001 | December 31, 2000 | Sep |
|---|-----------------------|----------------------|-----------|
| ASSETS: | | | |
| Cash and due from banks | \$ 265,420 | \$ 348,891 | \$ |
| Interest-bearing deposits in banks and federal funds sold | 96,799 | 15,855 | |
| Securities available for sale | 1,888,081 | 1,449,386 | |
| Investment securities | 32,076 | 44,310 | |
| Mortgage loans held for sale | 24,668 | 9,866 | |
| Loans, net of unearned income | 9,725,389 | 9,416,770 | |
| Less: Allowance for loan losses | (112,074) | (107,165) | |
| Loans, net | 9,613,315 | 9,309,605 | |
| Premises and equipment, net | 183,381 | 184,831 | |
| Excess of cost over tangible and identified intangible assets acquired, net | 89,491 | 74,393 | |
| Other real estate owned | 12,805 | 8,928 | |
| Accrued interest and other assets | 282,984 | 281,572 | |
| TOTAL ASSETS: | \$12,489,020 | \$11,727,637 | \$ |
| LIABILITIES AND SHAREHOLDERS' EQUITY: | | | |
| Deposits | \$ 8,048,183 | \$ 8,143,017 | \$ |
| FHLB short-term borrowings | 50,000 | 425,000 | |
| Other short-term borrowings | 1,821,788 | 1,463,328 | |
| Subordinated debt | 274,047 | 111,900 | |
| Trust preferred securities | 70,000 | 70,000 | |
| FHLB long-term debt | 1,196,603 | 547,022 | |
| Other long-term debt | 88,062 | 102,325 | |
| Other liabilities | 101,052 | 108,193 | |
| Total liabilities | 11,649,735 | 10,970,785 | |
| SHAREHOLDERS' EQUITY: | | | |
| Common Stock, \$2.50 par value; 200,000,000 shares authorized; 113,147,165, 113,081,198, and 113,083,937 shares issued at September 30, 2001, December 31, 2000, and September 30, 2000, respectively | 282,868 | 282,703 | |
| Treasury stock (2,423,512, 2,773,782, and 2,788,420 at September 30, 2001, December 31, 2000, and September 30, 2000, respectively) | (25,506) | (26,467) | |
| Additional paid in capital | 122,093 | 118,600 | |
| Retained earnings | 439,308 | 390,442 | |
| Unearned compensation | (3,661) | (2,541) | |
| Accumulated other comprehensive income (loss), net of taxes | 24,183 | (5,885) | |
| Total shareholders' equity | 839,285 | 756,852 | |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | \$12,489,020 | \$11,727,637 | \$ |

See Notes to the Unaudited Condensed Consolidated Financial Statements

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THE COLONIAL BANCGROUP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

(Dollars in thousands, except per share amounts)

| | Nine Months Ended September 30, | | Three Months Ended September 30, |
|--|------------------------------------|-----------|-------------------------------------|
| | 2001 | 2000 | 2001 |
| INTEREST INCOME: | | | |
| Interest and fees on loans | \$599,849 | \$579,127 | \$188,058 |
| Interest on investments | 75,815 | 81,234 | 27,060 |
| Other interest and dividends income | 1,809 | 1,967 | 374 |
| Total interest income | 677,473 | 662,328 | 215,492 |
| INTEREST EXPENSE: | | | |
| Interest on deposits | 254,281 | 256,576 | 75,647 |
| Interest on short-term borrowings | 55,455 | 68,375 | 12,987 |
| Interest on long-term debt | 63,850 | 44,564 | 24,764 |
| Total interest expense | 373,586 | 369,515 | 113,398 |
| NET INTEREST INCOME | 303,887 | 292,813 | 102,094 |
| Provision for possible loan losses | 24,498 | 21,822 | 7,601 |
| Net Interest Income After Provision for Possible Loan Losses | 279,389 | 270,991 | 94,493 |
| NONINTEREST INCOME: | | | |
| Service charges on deposit accounts | 30,254 | 28,354 | 10,493 |
| Wealth management | 6,499 | 6,842 | 1,975 |
| Electronic banking | 4,783 | 4,086 | 1,636 |
| Mortgage origination | 5,414 | 4,516 | 1,896 |
| Securities gains (losses), net | 1,899 | (40) | - |
| Other income | 13,879 | 13,848 | 4,416 |
| Total noninterest income | 62,728 | 57,606 | 20,416 |
| NONINTEREST EXPENSE: | | | |
| Salaries and employee benefits | 103,313 | 94,509 | 34,264 |
| Occupancy expense of bank premises, net | 25,257 | 22,479 | 8,578 |
| Furniture and equipment expenses | 21,497 | 21,521 | 7,142 |
| Amortization of intangibles | 5,363 | 3,898 | 2,093 |
| Other expense | 47,173 | 45,668 | 14,775 |
| Total noninterest expense | 202,603 | 188,075 | 66,852 |
| INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES | 139,514 | 140,522 | 48,057 |
| Applicable income taxes | 50,225 | 51,305 | 17,301 |
| INCOME FROM CONTINUING OPERATIONS | 89,289 | 89,217 | 30,756 |

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DISCONTINUED OPERATIONS:

Net loss from discontinued operations and loss on disposal, net of income taxes of (\$371), (\$2,844), (\$371), and \$0 for the nine months ended and for the three months ended September 30, 2001 and 2000, respectively

| | | | |
|------------|-----------|-----------|-----------|
| | (613) | (4,699) | (613) |
| NET INCOME | \$ 88,676 | \$ 84,518 | \$ 30,143 |

EARNINGS PER SHARE:

INCOME FROM CONTINUING OPERATIONS:

| | | | |
|------------|---------|---------|---------|
| Basic | \$ 0.81 | \$ 0.80 | \$ 0.28 |
| Diluted | \$ 0.80 | \$ 0.80 | \$ 0.28 |
| NET INCOME | | | |
| Basic | \$ 0.80 | \$ 0.76 | \$ 0.27 |
| Diluted | \$ 0.80 | \$ 0.76 | \$ 0.27 |

See Notes to the Unaudited Condensed Consolidated Financial Statements

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THE COLONIAL BANGROUP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)
(Dollars in thousands, except per share amounts)

| | Nine Months Ended September 30, | |
|--|------------------------------------|----------|
| | 2001 | 2000 |
| NET INCOME | \$ 88,676 | \$84,518 |
| OTHER COMPREHENSIVE INCOME, NET OF TAXES: | | |
| Unrealized gains (losses) on securities available for sale arising during the period, net of taxes | 31,284 | 6,194 |
| Less: reclassification adjustment for net (gains) losses included in net income | (1,216) | (18) |
| COMPREHENSIVE INCOME | \$118,744 | \$90,694 |

See Notes to the Unaudited Condensed Consolidated Financial Statements

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THE COLONIAL BANGROUP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOW
(Unaudited)
(Dollars in thousands, except per share amounts)

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| | Nine Months Ended September 30, | |
|---|------------------------------------|-------|
| | ----- 2001 ----- | |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | \$ 37,819 | \$ 2 |
| Cash flows from investing activities: | | |
| Proceeds from maturities and calls of securities available for sale | 366,037 | 1 |
| Proceeds from sales of securities available for sale | 55,998 | 1 |
| Purchase of securities available for sale | (740,595) | (3 |
| Proceeds from maturities of investment securities | 12,033 | |
| Net increase in loans | (288,597) | (8 |
| Cash received in bank acquisitions | 33,298 | |
| Capital expenditures | (20,294) | (|
| Proceeds from sale of other real estate owned | 6,648 | |
| Other, net | 3,666 | |
| NET CASH USED IN INVESTING ACTIVITIES | (571,806) | (8 |
| Cash flows from financing activities: | | |
| Net (decrease) increase in demand, savings, and time deposits | (197,848) | |
| Net increase in federal funds purchased, repurchase agreements and other short-term borrowings | 188,455 | 6 |
| Proceeds from issuance of long-term debt | 650,000 | |
| Repayment of long-term debt | (219,677) | (1 |
| Proceeds from issuance of subordinated debt | 150,000 | |
| Proceeds from sale of treasury stock | 7,380 | |
| Proceeds from issuance of common stock | 1,732 | |
| Purchase of treasury stock | (8,772) | |
| Dividends paid (\$0.24 and \$0.22 per share for 2001 and 2000, respectively) | (39,810) | (|
| NET CASH PROVIDED BY FINANCING ACTIVITIES | 531,460 | 5 |
| Net decrease in cash and cash equivalents | (2,527) | (|
| Cash and cash equivalents at beginning of year | 364,746 | 3 |
| Cash and cash equivalents at September 30 | \$ 362,219 | \$ 3 |
| | ===== | ===== |

See Notes to the Unaudited Condensed Consolidated Financial Statements

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THE COLONIAL BANGROUP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOW
(Unaudited)
(Dollars in thousands, except per share amounts)

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:

2001

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| | |
|--|-----------|
| Cash paid during the year for: | |
| Interest | \$388,293 |
| Income taxes | 50,225 |
| Non-cash investing activities: | |
| Transfer of loans to other real estate | \$ 8,399 |
| Securitization of residential mortgage loans | 307,523 |
| Origination of loans for the sale of other real estate | 169 |
| Non-cash financing activities: | |
| Conversion of subordinated debentures | \$ 643 |

See Notes to the Unaudited Condensed Consolidated Financial Statements.

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THE COLONIAL BANCGROUP, INC. AND SUBSIDIARIES
NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE A: ACCOUNTING POLICIES

The Colonial BancGroup, Inc. and its subsidiaries ("BancGroup" or the "Company") have not changed their accounting and reporting policies from those stated in the 2000 annual report on Form 10-K. These unaudited interim financial statements should be read in conjunction with the audited financial statements and footnotes included in BancGroup's 2000 annual report on Form 10-K.

In the opinion of BancGroup, the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting only of normal recurring accruals) necessary to present fairly the financial position as of September 30, 2001 and 2000 and the results of operations and cash flows for the interim periods ended September 30, 2001 and 2000. All 2001 interim amounts are subject to year-end audit, and the results of operations for the interim period herein are not necessarily indicative of the results of operations to be expected for the year.

NOTE B: COMMITMENTS AND CONTINGENCIES

BancGroup and its subsidiaries are from time to time defendants in legal actions arising from normal business activities. Management does not anticipate that the ultimate liability arising from litigation outstanding at September 30, 2001 will have a materially adverse effect on BancGroup's financial statements.

NOTE C: BUSINESS COMBINATIONS AND ACQUISITIONS

On January 13, 2001, Colonial Bank acquired two branches in Nevada from First Security Bank in a branch divestiture resulting from its merger with Wells Fargo. Through this acquisition, the Company purchased \$49.5 million in loans and assumed \$102.9 million in deposits.

The previously announced acquisition of Manufacturers Bancshares, Inc. ("Manufacturers") and its wholly owned subsidiary, Manufacturers Bank of Florida ("Manufacturers Bank") was closed October 25, 2001. Manufacturers Bank operated four branches in the Tampa area and had \$297.4 million in assets as of September 30, 2001. BancGroup issued 4,458,437 shares of its common stock to shareholders of Manufacturers, including shares issued pursuant to the exercise of Manufacturers stock options. This transaction was accounted for as a pooling of

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interests with prior periods restated to include results on a combined basis and will be fully reflected in BancGroup's 2001 Annual Report on Form 10-K. This restatement during the fourth quarter of 2001 is expected to dilute Colonial's previously reported earnings per share for the first three quarters of 2001 by \$.01 to \$.02 per share.

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The previously announced branch purchase and assumption agreement with Union Planters Corporation to acquire 13 Union Planters offices was completed on October 11, 2001. This transaction was accounted for as a purchase with approximately \$21 million in intangible assets.

NOTE D: RECENT ACCOUNTING PRONOUNCEMENTS

In June 1998, the Financials Accounting Standards Board issued SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities" which establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, (collectively referred to as derivatives) and for hedging activities. It requires that entities recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. If certain conditions are met, a derivative may be specifically designated as (a) a hedge of the exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment, (b) a hedge of the exposure to variable cash flows of a forecasted transaction, or (c) a hedge of the foreign currency exposure of a net investment in a foreign operation, an unrecognized firm commitment, an available-for-sale security, or a foreign-currency-denominated forecasted transaction. The accounting for changes in the fair value of a derivative (that is, gains and losses) depends on the intended use of the derivative and the resulting designation.

Under this Statement, an entity that elects to apply hedge accounting is required to establish at the inception of the hedge the method it will use for assessing the effectiveness of the hedging derivative and the measurement approach for determining the ineffective aspect of the hedge. Those methods must be consistent with the entity's approach to managing risk.

On September 23, 1999, the Financial Accounting Standards Board issued SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities -- Deferral of the Effective Date of FASB Statement No. 133," an amendment to delay the effective date of SFAS No. 133. The effective date for this statement was delayed from fiscal years beginning after June 15, 1999 to fiscal years beginning after June 15, 2000. BancGroup adopted SFAS No. 133 and SFAS No. 137 on January 1, 2001 and as of the date of these financial statements, all of BancGroup's hedging relationships qualified for hedge accounting treatment per these statements. The effect of these statements is immaterial to the financials statements presented.

On September 29, 2000, the Financial Accounting Standards Board issued SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, a Replacement of FASB Statement No. 125." This statement is effective for transfers after April 1, 2001. The implementation of SFAS No. 140 did not have a material impact on BancGroup's financial statements.

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On June 29, 2001, the Financial Accounting Standards Board issued SFAS No. 141, "Business Combinations". The effective date for this statement is effective for all business combinations initiated after June 30, 2001. This statement

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supercedes Accounting Principles Board Opinion No. 16, "Business Combinations". SFAS No. 141 requires the purchase method of accounting be used for all business combinations initiated after June 30, 2001, establishes specific criteria for the recognition of intangible assets separately from goodwill, and requires unallocated negative goodwill to be written off immediately as an extraordinary gain instead of being deferred and amortized.

On June 29, 2001, the Financial Accounting Standards Board issued SFAS No. 142, "Intangible Assets". The effective date for this statement is effective for fiscal years beginning after December 15, 2001. SFAS No. 142 requires that goodwill and indefinite lived intangible assets no longer be amortized, that goodwill will be tested for impairment at least annually, that intangible assets deemed to have an indefinite life will be tested for impairment at least annually, and that amortization period of intangible assets with finite lives will no longer be limited to forty years. Management is currently evaluating the impact that SFAS No. 142 will have on BancGroup's financials.

In June 2001, the Financial Accounting Standards Board issued SFAS No. 143, "Accounting for Asset Retirement Obligations". The effective date for this statement is January 1, 2003, with early adoption permitted. SFAS No. 143 addresses the recognition and measurement of obligations associated with the retirement of tangible long-lived assets resulting from acquisition, construction, development, or the normal operation of a long-lived asset. SFAS No. 143 requires that the fair value of an asset retirement obligation be recognized as a liability in the period in which it is incurred. The asset retirement obligation is to be capitalized as part of the carrying amount of the long-lived asset and the expense is to be recognized over the useful life of the long-lived asset. Management is currently evaluating the impact that SFAS No. 143 will have on BancGroup's financials.

In August 2001, the Financial Accounting Standards Board issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". The effective date for this statement is January 1, 2002 and supersedes SFAS No. 121. SFAS No. 144 carries forward from SFAS No. 121 the fundamental guidance related to the recognition and measurement of an impairment loss related to assets to be held and used and provides guidance related to the disposal of long-lived assets to be abandoned or disposal by sale. Management is currently evaluating the impact that SFAS No. 144 will have on BancGroup's financials.

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NOTE E: DISCONTINUED OPERATIONS

As noted in prior quarters, in July 2000 the Company decided to exit the mortgage servicing business and discontinue the operations of mortgage servicing as a separate business unit. As of December 31, 2000, all loan transfers were completed and the mortgage servicing rights removed from the Company's balance sheet. In addition, the escrow and custodial deposits related to those servicing rights have been transferred out of Colonial Bank resulting in a \$209 million reduction in average noninterest bearing deposits from September 30, 2000 to September 30, 2001. At September 30, 2001, the balance sheet of the Company includes approximately \$5.4 million in receivables and other advances related to the various transfers of servicing. These receivable and advance balances represent the expected recoverable amounts once all documentation supporting the transferred loans is provided to the new servicer. The anticipated costs of providing the necessary documents have been accrued. However, due to the volume of loans transferred and the costs and complexity in providing certain documentation, the Company revised its estimate of the cost to complete the disposition of this business resulting in a \$613,000 after-tax expense in the third quarter of 2001. Current estimates of recoverable amounts or costs may be revised for future periods.

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NOTE F: MORTGAGE SERVICING RIGHTS

An analysis of mortgage servicing rights and the related valuation reserve is as follows: (in thousands)

| | Nine Months Ended September 30 | |
|--------------------------------|-----------------------------------|------------|
| | 2001 | 2000 |
| MORTGAGE SERVICING RIGHTS | | |
| Balance, January 1 | \$ - | \$ 265,888 |
| Additions, net | - | 981 |
| Sales | - | (203,712) |
| Scheduled amortization | - | (13,432) |
| Hedge losses applied | - | (49,725) |
| | ----- | ----- |
| Balance, September 30 | - | - |
| | ----- | ----- |
| VALUATION RESERVE | | |
| Balance, January 1 | - | 27,483 |
| Reductions | - | (27,783) |
| Additions | - | 300 |
| | ----- | ----- |
| Balance, September 30 | - | - |
| | ----- | ----- |
| Mortgage Servicing Rights, net | \$ - | \$ - |
| | ===== | ===== |

As a result of the exit of the mortgage servicing business, all hedges related to MSR's were liquidated during the third quarter of 2000.

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NOTE G: EARNINGS PER SHARE

The following table reflects a reconciliation of the numerator and denominator of the basic EPS computation to the numerator and denominator of the diluted EPS computation:

(Dollars in thousands, except per share amounts)

| 2001 | Nine Months Ended September 30, | | | Three Months Ended September 30, | |
|--------------------------------|---------------------------------|---------|------------------|----------------------------------|------------------|
| | Income | Shares | Per Share Amount | Income | Per Share Amount |
| | ----- | ----- | ----- | ----- | ----- |
| Basic EPS | | | | | |
| Net Income | \$88,676 | 110,643 | \$0.80 | \$30,143 | 1 |
| Effect of dilutive securities: | | | | | |

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| | | | | |
|-------------------------------|----------|---------|--------|----------|
| Options | | 458 | | |
| Convertible debentures | 136 | 552 | | 39 |
| Diluted EPS | \$88,812 | 111,653 | \$0.80 | \$30,182 |
| ----- | | | | |
| 2000 | | | | |
| Basic EPS | | | | |
| Net income | \$84,518 | 110,917 | \$0.76 | \$28,561 |
| Effect of dilutive securities | | | | |
| Options | | 135 | | |
| Convertible debentures | 143 | 598 | | 48 |
| Diluted EPS | \$84,661 | 111,650 | \$0.76 | \$28,609 |
| ----- | | | | |

NOTE H: SEGMENT INFORMATION

Through its wholly owned subsidiary Colonial Bank, BancGroup has previously segmented its operations into two distinct lines of business: Commercial Banking and Mortgage Banking. Mortgage Banking was discontinued as a line of business in 2000 (See Note E to the Consolidated Financial Statements). Colonial Bank operates 259 branches throughout 6 states.

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

OPERATIONS

FINANCIAL CONDITION:

Ending balances of total assets, securities, mortgage loans held for sale, net loans, mortgage servicing rights, deposits, and long term debt changed for the nine months and twelve months ended September 30, 2001, respectively, as follows (Dollars in thousands):

| | December 31, 2000 to September 30, 2001 Increase (Decrease) | | September 30, 2000 to September 30, 2001 Increase (Decrease) | |
|-------------------------------|---|--------|--|--|
| | Amount | % | Amount | |
| ----- | | | | |
| Assets: | | | | |
| Bank | \$788,408 | 6.8% | \$1,101,541 | |
| Mortgage Banking | (27,489) | -78.4% | (88,539) | |
| Other | 464 | 3.7% | 490 | |
| ----- | | | | |
| Total Assets | 761,383 | 6.5% | 1,013,492 | |
| Securities | 426,461 | 28.6% | 389,381 | |
| Loans, net of unearned income | 308,618 | 3.3% | 617,996 | |

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| | | | |
|------------------|----------|--------|-----------|
| Deposits: | | | |
| Bank | (82,557) | -1.0% | 122,846 |
| Mortgage Banking | (12,277) | -98.7% | (118,513) |
| | ----- | | |
| Total Deposits | (94,834) | -1.2% | 4,333 |
| Short-term debt | (16,540) | -0.9% | (78,738) |
| Long-term debt | 797,465 | 95.9% | 965,172 |

Assets:

BancGroup's assets have increased 8.8% and 6.5% since September 30, 2000 and December 31, 2000, respectively. This growth resulted primarily from increases in investment securities and internal loan growth throughout BancGroup's banking regions partially offset by the decline in mortgage banking assets due to the discontinuance of this line of business, as discussed in Note E to the consolidated financial statements.

Securities:

Investment securities and securities available for sale have increased \$389.4 million (25.4%) and \$426.5 million (28.6%) from September 30, 2000 and December 31, 2000, respectively. In addition to normal business activities, in June 2001, BancGroup securitized and retained as investments \$307 million of single-family real estate loans. BancGroup retained substantially all of the securitized assets which are reflected as mortgage backed securities in the investment portfolio.

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Loans and Mortgage Loans Held for Sale:

Loans, net of unearned income, have increased \$618.0 million (6.8%) and \$308.6 million (3.3%) from September 30, 2000 and December 31, 2000, respectively. Loan growth was partially offset by the securitization of \$307 million of single-family real estate loans which were transferred to securities in the investment portfolio as mortgage backed securities during the second quarter of 2001. The Mortgage Warehouse Lending unit, which provides lines of credit secured by single-family residential loans in the process of being sold, contributed \$550.2 million and \$470.5 million of this growth from September 30, 2000 and December 31, 2000, respectively. In addition to internal growth, \$49.5 million of the increase in loans was the result of the acquisition of two branches in Nevada, as discussed in Note C of the consolidated financial statements.

| GROSS LOANS BY CATEGORY (Dollars in thousands) | September 30, 2001 | December 31, 2000 | September 30, 2000 |
|---|-----------------------|----------------------|-----------------------|
| | ----- | | |
| Commercial, financial, and agricultural | \$1,145,169 | \$1,221,131 | \$1,164,52 |
| Real estate-commercial | 3,298,273 | 3,174,483 | 2,962,51 |
| Real estate-construction | 2,128,974 | 1,693,958 | 1,706,19 |
| Real estate-residential | 2,017,017 | 2,562,708 | 2,546,49 |
| Installment and consumer | 246,773 | 272,124 | 285,28 |
| Mortgage warehouse lending | 847,448 | 376,995 | 297,29 |
| Other | 41,751 | 115,413 | 145,14 |
| | ----- | | |
| Total Loans | \$9,725,405 | \$9,416,812 | \$9,107,45 |
| | ===== | | |

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Commercial loans collateralized by real estate and construction loans increased approximately \$123.8 million and \$435.0 million, respectively from December 31, 2000 and \$335.8 million and \$422.8 million, respectively, from September 30, 2000. Mortgage Warehouse Lending's loan growth was due primarily to declines in mortgage interest rates which significantly increased the volume of mortgage loan applications for new and refinanced borrowing. The decrease in Residential Real Estate is primarily due to the second quarter securitization previously discussed. The remaining decrease in Residential Real Estate is due to a shift from portfolio adjustable rate products to fixed rate products which are sold in the secondary market. BancGroup's loans are concentrated in various areas of Alabama, the metropolitan Atlanta market in Georgia as well as its markets in Florida, Nevada, and Texas.

BancGroup does not have a syndicated lending department; however, the Company has commitments (including unfunded amounts) that fall within the regulatory definition of a "shared national credit". These commitments total approximately \$552 million, up from \$193 million at December 31, 2000. Substantially all of this increase was attributed to the growth within our Mortgage Warehouse Lending unit.

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Management believes that any existing distribution of loans, whether geographically, by industry, or by borrower, does not expose BancGroup to unacceptable levels of risk. The current distribution of loans remains diverse in location, size, and collateral function. These differences, in addition to our emphasis on quality underwriting, serve to reduce the risk of losses. The following chart reflects the geographic diversity and industry distribution of Construction and Commercial Real Estate loans as of September 30, 2001.

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CONSTRUCTION & COMMERCIAL REAL ESTATE
GEOGRAPHIC DIVERSITY AND INDUSTRY DISTRIBUTION
SEPTEMBER 30, 2001

| (Dollars in thousands) | Construction ----- | Commercial ----- |
|------------------------|-----------------------|---------------------|
| Average Loan Size | \$ 416 | \$ |
| Geographic Diversity | | |
| Alabama | \$ 348,475 | \$ |
| Georgia | 388,523 | |
| Florida | 996,289 | 1, |
| Texas | 179,476 | |
| Nevada | 121,495 | |
| Other | 94,716 | |
| | ----- | ----- |
| Total | \$2,128,974 | \$3, |

| Industry Distribution | % of Industry Distribution to ----- | | % |
|-----------------------|--|-------|---|
| | Construction | Total | C |

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| | Portfolio ----- | Portfolio ----- | |
|------------------------|--------------------|--------------------|---------------------------------|
| 1-4 Family Residential | 26% | 6% | Retail |
| Developments | 20% | 4% | Office |
| Land Only | 17% | 4% | Multi-Family |
| Multi-Family | 8% | 2% | Lodging |
| Retail | 6% | 1% | Nursing Home |
| Condominium | 6% | 1% | Warehouse |
| Other (13 types) | 17% | 4% | Other (11 types) |
| | --- | ----- | |
| Total Construction | 100% | 22% | Total Commercial Real Estate |
| | ----- | ----- | |

 Characteristics of the 75 Largest Loans

| | Construction ----- |
|---|-----------------------|
| 75 Largest Loans Total | \$758,195 |
| % of 75 largest loans to category total | 35.6% |
| Average Loan to Value Ratio (75 largest loans) | 70% |
| Debt Coverage Ratio (75 largest loans) | N/A |

 Substantially all Construction and Commercial Real Estate loans have personal guarantees of the principals involved. Owner occupied Commercial Real Estate portfolio totals represented 30% of the total Commercial Real Estate portfolio at September 30, 2001.

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ALLOCATION OF THE ALLOWANCE FOR LOAN LOSSES

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

| (Dollars in thousands) | September 30, 2001 | Percent of Loans to Total Loans | December 31, 2000 | Percent of Loans to Total Loans |
|---|-----------------------|---------------------------------------|----------------------|---------------------------------------|
| | ----- | ----- | ----- | ----- |
| Commercial, financial, and agricultural | \$ 33,280 | 11.8% | \$ 27,861 | 13.0% |
| Real estate-commercial | 43,907 | 33.9% | 43,843 | 33.7% |
| Real estate-construction | 16,086 | 21.9% | 15,909 | 18.0% |
| Real estate-mortgage | 10,085 | 20.7% | 12,814 | 27.2% |
| Installment and consumer | 2,544 | 2.5% | 2,927 | 2.9% |

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| | | | | |
|----------------------------|-----------|--------|-----------|--------|
| Mortgage warehouse lending | 2,119 | 8.7% | 942 | 4.0% |
| Other | 4,053 | 0.5% | 2,869 | 1.2% |
| TOTAL | \$112,074 | 100.0% | \$107,165 | 100.0% |

SUMMARY OF LOAN LOSS EXPERIENCE

| (Dollars in thousands) | September 30, 2001 | December 31, 2000 | Septemb 200 |
|---|-----------------------|----------------------|----------------|
| Allowance for loan losses - January 1 | \$107,165 | \$ 95,993 | \$ |
| Charge-offs: | | | |
| Commercial, financial, and agricultural | 9,317 | 10,493 | |
| Real estate-commercial | 8,255 | 3,240 | |
| Real estate-construction | 45 | 529 | |
| Real estate-residential | 2,275 | 3,260 | |
| Installment and consumer | 2,380 | 4,345 | |
| Other | 651 | 1,119 | |
| Total charge-offs | 22,923 | 22,986 | |
| Recoveries: | | | |
| Commercial, financial, and agricultural | 465 | 1,210 | |
| Real estate-commercial | 310 | 627 | |
| Real estate-construction | 8 | 62 | |
| Real estate-residential | 326 | 440 | |
| Installment and consumer | 1,508 | 1,856 | |
| Other | 151 | 283 | |
| Total recoveries | 2,768 | 4,478 | |

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| | September 30, 2001 | December 31, 2000 | Septemb 200 |
|--|-----------------------|----------------------|----------------|
| Net charge-offs | 20,155 | 18,508 | |
| Addition to allowance for branch acquisition | 566 | - | |
| Addition to allowance charged to operating expense | 24,498 | 29,680 | |
| Allowance for loan losses-end of period | \$112,074 | \$107,165 | \$ |

Based on softening economic conditions, nonperforming assets increased to 0.74% of net loans and other real estate at September 30, 2001. Nonperforming assets have increased \$21.0 million from December 31, 2000. Most of this increase was from one loan relationship. Annualized net charge-offs remained relatively low at .27% of loans year to date. Management continuously monitors and evaluates

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recoverability of problem assets and adjusts loan loss reserves accordingly. Loan loss reserve was 1.15% of loans at September 30, 2001 compared to 1.14% at December 31, 2000 and 1.14% at September 30, 2000.

NONPERFORMING ASSETS ARE SUMMARIZED BELOW

| (Dollars in thousands) | September 30, 2001 | December 2000 |
|---|-----------------------|------------------|
| | ----- | ----- |
| Nonaccrual loans | \$57,743 | \$40,624 |
| Restructured loans | 1,125 | 1,161 |
| | ----- | ----- |
| Total nonperforming loans* | 58,868 | 41,785 |
| Other real estate owned and in substance foreclosures | 12,805 | 8,928 |
| | ----- | ----- |
| Total nonperforming assets* | \$71,673 | \$50,713 |
| | ===== | ===== |
| Aggregate loans contractually past due 90 days for which interest is being accrued | \$21,091 | \$ 9,841 |
| Net charge-offs quarter-to-date | \$ 9,233 | \$ 4,998 |
| Net charge-offs year-to-date | \$20,155 | \$18,508 |
| RATIOS | | |
| PERIOD END: | | |
| Total nonperforming assets as a percent of net loans and other real estate | 0.74% | 0.54 |
| Allowance as a percent of net loans | 1.15% | 1.14 |
| Allowance as a percent of nonperforming assets* | 156% | 211 |
| Allowance as a percent of nonperforming loans* | 190% | 256 |
| FOR THE PERIOD ENDED: | | |
| Net charge-offs as a percent of average net loans- (annualized basis): | 0.38% | 0.25 |
| Quarter to date | | |
| Year to date | 0.27% | 0.21 |

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

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In addition to the monitoring of the nonperforming Assets identified above, management, through its loan officers, internal credit review staff and external examinations by regulatory agencies, regularly monitors selected accruing loans for which general economic conditions or changes within a particular industry could cause the borrower financial difficulties. This continuous monitoring of the loan portfolio and the related identification of loans with a high degree of credit risk are essential parts of the BancGroup's credit management. In connection with such reviews, collateral values are updated where considered necessary. If collateral values are judged insufficient or other sources of repayment inadequate, the loans are reduced to estimated recoverable amounts through increases in reserves allocated to the loans or charge-offs.

Nonperforming loans and selected potential problem loans represent all material credits for which management has serious doubts as to the ability of the borrowers to comply with the loan repayment terms. Management also expects that the resolution of these problem credits as well as other performing loans will not materially impact future operating results, liquidity or capital resources. The recorded investment in impaired loans at September 30, 2001 was \$54.0

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million and these loans had a corresponding valuation allowance of \$22.6 million.

LIQUIDITY:

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

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

Core deposit growth is a primary focus of BancGroup's funding and liquidity strategy. Average retail deposits excluding broker and time deposits grew at an annualized rate of 11% for the nine months ended September 30, 2001. Core deposit growth continues to be a primary strategic objective of the Company.

In addition to funding growth through core deposits, BancGroup has worked to expand the availability of long and short term wholesale funding sources. As of September 30, 2001 the Bank utilized just 49% of the total wholesale funding sources estimated to be available to them. Management believes its liquidity sources and funding strategies are adequate given the nature of its asset base and current loan demand.

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INTEREST RATE SENSITIVITY:

The Federal Reserve has lowered the target fed funds rate 10 times this year, a total of 450 basis points, to 2.00% its lowest level in over 40 years. Such a series of rate cuts by the Federal Reserve has not been observed since the last recession of 1991.

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

The following table represents the output from the Company's most recent simulation model when the fed funds rate was 2.50% and measures the impact on net interest income of an immediate and sustained change in interest rates in 100 basis point increments for the 12 calendar months following the date of the change. This twelve month projection of net interest income under these scenarios is compared to both the twelve month net interest income projection with rates unchanged and the third quarter 2001 net interest income annualized.

Percentage Change in 12 month projected (1

3rd Quar

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| | Fed Funds Rate | Net Interest Income | Income Net I |
|---------------------------------|----------------|---------------------|-----------------|
| Basis Points change from stable | | | |
| +200..... | 4.50 | 2% | |
| +100..... | 3.50 | 1 | |
| No Change | 2.50 | - | |
| - 100..... | 1.50 | (2) | |
| - 200..... | 0.50 | (4) | |

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

This table shows that under all rate shock scenarios, net interest income is expected to improve versus recent results, although the expected benefit is less if rates continue to decline. The improvement in margin is due largely to the downward repricing of the CD portfolio. As of September 30, 2001, \$2.5 billion of BancGroup's CD Portfolio will mature and reprice within the next six months at rates that are expected to be approximately 2.50% below their current cost. The benefit is reduced if rates continue to decline due to compression, as many deposit products are nearing natural floors.

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The following table summarizes BancGroup's Maturity / Rate Sensitivity or Gap at September 30, 2001.

(Dollars in millions)

| | 0-90 days | 0-365 days |
|---|-----------|------------|
| Rate Sensitive Assets (RSA) | \$5,972 | \$7,894 |
| Rate Sensitive Liabilities (RSL) | 4,114 | 6,927 |
| Cumulative Gap (RSA-RSL) | 1,858 | 967 |
| Cumulative Gap Ratio (Cum. Gap / Total Assets) | 15 | 8% |

The last two lines of the proceeding table represents interest rate sensitivity gap which is the difference between rate sensitive assets and rate sensitive liabilities.

In reviewing the table, it should be noted that the balances are shown for a specific point in time and, because the interest sensitivity position is dynamic, it can change significantly over time. For all interest earning assets and interest bearing liabilities, variable rate assets and liabilities are reflected in the time interval of the assets or liabilities' earliest repricing date. Fixed rate assets and liabilities have been allocated to various time intervals based on contractual repayment and prepayment assumptions. Furthermore, the balances reflect contractual repricing of the deposits and management's position on repricing certain deposits where management discretion is permitted. Certain demand deposit accounts and regular savings accounts have

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been classified as repricing beyond one year in accordance with regulatory guidelines. While these accounts are subject to immediate withdrawal, experience and analysis have shown them to be relatively rate insensitive.

CAPITAL RESOURCES:

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

The amount of a cash dividend, if any, rests with the discretion of the Board of Directors of BancGroup as well as upon applicable statutory constraints such as the Delaware law requirement that dividends may be

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paid only out of capital surplus or net profits for the fiscal year in which the dividend is declared or the preceding fiscal year.

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

The Federal Reserve Board has issued guidelines identifying minimum Tier I leverage ratios relative to total assets and minimum capital ratios relative to risk-adjusted assets. The minimum leverage ratio is 3% but is increased from 100 to 200 basis points based on a review of individual banks by the Federal Reserve. The minimum risk adjusted capital ratios established by the Federal Reserve are 4% for Tier I and 8% for total capital. BancGroup's actual capital ratios and the components of capital and risk adjusted asset information (subject to regulatory review) as of September 30, 2001 are stated below:

Capital (in thousands):

| | |
|-------------------------------------|--------------|
| Tier I Capital | \$ 795,610 |
| Tier II Capital | 373,597 |
| | ----- |
| Total Capital | \$ 1,169,207 |
| | ===== |
| Risk Adjusted Assets (in thousands) | \$10,234,046 |

Capital Ratios:

| | September 30, 2001 | December 31, 2001 |
|------------------------------------|--------------------|-------------------|
| | ----- | ----- |
| Tier I leverage ratio (minimum 3%) | 6.56% | 6.63% |
| Risk Adjusted Capital Ratios: | | |
| Tier I Capital Ratio (minimum 4%) | 7.77% | 8.21% |
| Total Capital Ratio (minimum 8%) | 11.42% | 10.58% |

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BancGroup has increased capital gradually through normal earnings retention as well as through stock registrations to capitalize acquisitions. The decrease in the Tier I Capital Ratio is primarily due to asset growth and a change in the mix of assets. The increase in the Total Capital Ratio is due to the issuance on May 23, 2001 of \$150 million in subordinated debt by Colonial Bank that qualifies as Tier II Capital.

Management continuously monitors its capital levels in order to ensure it is taking the necessary steps to support future internally generated growth and fund the quarterly dividend rates that are currently \$0.12 per share each quarter.

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AVERAGE VOLUME AND RATE
(UNAUDITED)
(Dollars in thousands)

| | Three Months Ended September | | | Average Volume |
|--|------------------------------|-----------|-------|-------------------|
| | 2001 | | | |
| | Average Volume | Interest | Rate | |
| ASSETS | | | | |
| Loans, net | \$ 9,765,986 | \$187,921 | 7.64% | \$ 8,953,2 |
| Mortgage loans held for sale | 22,733 | 357 | 6.28% | 7,8 |
| Investment securities and securities available for sale and other interest- earning assets | 1,805,698 | 28,055 | 6.21% | 1,674,9 |
| Total interest-earning assets(1) | 11,594,417 | 216,333 | 7.42% | 10,635,9 |
| Nonearning assets | 640,208 | | | 812,2 |
| Total assets | \$12,234,625 | | | \$11,448,1 |
| LIABILITIES AND SHAREHOLDERS' EQUITY: | | | | |
| Interest-bearing deposits | \$ 6,947,488 | 75,647 | 4.32% | \$ 6,866,9 |
| Short-term borrowings | 1,472,966 | 12,987 | 3.50% | 1,626,9 |
| Long-term debt | 1,663,935 | 24,861 | 5.93% | 895,4 |
| Total interest-bearing liabilities | 10,084,389 | 113,495 | 4.47% | 9,389,4 |
| Noninterest-bearing demand deposits | 1,227,566 | | | 1,250,1 |
| Other liabilities | 104,043 | | | 95,1 |
| Total liabilities | 11,415,998 | | | 10,734,6 |
| Shareholders' equity | 818,627 | | | 713,4 |
| Total liabilities and shareholders' equity | \$12,234,625 | | | \$11,448,1 |
| RATE DIFFERENTIAL | | | 2.95% | |
| NET YIELD ON INTEREST-EARNING ASSETS | | \$102,838 | 3.53% | |

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(1) Interest earned and average rates on obligations of states and political subdivisions are reflected on a tax equivalent basis. Tax equivalent interest earned is equal to actual interest earned times 145%. The taxable equivalent adjustment has given effect to the disallowance of interest expense deductions, for federal income tax purposes, related to certain tax-free assets.

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AVERAGE VOLUME AND RATE
(UNAUDITED)
(Dollars in thousands)

| | 2001 | | | Average Volume |
|---|-------------------|-----------|-------|-------------------|
| | Average Volume | Interest | Rate | |
| Nine Months Ended September 30, | | | | |
| ----- | | | | |
| ASSETS | | | | |
| Loans, net | \$ 9,849,752 | \$599,472 | 8.13% | \$ 8,692,8 |
| Mortgage loans held for sale | 19,209 | 933 | 6.48% | 16,7 |
| Investment securities and securities available for sale and other interest-earning assets | 1,636,833 | 79,518 | 6.48% | 1,673,7 |
| | ----- | ----- | | ----- |
| Total interest-earning assets(1) | 11,505,794 | 679,923 | 7.89% | 10,383,4 |
| | ----- | | | |
| Nonearning assets | 651,158 | | | 894,2 |
| | ----- | | | ----- |
| Total assets | \$12,156,952 | | | \$11,277,6 |
| | ===== | | | ===== |
| LIABILITIES AND SHAREHOLDERS' EQUITY: | | | | |
| Interest-bearing deposits | \$ 7,062,345 | 254,281 | 4.81% | \$ 6,755,7 |
| Short-term borrowings | 1,599,597 | 55,455 | 4.64% | 1,466,4 |
| Long-term debt | 1,428,009 | 64,250 | 6.01% | 946,9 |
| | ----- | ----- | | ----- |
| Total interest-bearing liabilities | 10,089,951 | 373,986 | 4.95% | 9,169,1 |
| | ----- | ----- | | ----- |
| Noninterest-bearing demand deposits | 1,170,231 | | | 1,301,9 |
| Other liabilities | 103,383 | | | 105,2 |
| | ----- | | | ----- |
| Total liabilities | 11,363,565 | | | 10,576,3 |
| Shareholders' equity | 793,387 | | | 701,2 |
| | ----- | | | ----- |
| Total liabilities and shareholders' equity | \$12,156,952 | | | \$11,277,6 |
| | ===== | | | ===== |
| RATE DIFFERENTIAL | | | 2.94% | |
| NET YIELD ON INTEREST-EARNING ASSETS | | \$305,937 | 3.55% | |
| | | ===== | | |

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- (1) Interest earned and average rates on obligations of states and political subdivisions are reflected on a tax equivalent basis. Tax equivalent interest earned is equal to actual interest earned times 145%. The taxable equivalent adjustment has given effect to the disallowance of interest expense deductions, for federal income tax purposes, related to certain tax-free assets.

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ANALYSIS OF INTEREST INCREASES / (DECREASES)
(UNAUDITED)

(Dollars in thousands)

Three Months Ended September 30, 2001
Change from 2000

| | Total | Attributed to Volume |
|---|-------------|-------------------------|
| | ----- | ----- |
| INTEREST INCOME: | | |
| Total loans, net | \$ (14,719) | \$ 17,583 |
| Mortgage loans held for sale | 188 | 246 |
| Investment securities and securities for sale and other interest-earning assets | (536) | 2,103 |
| | ----- | ----- |
| Total interest income (2) | (15,067) | 19,931 |
| | ----- | ----- |
| INTEREST EXPENSE: | | |
| Interest-bearing deposits | \$ 17,071 | \$ (1,088) |
| Short-term borrowings | 13,883 | 2,333 |
| Long-term debt | (10,231) | (11,614) |
| | ----- | ----- |
| Total interest expense | 20,723 | (10,369) |
| | ----- | ----- |
| Net interest income | \$ 5,656 | \$ 9,563 |
| | ===== | ===== |

- (1) Increases (decreases) are attributed to volume changes and rate changes on the following basis: Volume Change = change in volume times old rate. Rate Change = change in rate times old volume. The Rate/Volume Change = change in volume times change in rate, and it is allocated between Volume Change and Rate Change at the ratio that the absolute value of each of those components bear to the absolute value of their total.
- (2) Interest earned and average rates on obligations of states and political subdivisions are reflected on a tax equivalent basis. Tax equivalent interest earned is: actual interest earned times 145%. Tax equivalent average rate is: tax equivalent interest earned divided by average volume.

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ANALYSIS OF INTEREST INCREASES / (DECREASES)
(UNAUDITED)

(Dollars in thousands)

Nine Months Ended September 30, 2001
Change from 2000

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| | Total | Attributed to Volume |
|---|-----------|-------------------------|
| | ----- | ----- |
| INTEREST INCOME: | | |
| Total loans, net | \$ 20,452 | \$ 72,653 |
| Mortgage loans held for sale | (72) | 135 |
| Investment securities and securities for sale and other interest-earning assets | (5,660) | (1,809) |
| | ----- | ----- |
| Total interest income(2) | 14,720 | 70,978 |
| | ----- | ----- |
| INTEREST EXPENSE: | | |
| Interest-bearing deposits | \$ 2,295 | \$(11,264) |
| Short-term borrowings | 12,920 | (5,766) |
| Long-term debt | (18,885) | (21,727) |
| | ----- | ----- |
| Total interest expense | (3,670) | (38,757) |
| | ----- | ----- |
| Net interest income | \$ 11,050 | \$ 32,222 |
| | ===== | ===== |

- (1) Increases (decreases) are attributed to volume changes and rate changes on the following basis: Volume Change = change in volume times old rate. Rate Change = change in rate times old volume. The Rate/Volume Change = change in volume times change in rate, and it is allocated between Volume Change and Rate Change at the ratio that the absolute value of each of those components bear to the absolute value of their total.
- (2) Interest earned and average rates on obligations of states and political subdivisions are reflected on a tax equivalent basis. Tax equivalent interest earned is: actual interest earned times 145%. Tax equivalent average rate is: tax equivalent interest earned divided by average volume.

NET INTEREST INCOME:

Net interest income from continuing operations on a tax equivalent basis increased \$5.9 million to \$102.9 million for the quarter ended September 30, 2001 from \$97.0 million for the quarter ended September 30, 2000. For the nine months ended September 30, 2001, net interest income from continuing operations on a tax equivalent basis increased \$10.9 million to \$306.3 as compared to \$295.4 million for the same period in 2000. Net interest margins remained constant at 3.53% for the third quarter of 2001 compared to 3.53% for the second quarter of 2001, and 3.65% for the third quarter of 2000. Net interest margins decreased from 3.79% to 3.55% for the nine months ended September 30, 2000 compared to the same period in 2001.

The average rate on loans was 7.64% for the third quarter of 2001 compared to 8.05% for the second quarter 2001 and 9.01% for the third quarter of 2000, respectively. During this same time, the rate on

average interest bearing deposits was 4.32% for the third quarter of 2001 compared to 4.80% and 5.37% for the second quarter of 2001 and third quarter of 2000, respectively. Although rates on deposits have declined, they reprice more slowly than loan rates primarily due to market competition and the natural lag in the repricing of the CD's portfolio. Although Certificates of Deposits

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represent approximately 50% of Interest Bearing Deposits as of September 30, 2001, \$2.5 billion will mature and reprice within the next six months at rates that are expected to be approximately 2.5% below their current cost.

LOAN LOSS PROVISION:

The provision for loan losses for the third quarter ended September 30, 2001 was \$7,601,000 compared to \$8,861,000 for the same period in 2000. The Company continues to focus its efforts on relationship based lending to known customers in its local market areas.

The current allowance for loan losses provides a 190% coverage of nonperforming loans compared to 256% at December 31, 2000 and 234% at September 30, 2000. See management's discussion on loan quality and the allowance for possible loan losses presented in the Financial Condition section of this report.

NONINTEREST INCOME:

Noninterest income increased \$5.1 million (8.9%) for the nine months ended September 30, 2001 compared to the same period in 2000 and decreased \$233,000 (1.1%) for the three months ended September 30, 2001 over the three months ended September 30, 2000. The year to date increase is primarily attributable to service charges on deposit accounts, cash management services, mortgage origination income, electronic banking fees and securities gains.

Mortgage origination fees increased \$898,000 (19.9%) for the nine months ended September 30, 2001 compared to the same period in 2000 and decreased \$210,000 (10.0%) for the three months ended September 30, 2001 over the three months ended September 30, 2000. The year-to-date increase is the result of additional production of one-to-four family mortgage loans sold in the secondary market. The increase in production is directly related to the decrease in mortgage rates throughout 2001. Management believes that the decrease in production for the quarter is due to uncertainty in the economy.

BancGroup continues to expand electronic banking services through its ATM network, check card services, and internet banking. Non-interest income from electronic banking services increased 17.1% for the nine months ended September 30, 2001 and 17.4% for the three months ended September 30, 2001 compared to the same periods in 2000.

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Service charges on deposit accounts increased \$1.9 million (6.7%) for the nine months ended September 30, 2001 over the same period in 2000 and \$817,000 (8.4%) for the three months ended September 30, 2001 when compared to the three months ended September 30, 2000. This increase is the result of normal deposit account related fees and an increase in cash management fees of approximately \$585,000 (36.1%) and \$185,000 (31.3%) for the six months and three months ended September 30, 2001, respectively.

Wealth management experienced a \$343,000 decrease in fee income from security sales for the nine months ended September 30, 2001 over the same period in 2000, but increased \$75,000 in the third quarter of 2001 when compared to the third quarter of 2000. Management believes that the nine month decrease is due to the volatility in the equity markets and the overall outlook on the economy by investors.

NONINTEREST EXPENSES:

In support of the Company's sales culture, BancGroup continues to make strategic investments in its product and service offerings, technology systems, incentives

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and branch network to enhance the Company's competitive presence in existing markets. BancGroup's philosophy is to make strategic investments in the tools employees need to optimize its customers' financial success. Accordingly, noninterest expense increased 6.2% for the quarter ended September 30, 2001 as compared to the same period last year.

As a result of slowing loan demand, the company took initiatives in the third quarter to reduce noninterest expenses. Accordingly, total noninterest expense excluding amortization of intangibles and approximately \$437,000 in merger related expense has decreased \$3.4 million (5%) as compared to the second quarter of 2001.

BancGroup's net overhead (total noninterest expense less noninterest income, excluding security gains) was \$141.8 million for the nine months ended September 30, 2001 and \$46.4 million for the three months ended September 30, 2001 compared to \$130.4 million and \$42.3 million for the nine months and three months ended September 30, 2000, respectively.

Noninterest expense increased \$14.5 million for the first nine months of 2001 compared to 2000 and \$3.9 million for the third quarter of 2001 compared to the third quarter of 2000. Noninterest expense to average assets decreased to 2.22% for the nine months ended September 30, 2001 from 2.23% at September 30, 2000.

The increase in bank related expenses is primarily due to an increase of approximately \$8.8 million and \$2.1 million for the nine months and three months ended September 30, 2001 over the same periods in

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2000, respectively, in salaries and employee benefits. These salary increases during the year are due to additional branches operating, normal salary increases, additional incentive related compensation, and increased pension costs.

In order to improve the Company's market presence, three of its regional headquarters were relocated in 2001. The Company also opened ten new branches and two loan production offices since September 2000. Occupancy and equipment expense for the nine months and third quarter of 2001 increased \$2.8 million and \$655,000, respectively, when compared to the same periods in 2000. This increase is also due to increased rent expense, higher utility cost, and improvements and expansions of bank facilities. In addition to the changes in branch structure, the Company continues to invest in improved technology equipment and software.

Intangible asset amortization increased \$1.5 million and \$796,000 for the nine months and three months ended September 30, 2001, respectively, over the same periods in 2000 due to the purchase of two branches in Nevada in January of 2001 (See Note C to the Consolidated Financial Statements).

PROVISION FOR INCOME TAXES:

BancGroup's provision for income taxes is based on an approximate 36.0% and 36.5%, estimated annual effective tax rate for the years 2001 and 2000, respectively. The provision for income taxes for the nine months ended September 30, 2001 and 2000 was \$50,225,000 and \$51,305,000, respectively.

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Item III Quantitative and Qualitative Disclosures About Market Risk
The information required by this item is included in Item II. Management's Discussion and Analysis of Financial Condition and Results of Operations.

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Part II Other Information

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

ITEM 2: Changes in Securities - N/A

ITEM 3: Defaults Upon Senior Securities - N/A

ITEM 4: Submission of Matters to a Vote of Security Holders - N/A

ITEM 5: Other Information - None

ITEM 6: Exhibits and Reports on Form 8-K

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

(b) Reports on Form 8-K

1. Form 8-K - Was filed on July 17, 2001 in regard to second quarter 2001 earnings.
2. Form 8-K - Was filed on October 16, 2001 in regard to third quarter 2001 earnings.

SIGNATURE

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

THE COLONIAL BANCGROUP, INC.

Date: November 14, 2001

By: /s/ W. Flake Oakley, IV

W. Flake Oakley, IV
its Chief Financial Officer