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FLAG FINANCIAL CORP
Form 10-Q
November 15, 2002

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2002

OR

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

For the Transition Period from _____ to _____

Commission file number 0-24532

FLAG FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

Georgia

58-2094179

(State of incorporation)

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

P.O. Box 3007
LaGrange, Georgia 30241

(Address of principal executive offices) (Zip Code)

(706) 845-5000

(Telephone Number)

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

YES NO

Common stock, par value \$1 per share: 8,386,365 shares
Outstanding as of November 8, 2002

FLAG Financial Corporation and Subsidiaries

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Part I. Financial Information
Item 1. Financial Statements
FLAG Financial Corporation and Subsidiaries
Consolidated Balance Sheets

September 30,
2002

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| | (UNAUDITED) | (|
|--|----------------|---|
| ASSETS | | |
| Cash and due from banks | \$ 12,401,953 | |
| Federal funds sold | -- | |
| Total cash and cash equivalents | 20,077,641 | |
| Interest-bearing deposits | -- | |
| Investment securities available-for-sale | 118,096,869 | 1 |
| Other investments | 7,142,682 | |
| Mortgage loans held-for-sale | 7,561,919 | |
| Loans, net | 376,582,848 | 3 |
| Premises and equipment, net | 13,171,474 | |
| Accrued interest receivable | 4,451,006 | |
| Other assets | 19,383,763 | |
| Total assets | \$ 558,792,514 | 5 |
| LIABILITIES | | |
| Non interest-bearing deposits | \$ 39,347,937 | |
| Interest-bearing demand deposits | 126,039,129 | 1 |
| Savings | 25,401,806 | |
| Time | 232,300,619 | 2 |
| Total deposits | 423,089,491 | 4 |
| Federal funds purchased and repurchase agreements | 865,071 | |
| Other borrowings | -- | |
| Advances from Federal Home Loan Bank | 62,000,000 | |
| Accrued expenses and other liabilities | 7,752,575 | |
| Total liabilities | 498,545,066 | 5 |
| STOCKHOLDERS' EQUITY | | |
| Preferred stock (10,000,000 shares authorized, none issued and outstanding) | -- | |
| Common stock (\$1 par value, 20,000,000 shares authorized, 9,631,451, 8,277,995 and 8,277,995 shares issued at September 30, 2002, December 31, 2001 and September 30, 2001, respectively) | 9,631,451 | |
| Additional paid-in capital | 23,426,500 | |
| Retained earnings | 34,185,472 | |
| Accumulated other comprehensive income | 2,471,535 | |
| Less: Treasury stock at cost; 1,236,961 shares at September 30, 2002, 908,001 shares at December 31, 2001 and 692,607 shares at September 30, 2001, respectively | (9,467,510) | |
| Total stockholders' equity | 60,247,448 | |

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Total liabilities and stockholders' equity

\$ 558,792,514

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See Accompanying Notes to Consolidated Financial Statements

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Consolidated Statements of Operations

| | (UNAUDITED) | |
|--|-------------------------------------|------------|
| | Three Months Ended September 30, | |
| | 2002 | 2001 |
| Interest Income | | |
| Interest and fees on loans | \$ 7,869,733 | 9,017,780 |
| Interest on securities | 5,294,916 | 5,428,029 |
| Interest on time deposits and federal funds sold | 14,705 | 105,678 |
| Total interest income | 9,610,978 | 11,118,344 |
| Interest Expense | | |
| Interest on deposits: | | |
| Interest Bearing Demand Deposits | 487,950 | 586,978 |
| Savings Deposits | 56,102 | 75,172 |
| Time Deposits | 2,026,869 | 3,778,473 |
| Other | 880,906 | 1,657,400 |
| Total interest expense | 9,393,457 | 15,770,520 |
| Net interest income before provision for loan losses | 6,744,914 | 6,017,235 |
| Provision for Loan Losses | 4,399,000 | 588,000 |
| Net interest income after provision for loan losses | 6,549,914 | 5,933,235 |
| Other Income | | |
| Service charges on deposit accounts | 848,151 | 977,356 |
| Mortgage loan and related fees | 808,334 | 588,816 |
| Insurance commissions and brokerage fees | 182,685 | 175,860 |
| Other income | 145,203 | 188,879 |
| Total other income | 1,984,373 | 1,930,911 |
| Other Expenses | | |
| Salaries and employee benefits | 3,989,371 | 3,389,703 |
| Occupancy | 876,378 | 863,082 |
| Professional fees | 165,790 | 254,501 |

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| | | |
|--|--------------|-------------|
| Postage, printing and supplies | 220,347 | 121,987 |
| | ----- | ----- |
| Amortization of intangibles | 126,367 | 124,322 |
| Communications and data | 484,814 | 561,703 |
| Other operating | 706,050 | 944,919 |
| | ----- | ----- |
| Total other expenses | 6,569,117 | 6,260,217 |
| | ----- | ----- |
| Earnings (loss) before provision for Income taxes and extraordinary item | 1,965,170 | 1,603,929 |
| Provision for income taxes | 607,414 | 437,957 |
| | ----- | ----- |
| Earnings (loss) before extraordinary item | 1,357,756 | (3,371,125) |
| Extraordinary item - loss on redemption of debt, net of income tax benefit of \$101,377 in 2002 | -- | -- |
| | ----- | ----- |
| Net earnings (loss) | \$ 1,357,756 | 1,165,972 |
| | ===== | ===== |
| | | |
| Basic earnings (loss) per share before extraordinary item | \$ (0.41) | 0.43 |
| Extraordinary item | -- | -- |
| | ----- | ----- |
| | | |
| Basic earnings (loss) per share | \$ 0.16 | 0.15 |
| | ===== | ===== |
| | | |
| Diluted earnings (loss) per share before extraordinary item | \$ 0.16 | 0.15 |
| Extraordinary item | -- | -- |
| | ----- | ----- |
| | | |
| Diluted earnings (loss) per share | \$ 0.16 | 0.15 |
| | ===== | ===== |

See Accompanying Notes to Consolidated Financial Statements.

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Consolidated Statements of Comprehensive Income

| | Three Months Ende | |
|---|-------------------|-----------|
| | September 30, | |
| | 2002 | 2001 |
| | ----- | |
| Net earnings (loss) | \$ 1,357,756 | 1,165,972 |
| Other comprehensive income, net of tax: | | |
| Unrealized gains on investment securities available-for-sale: | | |
| Unrealized gains arising during the period, net of tax of \$179,619, \$500,936, \$659,785 and \$1,463,021, respectively | 293,063 | 817,000 |

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| | | | |
|---|----|-----------|-----------|
| Plus: Reclassification adjustment for losses included in net earnings (loss), net of tax of | \$ | 4,240 | |
| Unrealized (losses) gains on cash flow hedges, net of tax of \$45,837, \$270,589, \$137,512 and \$28,026 respectively | | (74,787) | (441,000) |
| | | ----- | ----- |
| Other comprehensive income | | 218,276 | 375,000 |
| Comprehensive income (loss) | \$ | 1,576,032 | 1,541,000 |
| | | ===== | ===== |

See Accompanying Notes to Consolidated Financial Statements

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Consolidated Statements of Cash Flows

| | Nine months Ended September 30, | |
|---|------------------------------------|--------------|
| | 2002 | 2001 |
| | (UNAUDITED) | |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net (loss) earnings | \$ (3,536,529) | \$ 3,400,000 |
| Adjustment to reconcile net (loss) earnings to net cash provided by (used in) operating activities: | | |
| Depreciation, amortization and accretion | 1,911,350 | 2,000,000 |
| Provision for loan losses | 4,399,000 | 5,000,000 |
| Loss on sale of available-for-sale securities | 11,157 | (7,000,000) |
| Gain on sales of loans | (1,016,539) | (7,000,000) |
| Gain on sale of other real estate | (56,639) | (7,000,000) |
| Change in: | | |
| Mortgage loans-held-for sale | (91,253) | 4,000,000 |
| Other | (7,829,338) | (1,900,000) |
| | ----- | ----- |
| Net cash provided by (used in) operating activities | (6,208,791) | 3,800,000 |
| | ----- | ----- |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Net change in interest-bearing deposits | 160,093 | 3,300,000 |
| Proceeds from sales and maturities of investment securities available-for-sale | 53,921,872 | 23,300,000 |
| Purchases of investment securities available-for-sale | (39,355,680) | (45,000,000) |
| Purchases of other investments | (1,113,700) | (7,000,000) |

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| | | |
|---|---------------|---------|
| Net change in loans | (12,014,759) | 16,0 |
| Proceeds from sale of other real estate | 735,029 | 1,2 |
| Proceeds from sale of premises and equipment | 430,763 | |
| Purchases of premises and equipment | | |
| | (1,297,089) | (7 |
| Purchases of cash surrender value life insurance | | |
| | (133,023) | (1 |
| | ----- | ----- |
| Net cash provided by (used in) investing activities . | 1,869,929 | (3,1 |
| | ----- | ----- |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Net change in deposits | | |
| | (17,491,834) | (5,4 |
| Change in federal funds purchased and repurchase agreements | (12,298,000) | 2 |
| Change in other borrowed funds | (5,000,000) | 1,7 |
| Proceeds from FHLB advances | 46,000,000 | 10,0 |
| Payments of FHLB advances | | |
| | (23,448,435) | (1,4 |
| Purchase of treasury stock | (3,022,872) | (3,7 |
| Proceeds from issuance of stock | 11,707,740 | |
| Proceeds from exercise of stock options | 481,705 | |
| Proceeds from issuance of warrants | 1,236,000 | |
| Cash dividends paid | (1,501,130) | (1,4 |
| | ----- | ----- |
| Net cash used in financing activities | (3,336,826) | (1 |
| | ----- | ----- |
| Net change in cash and cash equivalents | 583,786 | (7,7 |
| Cash and cash equivalents at beginning of period | | |
| | 20,077,641 | 21,8 |
| | ----- | ----- |
| Cash and cash equivalents at end of period | \$ 12,401,953 | \$ 22,4 |
| | ===== | ===== |

See Accompanying Notes to Consolidated Financial Statements

Notes to Consolidated Financial Statements

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

The accounting principles followed by FLAG Financial Corporation ("FLAG") and its bank subsidiary and the methods of applying these principles conform with accounting principles generally accepted in the United States of America and with general practices within the banking industry. Certain principles, which significantly affect the determination of financial position, results of operations, and cash flows are summarized below and in FLAG's annual report on Form 10-K for the year ended December 31, 2001.

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Note 1. Basis of Presentation

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

The consolidated financial information furnished herein represents all adjustments that are, in the opinion of management, necessary to present a fair statement of the results of operations, and financial position for the periods covered herein and are normal and recurring in nature. For further information, refer to the consolidated financial statements and footnotes included in FLAG's annual report on Form 10-K for the year ended December 31, 2001.

Note 2. Earnings Per Share

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

| | Three Months Ended September 30, | | 2001 |
|--|-------------------------------------|-------------|-----------|
| | 2002 | 2001 | |
| Basic earnings (loss) per share: | | | |
| Net earnings (loss) after extraordinary item | \$1,357,756 | \$1,165,972 | \$(3,536) |
| Weighted average common shares outstanding | 8,393,364 | 7,768,959 | 8,136 |
| Per share amount | \$ 0.16 | \$ 0.15 | \$ () |
| Diluted earnings (loss) per share: | | | |
| Net earnings (loss) | \$1,357,756 | \$1,165,972 | \$(3,536) |
| Effect of dilutive securities - stock options | 252,268 | 48,852 | |
| Per share amount | \$ 0.16 | \$ 0.15 | \$ () |

Item 2: Management's Discussion and Analysis of
Financial Condition and Results of Operations

Forward-Looking Statements

The following is a discussion of our financial condition as of September 30, 2002 compared to December 31, 2001 and the results of our operations for the quarter and nine months ended September 30, 2002 compared to the quarter and nine months ended September 30, 2001. These comments should be read in conjunction with our consolidated financial statements and accompanying footnotes appearing in this report. This report contains "forward-looking statements" relating to, without limitation, future economic performance, plans and objectives of management for future operations, and projections of revenues

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and other financial items that are based on the beliefs of our management, as well as assumptions made by and information currently available to our management. The words "expect", "estimate", "anticipate", and "believe", as well as similar expressions, are intended to identify forward-looking statements. Our actual results may differ materially from the results discussed in the forward-looking statements, and our operating performance each quarter is subject to various risks and uncertainties. Factors that could cause actual results to differ from those discussed in the forward-looking statements include, but are not limited to:

- (1) the strength of the U.S. economy in general and the strength of the local economies in which operations are conducted;
- (2) 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;
- (3) inflation, interest rate, market and monetary fluctuations;
- (4) the timely development of and acceptance of new products and services and perceived overall value of these products and services by users;
- (5) changes in consumer spending, borrowing and saving habits;
- (6) technological changes;
- (7) acquisitions;
- (8) the ability to increase market share and control expenses;
- (9) the effect of changes in laws and regulations (including laws and regulations concerning taxes, banking, securities and insurance) with which the Company and its subsidiary must comply;
- (10) the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies as well as the Financial Accounting Standards Board;
- (11) changes in the Company's organization, compensation and benefit plans;
- (12) the costs and effects of litigation and of unexpected or adverse outcomes in such litigation; and
- (13) the Company's success at managing the risks involved in the foregoing.

Forward-looking statements speak only as of the date on which they are made. We undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made to reflect the occurrence of unanticipated events.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Financial Condition

Assets and Funding

Total assets were \$558.8 million at September 30, 2002, a decrease of \$11.4 million or 2.0% from December 31, 2001. The Company has worked during 2002 to reduce the level of lower yielding assets (loans and investment securities) as well as similar amounts of funding identified as relatively expensive (CDs and fixed FHLB advances). Resulting from these efforts are lower levels of earning

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assets and deposits that are producing slightly higher net interest income. While total assets reflected a decrease of \$11.4 million, earning assets during the same period decreased only \$3.6 million.

Gross loans outstanding at September 30, 2002 were \$383.9 million compared to \$376.3 million at December 31, 2001. Loans outstanding, while up 2.0% over prior year amounts, have just recently begun to grow. The Company's efforts at reducing lower earning and higher risk assets during 2002 trimmed loans outstanding to as low as \$344.9 million during the second quarter. Loans outstanding at September 30, 2002 represent growth of approximately \$46.5 million or 13.4% from the lower balances experienced during the second quarter of 2002.

Investment securities at September 30, 2002 totaled \$125.2 million versus \$137.4 million at December 31, 2001. While the Company has reinvested some of the funds that have resulted from maturities and sales during 2002, a portion of those proceeds have been used to offset decreases in certain funding sources as well as to fund loan growth.

Non-interest-bearing deposits have decreased by \$9.2 million compared to December 31, 2001 levels. This decrease is attributable to the divestiture of two branches in December 2001 as well as the closure of five branches during 2002. Interest bearing transaction accounts have increased over the same period by \$11.7 million and largely results from the Company's focus on this type of funding as opposed to time deposits. Time deposits have decreased substantially over the same period, from \$270.7 million at September 30, 2001 to \$232.3 million at September 30, 2002.

Liquidity and Capital Resources

The Company maintains borrowing lines with various other financial institutions including the Federal Home Loan Bank. At September 30, 2002, the Company had total borrowing agreements of approximately \$101 million of which approximately \$62.0 million was advanced.

The Company's Board of Directors approved a private placement of 1.3 million shares of common stock and 1.3 million warrants to purchase common stock during the first quarter of 2002. At September 30, 2002, 1,272,000 shares and 1,272,000 warrants to purchase common stock had been sold for an aggregate of \$12.9 million. All shares and warrants issued in the private placement were issued to members of the Company's management team and other employees under Rule 506 under the Securities Act of 1933, as amended.

The funds provided from the private placement contributed to an increase of 11.5% in stockholders' equity to \$60.2 million over December 31, 2001 levels. The increase provided by the private placement funds was partially offset by the net loss of \$3.5 million and an increase in treasury stock of \$3.0 million. Stockholders' equity as a percentage of total assets was 10.8% at September 30, 2002 versus 9.5% at December 31, 2001.

Management's Discussion and Analysis of
Financial Condition and Results of Operations

Results of Operations

Overview of nine month period ending September 30, 2002

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Net loss for the nine month period ending September 30, 2002 was \$3.5 million or \$0.43 per share compared to net income of \$3.4 million or \$0.43 per share for the first nine months of 2001. The net loss in 2002 includes an after tax restructuring charge of \$3,380,000, a one-time after tax provision for loan losses of \$2,483,000, and an after tax extraordinary charge of \$165,000 related to the prepayment of a portion of the Company's Federal Home Loan Bank borrowings.

Net interest income for the nine months ending September 30, 2002 was \$18.2 million, a decrease of \$600,000 or 3.1% from the same period in 2001. This decrease is primarily attributed to the significant decrease in interest rates as well as a slight contraction in earning assets during 2002.

Non-interest income for the nine month period ending September 30, 2002 decreased 1.6% to \$5.4 million when compared to the nine months ending September 30, 2001. While income from mortgage banking activities increased \$185,000 or 11.1% for the period, FLAG experienced a decrease in fees and service charges on deposit accounts of \$418,000 or 14.2%. This decrease was mainly attributed to FLAG's decision to sell two branches in December 2001 with approximately \$37 million in deposits.

Excluding the one-time charges mentioned above, the Company would have earned approximately \$2.5 million with non-interest expenses of approximately \$19.6 million for the nine month period ending September 30, 2002. This level of non-interest expenses represents an increase of approximately \$600,000 and is largely comprised of higher salaries and benefits.

Results of operations for quarter ending September 30, 2002

Net income for the quarter ended September 30, 2002 was \$1,358,000 or \$0.16 per diluted share. This level of net income represents an increase of 16.5% compared to net income of \$1,166,000 for the comparable period in 2001. Diluted earnings per share also increased from 2001 levels of \$0.15 per share.

Net interest income for the quarter ending September 30, 2002 increased approximately \$728,000 or 12.1% over the comparable quarter in 2001. For these periods, net interest margin increased to 5.30% from 4.63%. The Company attributes most of the decrease in interest income and interest expense to the lower rate environment that has persisted during 2002. The decrease in interest expense has been more significant than the decrease in interest income, resulting in increased net interest income.

Interest income for the third quarter of 2002 was \$9.6 million, a decrease of \$1.5 million or 13.6% over the same quarter in 2001. Interest and fees on loans decreased from \$9.0 million to \$7.9 million, a decrease of 12.7%. FLAG's yield on loans during the quarter ended September 30, 2002 decreased to 8.35% from 9.46% in the third quarter of 2001. Average loans outstanding during the third quarter of 2002 were \$374.0 million, a decrease of \$4.1 million or 1.1% compared to the comparable quarter a year ago. At September 30, 2002, gross loans accounted for 68.7% of total assets and approximately 74.3% of interest earning assets. This compares favorably with the quarter ended September 30, 2001 ratios of 66.1% and 73.2%, respectively.

Interest income on investment securities decreased by \$268,000 during the quarter ending September 30, 2002 to \$1.7 million when compared to the same quarter in 2001. The yield on the investment portfolio decreased from 5.86% to 5.24% over this period. For the quarters ended September 30, 2002 and 2001, FLAG had average investment securities of \$129.6 million and \$134.0 million, respectively.

FLAG aggressively manages earning assets in order to maintain a balanced combination of credit and market risk, as well as yield. In the current rate environment, FLAG has attempted to maintain a very low level of federal funds sold, relying on borrowing lines with other financial institutions, including but not limited to the FHLB. During the third quarter of 2002, FLAG was successful in averaging only \$1.3 million of federal funds sold and interest bearing deposits with other banks, compared to \$3.3 million during the third quarter of 2001. Federal funds sold and interest-bearing deposits with other banks averaged 0.25% and 0.64% of total interest earning assets for the quarters ending September 30, 2002 and 2001, respectively.

FLAG uses customer deposits and borrowings from other financial institutions as its two primary sources to fund interest earning assets. Total funding for FLAG at September 30, 2002 was \$490.8 million with an overall cost for the quarter of 2.36%, compared to \$500.6 million, costing 4.10% in the comparable quarter of 2001. The decreases in costs and balances resulted in a savings of \$2.2 million or 43.8% for the quarter, and allowed FLAG to improve total net interest income with lower levels of interest earning assets.

Interest expense on customer deposits for the third quarter of 2002 decreased by \$1.9 million to \$2.6 million when compared to the quarter ended September 30, 2001. This 42% decrease was mainly attributable to aggressive repricing efforts on all elements of FLAG's deposit base. Interest bearing demand deposits averaged \$126.7 million with an average cost of 1.53% for the quarter ending September 30, 2002 compared to \$108.6 million costing an average of 2.15% for the comparable quarter of 2001. Time deposits averaged \$233.3 million and \$266.7 million with average costs of 3.45% and 5.62% for the third quarter of 2002 and 2001, respectively.

Interest expense on other borrowings consists of interest on FHLB advances, other borrowings and federal funds purchased. For the third quarter of 2002, interest expense on other borrowings was approximately \$295,000 compared to \$660,000 for the same quarter in 2001. This decrease of 55.3% is the result of the early repayment and refinancing of fixed FHLB advances in recent quarters. This refinancing allowed FLAG to reduce the overall cost on other borrowings to 1.97% for the third quarter of 2002 compared to 5.25% a year ago.

Non-Interest Income and Expense

Non-interest income grew 2.8% during the third quarter of 2002 compared to the same period in 2001. The decrease in non-interest bearing balances discussed earlier contributed to a decrease in service charges of 13.2% to \$848,000. Income from mortgage banking activities (origination fees, gain on sale of loans and service release premiums) grew \$220,000 to \$808,000 in the third quarter of 2002, mostly the result of very favorable interest rates on home mortgages. Non-interest income as a percent of total revenue decreased to 22.7% from the 2001 level of 24.3%.

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Financial Condition and Results of Operations

Non-interest expenses increased during the quarter ended September 30, 2002 to \$6.6 million from \$6.3 million in the same quarter of 2001. This 4.9% increase includes an \$13,000 increase in occupancy expense, a \$239,000 decrease in other operating expense and a \$600,000 increase in salaries and benefits. A significant portion of the increase in salaries and benefits is attributed to increased commissions related to improved production in the mortgage, insurance and investment groups.

Income Taxes

Income tax expense for the quarter ending September 30, 2002 was \$607,000 compared to \$438,000 for the same quarter in 2001. FLAG's effective tax rate for the quarter ended September 30, 2002 was 30.9% compared to 27.3% for the quarter ended September 30, 2001.

Loans

FLAG engages in a full complement of lending activities, including real estate-related, commercial and financial loans and consumer installment loans. FLAG generally concentrates lending efforts on real estate related loans. As of September 30, 2002, FLAG's loan portfolio consisted of 84.3% real estate-related loans, 11.1% commercial and financial loans, and 4.4% consumer installment loans. While risk of loss is primarily tied to the credit quality of the various borrowers, risk of loss may also increase due to factors beyond the FLAG's control, such as local, regional and/or national economic downturns. General conditions in the real estate market may also impact the relative risk in the real estate portfolio. Of the target areas of lending activities, commercial and financial loans are generally considered to have a greater risk of loss than real estate loans or consumer installment loans.

Loans are stated at unpaid balances, net of unearned income and deferred loan fees. Balances within the major loans receivable categories are represented in the following table: (000's omitted)

| | September 30, 2002 | December 31, 2001 | September 30, 2001 |
|--|-----------------------|----------------------|-----------------------|
| | ----- | ----- | ----- |
| Commercial/financial/agricultural..... | \$ 42,750 | 79,722 | 57,913 |
| Real estate construction | 76,036 | 65,052 | 65,341 |
| Real estate - mortgage | 53,858 | 47,180 | 43,925 |
| Real estate - other | 194,142 | 166,568 | 184,574 |
| Installment loans to individuals | 17,094 | 17,793 | 22,822 |
| | ----- | ----- | ----- |
| Total loans | 383,880 | 376,315 | 374,575 |
| less: | | | |
| Allowance for loan losses | 7,297 | 7,348 | 6,531 |
| | ----- | ----- | ----- |
| Total net loans | \$376,583 | 368,967 | 368,044 |
| | ===== | ===== | ===== |

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Management's Discussion and Analysis of Financial Condition and Results of Operations

Provision and Allowance for Loan and Lease Losses

FLAG maintains an allowance for loan losses appropriate for the quality of the loan portfolio and sufficient to meet anticipated future loan losses. FLAG utilizes a comprehensive loan review and risk identification process and the analysis of FLAG's financial trends to determine the adequacy of the allowance. Many factors are considered when evaluating the allowance. The analysis is based on historical loss trends; trends in criticized and classified loans in the portfolio; trends in past due and non-accrual loans; trends in portfolio volume, composition, maturity, and concentrations; changes in local and regional economic market conditions; the accuracy of the loan review and risk identification system, and the experience, ability, and depth of lending personnel and management.

Management evaluates the allowance on a quarterly basis. Through this evaluation, the appropriate provision for loan losses is determined by considering the current allowance level, actual loan losses and loan recoveries.

The provision for loan losses for the third quarter of 2002 was \$195,000 versus \$84,000 for comparable period in 2001. The allowance for loan and lease losses at September 30, 2002 was \$7.3 million, approximately the same as December 31, 2001. The ratio of the allowance for loan losses to net outstanding loans at September 30, 2002 and December 31, 2001 was 1.94% and 1.99%, respectively.

The following table summarizes the changes in the allowance for loan losses arising from loans charged off and recoveries on loans previously charged off by loan category, and additions to the allowance that have been charged to operations in the Company's consolidated statements of operations. (000's omitted)

| | Nine months ended | |
|---|-------------------|--------------|
| | September 30, | |
| | 2002 | 2001 |
| | ---- | ---- |
| Balance of allowance for loan losses at beginning of period | \$7,348 | 6,583 |
| Provision charged to operating expense | 4,399 | 588 |
| Charge offs: | | |
| Commercial | 959 | 218 |
| Construction | | |
| Real estate - mortgage | 469 | 359 |
| Real estate - other | 3,221 | 45 |
| Consumer | 312 | 251 |
| Total charge-offs | ----- 4,961 | ----- 873 |
| Recoveries: | | |
| Commercial | 120 | 83 |
| Construction | 1 | |

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| | | |
|---|---------|-------|
| Real estate - mortgage | 23 | 13 |
| Real estate - other | 283 | 108 |
| Consumer | 84 | 29 |
| | ----- | ----- |
| Total recoveries | 511 | 233 |
| | ----- | ----- |
| Net charge-offs | 4,450 | 640 |
| | ----- | ----- |
| Balance of allowance for loan losses at end of period | \$7,297 | 6,531 |
| | ===== | ===== |

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Management's Discussion and Analysis of
Financial Condition and Results of Operations

Non-Performing Assets

Non-performing assets (nonaccrual loans, real estate owned and repossessions) totaled approximately \$12.5 million at September 30, 2002 compared to \$18.9 million at December 31, 2001 and \$9.6 million at September 30, 2001. These levels as a percentage of net loans outstanding represented 3.33%, 5.14% and 2.62%, respectively.

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

| Non-performing assets (000's omitted) | September 30, 2002 | December 31, 2001 | Septem 200 |
|---|-----------------------|----------------------|---------------|
| | ----- | ----- | ----- |
| Loans on nonaccrual | \$9,464 | 17,122 | 6,97 |
| Loans past due 90 days and still accruing | 2,084 | 594 | 1,36 |
| Other real estate owned | 989 | 1,231 | 1,30 |
| | ----- | ----- | ----- |
| Total non-performing assets | \$9,645 | 12,537 | 18,94 |
| | ===== | ===== | ===== |
| Total non-performing assets as a percentage of net loans | 3.33% | 5.14% | 2.6 |

Capital

At September 30, 2002, FLAG and its bank were in compliance with various regulatory capital requirements administered by Federal and State banking agencies. The following is a table representing the Company's consolidated

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Tier-1 Capital, Tangible Capital, and Risk-Based Capital:

September 30, 2002

| | Actual Amount | % | Required Amount | % |
|--|------------------|--------|--------------------|-------|
| Total Capital (to Risk Weighted Assets) | \$ 56,897 | 12.77% | \$ 35,654 | 8.00% |
| Tier 1 Capital (to Risk Weighted Assets) | \$ 51,286 | 11.51% | \$ 17,827 | 4.00% |
| Tier 1 Capital (to Average Assets) | \$ 51,286 | 9.49% | \$ 21,627 | 4.00% |

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Management's Discussion and Analysis of Financial Condition and Results of Operations

Item 3. Quantitative and Qualitative Disclosures about Market Risk

As of September 30, 2002, there were no substantial changes in the composition of the Company's market-sensitive assets and liabilities or their related market values from that reported as of December 31, 2001. The foregoing disclosures related to the market risk of the Company should be read in conjunction with the Company's audited consolidated financial statements, related notes and management's discussion and analysis of financial condition and results of operations for the year ended December 31, 2001 included in the Company's 2001 Annual Report on Form 10-K.

Item 4. Controls and Procedures

Within 90 days prior to the date of this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-14. Based upon that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in timely alerting them to material information relating to the Company (including its consolidated subsidiaries) that is required to be included in the Company's periodic filings with the Securities and Exchange Commission. There have been no significant changes in the Company's internal controls or, to the company's knowledge, in other factors that could significantly affect those internal controls subsequent to the date the Company carried out its evaluation, and there have been no corrective actions with respect to significant deficiencies or material weaknesses.

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Part 2. Other Information
FLAG Financial Corporation and Subsidiaries

PART II. Other Information

Item 1. Legal Proceedings - None

Item 2. Changes in Securities - None

Item 3. Defaults upon Senior Securities - None

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

Item 5. Other Information

Pursuant to Rule 14a-14(c)(1) promulgated under the Securities Exchange Act of 1934, as amended, shareholders desiring to present a proposal for consideration at the Company's 2003 Annual Meeting of Shareholders must notify the Company in writing to the Secretary of the Company, at Eagle's Landing, 235 Corporate Center Drive, Stockbridge, Georgia 30281 of the contents of such proposal no later than December 15, 2002 to be included in the 2003 Proxy Materials. A shareholder must notify the Company before January 15, 2003 of a proposal for the 2003 Annual Meeting that the shareholder intends to present other than by inclusion in the Company's proxy material. If the Company does not receive such notice prior to January 15, 2003, proxies solicited by the management of the Company will confer discretionary authority upon the management of the Company to vote upon any such matter.

Item 6. Exhibits and Report on Form 8-K

(a) Exhibits

99.1 Certification by Chief Executive Officer and Chief Financial Officer.

(b) Reports on Form 8-K

Reports on Form 8-K filed during the Third Quarter of 2002:

None

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FLAG Financial Corporation and Subsidiaries

SIGNATURES

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

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FLAG Financial Corporation

By: /s/ Joseph W Evans

Joseph W. Evans
(Chief Executive Officer)

Date: 11/12/02

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

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

Date: 11/12/02

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Certification

I, Joseph W. Evans, Chief Executive Officer of FLAG Financial Corporation, certify that:

1. I have reviewed this quarterly report on Form 10-Q of FLAG Financial Corporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

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5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
- a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officer(s) and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 12, 2002

/s/ Joseph W. Evans

Joseph W. Evans
Chief Executive Officer

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Certification

I, J. Daniel Speight, Jr., Chief Financial Officer of FLAG Financial Corporation, certify that:

- 1. I have reviewed this quarterly report on Form 10-Q of FLAG Financial Corporation;
- 2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
- 3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
- 4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a) designed such disclosure controls and procedures to ensure that

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material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

- b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
- a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officer(s) and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 12, 2002

/s/ J. Daniel Speight, Jr.

J. Daniel Speight, Jr.
Chief Financial Officer