SECOND BANCORP INC
Form 10-K405
March 27, 2002

**Table of Contents**

# SECURITIES AND EXCHANGE COMMISSION
**Washington, D.C. 20549**

## Form 10-K

**[x] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2001**

**[ ] TRANSITIONAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM __________TO ________.**

**Commission File Number : 0-15624**

**Second Bancorp Incorporated**
*(Exact name of registrant as specified in charter)*

| **Ohio** | **34-1547453** |
|---|---|
| *(State or other jurisdiction of incorporation or organization)* | *(IRS Employer Identification No.)* |

**108 Main Avenue SW, Warren, Ohio 44481**
*(Address of principal executive offices) (Zip Code)*

**Registrant s telephone number, including area code:**
**330.841.0123**

**Securities registered pursuant to Section 12(g) of the Act:**

| **Title of each class** | **Name of each exchange on which registered** |
|---|---|
| Common Stock, no par value | The Nasdaq National Market |

**Securities registered pursuant to Section 12(b) of the Act:**
None

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter periods that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [x] No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant s knowledge, in definitive proxy of information statements, incorporated by reference in Part III of this Form 10-K or any amendment to this form 10-K. [x]

The aggregate market value of the Common Stock held by non-affiliates of the registrant as of February 22, 2002 as reported on the NASDAQ National Market System, was approximately $201,375,374. Shares of Common Stock held by each officer and director and by each person who owns 5% or more of the outstanding Common Stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of February 22, 2002, the registrant had outstanding 9,936,971 shares of Common Stock.

**DOCUMENTS INCORPORATED BY REFERENCE**
Portions of the proxy statement for the annual shareholders meeting to be held on April 18, 2002 are incorporated by reference into Part III.

1

**TABLE OF CONTENTS**

PART I.
- Item 1. BUSINESS
- Item 2. PROPERTIES
- Item 3. LEGAL PROCEEDINGS
- Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS
- Item 4A. IDENTIFICATION OF EXECUTIVE OFFICERS

PART II.
- Item 5. MARKET FOR REGISTRANT S COMMON STOCK AND RELATED SHAREHOLDER MATTERS
- Item 6. SELECTED FINANCIAL DATA
- Item 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
- Item 7 (a). QUANITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK
- Item 8. Financial Statements and Supplementary Data
- Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosures

PART III
- Item 10. Directors and Executive Officers of the Registrant
- Item 11. Executive Compensation
- Item 12. Security Ownership of Certain Beneficial Owners and Management
- Item 13. Certain Relationships and Related Transactions

PART IV
- Item 14. Exhibits, Financial Statement Schedules, and Reports on Form 8-K

SIGNATURES
EXHIBIT 10.10
EXHIBIT 10.11
EXHIBIT 10.12
EXHIBTI 21
EXHIBIT 23.1

---

Table of Contents

## PART I.

### Item 1. BUSINESS

#### General

Second Bancorp Incorporated, ( Second Bancorp ) is a one-bank financial holding company with its most significant subsidiary being The Second National Bank of Warren ( Second National ), a Warren, Ohio based commercial bank. Operating through thirty-seven branches, Second National offers a wide range of commercial and consumer banking and trust services primarily to business and individual customers in various communities in a nine county area in northeastern and east-central Ohio. At December 31, 2001, Second Bancorp had consolidated total assets of $1.68 billion, deposits of $1.12 billion and shareholders equity of $128 million. The Corporation also maintains another subsidiary, Second Bancorp Capital Trust I, which was established in 2001 to facilitate raising Tier I eligible capital in the form of corporation-obligated mandatorily redeemable capital securities of subsidiary trust for the primary purpose of funding our acquisition of Commerce Exchange Corporation.

Second National focuses its marketing efforts primarily on local independent commercial and professional firms, the individuals who are the owners and principals of such firms as well as the low-to-moderate to upper income retail customers in Second National s trade areas. In recent years, Second Bancorp has emphasized increased commercial, direct consumer and real estate lending as well as market area expansion.

#### Primary Business Operations

We currently have four traditional primary business operations.

**Commercial Lending.** Our commercial lending activities focus primarily on providing local independent commercial and professional firms with commercial business loans and loans secured by owner-occupied real estate. Typically, our customers financing requirements range from $250,000 to $10 million. We primarily make secured and unsecured commercial loans for general business purposes, including working capital, accounts receivable financing, machinery and equipment acquisition, and commercial real estate financing. These loans have both fixed and floating interest rates and typically have maturities of three to seven years. Commercial loans comprised approximately 45% of our total loan portfolio at December 31, 2001.

**Consumer Lending.** We offer a full range of consumer loans to individuals, including the owners and principals of our commercial customers and a wide range of retail customers in our market area. We offer consumer loans for a variety of personal financial needs, including home equity, new and used automobiles, boat loans, credit cards and overdraft protection for checking account customers. At December 31, 2001, approximately 42% of our consumer loans consisted of indirect auto loans which are originated through auto dealers in the local area. Consumer loans comprised approximately 28% of our total loan portfolio at December 31, 2001.

**Trust.** Our trust department is a traditional provider of fiduciary services with a focus on administration of estates, trusts and qualified employee benefit plans. During 2001, personal trust accounts and employee benefit plan accounts produced approximately 76% and 24% of the total revenues of the department, respectively. The anticipated addition of a daily valuation service for 401(k) plans is expected to position us well for future growth in employee benefit plan assets and revenues. Our trust department had approximately $622 million in assets under management at December 31, 2001.

**Mortgage Banking.** Our mortgage banking department underwrites and originates a wide range of retail mortgage loan products and sells a significant volume of them primarily on a servicing retained basis. Generally, the loans sold into the secondary mortgage market make funds available for reuse in mortgage or other lending activities. The sales typically generate a net gain (including origination fee income and deferred origination costs), limit the interest rate risk caused by holding long-term, fixed-rate loans, and supplement our portfolio of serviced loans which generate fee income. We originated approximately $600 million of loans in 2001 and serviced $813 million in mortgage loans for others at December 31, 2001.

Table of Contents

**Operating Strategy**

**Reallocating our business mix to strengthen and stabilize our net interest margin.** We are focused on restructuring both the asset and liability side of our balance sheet in order to increase our net interest margin and reduce net interest margin volatility. We are actively working to improve profitability by generating more core deposits in order to reduce our cost of funds. To achieve this goal, we have launched a new product line of personal and business deposit accounts including many new and innovative products, allocated more funding to advertising, and introduced employee incentives focused on core deposit growth. During 2001 (and excluding accounts acquired through acquisition), the number of transaction accounts (demand deposit and NOW accounts) increased at an annualized rate of 3.9%. On the asset side, we intend to return to a more traditional commercial bank mix which had been impacted by our acquisition of a large thrift in 1998. We are focused on making our loan portfolio more balanced and our plan is to grow the higher yielding consumer loans, which were approximately 28% of total loans at December 31, 2001, to at least 35% of total loans within two years. Although we plan to reduce the size of our real estate loan portfolio to help achieve this balance, we will continue to aggressively develop the real estate side of our business, selling a large part of our production while retaining the loan servicing rights.

**Improving financial performance by leveraging our financial information system and controls.** We intend to improve our financial performance and efficiency by leveraging our newly installed, state-of-the-art financial information system which will allow us to budget and assess financial performance across the entire organization. the use of this sophisticated tool throughout the organization is a vital link in our efforts to rigorously control costs and react quickly to changes in our markets. This financial information system supports growth, efficiency and flexibility, by incorporating line-of-business accountability, comprehensive budgeting, forecasting flexibility and real-time reporting. This comprehensive new budgeting and forecasting system will give us the ability to forecast on an 18-month time horizon and to continuously update those forecasts as market conditions change. The value of the financial information system is that it allows us to better manage our business by the numbers , focusing on responsibility, accountability and the ability to proactively manage our lines of business. We anticipate that the financial information system will allow us to keep on budget and remain responsive to market opportunities.

**Improving efficiency.** We are committed to improving our efficiency, including implementing disciplined cost controls and aligning management incentives with corporate goals. We are focused on streamlining, reorganizing and re-examining our policies, processes and procedures. We believe we will be able to reduce personnel costs through attrition and still maintain our high level of customer service, due in part to the accountability and responsibility focus enabled by our new financial information system. Evidence of success in these efficiency measures are the reduction in our efficiency ratio from 62.2% for 2000 to 58.4% for 2001 and the reduction in our non-interest expenses (on an operating basis, exclusive of 2000 restructuring charges and 2001 merger-related costs) for 2001 by approximately 6% compared to the same period last year.

**Creating a culture focused on building strong, profitable customer relationships.** Our business depends on increased relationship building in our northeastern and east-central Ohio service area where we do all of our banking business. We believe one of our key competitive products and services typically offered by regional banks while, at the same time, allowing us the ability to establish the closer customer relationships of a community bank. We focus on a decentralized decision making structure which delegates increased authority to the employees located in our 37 retail banking centers. This approach enables us to develop long-term customer relationships, maintain high quality service and respond quickly to customer needs.

**Increasing emphasis on fee income.** In order to diversify our revenues, we are committed to movement toward greater fee income through enhancement and extension of our financial services. Our mortgage banking business and our trust department should contribute to fee income growth through market expansion of our mortgage originations and increased sales of trust services. In addition, we intend to increase fee income through the growth of our private banking business and our investment center, which provides a wide variety of mutual funds, annuities, stocks, bonds and insurance products. We believe there will be opportunities to create synergies among trust, private banking and investment center clients allowing us to become a more relationship-based financial services provider. Non-interest income represented 27.3% of total revenues during 2001 compared to 22.3% for the same period last year.

Table of Contents

**Expansion Strategy**

We have been committed to controlled expansion since 1988 by focusing on strengthening market share in our existing communities and expanding into new markets, many of them in high growth areas with strong demographics. During this period, we have expanded our coverage area from one county served by 9 retail banking centers to our current 9 counties covered by 37 retail banking centers. In the process, we have grown from less than $300 million in assets in 1988 to $1.7 billion at December 31, 2001, specifically through our 1998 acquisitions of two financial institutions, The Trumbull Savings and Loan Company also headquartered in Warren and Enterprise Bank located in the dynamic suburban Cleveland market. Also, we acquired Commerce Exchange Bank in 2001 to add to our presence in the Cuyahoga County/Cleveland market.

In the future, we intend to explore and consider de novo branching opportunities and potential acquisitions of community banks, thrifts and other financial service businesses. We will focus on acquiring institutions which are accretive to our earnings per share. Our de novo branching strategy will focus primarily on high growth areas with strong market demographics in which we have the potential to grow market share.

**Acquisition of Commerce Exchange Corporation**

On October 25, 2001 we acquired Commerce Exchange Corporation. Its subsidiary, Commerce Exchange Bank, had two branches one in Beachwood, Ohio and one in North Olmsted, Ohio. Both became Second National Bank of Warren retail banking centers upon completion of the transaction. The acquisition enhances our presence in the attractive suburban Cleveland market. Commerce Exchange Corporation, had total assets of $111 million, total loans of $91 million, total deposits of $95 million and shareholders equity of $11 million at the acquisition date. We paid $26.9 million in cash for Commerce Exchange Corporation.

**Cornerstones of Progress**

In last year s annual report, we established four cornerstones of our continuing progress:

- People
- Knowledge
- Products and Services
- Communications

During 2001, Second National Bank built upon this foundation in a concerted effort to stretch higher than ever...to reach farther than our competition...and to achieve objectives that will contribute to well-managed future growth and profitability. Cornerstones are sometimes thought of as rigid and unmoving. In reality, our cornerstones are dynamic and energized. They are solid and time-tested to support our discipline and good business practices...yet flexible enough to meet the changing needs of the markets we serve. In short...they are patterns. Patterns of progress. What follows is an overview of the shapes those patterns took during 2001.

People provide the energy that drives business forward. That seems like a self-evident statement...but some businesses forget that it is true. Not us. At Second National Bank we believe in the strong, reliable, fundamental principle of managing by the numbers . At the same time we never forget that the numbers, themselves, must be managed by well-trained, dedicated professional people. One of the best examples of how people become part of our patterns of progress is the Bank s Trust Department which, during 2001, attracted and hired a number of highly qualified professionals with considerable trust experience in community banking environments. Second National Bank was the first choice of these individuals because of our reputation for working directly and personally with clients. Other trust departments have become characterized by impersonal 800-number-type transactions with little or no continuity in relationship management. We are gratified that top-quality talent regards Second National Bank as a business where people truly do make the difference in banking.

Once again, the U.S. Small Business Administration (SBA) recognized Second National Bank for achieving the top position in SBA loan volume among community bank lenders in the Cleveland District. During the SBA s fiscal 2001, Second National originated 74 loans representing nearly $9 million. Our lending expertise positions us to fulfill our commitment to business growth within our communities, especially small businesses and women or minority entrepreneurs who need an extra boost in getting started.

Table of Contents

Second National Bank s new, highly innovative Client Advantage Program (CAP) guides all Bank resources toward the highly focused goal of providing maximum...but also highly individualized ...advantages to clients. CAP is built on a three-part foundation:

1) Cultivating positive, long-term relationships with clients.

To remain competitive we believe that our Bank can no longer be satisfied with short-term customer business based on simple, periodic purchases of products and services, but must enable customers to become clients through dedicated relationship-building that accurately identifies their true preferences. That, in turn, will determine which combination of our high-quality products and services will best meet clients continuing needs.

2) Discovering our clients preferences and needs through Client Preference Interviews.

During this key process, comprehensive knowledge gathered by Second National Bank associates replaces guesswork in the Bank s ability to address current client preferences and anticipate future needs. In order to build positive, long-term client relationships we must develop a keen insight into client needs. In order to increase cross-sell ratios we must have knowledge of what product mixes are most valuable...and this knowledge must be specific to each individual client. Educated selling means that every time we have contact with a client we expand our knowledge of who they are, what their goals are, what their financial circumstances are...even personal details having to do with their families, jobs, hobbies, birthdays. Sometimes we ll gain this knowledge through formal tools such as Client Preference Interviews. Other times, it will be a simple matter of jotting down observations made during relatively informal conversations. The key, of course, is learning to listen.

3) Using detailed, reliable knowledge about our clients as the basis for determining how our five major lines of business can be best used to the advantage of all.

Second National Bank provides a diverse selection of products and services to meet client needs. The strength of CAP is rooted in the organization s ability to access, for the benefit of clients, combined resources from all areas: Retail and Commercial Banking...Trust...Mortgage Lending...Deposit Generation. Enhanced flexibility in responding to client needs, based on solid knowledge of how we can best provide advantages, will enable our Bank to work together efficiently without traditional, territorial walls between lines of business.

Although other banking and financial organizations cite the process of long-term relationship building as an objective, what differentiates our CAP effort is the level to which it has been formalized and integrated into Second National s superstructure. Our Client Preference Interviews, for example, are highly detailed, demographically based surveys intended to be evolutionary and long-term in nature. They are part of the Bank s overall computer network so as to be accessible by all who need the information as a way of knowing how and when a client should be approached for cross-selling purposes. The client data provided via this process will help ensure that we not only address individual client needs in an educated fashion, but it also accommodates geographic and other demographic differences between markets.

Moreover, we have built into the CAP program well defined methods for measuring progress. A Monthly Achievement Results progress report gives us the ability to evaluate each of our banking centers and the associates within those locations, as to how effectively the CAP program is being initiated. This too is fully integrated with our internal computer network as a way of capturing and evaluating performance data as it relates to specific client needs.

Once CAP has been firmly established in the banking centers, throughout the retail side of the business and encompasses all personal bankers and account managers, the program will then be broadened into other areas including Mortgage Lending, the Trust Department, and Private Banking. Our initial experiences in retail sales will have, by that time, helped us to refine our tracking methodology and our overall expectations. We will be able to establish accurate benchmarks. We will understand where additional training is necessary. We will have a firm foundation for effective communications within the organization. Of most importance, we will be in a position to build upon the success that comes from knowing our clients.

**Table of Contents**

Second National Bank is driven by facts...not by guesses, or hunches, or the flip of a coin. Our success is based on the reality that knowledge is strength. Strength is the ability to use resources to optimum efficiency. Efficiency enables a competitive advantage. A competitive advantage results in improving profitability.

2001 was a year of growing...through knowing...and a continued emphasis on managing by the numbers . The examples are numerous:

- Implementation of the Financial Information System
(FIS) continues to provide improved accountability and responsibility for each line of business. In 2002, results will be used to measure line of business profitability.

- A more robust foundation for Second National Bank s in-house document preparation system was implemented in September. As a result, all retail Bank associates now share information stored in a centralized database.

- A Monthly Achievement Results progress report was designed and activated to give up-to-date information regarding the performance of sales associates in the banking centers. The information is collected from several tracking and reporting systems bank-wide and is presented in a consolidated user-friendly format by individual associate, by banking center, by region and by bank totals for the current month, year-to-date, and a running 12 month period. This initiative will assist in the ongoing professional development of sales associates through our Client Advantage Program.

How specifically has knowledge resulted in gains for the organization?

An unwavering focus on efficiency resulted in notable achievements during 2001 including successful control of fixed asset spending. Outstanding fixed asset balances have decreased by 9 percent at year-end compared to year-end 2000. Control over expenses was also right on target.

Additionally, our command of the numbers, and ability to act correctly according to what we learn from them, has enabled Second National to:

- Implement pricing models allowing for profitable pricing in the face of lower rates.

- Achieve strong investment performance on our portfolio during a year of rapidly falling rates.

- Maintain well-structured assets.

- Successfully implement beneficial tax strategies.

- Effectively manage interest rate risk during a year of continuously falling rates, allowing for improvement of the interest margin during the year and projections for a stronger margin once rates stabilize.

- Implement new procedures for providing for loan losses, assuring proper reserve levels and reducing risk of fluctuations in earnings going forward.

What we do is who we are. The diverse selection of high-quality products and services, offered by Second National Bank to its growing base of clients, is a reflection of the organization we strive to be: purposeful, responsive, helpful, rewarding.

Second National s Personal Online Banking Program is exactly where we projected it to be. Based on industry standards we initially anticipated that 5% of Second National customers would opt into the online program during the first year, with 5% of those participants signing up for the online bill payment feature. In that regard, registrations are running true to expectations.

Moreover, with a few clicks on www.secondnationalbank.com, business clients of Second National Bank can access balance and transaction information, initiate transactions and perform other cash-management functions, all without leaving the office...thanks to Second National s new Online Business Banking program.

**Table of Contents**

This new service will save our clients significant time by streamlining their day-to-day banking tasks. Online Business Banking provides 24-hours-a-day flexibility that features more control over cash balances and enables users to increase their professional productivity by reducing physical trips to the bank, leaving more time for other important business issues. Specific attributes of Online Business Banking capabilities include the ability to originate electronic debits and credits; pay bills, loans and taxes; transfer funds between accounts; create payroll direct deposit transactions; and request wire transfers. Accessible via a standard web browser, Second National s Online Business Banking thoroughly secures client data and protects deposits using an advanced technology that ensures proper authentication of authorized users.

A business debit card is now available on Small Business Checking, Small Business Interest Checking, Flex Business Checking and Flex Business Interest Checking accounts. With the business debit card all purchases made are conveniently debited from a Second National Bank business checking account. Among the many benefits of the new business debit card: the fact that it s more convenient to carry than a business check book...is accepted worldwide by stores, by mail, via the Internet and telephone...can be set by the user for different spending limits and transaction capabilities for each employee s card...and, unlike a credit card, will incur no monthly finance charges.

A new Express Home Improvement Loan was made available for low-and-moderate income families. This program makes home improvement financing more affordable. That, in turn, builds property values and enhances our communities. This is yet another example of the many ways in which Second National strives to be and succeeds in being a true leader in meeting the credit needs of the communities we serve.

Progress serves little purpose if it cannot be shared to the benefit of all. At Second National Bank, the patterns of our business life link us together with the clients we serve. We take this bond seriously. Our work is governed and focused by a commitment to reach out beyond the norm...to be much, much more than just another bank...to be exceptional in our care of clients...and to share our opportunities throughout our marketplace.

Throughout the organization, during 2001, numerous communications initiatives were enacted. These included a variety of direct mailings with follow-up outbound calls to promote consumer loans, new and refinanced mortgages and investment center offerings.

The Bank also gained high visibility within the communities we serve via well-placed television, radio and newspaper advertising. Statement stuffers, coupons and point-of-purchase materials supported product and service promotions, as did sweepstakes focused on individual products or individual banking centers. Of key importance, a proactive emphasis was placed on the importance of telemarketing, with outbound call training being provided to all retail banking center associates. We believe that every person at Second National is a relationship builder. In today s highly competitive environment, each of us must evaluate how, in our particular jobs, he or she can use effective communication techniques to first get the attention of a prospect or client...second, gather information from that person so as to learn their needs...and third, ask for their business based on what we know those needs to be.

On July 23, Second Bancorp, Inc. and Commerce Exchange Corporation announced a merger agreement for the acquisition of Commerce and its banking subsidiary Commerce Exchange Bank by Second Bancorp. Commerce Exchange Bank merged into Second Bancorp subsidiary Second National Bank. The acquisition contributed more than $100 million in assets and two additional Second National Bank retail banking centers.

This consolidation combines the traditional small- to mid-market commercial lending strengths of both companies and will strengthen Second National s presence in the attractive suburban Cleveland market. This represents our organization s second acquisition in Cuyahoga County during the past four years, demonstrating our commitment to this dynamic market.

On September 4, Second National Bank opened a facility in Hubbard, Ohio, capitalizing on a solid existing customer base plus establishing closer geographic ties to the Pennsylvania market.

With six banking centers in Summit County, the time came, during 2001, for Second National to expand its downtown presence in Akron. Our banking center at 76 S. Main Street is under renovation and will more than double its physical size. More importantly, additional professionals in the areas of commercial lending, trust, private banking, and insurance and investments will support the current staff. Second National has had a presence in Akron for over 10 years and our expansion will help us to leverage the history that we ve enjoyed through the strong contact base we currently have.

**Table of Contents**

Progress in Akron is very important for our future. Summit and Stark Counties are areas that offer true growth opportunities for us, especially with our ability to provide face-to-face personalized service to clients whose past experience has been dealing with large, impersonal banks.

The Streetsboro Banking Center is also on the move...and even though that move is just a short distance, the reason and result are very important. Streetsboro s soon-to-be-previous location at the corner of Routes 41 and 43 presented access difficulties for customers due to widening of the intersection and elimination of a drive-thru lane. Because Second National is committed to Streetsboro and its surrounding communities, a new, more convenient banking center, complete with added drive-thru capabilities, will be built fronting onto Route 303 slightly more than a quarter of a mile west of the current property. The relocation will take place late in the first quarter of 2002.

On January 16, the Boardman Banking Center officially was renamed the Tippecanoe Banking Center and relocated a short distance from its prior location. The new Tippecanoe Banking Center is located on the west-end of Creekside Place, a mini-plaza on Route 224 at Tippecanoe.

The banking center provides a complete range of products and services with three drive-thru lanes, a drive-up automated teller machine, night depository, vault, safe deposit boxes, and ample parking. Representatives from Commercial Banking, Private Banking, and Investments are also available to clients of this banking center.

The Operations Division of Second National Bank contributed significantly during 2001 to our objective of staying at the leading edge of advances in banking technology. Specifically:

- Enhancements to our in-house document preparation system included the addition of an ever-expanding online forms library...an automated Client Preference Interview form and a retail sales Monthly Achievement Results report used in conjunction with our new Client Advantage Program...as well as other automated sales tracking reports.
- In support of overall bank functions, Operations implemented a frame relay data network, increasing processing speed and capacity with no increase in monthly network cost.
- A bank-wide e-mail system was implemented to optimize both internal and external communications and reporting.
- Operations provided a reliable infrastructure for Second National Bank s Online Banking Program.

Additionally, our Operations Division contributed to numerous efficiencies, foremost among them a conversion of low volume ATM machines to dial-up mode resulting in significant monthly savings. A review of all technology-related service contracts led to significant annual cost savings. The development of an acquisition conversion program model for multi-branch acquisitions (used with the Commerce Exchange acquisition) enables us to assimilate smaller acquisitions in-house at considerable cost savings and increased efficiencies.

During 2001, our Retail business line made strides toward its objectives of adopting new technology, moving transactions and inquiries to automated channels and streamlining operational activities.

During May we completed installation of a loan document preparation system that improves direct consumer loan turnaround time and maximizes customer service by reducing errors. Most direct loan clients now leave the banking center with loan decisions made, documents signed and checks in hand the same day they apply.

Second National clients have the ability to order or reorder and track their checks via our web site: www.secondnationalbank.com. This service, free of charge to clients, is not only a convenience to them but also cost savings to the Bank.

Additional examples of client value-adds combined with benefits to Second National include conversion of numerous ATM cardholders to debit cards providing not only more features for clients but also increasing the Bank s potential income.

Table of Contents

More efficient scheduling and staffing in the banking centers during 2001 resulted in substantial savings without reduction of full-time employees and allowed for extended business hours at no additional cost. Our service to clients was further strengthened by enhancements to our Call Center operation and our Interactive Voice Response (IVR) system that now handles approximately 60,000 calls per month. As a first line automated response to basic customer inquiries, the IVR gives clients the option to transfer to Call Center personal bankers who handle more in-depth issues and cross-sell bank products and services.

2001 was a year of refocusing our efforts for deposit generation. The function was raised to an official new line of business, recognizing the long-term importance of deposit generation to the improved financial success of our Bank. A three-pronged strategy was employed in 2001, which generated impressive results. The strategy combined a new deposit line-up, an increased marketing effort and internal incentives to produce the positive results.

Even excluding the acquisition of accounts from Commerce Exchange, core deposit accounts, which are the lower cost transaction and savings accounts, increased by 7.4% during the year. Non-interest bearing DDA accounts increased in number by 5.5%. These accounts are particularly important, not only because they are interest free, but because they help to generate service charge income through client usage of ATM and debit cards. Deposit service charges increased an impressive 20% from 2000.

Our Trust Department continues to explore and develop opportunities for moving from a traditional fiduciary business to an investment management center focused on the enhancement of business relationships throughout the organization. Central to this goal is identifying and implementing ways of integrating the functions of Private Banking, Investments, and Trust in such a way that client needs can be addressed efficiently and professionally through an effectively streamlined, highly-focused wealth management program.

Philosophically, our commitment remains: We will differentiate ourselves from other providers by staying as close as possible to our clients...by keeping the decision making process quick and effective...and by acting upon a well-informed financial plan for each client. By living up to those benchmarks we will remain competitive and will establish a reliable platform for cross-selling products and services across all Second National business lines.

An upgrade of the Trust Department s accounting system to a Windows -based operating system has resulted in significant improvements in the ease-of-use and assimilation of data resulting in reports that are very readable and understandable by clients.

Also, a new 401(k) plan will have numerous advantages for Bank associates and clients, helping ensure a high level of management expertise resulting in the ability of individuals to benefit from a range of investment options offered to help meet unique, individual financial goals.

Second National Bank s Mortgage business line continues to build upon its emphasis for relationship growth, fee generation, origination of investment quality mortgages, staff development and technological resources.

In total 1-4 family mortgage loan originations, Second National Bank closed 2001 at $598,099,650 versus $194,705,629 in 2000, an increase of 207%, with funding in November representing the single largest funding month in Bank history.

In Mortgage Servicing, Second National Bank crossed the $1 billion benchmark in total mortgages serviced and reached the highest Tier 1 rating assigned by Freddie Mac, while increasing dollars serviced for investors by 65%. This mortgage banking activity significantly increased fee income for the Bank and enabled us to obtain better interest rates for our customers.

Internally, the Mortgage Loan business line successfully launched new software that restructured the flow of the application process and enhanced efficiency. A first-ever pipeline report was created and made available on the bank-wide network to monitor loan status on a daily basis for all mortgage originators and banking center officers. A direct mail solicitation campaign was also developed to target potential refinance customers.

Table of Contents

Second National Bank will continue to expand our commercial lending presence in Ohio and Western Pennsylvania by leveraging opportunities brought about by acquisitions, client calls, referral sources, new product introductions, and growth by our individual clients. Our lenders are well-seasoned, from a multitude of backgrounds, and experienced in working through volatile economic conditions. The development of a commercial banking profitability model has provided our commercial bankers with an objective pricing tool, placing each loan transaction on an even playing field and focusing on the client s relationship with us. The approval and administration process for commercial credits generated by Private and Retail Banking was restructured to provide ready access to experienced commercial lenders and a timely response to credit needs. The addition of a leasing program, an accounts receivable financing product, and enhancements to our cash management line-up, positions our Commercial Banking business line for continued success.

We closed last year s annual report by stating that True success is not a random occurrence. So too, the patterns of progress do not simply happen. They are the positive outcome of employing well-trained, dedicated professionals...basing forward movement on knowledge and a factual understanding of the numbers...developing products and services not because of what others might be offering, but because we understand our clients needs...and communicating to those we serve what they can expect from us and how they will benefit from their confidence in our proven expertise.

Second Bancorp has no significant industry segments, which require disclosure.

**Market Area**

Second National s primary market area consists of Trumbull, Ashtabula, Portage, Jefferson, Mahoning, Summit, Medina, Stark and Cuyahoga counties in the northeastern and east-central portions of Ohio, to the east and south of the Cleveland metropolitan area. The market area s economy is heavily influenced by the manufacturing sector with an emphasis on steel, auto manufacturing and a variety of related and smaller industries. The area has benefited from an extensive transportation system comprised mainly of railroad and trucking systems.

**Competition**

There is significant competition in the financial services industry in northeastern Ohio among commercial banks. As a result of deregulation of the financial services industry, Second Bancorp also competes with other providers of financial services such as savings and loan associations, credit unions, commercial finance companies, brokerage and securities firms, insurance companies, commercial finance and leasing companies and the mutual fund industry. Some of Second Bancorp s competitors, including certain regional bank holding companies which have operations in Second Bancorp s market area, have substantially greater resources than Second Bancorp, and as such, may have higher lending limits and may offer other services not available through Second National. Second Bancorp also faces significant competition, particularly with respect to interest rates paid on deposit accounts, from well-capitalized local thrift institutions. Second National competes on the basis of rates of interest charged on loans, the rates of interest paid on funds, the availability of services and responsiveness to the needs of its customers.

**Regulation**

Second Bancorp is a one bank financial holding company and is regulated by the Federal Reserve Bank (the FRB ). Second National is a national bank and is regulated by the Office of the Comptroller of the Currency (the OCC ), as well as the Federal Deposit Insurance Corporation (the FDIC ). Dramatic changes have developed over the past several years regarding minimum capital requirements for financial institutions. A listing of the minimum requirements for capital and Second Bancorp s capital position as of December 31, 2001 and 2000 are presented in footnote 16 of Item 8; Financial Statements and Supplementary Data and is hereby incorporated by reference.

Second Bancorp is subject to regulation under the Bank Holding Company Act of 1956, as amended (the Act ). The Act requires the prior approval of the Federal Reserve Board for a bank holding company to acquire or hold more than a 5% voting interest in any bank, and restricts interstate banking activities. The Act allows interstate bank acquisitions anywhere in the country and interstate branching by acquisition and consolidation in those states that have not opted out by January 1, 1997. Among the states where Second Bancorp may acquire banks are Ohio, Michigan, Indiana, West Virginia and Pennsylvania. The Act restricts non-banking activities to those which are determined by the Federal Reserve Board to be closely related to banking and a proper incident thereto. The Act does not place territorial restrictions on the activities of non-bank subsidiaries of bank holding companies. The Act also regulates transactions between Second Bancorp and Second National and generally prohibits tie-ins between credit and other products and services.

Table of Contents

Second National is subject to regulation under the National Banking Act and is periodically examined by the OCC and is subject, as a member bank, to the rules and regulations of the FRB. Second National is an insured institution and member of the Bank Insurance Fund ( BIF ) and also has approximately $417 million in deposits acquired through acquisitions of savings and loan institutions that are insured through the Savings Association Insurance Fund ( SAIF ). As such, Second National is also subject to regulation by the FDIC. Establishment of branches is subject to approval of the OCC and geographic limits established by state law.

**The Graham-Leach-Bliley Act**

The enactment of the Graham-Leach-Bliley Act of 1999 (the GLB Act"') represents a pivotal point in the history of the financial services industry. The GLB Act sweeps away large parts of a regulatory framework that had its origins in the Depression Era of the 1930s. Effective March 11, 2000, new opportunities were available for banks, other depository institutions, insurance companies and securities firms to enter into combinations that permit a single financial services organization to offer customers a more complete array of financial products and services. The GLB Act provides a new regulatory framework for regulation through the financial holding company, which will have as its umbrella regulator the Federal Reserve Board. Functional regulation of the financial holding company s separately regulated subsidiaries will be conducted by their primary functional regulator. The GLB Act makes satisfactory or above Community Reinvestment Act compliance for insured depository institutions and their financial holding companies necessary in order for them to engage in new financial activities. The GLB Act provides a federal right to privacy of non-public personal information of individual customers.

**FIRREA**

FIRREA restructures the regulation, supervision and deposit insurance of savings and loan associations and federal savings banks whose deposits were formerly insured by the Federal Savings and Loans Insurance Corporation ( FSLIC ). FSLIC was replaced by the Savings Association Insurance Fund ( SAIF ) administered by the FDIC. A separate fund, the Bank Insurance Fund ( BIF ), which was essentially a continuation of the FDIC s then existing fund, was established for banks and state savings banks. An acquired thrift generally would be required to continue its deposit insurance with the SAIF unless significant exit and entrance fees were paid in connection with a conversion to BIF insurance.

**FDICIA**

The Federal Deposit Insurance Corporation Improvement Act of 1991 ( FDICIA ) substantially revised the bank regulatory and funding provisions of the Federal Deposit Insurance Act and several other federal banking statutes. Among other things, FDICIA requires federal banking agencies to broaden the scope of regulatory corrective action taken with respect to banks that do not meet minimum capital requirements and to take such actions promptly in order to minimize losses to the FDIC. FDICIA established five capital tiers: well capitalized ; adequately capitalized ; undercapitalized ; significantly capitalized ; and critically undercapitalized and imposes significant restrictions on the operations of a depository institution that is not in either of the first two of such categories. A depository institution s capital tier will depend upon the relationship of its capital to various capital measures. A depository institution will be deemed to be well capitalized if it significantly exceeds the minimum level required by regulation for each relevant capital measure, adequately capitalized if it meets each such measure, undercapitalized if it is significantly below any such measure and critically undercapitalized if it fails to meet any critical capital level set forth in regulations. An depository institution may be deemed to be in a capitalization category that is lower than is indicated by its actual capital position if it receives an unsatisfactory examination rating or is deemed to be in an unsafe or unsound condition or to be engaging in unsafe or unsound practices.

Under regulations adopted under these provisions, for a depository institution to be well capitalized it must have a total risk-based capital ratio of at least 10%, a Tier I risk-based capital ratio of at least 6% and a Tier I leverage ratio of at least 5% and not be subject to any specific capital order or directive. For a depository institution to be adequately capitalized, it must have a total risk-based capital ratio of at least 8%, a Tier I risk-based capital ratio of at least 4% and a Tier I leverage ratio of at least 4% (or in some cases 3%). Under the regulations, a depository institution will be deemed to be undercapitalized if the depository institution has a total risk-based capital ratio that is less than 8%, a Tier I risk-based capital that is less than 4% or a Tier I leverage ratio of less than 4% (or in some cases 3%). A depository institution will be deemed to be significantly undercapitalized if the depository institution has a total risk-based capital ratio that is less than 6%, a Tier I risk-based capital ratio that is less than 3%, or a leverage ratio that is less than 3% and will be deemed to be critically undercapitalized if it has a ratio of tangible equity to total assets that is equal to or less than 2%.

FDICIA generally prohibits a depository institution from making a capital distribution (including payment of dividends) or paying management fees to any entity that controls the institution if it thereafter would be undercapitalized. If a depository institution becomes undercapitalized, it will be generally restricted from borrowing from the Federal Reserve, increasing its average total assets, making any acquisitions, establishing any branches or engaging in any new line of business. An undercapitalized institution must submit an acceptable capital restoration plan to the appropriate federal banking agency, which plan must, in the opinion of such agency, be based on realistic assumptions and be likely to succeed in restoring the depository institution s capital. In connection with the approval of such a plan, the holding company of the depository institution must guarantee that the institution will comply with the plan, subject to a limitation of liability equal to a portion of the depository institution s assets. If an undercapitalized depository institution fails to submit an acceptable plan or fails to implement such a plan, it will be treated as if it is significantly undercapitalized.

Under FDICIA, bank regulators are directed to require significantly undercapitalized depository institutions, among other things, to restrict business activities, raise capital through a sale of stock, merge with another depository institution and/or take any other action which the agency determines would better carry out the purposes of FDICIA.

Within 90 days after a depository institution is determined to be critically undercapitalized , the appropriate federal banking agency must, in most cases, appoint a receiver or conservator for the institution or take such other action as the agency determines would better achieve the purposes of FDICIA. In general, critically undercapitalized depository institutions will be prohibited from paying principal or interest on their subordinated debt and will be subject to other substantial restrictions.

FDICIA also contains a variety of other provisions that could affect the operations of Second Bancorp, including new reporting requirements, regulatory standards for real estate lending, truth in savings provisions, the requirement that a depository institution give 90 days prior notice to customers and regulatory authorities before closing any branch, limitations on credit exposure between banks, restrictions on loans to a bank s insiders and guidelines governing regulatory examinations.

**Deposit Insurance Assessments**

The FDIC is authorized to establish separate annual assessment rates for deposit insurance for members of the BIF and the SAIF. The FDIC may increase assessment rates for either fund if necessary to restore the fund s ratio of reserves to insured deposits to its target level within a reasonable time and may decrease such rates if such target level has been met. The FDIC has established a risk-based assessment system for both BIF and SAIF members. Under this system, assessments vary based on the risk the institution poses to its deposit insurance fund. The risk level is determined based on the institution s capital level and the FDIC s level of supervisory concern about the depository institution.

Based upon its respective level of deposits at December 31, 2001, the projected BIF and SAIF assessments for Second National for 2002 will be approximately $213,000.

**Interstate Banking and Branching Legislation**

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the IBBEA ) authorized interstate acquisitions of banks and bank holding companies without geographic constraint beginning September 29, 1995. Beginning June 1, 1997, the IBBEA also authorizes banks to merge with banks located in another state provided that neither state has opted out of interstate branching between September 29, 1994 and May 31, 1997. After acquiring interstate branches through a merger, a bank may establish additional branches in that state at the same locations as any bank involved in the merger could have established branches under state and federal law. In addition, a bank may establish a de novo branch in another state that expressly permits the establishment of such branches. A bank that establishes a de novo interstate branch may thereafter establish additional branches on the same basis as a bank that has established interstate branches through a merger transaction.

If a state opts out of interstate branching, no bank from another state may establish a branch in that state, whether through a merger or by a de novo establishment. Pennsylvania, the state in closest proximity to Second National, has opted to permit interstate branching, creating the possibility of branching into that state. To date, Second National has taken no action to branch into Pennsylvania or any other state, however Second National may do so in the future.

Table of Contents

**Employees**

The number of full time equivalent employees of Second Bancorp as of December 31, 2001 was approximately 557. Second Bancorp considers its employee relations to be good. None of the employees are covered by a collective bargaining agreement.

## Item 2. PROPERTIES

Second Bancorp s executive offices are located at Second National s main office building in Warren, Ohio, which is leased by Second National under a long-term triple net lease agreement with a term, including optional renewals, expiring on October 31, 2029. Second National has the option to purchase the main office facility before two optional renewal periods at the fair market value in existence at that time. Second National owns 10 of its banking center locations and one administrative building, while Second National s 27 other banking center locations are leased under lease and sublease agreements with remaining terms of 1 to 13 years. Second National also has a lease for record retention and office space with a remaining lease term of five years.

## Item 3. LEGAL PROCEEDINGS

Second Bancorp is subject to various pending and threatened lawsuits in which claims for monetary damages are asserted in the ordinary course of business. While any litigation involves an element of uncertainty, in the opinion of management, liabilities, if any, arising from such litigation or threat thereof will not have a material effect on the financial position or results of operations of Second Bancorp.

## Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

There were no special meetings for shareholders since last year s annual meeting.

Table of Contents

**Item 4A. IDENTIFICATION OF EXECUTIVE OFFICERS**

The following table sets forth the names and ages and business experience for the last five years of each of the executive officers of the Corporation. Each executive officer of the Corporation is appointed by the Board of Directors on an annual basis, and serves at the pleasure of the Board.

| Name | Age | Position and Experience | Year Appointed |
|---|---|---|---|
| R. L. (Rick) Blossom | 54 | Chairman, President, Chief Executive Officer and Director of Second Bancorp and Chairman, President, Chief Executive Officer and Director of Second National. Former Chief Executive Officer and Director of First National Bank of Southwestern Ohio and Senior Vice President and Chief Lending Officer of First Financial Bancorp. | 1999 |
| David L. Kellerman | 44 | Treasurer of Second Bancorp and Executive Vice President and Chief Financial Officer of Second National. | 1987 |
| Christopher Stanitz | 53 | Executive Vice President and Secretary of Second Bancorp and Senior Vice President of Second National. | 1992 |
| Thomas W. Allen | 57 | Executive Officer of Second Bancorp and Senior Vice President of Second National Bank, previously Senior Vice President and Senior Fiduciary Officer for Northern Indiana for Key Trust Company of Indiana from 1997 to 2000 and as Chairman and Chief Executive Officer of Midwest Trust Company, NA of Joliet, Illinois from 1995 to 1997. | 2000 |
| Diane C. Bastic | 58 | Executive Officer of Second Bancorp and Senior Vice President of Second National. | 1985 |
| John L. Falatok | 44 | Executive Officer of Second Bancorp and Senior Vice President of Second National. | 2000 |
| Mike Filarski | 53 | Executive Officer of Second Bancorp and Senior Vice President of Second National. Former President for Signal Mortgage (1998-99), previously President for National Auto Credit (1996-1997) | 1999 |
| Darryl E. Mast | 51 | Executive Officer of Second Bancorp and Senior Vice President of Second National. | 1986 |
| Terry L. Myers | 53 | Executive Officer of Second Bancorp and Senior Vice President of Second National. | 1986 |

**Table of Contents**

**PART II.**

**Item 5. MARKET FOR REGISTRANT S COMMON STOCK AND RELATED SHAREHOLDER MATTERS**

Second Bancorp s Common Stock trades on The Nasdaq National Market tier of The Nasdaq Stock Market under the trading symbol SECD. As of February 22, 2002, the number of shareholders of record of the Common Stock totaled 2,317. The detail of stock prices and dividend payments are incorporated herein by reference from Item 7; Management s Discussion and Analysis of Financial Condition and Results of Operations. Dividend restrictions are detailed in footnote 16 of Item 8; Second Bancorp s Financial Statements and Supplementary Data are incorporated herein by reference.

The subsidiary Second Bancorp Capital Trust I s Corporation-obligated mandatorily redeemable capital securities ( Trust Preferred Securities ) also trade on The Nasdaq National Market under the trading symbol SECDP. The securities began trading September 28, 2001 and have traded to a high of $11.25, and a low of $10.10 and closed at $11.00 on December 31, 2001.

**Item 6. SELECTED FINANCIAL DATA**

The following is a summary of the quarterly results of operations for the years ended December 31, 2001 and 2000.

| | Three Months Ended | | | |
|---|---|---|---|---|
| | **Mar. 31** | **June 30** | **Sept. 30** | **Dec. 31** |
| **2001** | | | | |
| Interest income | $28,478 | $28,405 | $27,880 | $27,794 |
| Interest expense | 16,652 | 16,107 | 15,407 | 14,291 |
| Net interest income | 11,916 | 12,298 | 12,473 | 13,503 |
| Provision for loan losses | 761 | 1,342 | 988 | 1,627 |
| Other income | 4,030 | 4,643 | 4,368 | 5,845 |
| Security gains (losses) | 529 | (12) | 123 | 2 |
| Merger-related costs | | | | 305 |
| Other expenses | 10,051 | 9,805 | 10,082 | 11,696 |
| Income before federal income taxes | 5,663 | 5,782 | 5,894 | 5,722 |
| Federal income taxes | 1,475 | 1,524 | 1,493 | 1,388 |
| Net income before cumulative effect of accounting change | 4,188 | 4,258 | 4,401 | 4,334 |
| Cumulative effect of accounting change SFAS No. 133 | (101) | | | |
| Net income | 4,087 | 4,258 | 4,401 | 4,334 |
| Earnings (loss) per common share: (1) | | | | |
| Basic before cumulative effect of accounting change | $ 0.42 | $ 0.42 | $ 0.44 | $ 0.43 |
| Diluted before cumulative effect of accounting change | 0.41 | 0.42 | 0.44 | 0.43 |
| Basic | 0.42 | 0.42 | 0.43 | 0.43 |
| Diluted | 0.41 | 0.42 | 0.43 | 0.43 |
| **2000** | | | | |
| Interest income | $27,435 | $29,179 | $29,894 | $29,790 |
| Interest expense | 15,017 | 16,534 | 18,288 | 17,082 |
| Net interest income | 12,418 | 12,645 | 11,606 | 12,708 |
| Provision for loan losses | 687 | 696 | 4,843 | 903 |
| Other income (expense) | 3,704 | 3,240 | (56) | 3,786 |
| Security gains (losses) | 99 | 206 | (2,802) | 98 |
| Other expenses | 10,297 | 10,431 | 13,140 | 10,345 |
| Income before federal income taxes | 5,237 | 4,964 | (9,235) | 5,344 |
| Federal income taxes | 1,301 | 1,251 | (3,690) | 1,314 |

| | | | | |
|---|---|---|---|---|
| Net income | 3,936 | 3,713 | (5,545) | 4,030 |
| | | | | |
| Earnings per common share: | | | | |
| Basic | $ 0.38 | $ 0.36 | $ (0.54) | $ 0.40 |
| Diluted | 0.38 | 0.36 | (0.54) | 0.40 |

(1) The sum of the four quarters of earnings per share might not equal the total earnings per share for the full year due to rounding.

**Table of Contents**

This management s discussion and analysis of financial condition and results of operations should be read in conjunction with the consolidated financial statements and accompanying footnotes.

| **Selected Financial Data Year ended December 31** | **2001** | **2000** | **1999** | **1998** | **1997** |
|---|---|---|---|---|---|
| Results of Operations: | | | | | |
| Interest Income | $ 112,557 | $ 116,298 | $ 104,582 | $ 106,997 | $ 104,990 |
| Interest expense | 62,367 | 66,921 | 55,310 | 55,888 | 55,707 |
| Net interest income | 50,190 | 49,377 | 49,272 | 51,109 | 49,283 |
| Provision for loan losses | 4,718 | 7,129 | 3,195 | 10,579 | 4,205 |
| Other income | 19,528 | 8,275 | 14,792 | 12,754 | 11,101 |
| Other expense | 41,939 | 44,213 | 39,330 | 46,248 | 39,198 |
| Income before federal income taxes | 23,061 | 6,310 | 21,539 | 7,036 | 16,981 |
| Federal tax expense | 5,880 | 176 | 5,361 | 1,403 | 3,745 |
| Net income before cumulative effect of accounting change | $ 17,181 | $ 6,134 | $ 16,178 | $ 5,633 | $ 13,236 |
| Cumulative effect of accounting change SFAS No. 133 | (101) | | | | |
| Net income | $ 17,080 | $ 6,134 | $ 16,178 | $ 5,633 | $ 13,236 |
| Per Common Share Data: (1) | | | | | |
| Basic earnings before cumulative effect of accounting change | $ 1.72 | N/A | N/A | N/A | N/A |
| Diluted earnings before cumulative | 1.70 | N/A | N/A | N/A | N/A |
| effect of accounting change | 1.71 | $ 0.60 | $ 1.52 | $ 0.53 | $ 1.25 |
| Basic earnings | 1.69 | 0.60 | 1.51 | 0.52 | 1.25 |
| Diluted earnings | 0.68 | 0.64 | 0.56 | 0.48 | 0.40 |
| Cash dividends | 12.90 | 11.65 | 11.12 | 11.53 | 11.34 |
| Book value, December 31 | 21.61 | 14.50 | 22.38 | 22.25 | 25.38 |
| Market value, December 31 | | | | | |
| Weighted-average shares outstanding (1) | 10,013,068 | 10,247,025 | 10,635,852 | 10,655,597 | 10,555,921 |
| Basic | 10,080,005 | 10,271,548 | 10,698,717 | 10,742,622 | 10,616,752 |
| Diluted | 9,949,316 | 10,057,110 | 10,458,450 | 10,688,450 | 10,606,749 |
| Shares outstanding at year-end (1) | | | | | |
| Balance Sheet Data: | | | | | |
| As of December 31: | $ 1,680,356 | $ 1,546,290 | $ 1,537,278 | $ 1,430,233 | $ 1,438,193 |
| Total assets | 1,105,197 | 1,054,872 | 1,060,493 | 960,114 | 858,321 |
| Loans, net of allowance for loan losses | 1,123,131 | 1,036,135 | 1,097,589 | 1,102,590 | 1,115,044 |
| Deposits | 128,299 | 117,197 | 116,347 | 123,273 | 120,318 |
| Shareholder s equity | | | | | |
| Averages: | 1,595,968 | 1,584,016 | 1,498,946 | 1,464,803 | 1,424,211 |
| Total assets | 1,502,164 | 1,488,334 | 1,405,195 | 1,386,894 | 1,351,117 |
| Earning assets | 1,078,196 | 1,107,948 | 1,005,998 | 938,408 | 869,333 |

| | | | | | |
|---|---|---|---|---|---|
| Loans | 1,070,439 | 1,091,441 | 1,092,260 | 1,086,074 | 1,079,809 |
| Deposits | 124,773 | 114,652 | 121,369 | 126,748 | 112,127 |
| Shareholders equity | | | | | |
| Ratios: | | | | | |
| Return on average assets | 1.09% | 0.39% | 1.08% | 0.38% | 0.93% |
| Return on average common shareholders equity | 13.93 | 5.35 | 13.33 | 4.44 | 11.80 |
| Net interest margin | 3.49 | 3.46 | 3.68 | 3.84 | 3.78 |
| Efficiency ratio | 58.35 | 70.67 | 59.45 | 70.11 | 63.04 |
| Dividend pay-out | 39.80 | 106.26 | 36.68 | 91.53 | 32.29 |
| Average loans to average deposits | 100.72 | 101.51 | 92.10 | 86.40 | 80.51 |
| Allowance for loan losses as a percent of loans | 1.49 | 1.42 | 1.04 | 1.11 | 1.02 |
| Net charge-offs as a percent of average loans | 0.47 | 0.28 | 0.27 | 0.92 | 0.53 |
| Non-performing loans to total loans | 0.94 | 0.75 | 0.55 | 0.71 | 0.80 |
| Allowance for loans losses to non-performing loans | 158 | 191 | 188 | 155 | 128 |
| Tier I leverage ratio | 8.22 | 7.47 | 8.15 | 8.65 | 7.87 |

(1) Prior period amounts have been restated for stock splits and pooling-of-interests transactions.

Table of Contents

The table below details operating results excluding the impact of the 2000 restructuring activity, the 2001 and 1998 merger activity and the cumulative effect of accounting change in 2001:

**Selected Financial Data Operating Results (Excludes Restructuring Charges, Merger Costs and Cumulative effect of Accounting Change)**

| Year ended December 31 | 2001 | 2000 | 1999 | 1998 | 1997 |
|---|---|---|---|---|---|
| Results of Operations: | | | | | |
| Interest Income | $112,557 | $116,950 | $104,582 | $106,997 | $104,990 |
| Interest expense | 62,367 | 66,921 | 55,310 | 55,888 | 55,707 |
| Net interest income | 50,190 | 50,029 | 49,272 | 51,109 | 49,283 |
| Provision for loan losses | 4,718 | 3,029 | 3,195 | 10,579 | 4,205 |
| Other income | 19,528 | 14,794 | 14,792 | 12,754 | 11,101 |
| Other expense | 41,634 | 41,604 | 39,330 | 39,591 | 39,198 |
| Income before federal income taxes | 23,366 | 20,190 | 21,539 | 13,693 | 16,981 |
| Federal tax expense | 5,987 | 5,034 | 5,361 | 3,063 | 3,745 |
| Net income | $ 17,379 | $ 15,156 | $ 16,178 | $ 10,630 | $ 13,236 |
| Per Common Share Data: (1) | | | | | |
| Basic earnings | $ 1.74 | $ 1.48 | $ 1.52 | $ 1.00 | $ 1.25 |
| Diluted earnings | 1.72 | 1.48 | 1.51 | 0.99 | 1.25 |
| Ratios: | | | | | |
| Return on average assets | 1.09% | 0.96% | 1.08% | 0.73% | 0.93% |
| Return on average common shareholders equity | 13.93 | 13.22 | 13.33 | 8.39 | 11.80 |
| Net interest margin | 3.49 | 3.51 | 3.68 | 3.84 | 3.78 |
| Efficiency ratio | 58.35 | 62.17 | 59.45 | 60.95 | 63.04 |

(1) Prior period amounts have been restated for stock splits and pooling-of-interests transactions.

The Corporation analyzes its performance on a net income basis determined in accordance with accounting principles generally accepted in the United States, as well as on an operating basis before restructuring charges, merger costs and cumulative effect of accounting changes, referred to in this analysis as operating results or operating earnings . Operating earnings and related discussions are presented as supplementary information in this analysis to enhance the readers understanding of, and highlight trends in, the Company s core financial results excluding the nonrecurring effects of discrete activities and events. Operating earnings should not be viewed as a substitute for net income and earnings per share as determined in accordance with accounting principles generally accepted in the United States. Restructuring charges, merger costs and cumulative effect of accounting change excluded from net income to derive operation earnings may be significant and may not be comparable to other companies.

**Item 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**FORWARD-LOOKING STATEMENTS**

Certain sections of this report contain certain forward-looking statements (as defined in the Private Securities Litigation Reform Act of 1995). These forward-looking statements may involve significant risks and uncertainties. Although the Corporation believes that the expectations reflected in such forward-looking statements are reasonable, actual results may differ materially from these results discussed in these forward-looking statements. Risks and uncertainties that could cause or contribute to such material differences include, but are not limited to, general economic conditions, interest rate environment, competitive conditions in the financial services industry, changes in law, governmental policies and regulations, and rapidly changing technology affecting financial services.

Table of Contents

**RESULTS OF OPERATIONS**

Net income for 2001 totaled $17,080 and represents a $10,946, or a 178%, increase over net income for 2000, which was significantly impacted by a major balance sheet restructuring during the third quarter of that year. Net income in 2001 was minimally impacted by $305 in pre-tax merger costs associated with the fourth quarter acquisition of Commerce Exchange Corporation ( Commerce ) and $(101) cumulative effect of accounting change associated with the adoption of SFAS No. 133. The acquisition of Commerce gives the Corporation further access to the attractive commercial lending market in the suburban Cleveland market. Prominent amongst the factors positively impacting 2001 earnings were a sharp increase in real estate lending and sales of loans into the secondary mortgage market. Nearly $600 million residential mortgage loans were closed in 2001 with over $520 million in loans being sold generating $5.4 million in gains. Also prominent in 2001 was the magnitude of interest rate changes induced by the Federal Reserve Bank. Despite 11 rate declines in 2001, the Corporation s net interest margin was able to improve by 3 basis points over 2000 s level and steadily improved during the course of the year.

The 2000 restructuring was designed to improved balance sheet flexibility and liquidity, reduce the earnings drag caused by the large mortgage loan portfolio, and improve net interest margin. The after-tax impact of the restructuring totaled $9,022. Included in the restructuring was an additional $4.1 million in provision for loan losses. The increased provisions resulted from a specific analysis of commercial credits and reflect current management s philosophy of loan analysis. Additionally, $2.8 million in security losses were realized as the Corporation repositioned the security portfolio and improved overall earning performance. An additional $4.4 million in losses were realized on the disposition of $130 million in low yielding, fixed rate mortgage loans. The effect of the sale was to minimally shrink the Corporation s balance sheet and reduce exposure to higher cost Federal Home Loan advances. Net income in 2000 was $15,156 excluding the restructuring charges, while net income in 1999 was $16,178.

The Corporation s return on average assets ( ROA ) was 1.09%, .39% and 1.08% for 2001, 2000 and 1999, respectively. The total shareholders return on average equity ( ROE ) was 13.93%, 5.35% and 13.33% in 2001, 2000 and 1999, respectively.

Diluted earnings per share were $1.69 in 2001, $.60 in 2000 and $1.51 in 1999. The market value of the Corporation s common stock, trading under the NASDAQ symbol of SECD, rebounded from its 2000 lows and increased to $21.61 per share at the end of 2001. The common stock generally followed the path of most bank stocks during 2000 finishing the year at $14.50 per share after reaching $22.38 at year-end 1999. The stock price at year-end 2001 represents a price of 168% of book value, up significantly from 124% the prior year-end. In 2000, the stock price was effected by higher interest rates and market concerns for a slowing economy and potential increased loan losses in the banking industry while in 2001 the stock price rebounded as the Corporation began showing positive financial results in consecutive quarters. The price / earnings ratio for the stock at year-end 2001 (based on the trailing twelve months earnings) was 12.8X. Dividends declared in 2001 totaled $.68 per share compared to $.64 per share the prior year.

Revenue continues to be provided primarily from interest and fees on loans, which totaled $86,723, $91,833 and $81,464 in 2001, 2000 and 1999, respectively. This represents 66%, 74% and 68% of total revenues for those years. The increase in 2000 was due to the restructuring activities, which resulted in lower non-interest income for the year. Interest income on securities is also a major source of revenue, contributing 19% of revenues in all three years. The Corporation is making steady improvement in diversifying its revenue source away from net interest income. Non-interest income (exclusive of securities gains and losses and restructuring losses) has increased as a percent of net revenues (net interest income plus non-interest income) from 23% and 22% in 1999 and 2000, respectively to 27% in 2001.

On an operating basis, which excludes non-recurring items including merger costs and cumulative effect of accounting change in 2001 and restructuring activities in 2000, net income was $17,379 in 2001, or 14.7% greater than the $15,156 earned in 2000. Operating earnings for 1999 were unchanged from GAAP earnings at $16,178. Operating performance measures were 1.09%, .96% and 1.08% for ROA, while ROE was 13.93, 13.22% and 13.33% for 2001, 2000 and 1999, respectively. The operating efficiency ratio was 58.35% in 2001 versus 62.17% in 2000 and 59.45% in 1999. Operating diluted earnings per share were $1.72, $1.48 and $1.51 for those same periods.

Table of Contents

**NET INTEREST INCOME**

Net interest income on a fully taxable equivalent (FTE) basis improved to $52,467 in 2001 due both to a slight improvement in the net interest margin and an increase in average earning assets. The net interest margin reached 3.49% in 2001 and improved as the quarters progressed. The rapid succession of rate reductions initiated by the Federal Reserve Bank muted the potential improvement in the net interest margin during 2001 as the Corporation is in a positive interest rate gap position in a one month time frame and in a negative interest rate gap position in a three month time frame. Average earning assets were up only 1% in 2001 to $1,502,164 as average loans declined by $31 million primarily due to the sale of $130 million in real estate loans during the third quarter restructuring in 2000. Net interest income declined slightly in 2000 from 1999 due to a decline in net interest margin. Significantly impacting both net interest income and net interest margin were steadily increasing interest rates resulting from the Federal Reserve Bank monetary tightening and an inverted yield curve environment. The yield on earning assets improved by 35 basis points to 7.96% in 2000, however, the cost of funds increased by 57 basis points to 4.96%. The net interest margin declined to 3.46% from 3.68% in 1999. Average earning assets increased by 5.9% in 2000 to $1,488,334 after averaging $1,405,195 in 1999.

The relationship between net interest income, FTE net interest income, earning assets and net interest margin for the past three years follows:

| | 2001 | 2000 | 1999 |
|---|---|---|---|
| Net interest income per financial statements | $ 50,190 | $ 49,377 | $ 49,272 |
| Tax equivalent adjustment | 2,277 | 2,175 | 2,403 |
| Net interest income FTE | $ 52,467 | $ 51,552 | $ 51,675 |
| Average earning assets | $1,502,164 | $1,488,334 | $1,405,195 |
| Net interest margin | 3.49% | 3.46% | 3.68% |

**Table of Contents**

Net interest income can be analyzed through the use of the Yields Analysis table. The table shows a three-year comparison of the average balance of interest earning assets and interest bearing liabilities along with interest and yields associated with them.

| **YIELDS ANALYSIS** Year Ended December 31 | | **2001** | | | **2000** | | | **1999** | |
|---|---|---|---|---|---|---|---|---|---|
| | **Average Balance** | **Interest** | **Yield/ Rate** | **Average Balance** | **Interest** | **Yield/ Rate** | **Average Balance** | **Interest** | **Yield/ Rate** |
| **ASSETS** | | | | | | | | | |
| Interest earning assets: | | | | | | | | | |
| Taxable loans (1)(3) | $1,058,506 | $85,361 | 8.09% | $1,089,484 | $90,819 | 8.34% | $992,643 | $80,783 | 8.14% |

(1) For purposes of these computations, non-accruing loans are included in the daily average loan amounts outstanding.

(2) The tax-exempt income and yields are shown on a tax equivalent basis using the 35%, 34% and 35% marginal Federal tax rates in effect during 2001, 2000 and 1999, respectively.

(3) Loan fees are included in the interest reported for loans. Those fees amounted to $2,835 in 2001, $2,326 in 2000 and $2,193 in 1999.

**Table of Contents**

You can further analyze the change in net interest income by separating the volume and rate impact of the change.

The following table details the breakdown of the major categories affecting the change:

| RATE / VOLUME ANALYSIS (1) | 2001 compared to 2000 Due to Change in | | | 2000 compared to 1999 Due to Change in | | |
|---|---|---|---|---|---|---|
| | Volume | Rate | Net | Volume | Rate | Net |
| Increase (decrease) in FTE interest income: | | | | | | |
| Taxable loans | $(2,582) | $(2,606) | $(5,188) | $7,881 | $ 2,155 | $10,036 |
| Tax-exempt loans | 102 | 42 | 144 | 400 | 88 | 488 |
| Taxable securities | 1,098 | (454) | 644 | 236 | 2,288 | 2,524 |
| Tax-exempt securities | 120 | (156) | (36) | (880) | (75) | (955) |
| Federal funds sold | 1,358 | (561) | 797 | (592) | (13) | (605) |
| Total interest bearing assets | 96 | (3,735) | (3,639) | 7,045 | 4,443 | 11,488 |
| Interest bearing liabilities: | | | | | | |
| Demand deposits interest bearing | 59 | (153) | (94) | (84) | (21) | (105) |
| Savings deposits | (790) | (1,853) | (2,643) | (368) | 677 | 309 |
| Time deposits | (232) | (1,257) | (1,489) | 726 | 3,368 | 4,094 |
| Federal funds purchased and securities sold under agreements to repurchase | (91) | (1,545) | (1,636) | (776) | 535 | (241) |
| Note payable | 38 | (16) | 22 | (44) | 5 | (39) |
| Other borrowed funds | (20) | (62) | (82) | (9) | 26 | 17 |
| Federal Home Loan Bank advances | 906 | (287) | 619 | 6,058 | 1,518 | 7,576 |
| Corporation-obligated mandatorily redeemable capital securities of subsidiary trust | 749 | | 749 | | | |
| Total interest bearing liabilities | 619 | (5,173) | (4,554) | 5,503 | 6,108 | 11,611 |
| Total effect on net interest income | $ (523) | $ 1,438 | $ 915 | $1,542 | $(1,665) | $ (123) |

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

**PROVISION FOR LOAN LOSSES**

The provision for loan losses totaled $4,718 in 2001 representing .44% of average loans. The provision was slightly less than net charge-offs, which were ..47% of average loans primarily due to a decrease in outstanding indirect automobile loans, which tend to have a higher expected loss experience. With the allowance acquired from Commerce, the allowance for loan losses represents 1.49% of loans at year-end 2001. The provision for loan losses was $7,129 in 2000. Included in the third quarter 2000 restructuring activities was an additional $4.1 million in provision for loan losses which helped increase the reserve for loan losses to 1.42% of loans at year-end 2000. The increased provision resulted from a specific analysis of commercial credits and reflects Management s philosophy of loan analysis based on the current economic environment. Excluding the third quarter additional provision, the provision would have been a more normalized .27% of loans. The provision for loan losses totaled $3,195 in 1999, representing .32% of average loans.

**NON-INTEREST INCOME**

The Corporation was well positioned to take advantage of the dramatically lower market rates in 2001. Mortgage loan originations increased significantly, totally nearly $600 million. Secondary market activities were also very strong and sales of residential mortgage loans totaled over $520 million, realizing $5.4 in gains. Gains on the sale of SBA loans generated an additional $.4 million in gains during the year. The gain on sale of securities totaled $642 in 2001 and represented gains realized on sales early in 2001 with the proceeds used to reinvest in longer-maturity, higher-rate securities. Service charges on deposit accounts improved significantly in 2001, increasing by 20.3% to $5,302. The increase was due to fee changes implemented in 2000 as well as a 5.5% increase in the number of non interest-bearing demand deposit accounts during 2001.

Trust fees were lower in 2001 as the market value of assets declined in 2001. Trust fees totaled $2,870 in 2001 versus $3,898 in 2000. Management added several new experienced, sales-focused professionals to the Trust line of business in 2001 and have solid plans for new business development for 2002.

Table of Contents

Total 2000 non-interest income was significantly impacted by the loan and security losses realized during the third quarter restructuring of $3,711 and $2,808, respectively. Absent the restructuring activity, non-interest income would have totaled $14,794, virtually unchanged from the prior year total of $14,792. Increases were realized in deposit service charges (up 2.2%), trust income (up 10.3%) and other income (up 3.0%). Reducing non-interest income was a loss on trading activity of $335 during the year.

Included in non-interest income over the past three years were pre-tax losses and gains on the sale of securities. The gain on sale of securities totaled $642 in 2001 and represented gains realized on sales early in 2001 with the proceeds used to reinvest in longer-maturity, higher-rate securities. During 2000, the security portfolio realized losses in the amount of $2,399. Absent the restructuring activity, gains of $409 would have been realized. Security gains in 1999 totaled $312.

**NON-INTEREST EXPENSE**

The Corporation continues to emphasize control and to be efficient in its utilization of resources to manage assets. Non-interest expenses as a percentage of average assets were 2.63%, 2.79% and 2.62% in 2001, 2000 and 1999, respectively. The overall level of expense reduction results in a 6% decline in costs from 2000 to 2001. The two categories that realized increases, salaries and benefits and net occupancy, were held to 3% and 2% increases, respectively. Included in the 2000 expenses were professional service costs incurred to facilitate restructuring and reengineering activities. Also in 2000, equipment costs increased by 17% due to an increase in the investment into technology (both hardware and software designed to make the Corporation more efficient) and its related service contracts. The amortization of goodwill and other intangibles declined in both periods presented below due to the accelerated nature of the amortization. The adoption of SFAS No. 142 will result in a $158 reduction in amortization expense in 2002, however that reduction will be offset by increased core deposit intangible amortization resulting from the Commerce acquisition as detailed in footnote 3. The table below details the percentage change in each non-interest expense category over the past three years:

| | Percentage Change | |
|---|---|---|
| | 2001 over 2000 | 2000 over 1999 |
| Salaries and benefits | 3% | 9% |
| Net occupancy | 2 | 1 |
| Equipment | (2) | 17 |
| Professional services | (49) | 59 |
| Assessment on deposits and other taxes | (8) | 0 |
| Amortization of goodwill & other intangibles | (32) | (19) |
| Other expenses | (13) | 17 |

**INCOME TAXES**

The provision for income taxes was $5,880, $176 and $5,361 in 2001, 2000 and 1999, respectively. The effective tax rate for the Corporation was 25.5%, 2.8% and 24.9% during the same periods. The reduction in the effective tax rate in 2000 was due to the reduced net income due to restructuring activities. The Corporation utilizes tax-exempt loans and securities as well as bank owned life insurance and low income housing tax credits to minimize the impact of taxes on earnings.

**Table of Contents**

**BALANCE SHEET**

Average assets grew minimally (up .8%) in 2001 after increasing by 5.7% in 2000. The growth rate for 2001 was adversely affected by the bulk sale of $130 million in residential real estate loans in the third quarter of 2000 along with further declines in residential mortgage loans in 2001 due to advancing pre-payments and strong secondary market activities. Additional loan balance reductions occurred in indirect automobile loan balances. Underwriting standards were strengthened during the 2001 and new loan volume and outstanding balances declined as a result. Commercial loan growth reached 20.7% in 2001 and was aided by the acquisition of $93 million in loans from Commerce. In 2000 the growth rate was influenced by strong growth in consumer lending. In 2001 core deposit balances (both interest-bearing and non interest-bearing demand deposit and savings accounts) experienced strong growth, reflecting management s focus on improving the net interest margin and reducing reliance on higher cost funding. A re-energized deposit line-up, increased advertising, internal incentives and the Commerce acquisition combined to allow core deposit balances to increase by 18.8% over the course of 2001. Even excluding the Commerce acquisition, core deposits increased by 9.4%. The number of non interest-bearing demand deposit accounts increased by 5.5% (excluding acquired Commerce accounts) in 2001, allowing for a greater potential for increased fee income in future years. Also, a lower interest rate environment typically accompanies deposit movement to more liquid accounts. The improvement in these core deposit balances allowed the Corporation to de-emphasize as planned the higher cost time deposit balances as a source of funding. Time deposits increased by only .6% during 2001, however excluding the time deposits acquired from Commerce, time deposit balances declined by 8.4%. Deposit growth in 2000 was influenced by low deposit growth rates. As an industry, financial institutions are experiencing slower deposit growth rates due to increased competition from non-traditional alternatives, especially mutual funds.

---

**EARNING ASSETS**

**Securities:**

The securities portfolio of the Corporation is used to provide an adequate rate of return to the Corporation along with appropriate levels of liquidity and pledging and as a tool for efficient tax management and interest rate risk management. The accounting treatment for the securities portfolio is determined by the Corporation s intent regarding particular security holdings. Purchases in longer maturity ranges that provided yield enhancement included purchases of tax-exempt securities, which provide the additional benefit of tax reduction.

The securities portfolio totaled $417,496 as of December 31, 2001 and is classified entirely as available-for-sale. That balance represents a 9.3% increase over the prior year-end. For 2001, the growth in securities was concentrated in mortgage backed securities, including collateralized mortgage obligations that helped improve the earnings performance characteristics of the portfolio. The securities portfolio totaled $382,098 as of December 31, 2000 representing a 4% increase over the prior year-end. For 2000, the growth in securities was concentrated in corporate issues that helped increase the duration of the portfolio during a period of historically high rates. In 1999, security balance growth was limited to leveraging activities that coupled like-term FHLB advances with securities purchases designed to enhance net income, earnings per share and return on equity. Growth in securities had previously been concentrated in tax-exempt issues.

The average yield on the portfolio is 6.7% as of December 31, 2001, down 20 basis points from the prior year-end. During 2001, the Corporation realized gains on security sales of $642. During 2000, the Corporation realized $2,399 in net losses on the sale of securities while in 1999 net security gains totaled $312. While rates have moved down over the past year, the Corporation now has an unrealized gain position for the portfolio of $5.4 million versus $.4 million the prior year-end. It is anticipated that the Corporation will move to shorten the average duration of the portfolio as rates are at historic lows.

**Table of Contents**

Summary yield and maturity information regarding the available-for-sale securities portfolios on December 31 follows. Yields are calculated on a fully taxable equivalent basis using the marginal federal income tax rate of 35% for 2001.

| | Book Value | | | |
|---|---|---|---|---|
| | **2001** | **2001** | **2000** | **1999** |
| | **Available-for-Sale** | **Yield** | **Available-for-Sale** | **Available-for-Sale** |
| U. S. Treasury and other U. S. Government agencies and corporations: | | | | |
| Under 1 year | $ 1,527 | 2.7% | $ 7,322 | $ 3,180 |
| 1 to 5 years | 5,413 | 5.1 | 28,128 | 60,349 |
| 5 to 10 years | 22,108 | 6.4 | 16,292 | 17,802 |
| Over 10 years | | | | |
| Total | 29,048 | 6.0 | 51,742 | 81,331 |
| Obligations of states and political subdivisions: | | | | |
| Under 1 year | 1,498 | 6.7 | 1,076 | 259 |
| 1 to 5 years | 19,858 | 7.4 | 13,458 | 11,065 |
| 5 to 10 years | 29,785 | 7.2 | 38,896 | 41,497 |
| Over 10 years | 17,069 | 7.1 | 13,406 | 24,334 |
| Total | 68,210 | 7.2 | 66,836 | 77,155 |
| Corporate: | | | | |
| Under 1 year | 3,524 | 8.7 | 3,790 | |
| 1 to 5 years | 13,650 | 7.1 | 20,558 | 3,163 |
| 5 to 10 years | 15,368 | 7.2 | 7,947 | |
| Over 10 years | 57,245 | 7.5 | 38,123 | 18,781 |
| Total | 89,787 | 7.4 | 70,418 | 21,944 |
| Mortgage-backed securities | 211,096 | 6.4 | 175,294 | 173,750 |
| Equity securities | 19,355 | 5.5 | 17,808 | 13,407 |
| Total securities | $417,496 | 6.7% | $382,098 | $367,587 |

Mortgage-backed securities have various stated maturities through October 2031. The estimated weighted-average maturity of this segment of the portfolio is 5.7 years.

Table of Contents

**Loans:**

Listed in the two tables below is the Corporation s loan distribution in dollars as a percent of total loans at the end of each of the last five years:

| Balance distribution | 2001 | 2000 | 1999 | 1998 | 1997 |
|---|---|---|---|---|---|
| Commercial | $ 508,579 | $ 421,229 | $ 413,097 | $373,244 | $347,173 |
| Consumer | 316,097 | 302,881 | 216,173 | 230,561 | 238,245 |
| Real estate mortgage | 297,216 | 345,979 | 442,392 | 367,048 | 281,729 |
| Balance as of December 31 | $1,121,892 | $1,070,089 | $1,071,662 | $970,853 | $867,147 |

An analysis of maturity and interest rate sensitivity of commercial loans as of December 31, 2001 follows:

| | One Year Or Less | One to Five Years | Over Five Years | Total |
|---|---|---|---|---|
| Fixed rate | $ 19,224 | $68,249 | $ 77,753 | $165,226 |
| Variable rate (primarily prime rate based) | 107,198 | 52,964 | 183,191 | 343,353 |
| Total commercial loans | $126,422 | $21,213 | $260,944 | $508,579 |

The Corporation emphasizes on-balance sheet growth in direct consumer and commercial. The Corporation emphasizes real estate lending through its branch network, reaching a broad range of customers, as well as through the use of mortgage loan originators and correspondent lender relationships. Generally, the loans sold into the secondary mortgage market make funds available for reuse in mortgage or other lending activities, generate a net gain (including origination fee income) from the sale, limit the interest rate risk caused by holding long-term, fixed-rate loans, and build a portfolio of serviced loans which generate fee income for the Corporation. The serviced portfolio of mortgages totaled $813 and $472 million as of December 31, 2001 and 2000, respectively.

Commercial loans are generated through a calling program targeting medium-sized companies. The Corporation is also generating an increasing volume of Small Business Administration ( SBA ) loans. The Corporation sells the guaranteed portion of the SBA loans originated. The sales generated $436 and $508 in net revenues, including $144 and $191 in revenues from the value of the servicing retained in 2001 and 2000, respectively. The amount of SBA loans being serviced by the Corporation totaled approximately $13.1 and $13.3 million at December 31, 2001 and 2000, respectively.

The Corporation s commercial loans are granted to customers within the immediate trade area of the Corporation. The mix is diverse, covering a wide range of borrowers. The table below details the stratification of commercial loan balances at the end of 2001:

| Stratification | Amount |
|---|---|
| Under $1 million | $342,686 |
| From $1 to $5 million | 140,175 |
| From $5 to $10 million | 25,718 |
| Over $10 million | |
| Total | $508,579 |

**Table of Contents**

The Corporation monitors and controls concentrations within a particular industry or segment. As of December 31, 2001, the Corporation had a concentration in commercial real estate loans totaling approximately $342 million, approximately 68.3% of which were owner-occupied businesses, including medical office buildings, retail and fast-food restaurants within the Corporation s market area. The table below details as of December 31, 2001 the industry concentrations by SIC code that exceed 10% of tier I capital:

| Industry | SIC Code | Amount |
|---|---|---|
| Non-residential buildings | 6512 | $71,520 |
| Restaurants retail | 5812 | 22,032 |
| Individuals | 8811 | 21,617 |
| Apartments | 6513 | 19,692 |
| Lessors real property | 6519 | 17,048 |
| Nursing homes | 8051 | 14,516 |

**ASSET QUALITY**

The allowance for loan losses is analyzed in the table below:

| Year Ended December 31 | 2001 | 2000 | 1999 | 1998 | 1997 |
|---|---|---|---|---|---|
| Balance at January 1 | $15,217 | $11,169 | $10,739 | $ 8,837 | $9,235 |
| Charge-offs: | | | | | |
| Commercial | 2,486 | 1,702 | 2,430 | 6,734 | 2,435 |
| Real estate | 175 | 164 | 86 | 820 | 12 |
| Consumer | 3,810 | 2,194 | 1,961 | 3,055 | 2,992 |
| | 6,471 | 4,060 | 4,477 | 10,609 | 5,439 |
| Recoveries: | | | | | |
| Commercial | 707 | 533 | 901 | 1,213 | 108 |
| Real estate | 5 | 8 | 4 | 50 | |
| Consumer | 641 | 438 | 807 | 669 | 717 |
| | 1,353 | 979 | 1,712 | 1,932 | 825 |
| Net charge-offs | 5,118 | 3,081 | 2,765 | 8,677 | 4,614 |
| Acquired reserves: | 1,878 | | | | |
| Provision for loan losses charged to operations | 4,718 | 7,129 | 3,195 | 10,579 | 4,205 |
| Balance at December 31 | $16,695 | $15,217 | $11,169 | $10,739 | $8,826 |
| Allowance for loan losses as a percentage of year-end loans | 1.49% | 1.42% | 1.04% | 1.11% | 1.02% |
| Allowance for loan losses as a percentage of non-performing loans | 158% | 191% | 188% | 155% | 128% |

Net charge-offs as a percent of average loans by major loan category are shown below:

| Year Ended December 31 | 2001 | 2000 | 1999 | 1998 | 1997 |
|---|---|---|---|---|---|
| Commercial | 0.44% | 0.29% | 0.40% | 1.55% | 0.68% |
| Real estate mortgage | 0.04% | 0.04% | 0.02% | 0.23% | |
| Consumer | 1.22% | 0.68% | 0.53% | 0.98% | 0.85% |

| | | | | | |
|---|---|---|---|---|---|
| Total net charge-offs to average loans | 0.47% | 0.28% | 0.27% | 0.92% | 0.53% |

Table of Contents

The balance of the allowance for loan losses has increased steadily from 1997 to 2001 as outstanding loan balances increased and the risk characteristics of the portfolios shifted from lower risk residential real estate loans to higher risk consumer and commercial loans. The allowance for loan losses was $16,695, or 1.49% of loans as of December 31, 2001. The allowance represents 158% of non-performing loans, which is lower than the coverage of non-performing loans at the end of the previous two years. With approximately $3 million of the non-performing loan balances as of December 31, 2001 represented by residential real estate loans, the allowance for loan losses, in Management s opinion is adequate to absorb losses inherent with the loan portfolios. Commercial loan charge-offs increased to .44% of commercial loans, representing a more normalized level of loss experience. The .29% commercial charge-off rate in 2000 represented the low point for these charge-offs for the past five years. Consumer charge-offs increased by 74% from 2000 as losses on indirect automobile lending increased starting in the second quarter of 2001. The increase was a result of increased losses per vehicle due to a soft resell market and an increase in voluntary surrender of vehicles. The underwriting standards were revised to include, among other factors, a reduced level of loan advance to vehicle value. The underwriting changes have resulted in a decline in new loan origination and a subsequent decline in the indirect automobile concentration within the consumer loan portfolio. Indirect automobile loans totaled $132 million at the end of 2001 as compared to $145 million as of December 31, 2000.

The following presents a breakdown of the allocation of the allowance for loan loss by loan category for each of the last five years:

| | | | December 31 | | |
|---|---|---|---|---|---|
| **Loan Category** | **2001** | **2000** | **1999** | **1998** | **1997** |
| Commercial | $11,673 | $ 9,927 | $ 7,449 | $ 7,351 | $4,817 |
| Consumer | 4,762 | 5,161 | 2,587 | 1,952 | 3,311 |
| Real Estate | 260 | 129 | 1,133 | 1,436 | 698 |
| Total | $16,695 | $15,217 | $11,169 | $10,739 | $8,826 |

The Corporation s loan portfolios are subject to varying degrees of credit risk. Credit risk is mitigated through portfolio diversification, limiting exposure to any single industry or customer (see the Loan section above for discussion on the commercial loan portfolio s balance stratification and industry concentration). The determination of the allowance for loan losses is based on Management s evaluation of the potential losses in the loan portfolio considering, among other relevant factors, repayment status, borrowers ability to repay, collateral and current foreseeable economic conditions. Management s determination of the adequacy of the allowance is based upon an evaluation of the collectibility of the loans. These evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, economic conditions that may affect the borrower s ability to repay (including the timing of future payments), overall quality, analysis of prior and current loss experience and a review of specific problem loans. The allowance reflects expected losses resulting from the analysis of individual loans and historical loss experience for each loan category. The Bank utilizes its internal loan gradings for commercial loans in conjunction with historical loss experience for loans of each grade level and current economic trends as parts of its analysis in determining the adequacy of its allowance for loan losses.

Below is a table listing the non-accrual, past due and restructured loans at the end of the last five years:

| | **2001** | **2000** | **1999** | **1998** | **1997** |
|---|---|---|---|---|---|
| Non-accrual loans | $ 5,004 | $4,699 | $2,743 | $4,130 | $5,819 |
| Past due loans | 5,304 | 3,239 | 3,132 | 2,725 | 1,075 |
| Restructured loans | 258 | 43 | 52 | 61 | 13 |
| Total | $10,566 | $7,981 | $5,927 | $6,916 | $6,907 |
| Percent of loans at year end | 0.94% | 0.75% | 0.55% | 0.71% | 0.80% |
| Other real estate owned | $ 1,399 | $ 902 | $ 281 | $ 79 | $ |

Loans 30 to 89 days past due, where the monthly payment is more than 30 days past due but less than 89 days past the payment date, excluding non-accrual and restructured loans included in the table above, amounted to $9,740 or 0.87% of outstanding loans, as of December 31, 2001, as compared to $7,356, or .69% of loans on December 31, 2000. Loans then current where some concerns existed as to ability of the borrower to

comply with loan repayment terms approximated $62,429 at December 31, 2001 and $28,536 on December 31, 2000. Such loans have been and are being closely monitored by Management.



---

Table of Contents

The provision for loan losses represents the charge to income necessary to adjust the allowance for loan losses to an amount that represents Management s assessment of the estimated probable loan losses inherent in the loan portfolios that have been incurred at each balance sheet date. All lending activity contains associated risks of loan losses that are a necessary element of business activity. The provision for loan losses for 2001 was $4,718, compared to $7,129 for 2000 and $3,195 in 1999. The changes in the provision for loan losses were attributable to changes in net charge-offs, increasing non-performing loans and the recognition of changes in the current risk factors. In 2000, the Corporation additionally underwent a more stringent review of specific problem loans, which necessitated the addition of $4,100 in additional provision during the third quarter of that year.

**FUNDING SOURCES**
**Deposits:**

| The average amounts of deposits are summarized below: | 2001 | 2000 | 1999 |
|---|---|---|---|
| Demand deposits non-interest bearing | $ 115,857 | $ 112,185 | $ 108,778 |
| Demand deposits interest bearing | 90,762 | 86,818 | 92,350 |
| Savings deposits | 242,242 | 266,863 | 279,305 |
| Time deposits | 621,578 | 625,575 | 611,827 |
| Total | $1,070,439 | $1,091,441 | $1,092,260 |

Average deposits declined slightly in 2001 after remaining virtually unchanged in 2000. Increases in average non interest-bearing and interest-bearing demand deposit balances did not offset the declines in average savings and time deposit balances. Loan balance reductions, primarily in residential real estate loans allowed the Corporation to reduce balances in higher cost time deposits and be aggressive in pricing down other savings accounts during the period of falling interest rates, resulting in some balance runoff. Average interest bearing demand deposits and savings deposits declined during 2000 as the Corporation utilized FHLB advances to supplement funding at rates and maturity structures more favorable than what was available in the retail market.

The following is a maturity distribution for the $596,329 of time deposits outstanding as of December 31, 2001:

| | |
|---|---|
| 2002 | $441,885 |
| 2003 | 112,585 |
| 2004 | 28,224 |
| 2005 | 5,859 |
| 2006 | 5,635 |
| Thereafter | 2,141 |

On December 31, 2001 time deposits over $100 totaled $126,996. The Bank continues to maintain strong relationships with the various public entities centered in the primary markets of the Bank which contributes to the balance of time deposits over $100. The increase in these balances was to supply short-term funding during a period of declining interest rates. The maturity schedule for time deposits over $100 as of December 31 is given in the table below:

| Maturing in: | 2001 | 2000 |
|---|---|---|
| 3 months or less | $ 84,107 | $42,168 |
| 3 to 6 months | 30,085 | 16,395 |
| 6 to 12 months | 9,995 | 27,065 |
| Over 12 months | 2,809 | 10,960 |

| | | |
|---|---|---|
| Total | $126,996 | $96,588 |

Table of Contents

**Other Sources of Funds:**
The Corporation has the availability to borrow $36 million from correspondent banks as overnight federal funds purchased. There were no federal funds purchased at December 31, 2001, while $29 million and $0 were outstanding at December 31, 2000 and 1999. The Corporation has repurchase agreements with corporate customers and local municipalities. These borrowings have an overnight maturity and are collateralized with U. S. Treasury and government agency securities, including agency-issued mortgage-backed securities with a market value of $107,160 and $100,609 as of December 31, 2001 and 2000, respectively. The Corporation continuously pledges collateral for these borrowings at an amount exceeding the outstanding balance. The securities are held in the Corporation s safekeeping account at the Federal Reserve Bank. Although there were no repurchase agreements with approved brokers outstanding at December 31, 2001, the Corporation previously maintained such balances, which were collateralized by U. S. Treasury and government agency securities held by the broker.

The following table summarizes certain information relative to these borrowings:

| | 2001 | 2000 | 1999 |
|---|---|---|---|
| Outstanding at December 31 | $107,279 | $100,895 | $106,532 |
| Weighted-average interest rate at December 31 | 3.58% | 4.49% | 4.46% |
| Maximum amount outstanding as of any month end | $133,743 | $120,026 | $166,043 |
| Average amount outstanding | $109,476 | $105,850 | $135,259 |
| Approximate weighted-average interest rate during the year | 3.40% | 4.50% | 4.61% |

The repurchase agreement program provides a sweep feature on the customer s primary business account along with competitive market rates of interest for their excess funds. The success of this product reflects the strong emphasis the Bank places on offering competitive products coupled with personalized service to the small-to mid-size businesses operating in the Bank s various markets. Federal funds purchased and securities sold under agreements to repurchase averaged $116.1 million in 2001 with the majority of the average balances representing the retail sweep product.

The Corporation also has available to it unsecured lines of credit with correspondent banks totaling $20 million. The lines of credit are renewable annually and bear interest at a floating rate based on several indices. There were no balances outstanding on the lines at the end of 2001. As of December 31, 2000, the Corporation had utilized $1 million in borrowings under these lines.

The Corporation also has access to federal tax deposits on a daily basis. After being deposited by customers, the tax deposits are held at the Corporation up to a self-imposed limit of $6 million until they are drawn upon by the federal government. The balance of these funds was $5,853 and $2,163 as of December 31, 2001 and 2000, respectively. The Corporation occasionally uses federal funds purchased from other financial institutions as a source of short-term funding. The Corporation had no federal funds purchased as of December 31, 2001 and $29 million outstanding as of December 31, 2000.

The Bank also is a member of the Federal Home Loan Bank ( FHLB ) system and utilizes the various advance programs offered by the FHLB. The funds are drawn from the FHLB for various terms through 2007 and are utilized to provide long-term funding to offset the interest rate risk inherent with holding long-term, fixed-rate mortgages. The balances of these advances were $275,152 and $251,733 as of December 31, 2001 and 2000, respectively.

Most recently, the Corporation has utilized the issuance of corporation-obligated mandatorily redeemable securities of subsidiary trust, more commonly known as trust preferred securities, to raise additional funding. The securities are traded under the symbol SECDP on the NASDAQ National Market System. The Corporation raised $32 million in these securities in 2001, primarily to fund the Commerce acquisition. The securities qualify as tier I capital for regulatory purposes and also bear interest that is tax deductible to the Corporation.

Table of Contents

**CAPITAL**

The shareholders equity increased to $128,299 at December 31, 2001 from $117,197 a year earlier. The increase was attributable to retention of earnings as well as the increase in market values for the available-for-sale securities. The increase was partially offset by the treasury share repurchase activities. The impact of the change in unrealized market value adjustment on securities available-for-sale, net of tax (SFAS No. 115 adjustment of $3,224 in 2001) resulted in a net unrealized gain position within other comprehensive income of $3,505 at December 31, 2001.

In 2000, total shareholders equity increased to $117,197 at December 31, 2000 from $116,347 a year earlier. The increase was attributable to the increase in market values for the available-for-sale securities. The increase offset the treasury share repurchase activities. The impact of the change in unrealized market value adjustment on securities available-for-sale, net of tax (SFAS No. 115 adjustment of $8,072 in 2000) resulted in a net unrealized gain position of $281 at December 31, 2000 versus a net unrealized loss position of $7,791 at December 31, 1999.

As of December 31, 1998, the Corporation had 50,400 shares held in treasury at a cost of $793. On August 10, 1999, the Board of Directors authorized the discretionary buy-back of up to 500,000 shares of common stock. As of December 31, 1999, 254,100 shares had been repurchased bring the total shares in treasury to 304,500. The number of shares authorized for repurchase was increased to 600,000 on April 20, 2000. The 600,000-share repurchase was completed on October 11, 2000. On October 12, 2000 the Board of Directors authorized the repurchase of up to 2% of outstanding shares on an annual basis. In 2001, the Corporation repurchased approximately 152,000 shares and the authorization to repurchase up to 2% of outstanding shares was renewed. As of December 31, 2001 there were 883,494 shares in treasury and another 133,756 remaining shares to be repurchased under the current authorization.

The Corporation has consistently had qualifying capital under the risk-based capital requirements in excess of those required to meet the well-capitalized standards. For further details on capital ratios, see Note 16.

The Corporation trades under the symbol SECD on the NASDAQ National Market System. The total market capitalization of the Corporation was approximately $215 million at December 31, 2001. The table below lists the high and low trading prices for the common stock by quarter for the last three years.

| Quarter | First | Second | Third | Fourth | Year |
|---|---|---|---|---|---|
| 2001: | | | | | |
| High | $18.75 | $23.00 | $22.89 | $22.36 | $23.00 |
| Low | 13.75 | 16.55 | 17.00 | 18.45 | 13.75 |
| Dividends Declared | .17 | .17 | .17 | .17 | .68 |
| 2000: | | | | | |
| High | $22.31 | $18.13 | $16.31 | $16.94 | $22.31 |
| Low | 17.06 | 12.25 | 13.75 | 12.13 | 12.13 |
| Dividends Declared | .16 | .16 | .16 | .16 | .64 |
| 1999 | | | | | |
| High | $24.00 | $29.50 | $30.75 | $27.00 | $30.75 |
| Low | 19.06 | 21.00 | 24.00 | 22.38 | 19.06 |
| Dividends Declared | .14 | .14 | .14 | .14 | .56 |

The Corporation s price for its common stock increased by 49% in 2001 while the trading range of $13.75 to $23.00 per share was virtually unchanged from the prior year. Steady improvement in the common stock price paralleled the Corporation s improved financial performance. The Corporation s stock has most recently traded slightly below the price earnings ratio for peer banks. Bank stock prices in general were subject to downward pressure in 2000 with the increase in market rates associated with Federal Open Market Committee activities and some rebounded in 2001 as market rates declined. Book value per common share was $12.90 and $11.65 at December 31, 2001 and 2000, respectively.

Table of Contents

The Corporation has historically paid cash dividends on a quarterly basis and has periodically paid stock dividends at the discretion of the Board of Directors. The payment and amount of future dividends on the common stock will be determined by the Board of Directors. The payment will depend on, among other things, earnings, financial condition and cash requirements of the Corporation at the time that such payment is considered, and on the ability of the Corporation to receive dividends from the Bank, the amount of which is subject to regulatory limitations. For 2001, 2000 and 1999, the dividend-payout ratio for the Corporation was 39.8%, 106.3%, and 36.7%, respectively. The unusually high dividend payout ratios for 2000 were attributable to the impact of restructuring activities.

---

**LIQUIDITY**

Management of the Corporation s liquidity position is necessary to ensure that funds are available to meet the cash flow needs of depositors and borrowers as well as the operating cash needs of the Corporation. Funds are available from a number of sources including maturing securities, payments made on loans, the acquisition of new deposits, the sale of packaged loans, borrowing from the FHLB and overnight lines of credit of over $36 million through correspondent banks. The parent company has three major sources of funding including dividends from the Bank, $20 million in unsecured lines of credit with correspondent banks, which are renewable annually, and access to the capital markets. The net cash provided by operating activities for 2001, 2000 and 1999 were approximately $22 million, $16 million and $20 million, respectively. Management does not expect future cash flows available from operations to be materially different from the cash flow experience of the prior three years. Factors affecting cash flows from investing or financing activities are not expected to have a significant negative impact and foreseeable future liquidity. As discussed in Note 16, the Bank is subject to regulation and may be limited in its ability to pay dividends to the parent company. Accordingly, consolidated cash flows may not represent cash available to common stockholders.

---

**MARKET RISK MANAGEMENT**

Market risk is the risk of economic loss from adverse changes in the fair value of financial instruments due to changes in (a) interest rates, (b) foreign exchange rates, or (c) other factors that relate to market volatility of the rate, index, or price underlying the financial instrument. The Corporation s market risk is composed primarily of interest rate risk. The Corporation s Asset/Liability Committee (ALCO) is responsible for reviewing the interest rate sensitivity position of the Corporation and establishing policies to monitor and limit the exposure to interest rate risk. Since nearly the Corporation s entire interest rate risk exposure relates to the financial instrument activity of the Bank, the Bank s Board of Directors review the policies and guidelines established by ALCO.

The primary objective of asset/liability management is to provide an optimum and stable net interest margin, after-tax return on assets and return on equity capital, as well as adequate liquidity and capital. Interest rate risk is monitored through the use of two complementary measures: dynamic gap analysis and earnings simulation models. While each of the measurement techniques has limitations, taken together they represent a reasonably comprehensive tool for measuring the magnitude of interest rate risk inherent in the Corporation.

The dynamic gap analysis measures the amount of repricing risk associated with the balance sheet at a specific point in time. Expected cash flows from fixed rate instruments are defined utilizing contractual maturities and anticipated cash flows through early repayment of loans, early calls and pay downs of securities and early withdrawals of deposits. Variable rate instrument s repricing frequencies are categorized according to their earliest repricing opportunity. Core deposits with non-contractual maturities are included in the gap repricing distributions based on historical patterns of pricing behavior.

Table of Contents

The earnings simulation model forecasts earnings for a one-year horizon frame under a variety of interest rate scenarios. Management evaluates the impact of the various rate simulations against earnings in a stable interest rate environment. The most recent model projects net income would decrease by 4.7% if interest rates would immediately fall by 200 basis points and increase by 2.0% if interest rates would immediately rise by 200 basis points. This represents a similar interest rate risk position as the prior year. At December 31, 2000 the model projected net income would decrease by 3.5% if interest rates would immediately fall by 200 basis points and would increase by 2.1% if interest rates would immediately rise by 200 basis points. The reason for the apparent mismatch in net income movement between the up 200 basis point shock scenario and down 200 basis point shock scenario as of December 31, 2001 is due to the low historical level of market rates, which may not permit some funding instruments to fully reprice lower if rates were to fall another 200 basis points. Management believes this asset sensitive position for the one-year time horizon is within acceptable levels of risk tolerance and is also within the Board approved levels of 5% variance in net income. The earnings simulation model includes assumptions about how the various components of the balance sheet and rate structure are likely to react through time in different interest rate environments. These assumptions are derived from historical analysis and Management s outlook.

Interest rate sensitivity is managed through the use of security portfolio management techniques, the use of fixed rate long-term borrowings from the FHLB, the establishment of rate and term structures for time deposits and loans, the sale of long-term fixed rate mortgages through the secondary mortgage market and off-balance sheet swaps, caps and floors.

---

**CRITICAL ACCOUNTING POLICIES**

The Corporation has established various accounting policies which govern the application of accounting principles generally accepted in the United States in the preparation of the Company s financial statements. The significant accounting principles of the Corporation are described in the footnotes to the consolidated financial statements. Certain accounting policies involve significant judgements and assumptions by Management, which have a material impact on the carrying value of certain assets and liabilities; Management considers such accounting policies to be critical accounting policies. The judgements and assumptions used by Management are based on historical experience and other factors, which are believed to be reasonable under the circumstances. Because of the nature of the judgements and assumptions made by Management, actual results could differ from these judgements and estimates, which could have a material impact on the carrying value of assets and liabilities and the results of operations of the Corporation.

Allowance for Loan Losses: The Corporation believes the allowance for loan losses is a critical accounting policy that requires the most significant judgements and estimates used in preparation of its consolidated financial statements. Refer to the section entitled Allowance for Loan Losses and Note 1. Accounting Policies for a detailed description of the Corporation s estimation process and methodology related to the allowance for loan losses.

Valuation of Mortgage Servicing Rights: The Corporation believes the valuations of mortgage servicing rights is a critical accounting policy that requires significant estimates in preparation of its consolidated financial statements. The Company recognizes as separate assets the value of mortgage servicing rights, whether those rights are acquired through loan origination activities or through purchase activities. Refer to the section entitled Mortgage Servicing Rights and Note 1, Statement of Accounting Policies, for a detailed description of the Company s process and methodology.

FASB 91 Deferral of Fees: The Corporation believes that SFAS No. 91 Deferral of fees is a critical accounting policy that utilizes estimates in its preparation of its consolidated financial statements. The Company accounts for loan origination and commitment fees and certain direct loan origination cost by deferring the net fees, or net costs, and amortizing them as an adjustment of the related loan s yield. Refer to the section entitled Revenue Recognition and Note 1, Statement of Accounting Policies, for a detailed description of the Company s process and methodology.

Table of Contents

**CONTRACTUAL OBLIGATIONS AND COMMITMENTS**

As disclosed in the Notes to the Consolidated Financial Statements, the Corporation has certain obligations and commitments to make future payments under contracts. At December 31, 2001, the aggregate contractual obligations and commitments are:

| Contractual obligations Principal due by period | Total | Less than 1 year | 2-5 Years | After 5 Years |
|---|---|---|---|---|
| Long-term debt | $305,594 | $3,139 | $25,000 | $277,455 |
| Annual rental commitments under non-cancelable leases | 14,130 | 2,069 | 7,226 | 4,835 |
| Total | $319,724 | $5,208 | $32,226 | $282,290 |

| Amount of commitment Expiration by period | Total | Less than 1 year | 2-5 Years | After 5 Years |
|---|---|---|---|---|
| Commitments to lend commercial | $108,810 | $ 93,667 | $13,353 | $1,790 |
| Commitments to lend residential real estate | 29,600 | 29,600 | | |
| Commitments to lend consumer | 57,944 | 57,944 | | |
| Stand-by letters of credit | 4,796 | 4,002 | 419 | 375 |
| Total | $201,150 | $185,213 | $13,772 | $2,165 |

**Item 7 (a). QUANITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The information included under the caption Market Risk Management presented in Item 7 above.

**Table of Contents**

**Item 8. Financial Statements and Supplementary Data**

**Consolidated Balance Sheets**

**Second Bancorp Incorporated and Subsidiaries**

| **ASSETS** | **Dollars in thousands, except per share data December 31 2001** | **2000** |
|---|---|---|
| Cash and due from banks | $ 40,837 | $ 35,272 |
| Federal funds sold and temporary investments | 24,016 | |
| Securities: | | |
| Available-for-sale (at market value) | 417,496 | 382,098 |
| Trading account | | 328 |
| Total securities | 417,496 | 382,426 |
| Loans | 1,121,892 | 1,070,089 |
| Less allowance for loan losses | 16,695 | 15,217 |
| Net loans | 1,105,197 | 1,054,872 |
| Premises and equipment | 16,416 | 18,039 |
| Accrued interest receivable | 10,272 | 11,181 |
| Goodwill and intangible assets | 26,578 | 6,038 |
| Other assets | 39,544 | 38,462 |
| Total assets | $ 1,680,356 | $ 1,546,290 |
| **LIABILITIES AND SHAREHOLDERS EQUITY** Deposits: | | |
| Demand non-interest bearing | $ 144,953 | $ 110,045 |
| Demand interest bearing | 105,221 | 87,268 |
| Savings | 276,628 | 246,056 |
| Time deposits | 596,329 | 592,766 |
| Total deposits | 1,123,131 | 1,036,135 |
| Federal funds purchased and securities sold under agreements to repurchase | 107,279 | 129,895 |
| Note payable | | 1,000 |
| Other borrowed funds | 5,853 | 2,163 |
| Federal Home Loan Bank advances | 275,152 | 251,733 |
| Accrued expenses and other liabilities | 10,200 | 8,167 |
| Corporation-obligated mandatorily redeemable capital securities of subsidiary trust | 30,442 | |
| Total liabilities | 1,552,057 | 1,429,093 |
| Shareholders equity: | | |
| Common Stock, no par value; 30,000,000 shares authorized; 10,832,810 and 10,787,310 shares issued in 2001 and 2000, respectively | 37,453 | 36,935 |
| Treasury stock, at cost; 883,494 and 730,200 shares, respectively | (16,798) | (13,947) |
| Accumulated other comprehensive income | 3,434 | 281 |
| Retained earnings | 104,210 | 93,928 |
| Total shareholders equity | 128,299 | 117,197 |
| Total liabilities and shareholders equity | $ 1,680,356 | $ 1,546,290 |

Table of Contents

**Consolidated Statements of Income**
**Second Bancorp Incorporated and Subsidiaries**

**Dollars in thousands, except per share data**

| | For the Calendar Year | | |
|---|---|---|---|
| **INTEREST INCOME** | **2001** | **2000** | **1999** |
| Loans (including fees): | | | |
| Taxable | $ 85,631 | $ 90,819 | $ 80,873 |
| Exempt from federal income taxes | 1,092 | 1,014 | 681 |
| Securities: | | | |
| Taxable | 21,614 | 20,970 | 18,446 |
| Exempt from federal income taxes | 3,137 | 3,209 | 3,781 |
| Federal funds sold and other | 1,083 | 286 | 891 |
| Total interest income | 112,557 | 116,298 | 104,582 |
| **INTEREST EXPENSE** | | | |
| Deposits | 42,010 | 46,236 | 41,938 |
| Federal funds purchased and securities sold under agreements to repurchase | 3,904 | 5,540 | 5,781 |
| Note payable | 47 | 25 | 64 |
| Other borrowed funds | 90 | 172 | 155 |
| Federal Home Loan Bank advances | 15,567 | 14,948 | 7,372 |
| Corporation-obligated mandatorily redeemable capital securities of subsidiary trust | 749 | | |
| Total interest expense | 62,367 | 66,921 | 55,310 |
| Net interest income | 50,190 | 49,377 | 49,272 |
| Provision for loan losses | 4,718 | 7,129 | 3,195 |
| Net interest income after provision for loan losses | 45,472 | 42,248 | 46,077 |
| **NON-INTEREST INCOME** | | | |
| Service charges on deposit accounts | 5,302 | 4,406 | 4,309 |
| Trust fees | 2,870 | 3,898 | 3,534 |
| Security gains (losses) | 642 | (2,399) | 312 |
| Gain (loss) on sale of loans | 5,814 | (2,001) | 2,066 |
| Trading gains (losses) | 19 | (335) | |
| Other operating income | 4,881 | 4,706 | 4,571 |
| Total non-interest income | 19,528 | 8,275 | 14,792 |
| **NON-INTEREST EXPENSE** | | | |
| Salaries and employee benefits | 21,544 | 20,817 | 19,054 |
| Net occupancy | 4,263 | 4,191 | 4,134 |
| Equipment | 3,891 | 3,985 | 3,418 |
| Professional services | 1,776 | 3,476 | 2,192 |
| Assessment on deposits and other taxes | 1,542 | 1,684 | 1,689 |
| Amortization of goodwill and other intangibles | 377 | 555 | 685 |
| Merger-related costs | 305 | | |
| Other operating expenses | 8,241 | 9,505 | 8,158 |
| Total non-interest expense | 41,939 | 44,213 | 39,330 |

| | | | |
|---|---|---|---|
| Income before federal income taxes | 23,061 | 6,310 | 21,539 |
| Income tax expense (benefit): | | | |
| Current | 4,050 | 1,415 | 4,516 |
| Deferred | 1,830 | (1,239) | 845 |
| Total federal income tax expense | 5,880 | 176 | 5,361 |
| Net income before cumulative effect of accounting change | $ 17,181 | $ 6,134 | $ 16,178 |
| Cumulative effect of accounting change, net of tax SFAS No. 133 | (101) | | |
| Net income | $ 17,080 | $ 6,134 | $ 16,178 |
| Earnings per common share: | | | |
| Basic before cumulative effect of accounting change | $ 1.72 | $ 0.60 | $ 1.52 |
| Diluted before cumulative effect of accounting change | 1.70 | 0.60 | 1.51 |
| Basic | 1.71 | 0.60 | 1.52 |
| Diluted | 1.69 | 0.60 | 1.51 |
| Average common shares outstanding: | | | |
| Basic | 10,247,025 | 10,247,025 | 10,635,852 |
| Diluted | 10,271,548 | 10,271,548 | 10,698,717 |

**Table of Contents**

**Consolidated Statements of Cash Flows**
**Second Bancorp Incorporated and Subsidiaries**

**Dollars in thousands, except per share data**

| | Common Stock | Treasury Stock | Accumulated Other Comprehensive Income | Retained Earnings | Total | Comprehensive Income |
|---|---|---|---|---|---|---|
| Balance, January 1, 1999 | $36,901 | $ (793) | $ 3,097 | $84,068 | $ 123,273 | |
| Comprehensive income: | | | | | | |
| Net income | | | | 16,178 | 16,178 | $ 16,178 |
| Change in unrealized gain on securities of $17,063, net of reclassification adjustment for gains included in net income of $312 and net of tax of $(5,863) | | | (10,888) | | (10,888) | (10,888) |
| Comprehensive income | | | | | | $ 5,290 |
| Cash dividends declared: | | | | | | |
| Common stock ($.56 per share) | | | | (5,934) | (5,934) | |
| Purchase of treasury stock | | (6,347) | | | (6,347) | |
| Common stock issued dividend reinvestment and stock option plans | 65 | | | | 65 | |