SECOND BANCORP INC
Form 10-K
March 26, 2003

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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, 2002

[ ] 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 *(State or Other Jurisdiction of Incorporation or Organization)*	**34-1547453** *(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. [ ]

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes [x] No [ ]

The aggregate market value of the Common Stock held by non-affiliates of the registrant as of June 28, 2002 as reported on the NASDAQ National Market System, was approximately $235,797,362. 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 21, 2003, the registrant had outstanding 9,642,154 shares of Common Stock.

DOCUMENTS INCORPORATED BY REFERENCE
Portions of the proxy statement for the annual shareholders meeting to be held on April 17, 2003 are incorporated by reference into Part II and Part III.

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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 35 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 northeast and east-central Ohio. A second operating subsidiary is Stouffer-Herzog Insurance Agency, which sells a wide range of property, casualty, life and health insurance products in northeast Ohio. At December 31, 2002, Second Bancorp had consolidated total assets of $1.89 billion, deposits of $1.20 billion and shareholders equity of $136 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. Additional non-operating subsidiaries include Second National Capital Corporation and Second National Financial Company, LLC, which were formed in 2002 to facilitate a capital conversion plan for the subsidiary Bank.

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 operate three major lines of business.

Commercial
Commercial includes credit and related financial services to small-to-large-sized corporations and businesses.

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 46% of our total loan portfolio at December 31, 2002.

Second National Commercial Banking Introduces the Financial Services Center Concept, Bringing Focus To a Combined Effort From All Business Lines. The growing complexity of commercial banking has meant that progressive banks can no longer do business in ways that had worked well for many years. During 2002, Second National responded to that reality by inaugurating its Financial Services Center or hub concept as a primary conduit to increased income coupled with reduced and controlled expenses.

By way of definition: a Financial Services Center is a strategically located facility in which commercial bankers are combined with a team of other disciplines: private banking, retail, wealth management, investments, all under the same roof. That creates an ideal environment for clients because it provides them all the product and service opportunities they would find at the main office in Warren. It is extremely efficient for Second National because our in-house team of diverse talents and expertise can bounce ideas off each other, help one another in cross-selling, and develop synergies between our different lines of business.

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Currently Second National operates four Financial Services Centers in Boardman, Beachwood, Akron and North Olmsted in addition to our Warren Headquarters. All are customized to some degree to accommodate local marketplace variations, but all follow a basic template for integrating on-site representatives from all of the Bank s lines of business.

Although it is tempting to simplify this as a one-stop shopping opportunity, the concept goes much deeper than that. Our objective is not just to make all our products available, but to match our wide-ranging product line to meet very specific client needs. The Financial Services Center concept is rooted in our commitment to sharing knowledge within for the purpose of coordinating cross-sells. Referrals between lines of business are logistically more likely when commercial lenders, private bankers, wealth managers and investment professionals are all literally just down the hall from each other.

Additionally, this new approach to doing business is in keeping with Second National s priority commitment to developing and maintaining long-term client relationships. Most notably, it puts our entire team much closer to local markets, making it easier to serve the needs of clients whom we know very well...and others whom we are now able to know better because we can efficiently offer everything they need from one location in their own backyard.

Commercial Banking Continues to Grow its Reputation as a Leader in Northeast Ohio. Our increasingly positive reputation has enabled us to successfully compete in larger commercial relationships.

As of July 31, 2002, our fee generation had already exceeded all of 2001 and ended this year at over $2 million or 67% above the prior year. Similarly, new loan production had already exceeded the entire year of 2001 by mid-2002 with year-end totals approaching $200 million, up 83% over the previous year.

This progress has been fueled by a very competent core team of bankers and underwriters, most of who have been with the organization for more than four years. Using input from our Finance Division and the Financial Information System (FIS), we are able to develop accurate pricing models balancing growth and profitability. We have also standardized practices for transferring of assets to Asset Recovery. Those procedures provide the Recovery Department with up-to-date analysis of the borrower s situation.

New Initiatives Emphasize Our Long-Standing Commitment to Small Business Banking. Small Business Banking at Second National benefited from an infusion of new energy during 2002 as professionals (charged with creating and enhancing commercial banking services to accounts with borrowings under $400,000) were located at each of our Financial Services Centers.

Those bankers will have at their disposal technology and product lines to equal or surpass the competition. Of equal importance, they will approach the marketplace with a positive differentiating philosophy. Unlike other organizations that use various business models to determine whether they will grant loans to small businesses, Second National maintains a high touch delivery system based on actual face-to-face interaction with each prospect or client, plus local loan authority resulting in quicker, more accurate decision-making. Our higher level of human contact will also help generate cross-selling opportunities in that each Financial Services Center includes wealth management, investment and retail associates.

These efforts are now supported by new display advertising and sales brochures plus a Small Business Banking section on www.secondnationalbank.com. Online Business Banking simplifies routine small business banking tasks. Clients can easily access daily account balances and transaction information, transfer funds between accounts, make loan payments and much more, without ever leaving the office. Business clients participating in this service have more than tripled since year-end 2001.

Reflective of our performance, Second National Bank has been, for the fourth consecutive year, recognized by the U.S. Small Business Administration (SBA) for achieving a top position in SBA loan volume among lenders in the Cleveland District. Second National s SBA activities resulted in 74 loans totaling $8.724 million, making us the largest community bank lender in the Cleveland SBA district, as well as the leading SBA lender to the small business community within the Warren-Youngstown market.

Retail

Retail includes deposit gathering, direct and indirect consumer lending along with a minor amount of small business banking services.

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 and recreational vehicle loans, credit cards and overdraft protection for checking account customers. At December 31, 2002, approximately 40% of our consumer loans consisted of indirect auto, boat and recreational vehicle loans, which are originated through dealers in the local area. Consumer loans comprised approximately 28% of our total loan portfolio at December 31, 2002.

Retail Banking Begins A Strategic Upgrade Of Its Entire Network. Second National has begun a strategic upgrade of its retail banking network based on an in-depth analysis of product demand and market share in primary market areas. We regard this as a prime opportunity to enhance and expand our ability to compete and serve in key markets where we have successfully grown from a small presence to a market share level that allows us to offer our clients new, state-of-the-art facilities in which to conduct their business. Specifically:

North Olmsted. Second National Bank relocated its North Olmsted Banking Center on November 12, 2002, opening the doors to a new Financial Services Center in North Olmsted.

This was much more than a routine relocation. Second National has now established a true hub to serve the financial needs of the entire west-Cleveland area. We have doubled the physical size of our presence in North Olmsted but more importantly have made all business lines available to clients from this single Financial Services Center. The new North Olmsted location features significant improvements including drive-thru lanes, a drive-up ATM and safe deposit boxes. A convenient night depository is also available. The new facility provides customer friendly access in and out from main roads where traffic is well controlled.

Hudson. With a capital expenditure of nearly $1 million, a new retail banking facility will be constructed in Hudson. The new full-service banking center will include drive-thru lanes, a drive-up ATM, additional safe deposit boxes and easy access. The enlarged office will retain its Western Reserve atmosphere. The Second National Stow and present Hudson banking centers will be merged into the newly expanded facility scheduled to open in the summer of 2003.

Kent. Another expanded banking facility will be built in Kent. An investment of nearly $1 million will provide multiple drive-thru lanes, a drive-up ATM and safe deposit boxes. Supported by the Bank s increasing market share in the Kent-Brimfield area and customer demand for an expanded facility, the present Brimfield and Kent banking centers will be moved into the new Kent facility in the spring of 2003.

Medina. Second National Bank will relocate its present Medina facility to a new office in a prime traffic area. The million-dollar retail banking center is scheduled to open in the summer of 2003 and will feature multiple drive-thru lanes, a drive-up ATM and safe deposit boxes.

Wooster. A new full-service banking center in Wooster in the summer of 2003 will provide Second National with an opportunity to establish a major presence in Wayne County adding to the Loan Production Office already serving clients there.

Howland. Second National Bank purchased approximately $2.6 million of deposits from Metropolitan National Bank headquartered in Youngstown, Ohio. Metropolitan had previously announced its intention to close its Howland office. The Second National banking centers closest to Metropolitan s former Howland office are our facilities in Niles and Howland.

Steubenville. As part of our intensified focus on taking advantage of proven growth opportunities in key northeast Ohio markets, Second National has sold our two banking centers in Steubenville, Ohio. The two locations have been acquired by Advance Financial Savings Bank, subsidiary of Advance Financial Bancorp located in Wellsburg, West Virginia. The two Steubenville banking centers

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originally became part of our organization through the acquisition of Trumbull Savings. Because they are not part of our primary northeast Ohio marketplace, their divestiture in February 2003 will enable Second National to reallocate important resources toward strengthening strategic efforts in demographics where we can take advantage of significant growth opportunities.

Solon. Second National Bank s Solon banking center was closed on September 30, 2002 for the purpose of expanding product and service opportunities at our banking centers in nearby Twinsburg and Beachwood. Specifically with: increased professional staff at each location ... added drive-thru lanes and safe deposit boxes at Twinsburg ... plus quick access to a full complement of commercial lenders and private banking, mortgage loan, and wealth management specialists at the Beachwood banking center.

New Concepts in Knowledge-Based Marketing Support Organizational Goals and Banking Center Reconfigurations. In previous years, our approach to marketing was driven by a universal or single-message approach to our entire market. As we grew and expanded into ever-changing markets, we recognized the need for streamlining our communications to reflect those changes. Consequently, 2002 was a watershed year in which we began to refine our marketing approaches with focused messages targeted to specific audiences, specific to banking center and market, thereby maximizing the potential of our diverse market areas.

During 2002, we strove to maintain, within established markets, our current client base while creating awareness of our broader capabilities. We also gave trial exposure to specific non-core deposit and consumer loan products. In our growth markets we addressed the need to further create basic awareness of Second National, drive core deposit and loan sales, and further introduce and build our overall brand position. Central to those efforts was the use of high-reach, high-impact television and radio media, while continuing print media display advertising, public relations and direct mailing as formats for communicating the highest degree of specific product detail.

Key to marketing and marketing communications was the decision, during 2002, to identify and capitalize on high growth opportunities within our marketplaces. To facilitate this we employed BancIntelligence, a professional service that examined our entire network and evaluated individual banking centers against numerous criteria. BancIntelligence also provided promotional effectiveness recommendations for each of our banking centers.

We have now matched BancIntelligence data, by banking center, with our 2003 organizational plan and various demographic data to determine our specific strategies by market. As dictated by our positioning line, The People Making Banking Better®, all communications will be guided according to our commitment to providing clients with unparalleled quality in products and services. Implementation of our new direction of approaching markets based on an educated understanding of varying needs will be undertaken with the ultimate objective of significantly increasing our return on investment.

Deposit Line of Business Introduces a New Interest Bearing Checking Account While Continuing Progress with Existing Products. As a revenue-driver for our deposit line of business, Second National Bank introduced the Satisfaction NOW℠ account, an interest bearing checking account. Satisfaction NOW is a premium priced, tiered transaction account. The features of the product are unlimited access to an account that pays an introductory rate for 90 days and a premium rate on a tiered basis thereafter. The Your Best Interest℠ account continues to be very popular with consumers and has become a product of choice through which to keep funds liquid while still receiving a competitive rate. More than $200 million is now resident in the Your Best Interest product.

Relative to the deposit line of business, we have also continued excellent progress in generating demand deposit accounts during 2002. As of year-end, we have increased outstandings by $34.8 million or 24.3%. Demand deposit transaction accounts are a springboard to profitability due to revenue generated by way of ATM, debit card and overdraft fees as well as interest spread.

Innovative Thinking Results in Increased Consumer Loans. During 2002, zero-percent financing programs offered by automotive manufacturers generated creative thinking on the part of professionals in Second National s Consumer Loan Department, resulting in an increase of 203% over 2001 specific to loans for boats and recreational vehicles. By attending marine and RV shows, lending officers were able

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to attract the attention of numerous dealers with our ability to understand their markets, provide highly competitive rates, and give extremely quick turnaround decisions on loan applications.

The Client Advantage Program Grows as Part of Our Corporate Culture. The Client Advantage Program (CAP) was created to build positive, long-term relationships with Second National clients by helping to identify optimum combinations of products and services.

The entire CAP initiative is based on the conviction that the more we know about our clients, the better service we can provide. To that end, our retail associates have completed 13,024 Client Preference Interviews during 2002. The detailed information provided by those surveys assists our associates in becoming more aware of the many opportunities to proactively help our clients. Because such knowledge is applied through direct contact with clients, ongoing training, coaching and counseling, such as outbound retail calling support programs for tellers and personal bankers, have also intensified to help ensure proper follow-through. During 2002, 48,255 outbound retail calls were made.

The backbone of CAP is the fact that all activities can be tracked and measured. Monthly Achievement Results (MARs) are now available on the BankWeb allowing associates and supervisors to review all current specifics. Information is also available for each banking center and for each region. A MAR for every teller will soon be added. Moreover, the MAR format has the capability of being expanded to include other sales associates in other areas of the Bank. MARs are used to coach and encourage selling efforts by providing a complete overview as to the status of goal achievement.

Additionally, CAP has contributed to an overall understanding of the importance of cross selling. In August 2001, the average associate cross sell was 2.23. In December 2002, the average associate cross sell was 2.65. In August 2001, the average banking center cross sell was 2.10. In December 2002, the average banking center cross sell was 2.62.

As part of the concerted effort to increase cross selling, CAP also embraced an initiative developed to focus on the objective of converting existing single-account clients into dual or multi-account clients.

Specifically: a large number of single-account clients were identified representing a large share of all current retail business. Most of those clients had done business with Second National Bank for some time. We applied our current technology, extensive training, sales skills, and diverse products to increase the retail cross sell ratio within this group of single-account clients.

Within the span of nine months, this initiative resulted in 1,200 clients being cross-sold into multiple relationships. As the overall program grows and expands, the single-account list will be further defined so-as to match clients with probable best cross sell products.

As CAP becomes firmly established in the banking centers, throughout the retail side of the business, the program will then be evaluated with an eye toward broadening it into other areas including Private Banking, Wealth Management and Mortgage Lending.

Mortgage

Mortgage includes mortgage banking activities, including the ownership, origination, sale and servicing of mortgages.

Our mortgage banking department underwrites and originates a wide range of 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 over $920 million of loans in 2002 and serviced $1.32 billion in mortgage loans for others at December 31, 2002.

A Year of Phenomenal Growth in Mortgage Loans. Second National s Mortgage Loan line of business has established for itself a very clear set of objectives. The strong commitment continues to be capitalizing on the profitability of mortgage loans with a sales culture focus while increasing fee generation; the sale of investment quality mortgages and enhanced technological resources.

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In January 2001, Second National processed and closed 113 mortgage loans for approximately $12.7 million. In the record month of October 2002, the Bank processed and closed 1,137 loans for a total of $124.8 million for a 983% growth in less than 24 months. For the entire year of 2002, the Bank processed and closed 9,112 loans for a total of $935.3 million.

During the entire year of 1999, Second National sold $119 million in mortgage loans. For the entire year of 2002, the Bank sold $865 million with $146 million in the month of December alone.

In just four years, mortgage loans serviced for others have exploded from an annual figure of only $41 million to surpassing the $1 billion benchmark.

Second National s mortgage loan servicing performance has earned the Bank the highest Tier 1 rating assigned by Freddie Mac. This, in turn, has created opportunities that have not before existed.

In 1999, the Bank had only 5 mortgage loan originators. Today there are a total of 75 persons taking mortgage loan applications; 15 do so as their sole job responsibility.

On the wholesale lending side of the mortgage business, the Bank has grown from approximately 10 correspondents to more than 200 highly qualified correspondents in a five state area.

In the past four years, the number of mortgage loans actively being serviced has risen from 2,000 to 18,500.

In less than five years, Second National Bank has gone from being a me-too mortgage lender to the leading mortgage loan institution in Trumbull County and a major player in Ohio.

One of the most far-reaching advancements made at Second National during recent years has been the implementation of LoanQuest by MortgageFlex. This fact-based system enables us to commit loans to an investor as soon as the initial application is locked, minimizing the Bank s mortgage interest rate risk. Our competitive rates have increased our volume to an all time record high. Moreover, such technological advancements have enabled loan applications to be channeled through a single system, broadening the number of authorized persons with access to origination procedures and contributing to speed, accuracy and the ability to handle high volume by electronically streamlining what used to be a time-consuming manual effort.

The benefits of technology are being felt in other ways as well. Second National has recently entered into a relationship with our primary mortgage loan investor FreddieMac and mortgagebot® a preferred FreddieMac vendor. Initially, a link on Second National s Web site will permit originators to perform instant pre-approvals at the point-of-sale.

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 2002, the number of demand deposit, NOW and MMDA accounts increased at an annualized rate of 5.3%. 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. The approximate loan distribution at December 31, 2002 was 38.8% of total loans were residential real estate, 33.11% were commercial real estate, 13.36% were commercial and 14.72% were consumer. Our goal is to achieve a mix of approximately 25% in each category.

*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

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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. Although on a GAAP basis there was a slight increase in our efficiency ratio in 2002, on a non-GAAP basis, excluding the banking center reconfiguration and merger costs, the efficiency ratio improved from 58.4% in 2001 to 58.1% in 2002.

Creating a culture focused on building strong, profitable customer relationships. Our business depends on increased relationship building in our northeast and east-central Ohio service area where we do all of our banking business. We believe one of our key competitive edges is that our size allows us to offer a full range of 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 35 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 wealth management department should contribute to fee income growth through market expansion of our mortgage originations and increased sales of 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. Non-interest income represented 28.8% of total revenues during 2002 compared to 27.3% for the same period last year.

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 nine retail banking centers to our current nine counties covered by 35 retail banking centers. In the process, we have grown from less than $300 million in assets in 1988 to $1.9 billion at December 31, 2002, 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. We acquired Commerce Exchange Bank in 2001 to add to our presence in the Cuyahoga County/Cleveland market. Also, in 2002, we acquired Stouffer-Herzog, a leading provider of life, health, property and casualty insurance products in Ashtabula County, Ohio.

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 Stouffer-Herzog. During the third quarter 2002, Second Bancorp completed a stock-for-stock acquisition of Stouffer-Herzog Insurance Agency, Inc. and Stouffer-Herzog Financial Services Agency, Inc., the leading provider of life, health, property and casualty insurance products in Ashtabula County, Ohio. Stouffer-Herzog had total assets of $1.0 million and shareholders equity of $283,000 at the acquisition date. We paid $1.98 million through the issuance of common stock to the shareholders of Stouffer-Herzog for all the outstanding shares of Stouffer-Herzog common stock. Stouffer-Herzog will

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operate as a Second Bancorp subsidiary and an affiliate of Second National Bank. Stouffer-Herzog provides a proven track record of successful operations with solid management and insurance professionals already in place and performing. Moreover, Stouffer-Herzog has a strong reputation for integrity and community commitment and benefits from long-standing relationships with high quality insurance carriers. As an affiliate of Second National Bank, the capabilities of Stouffer-Herzog will provide direct benefits to Second National clients who will have access to a diverse array of insurance products and financial services at highly competitive prices.

Additional Business Strategies

Wealth Management...An Evolution of Traditional and New Capabilities. An important evolution is taking place at Second National Bank. Our business line previously identified as the Trust Department is now known as Wealth Management.

Why the name change? Because many persons perceive Trust as being limited to planning estates and administering probate.

What exactly is Wealth Management? The mission of Wealth Management is to build and maintain long-term relationships by coordinating trust, private banking and investment expertise to protect, manage, and grow the assets of individual and business clients. Wealth Management is not simply a name change. It is a new way of doing business in response to changing client needs.

Wealth Management integrates traditional trust products and services with the financial specialization capabilities of private banking plus opportunity guidance provided by our Investment Center. Specifically:

Personal Wealth Management services to individual clients of Second National Bank include:

- Comprehensive planning to establish and realize financial goals.
- Safeguarding and managing the growth of lifetime assets.
- Accommodating the needs of a financially sound retirement.
- Distributing assets in strict accordance with the wishes of each client as governed by the trust or will created through careful estate planning.

Wealth Management services for both small and large business clients of Second National Bank include:

- Beneficial asset management
- Investment strategies
- Design, implementation and administration of profit sharing, retirement, pension and other employee benefit plans.

Acting as an agent on behalf of either individual or business clients, Second National Bank Wealth Management is prepared to accept partial or full responsibility for managing investments through proven avenues of opportunity. The goal is to build an investment program utilizing a combination of investment vehicles to achieve agreed upon goals.

Some components of Wealth Management capabilities are designed for executives, business owners, professionals and others whose financial service requirements extend beyond the scope of most bank clients. For those with complex financial needs, our Private Banking Program offers individualized attention, a high level of service and specialized banking instruments.

Successful asset and investment management is possible only with the knowledge that each client has unique needs and objectives. Positive relationships established through Wealth Management will be built and will mature on the basis of superior service and results. A high level of personalized service will ensure that clients have direct access to key decision-making professionals within Second National Bank s Wealth Management business line structure.

Community Development Banking Becomes a Line of Business as Community Reinvestment Continues to Make Significant Progress. Second National s primary community development strategy is to provide financing for affordable housing. Going forward, we plan to specifically enhance our home ownership and mortgage lending activities in urban markets. To facilitate that objective, Community Development

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Banking will evolve into a distinct line of business demonstrating a strong and increasing commitment to better serving the credit needs of our communities. During 2003, we will expand our community mortgage originators from one originator to three, housed in Mahoning, Trumbull and Summit Counties. Those originators will specifically originate residential mortgage loans for low- and moderate-income families as well as provide educational programs and financial literacy counseling to potential homebuyers.

Second National s commitment to community development efforts through loans, investments and services continued to strengthen during 2002. Providing affordable housing opportunities for our host communities was a priority as indicated by more than $14 million in community development loans. We have also issued financing commitments totaling more than $12 million in community development affordable housing projects slated for 2003.

Among the specific projects funded for our clients during 2002:

Construction of a 40 unit affordable housing project in Mahoning County.

Construction of a 30,000 square foot expansion of a church facility in Mahoning County.

Construction of an 18,000 square foot community center in Trumbull County.

Acquisition financing for nursing homes in Summit, Holmes and Franklin Counties.

Improvements to a community educational center in Trumbull County.

Expansion of an economic development corporation in Ashtabula County.

Our commitment to our communities was also reflected in financial support of organizations that provide community services. During 2002 Second National Bank made investments and commitments totaling more than $1.1 million to help create affordable housing, new jobs, and other economic development opportunities in our market areas. Contributions of time and talent have also been a hallmark of Second National s community involvement commitment. Bank officers and associates participated in numerous community events including minority business trade fairs, entrepreneurial programs, financial literacy programs, home buyer seminars, Community Days of Caring with United Way, economic opportunity mixers and small business workshops.

Survey Shows Improvements in Second National Service Quality. Extensive surveying of Second National clients was conducted during 2002 to determine if new account service quality, as well as teller service quality, improved from the year 2000 to 2002. A total of 261 client interviews were conducted specific to teller performance and 144 related to personal bankers.

In seven of nine categories profiling personal bankers, clients thought that Second National had improved or maintained its levels of service quality. 11 of 17 questions received a similar positive response when posed to clients regarding service quality performance of tellers.

An impressive 99% of clients interviewed stated that they would recommend a friend to Second National...up from 95% in 2000. 93% of those interviewed said they would recommend us to a friend based on teller service quality.

A New Relationship-Building Program Focuses on Making Things Right. Our first priority for successful client relationship building is: Do it right the first time. Although we are proud of our success rate in properly serving our clientele, it is a fact of life that mistakes will occur. Now, in addition to our commitment to avoiding such mistakes, Second National Bank has introduced the innovative Uh-oh! Better Banking Program[sm].

Simply defined, Uh-oh! promises our clients: If we make a mistake, we ll fix your problem quickly...plus we ll give you $5 for the inconvenience!

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Examples of how and when the program might be applicable:

- If a client waits more than 10 minutes in a teller line.
- If a client does not receive a thank you after a visit or phone call.
- If there is a printing error on a client s checks.
- If an error is made on a statement checking, savings or money market account, home equity or personal line of credit, trust, or commercial loan.
- If a client who calls the Bank before 3:00 p.m. does not receive a return call that same day.

Uh-oh! is our way of ensuring that we have made things right in our commitment to build and grow successful long-term client relationships.

The People Making Banking Better® Our commitment to hiring, training and maintaining world-class human resources was underscored by a myriad of effective training opportunities developed and coordinated by the Retail Staff Development Group. In total, 220 training sessions were held in 2002 versus 103 the previous year, encompassing 1,221 participating associates versus 934 during 2001.

The Retail Staff Development area provides education to all Second National banking centers including the Call Center and Private Banking associates. The Consumer Lending Department has also taken advantage of specific sessions, as have several non-retail departments throughout the Bank.

The high quality of individuals at Second National continues to also be evident outside the working place as numerous associates give freely of their time to civic and charitable organizations, events and causes.

Operational Actions Continue to Contribute to Efficiency. Second National s Operations Division is charged with the ongoing task of identifying and implementing new technology that is not only of functional value to our organization, but truly provides a balance of effectiveness and efficiency as a means of remaining competitive in a quickly moving business world. Among the many achievements for 2002:

- Implementation of a Customer Relationship Management (CRM) system through the Bank s Intranet module enabling users to identify a more complete profile of a client s total relationship with Second National. That includes CRM data from the Investment Center, Wealth Management, Credit Card and Online Banking.
- Migration of all consumer and mortgage loan payments to an automated environment.
- Launch of Second National Bank s Intranet: BankWeb. Available to all associates this includes a searchable internal phone directory, access to a forms library, two in-house applications linking information from sales associates to the Operations Department, links to authorized sites such as the Federated 401(k), United Healthcare, secondnationalbank.com, a 401(k) wizard, and Second National s online banking module.
- A system upgrade replacing our current conventional proof process increasing throughput in the proof area by as much as 65%.
- Methodology for helping to ensure that client records are clean, current, and are not duplicated throughout our data system.
- Enhancements to our Advanced Financial Solutions software enabling automatic corrections on rejects on items captured by the image system through our sorters.

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Second Bancorp, Inc. Rates High in Plain Dealer Ranking of Ohio Businesses. Early in 2002, Second Bancorp, Inc. once again achieved prominence in The Plain Dealer 100, an annual ranking of Ohio companies. Second Bancorp ranked 64th among Ohio s leading companies.

Market Area

Second National s primary market area consists of Trumbull, Ashtabula, Portage, Jefferson, Mahoning, Summit, Medina, Stark and Cuyahoga counties in the northeast 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 northeast 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, 2002 and 2001 are presented in footnote 17 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.

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 $429 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.

Gramm-Leach-Bliley Act

The Gramm-Leach-Bliley Act (the GLB Act) established a comprehensive framework to permit affiliations among commercial banks, insurance companies, securities firms and other financial service providers through the creation of a financial holding company entity. Bank holding companies that elect to become financial holding companies have the ability to expand their activities from those historically permissible for bank holding companies and engage in activities that are financial in nature or complementary to financial activities, including securities and insurance activities, sponsoring mutual funds and investment companies

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and merchant banking. Financial holding companies are also permitted to acquire, without regulatory approval, a company, other than a bank or savings association, engaged in activities that are financial in nature or incidental to activities that are deemed financial in nature by the Federal Reserve Board.

In order to become a financial holding company, a bank holding company must file a declaration with the Federal Reserve Bank indicating its desire to become a financial holding company. In addition, all subsidiary banks of the bank holding company must be well capitalized, well managed and have at least a satisfactory rating under the Community Reinvestment Act. Failure to maintain the well-capitalized standard or the other criteria for a financial holding company may result in requirements to correct the deficiency or limit activities to those allowed bank holding companies.

In 2000, Second Bancorp elected to become a financial holding company.

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 undercapitalized ; 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 marginally below any such measure, significantly 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. A 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 ratio 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 Tier I 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, 2002, the projected BIF and SAIF assessments for Second National for 2003 will be approximately $211,000.

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.

Environmental Regulations
Compliance with federal, state and local provisions regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, have had no material effect on our capital expenditures, earnings or competitive position.

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Recent Legislation

On July 30, 2002, President Bush signed into law the Sarbanes-Oxley Act of 2002 (the Sarbanes-Oxley Act). The stated goals of the Sarbanes-Oxley Act are to increase corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies and to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws. The proposed changes are intended to allow shareholders to monitor the performance of companies and directors more easily and efficiently.

The Sarbanes-Oxley Act generally applies to all companies, both U.S. and non-U.S., that file or are required to file reports with the SEC under the Exchange Act. Further, the Sarbanes-Oxley Act includes very specific additional disclosure requirements and new corporate governance rules, requires the SEC, securities exchanges and the NASDAQ Stock Market to adopt extensive additional disclosure, corporate governance and other related rules and mandates further studies of certain issues by the SEC and the Comptroller General. Given the extensive role in implementing rules relating to many of the Sarbanes-Oxley Act s new requirements, the final scope of these requirements remains to be determined.

The Sarbanes-Oxley Act addresses, among other matters: audit committees; certification of financial statements by the chief executive officer and the chief financial officer; the forfeiture of bonuses and profits made by directors and senior officers in the twelve month period covered by restated financial statements; a prohibition on insider trading during pension plan black out periods; disclosure of off-balance sheet transactions; a prohibition on personal loans to directors and officers (excluding loans by insured depository institutions the are subject to the insider lending restrictions of the Federal Reserve Act); expedited filing requirements for stock transaction reports by officers and director; the formation of a public accounting oversight board; auditor independence; and various increased criminal penalties for violations of securities laws.

Employees

The number of full time equivalent employees of Second Bancorp as of December 31, 2002 was approximately 589. Second Bancorp considers its employee relations to be good. None of the employees are covered by a collective bargaining agreement.

Web Site Access to United States Securities and Exchange Commission Filings

All reports filed electronically by Second Bancorp Incorporated with the United States Securities and Exchange Commission (SEC), including the annual report on Form 10-K, quarterly reports on Form 10-Q and current event reports in Form 8-K, as well as any amendments to those reports, are accessible at no cost through the Corporation s Web site at secondnationalbank.com. These filings are also accessible on the SEC s Web site at www.sec.gov.

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 25 other banking center locations are leased under lease and sublease agreements with remaining terms of 1 to 20 years. Second National also has leases for two loan production offices for one year and office space with a remaining lease term of four 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.

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

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

Item 4 A IDENTIFICATION OF EXECUTIVE OFFICERS

The following table sets forth the names, 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	55	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	45	Treasurer of Second Bancorp and Executive Vice President, Chief Financial Officer and Director of Second National.	1987
Christopher Stanitz	54	Executive Vice President and Secretary of Second Bancorp and Senior Vice President of Second National.	1992
Thomas W. Allen	58	Executive Officer of Second Bancorp and Senior Vice President of Second National, previously Senior Vice President and Senior Fiduciary Officer for Northern Indiana for Key Trust Company of Indiana (1997 to 2000).	2000
Diane C. Bastic	59	Executive Officer of Second Bancorp and Senior Vice President of Second National.	1985
John L. Falatok	45	Executive Officer of Second Bancorp and Senior Vice President of Second National. Previously Vice President of Second National.	2000
Myron Filarski	54	Executive Officer of Second Bancorp and Senior Vice President of Second National. Former President for Signal Mortgage (1998-99).	1999
Darryl E. Mast	52	Executive Officer of Second Bancorp and Senior Vice President of Second National.	1986
Terry L. Myers	54	Executive Officer of Second Bancorp and Senior Vice President of Second National.	1986

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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 21, 2003, the number of shareholders of record of the Common Stock totaled 2,526. 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 17 of Item 8; Second Bancorp s Financial Statements and Supplementary Data are incorporated herein by reference.

Equity Compensation Plan information is incorporated herein by reference to Second Bancorp s definitive proxy statement for the annual meeting of shareholders to be held April 17, 2003 (the Proxy Statement). Such Proxy Statement has been filed with the Securities and Exchange Commission on March 5, 2003.

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 in 2001 traded to a high of $11.25, and a low of $10.10 and closed at $11.00 on December 31, 2001. In 2002, the securities traded to a high of $11.60, a low of $9.985 and closed at $10.63 on December 31, 2002.

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Item 6. SELECTED FINANCIAL DATA

(Dollars in thousands except per share data or as otherwise indicated)

The following is a summary of the quarterly results of operations for the years ended December 31, 2002 and 2001.

	Three Months Ended			
2002	**March 31**	**June 30**	**September 30**	**December 31**
Interest income	**$27,023**	**$27,104**	**$26,834**	**$26,311**
Interest expense	**12,866**	**12,701**	**12,880**	**12,365**
Net interest income	**14,157**	**14,403**	**13,954**	**13,946**
Provision for loan losses	**933**	**1,303**	**1,573**	**2,350**
Other income	**5,157**	**4,053**	**6,329**	**7,314**
Net security (losses) gains	**(193)**		**832**	**(67)**
Merger-related costs			**124**	**10**
Banking center reconfiguration				**2,096**
Other expenses	**11,797**	**11,283**	**11,717**	**12,469**
Income before federal income taxes	**6,391**	**5,870**	**7,701**	**4,268**
Federal income taxes	**1,708**	**1,517**	**2,165**	**840**
Net income	**4,683**	**4,353**	**5,536**	**3,428**
Earnings per common share:				
Basic	**$ 0.47**	**$ 0.44**	**$ 0.56**	**$ 0.35**
Diluted	**0.47**	**0.43**	**0.55**	**0.34**

2001	**March 31**	**June 30**	**September 30**	**December 31**
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
Net 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 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

(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.

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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 notes.

For the Years Ended December 31

Selected Financial Data	2002	2001	2000	1999	1998
Results of Operations:					
Interest income	**$ 107,272**	$ 112,557	$ 116,298	$ 104,582	$ 106,997
Interest expense	**50,812**	62,367	66,921	55,310	55,888
Net interest income	**56,460**	50,190	49,377	49,272	51,109
Provision for loan losses	**6,159**	4,718	7,129	3,195	10,579
Other income	**23,425**	19,528	8,275	14,792	12,754
Other expense	**49,496**	41,939	44,213	39,330	46,248
Income before federal income taxes	**24,230**	23,061	6,310	21,539	7,036
Federal income tax expense	**6,230**	5,880	176	5,361	1,403
Net income before cumulative effect of accounting change	**$ 18,000**	$ 17,181	$ 6,134	$ 16,178	$ 5,633
Cumulative effect of accounting change-SFAS No.133		(101)			
Net income	**$ 18,000**	$ 17,080	$ 6,134	$ 16,178	$ 5,633
Per Common Share Data: (1)					
Basic earnings before cumulative effect of accounting change	**N/A**	$ 1.72	N/A	N/A	N/A
Diluted earnings before cumulative effect of accounting change	**N/A**	1.70	N/A	N/A	N/A
Basic earnings	**$ 1.82**	1.71	$ 0.60	$ 1.52	$ 0.53
Diluted earnings	**1.79**	1.69	0.60	1.51	0.52
Cash dividends	**0.72**	0.68	0.64	0.56	0.48
Book value, December 31	**13.97**	12.90	11.65	11.12	11.53
Market value, December 31	**26.50**	21.61	14.50	22.38	22.25
Weighted-average shares outstanding (1)					
Basic	**9,905,832**	10,013,068	10,247,025	10,635,852	10,655,597
Diluted	**10,040,001**	10,080,005	10,271,548	10,698,717	10,742,622
Shares outstanding at year-end (1)	**9,762,254**	9,949,316	10,057,110	10,458,450	10,688,450
Balance Sheet Data:					
As of December 31:					
Total assets	**$ 1,894,775**	$ 1,680,356	$ 1,546,290	$ 1,537,278	$ 1,430,233
Loans, net of allowance for loan losses	**1,150,196**	1,105,197	1,054,872	1,060,493	960,114
Deposits	**1,195,112**	1,123,131	1,036,135	1,097,589	1,102,590
Shareholders equity	**136,334**	128,299	117,197	116,347	123,273
Averages:					
Total assets	**1,754,156**	1,595,968	1,584,016	1,498,946	1,464,803
Earning assets	**1,642,907**	1,502,164	1,488,334	1,405,195	1,386,894
Loans	**1,121,777**	1,078,196	1,107,948	1,005,998	938,408
Deposits	**1,159,350**	1,070,439	1,091,441	1,092,260	1,086,074
Shareholders equity	**134,178**	124,773	114,652	121,369	126,748

Ratios:					
Return on average assets	**1.03%**	1.09%	0.39%	1.08%	0.38%
Return on average common shareholders equity	**13.42**	13.93	5.35	13.33	4.44
Net interest margin	**3.56**	3.49	3.46	3.68	3.84
Efficiency ratio	**60.81**	58.35	70.67	59.45	70.11
Dividend pay-out	**39.53**	39.80	106.26	36.68	91.53
Average loans to average deposits	**96.76**	100.72	101.51	92.10	86.40
Allowance for loan losses as a percent of loans	**1.51**	1.49	1.42	1.04	1.11
Net charge-offs as a percent of average loans	**0.47**	0.47	0.28	0.27	0.92
Non-performing loans to total loans	**1.64**	0.94	0.75	0.55	0.71
Allowance for loans losses to non-performing loans	**92**	158	191	188	155
Equity to assets	**7.17**	7.64	7.58	7.57	8.62
Tier I leverage ratio	**7.68**	8.22	7.47	8.15	8.65

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

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The table below details non-GAAP operating results, including the non-GAAP adjustments to GAAP income for the five years ended December 31:

Selected Financial Data Non-GAAP Operating Results

Reconciliation of GAAP vs. non-GAAP results of operations	2002	2001	2000	1999	1998
Net income	**$ 18,000**	$ 17,080	$ 6,134	$ 16,178	$ 5,633
Adjustments to GAAP to reflect non-GAAP operating results:					
Add non-recurring costs:					
Merger costs	**134**	305			6,657
Banking center reconfiguration	**2,096**				
Restructuring costs:					
Interest income-deferred costs on sold mortgages			652		
Provision for loan losses			4,100		
Loss on sale of loans			3,711		
Loss on sale of securities			2,808		
Other expenses			2,609		
Total adjustments	**2,230**	305	13,880		6,657
Federal income tax expense	**781**	107	4,858		1,660
Add: Cumulative effect of accounting change, net of tax		101			
Net income	**$ 19,449**	$ 17,379	$ 15,156	$ 16,178	$ 10,630
Non-GAAP results of operations:					
Interest income	**$107,272**	$112,557	$116,950	$104,582	$106,997
Interest expense	**50,812**	62,367	66,921	55,310	55,888
Net interest income	**56,460**	50,190	50,029	49,272	51,109
Provision for loan losses	**6,159**	4,718	3,029	3,195	10,579
Other income	**23,425**	19,528	14,794	14,792	12,754
Other expense	**47,266**	41,634	41,604	39,330	39,591
Income before federal income taxes	**26,460**	23,366	20,190	21,539	13,693
Federal income tax expense	**7,011**	5,987	5,034	5,361	3,063
Net income	**$ 19,449**	$ 17,379	$ 15,156	$ 16,178	$ 10,630
Non-GAAP ratios:					
Return of average assets	**1.11%**	1.09%	0.96%	1.08%	0.73%
Return on average common shareholders equity	**14.49**	13.93	13.22	13.33	8.39
Net interest margin	**3.56**	3.49	3.51	3.68	3.84
Efficiency ratio	**58.07**	58.35	62.17	59.45	60.95

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 a non-GAAP operating basis, referred to in this analysis as non-GAAP operating results or non-GAAP 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 Corporation 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. Banking center reconfiguration charges, restructuring charges, merger-related costs and cumulative effect of accounting change excluded from net income to derive operating earnings may be significant and may not be comparable to other companies.

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

(Dollars in thousands except per share data or as otherwise indicated)

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.

Results of Operations

Net income for 2002 totaled $18,000 and represents a $920, or a 5.4% increase over net income for 2001. Net income in 2002 was impacted by a $2,096 expense for the execution of a banking center reconfiguration strategy. The strategy is designed to improve the overall growth potential and profitability of the retail banking center network. Included in the reconfiguration is the sale of two banking centers in the most remote County, the closure of two facilities, the consolidation of four facilities into two larger, more accessible facilities, the relocation of two facilities to larger, more accessible locations and the de novo opening of a new banking center in a new market. Net income in 2002 and 2001 were minimally impacted by $134 and $305, respectively in pre-tax merger costs. The 2002 merger-related costs were related to the acquisition of Stouffer-Herzog Insurance Agency, which is the first or foundation agency acquired in a plan to have a regional insurance entity throughout the Corporation s market area. The 2001 merger-related costs were associated with the acquisition of Commerce Exchange Corporation (Commerce). The acquisition of Commerce gives the Corporation further access to the attractive commercial lending market in the suburban Cleveland market.

Also prominent amongst the factors positively impacting 2002 and 2001 earnings were the higher levels of mortgage banking activities, including the origination and sale of mortgages into the secondary market. Over $920 million and nearly $600 million in mortgage loans were originated in 2002 and 2001, respectively. Nearly $865 and $520 million in residential mortgage loans were sold in 2002 and 2001, respectively, generating $10.5 and $5.4 million in gains during those same periods. Also prominent in 2001 was the magnitude of interest rate changes induced by the Federal Reserve Bank. Despite 11 downward rate movements in 2001, the Corporation s net interest margin was able to improve by three basis points over 2000 s level and steadily improved during the course of the year. The improvement was due to an increase in commercial loan balances. The continuation of low interest rates throughout 2002 began placing downward pressure on the net interest margin in the second half of the year, however the margin improved by seven basis points over the prior year.

In 2000, a balance sheet restructuring was executed. It was designed to improve balance sheet flexibility and liquidity, reduce the earnings drag caused by the large mortgage loan portfolio and improve the 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 provision resulted from a specific analysis of commercial credits and reflects 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 $6,134. Excluding the restructuring charges, net income in 2000 was $15,156.

The Corporation s return on average assets (ROA) was 1.03%, 1.09% and 0.39% for 2002, 2001 and 2000, respectively. The total shareholders return on average equity (ROE) was 13.42%, 13.93% and 5.35% in 2002, 2001 and 2000, respectively.

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Diluted earnings per share were $1.79, $1.69 and $0.60 in 2002, 2001 and 2000, respectively. 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 and $26.50 at the end of 2002. The stock price at year-end 2002 represents a price of 189% of book value, up significantly from 168% and 124% at the end of 2001 and 2000, respectively. The price/earnings ratio for the stock at year-end 2002 (based on the trailing twelve months earnings) was 14.8X. Dividends declared in 2002 totaled $0.72 per share compared to $0.68 per share the prior year.

Revenue continues to be provided primarily from interest and fees on loans, which totaled $80,593, $86,723 and $91,833 in 2002, 2001 and 2000, respectively. This represents 62%, 66% and 74% 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 20%, 19% and 19% of revenues in 2002, 2001 and 2000, respectively. The Corporation is making steady improvement in diversifying its revenue source away from net interest income, primarily through strength in mortgage banking and deposit service charge activities. 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 22% and 27% in 2000 and 2001, respectively to 29% in 2002.

On a non-GAAP operating basis, which excludes non-recurring items including merger-related costs in 2002, merger-related costs and cumulative effect of accounting change in 2001 and restructuring activities in 2000, net income was $19,449 in 2002, or 12% greater than the $17,379 earned in 2001. Operating earnings for 2000 were 15,156. Operating performance measures were 1.11%, 1.09% and 0.96% for ROA, while ROE was 14.49%, 13.93% and 13.22% for 2002, 2001 and 2000, respectively. The operating efficiency ratio was 58.07% in 2002 versus 58.36% in 2001 and 62.17% in 2000. Operating diluted earnings per share were $1.94, $1.72 and $1.48 for those same periods.

Net Interest Income

Net interest income improved by 12.5% in 2002 as compared to 2001 and totaled $56,460. The improvement was generated by a 9.4% increase in average earning assets and a seven basis point improvement in the net interest margin. While the margin improved to 3.56% in 2002, the continuation of a low interest rate environment has placed downward pressure on the net interest margin. The net interest margin for the fourth quarter of 2002 was 3.38% compared to 3.72% for the first quarter of the year.

During 2001, the 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. Significantly impacting both net interest income and net interest margin were steadily increasing interest rates in 2000 resulting from the Federal Reserve Bank monetary tightening and an inverted yield curve environment. The yield on earning assets reached 7.96% in 2000, however, the cost of funds increased to 4.96%, holding the net interest margin to 3.46%.

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

	2002	2001	2000
Net interest income per financial statements	**$ 56,460**	$ 50,190	$ 49,377
Tax equivalent adjustment	**2,083**	2,277	2,175
Net interest income FTE	**$ 58,543**	$ 52,467	$ 51,552
Average earning assets	**$1,642,907**	$1,502,164	$1,488,334
Net interest margin FTE	**3.56%**	3.49%	3.46%

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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

	2002			2001			2000		
Year Ended December 31	**Average Balance**	**Interest**	**Yield/ Rate**	**Average Balance**	**Interest**	**Yield/ Rate**	**Average Balance**	**Interest**	**Yield/ Rate**
Assets									
Interest earning assets:									
Taxable loans (1)(3)	$1,104,300	$ 79,671	7.21%	$1,058,506	$ 85,361	8.09%	$1,089,484	90,819	8.34%
Tax-exempt loans (2)	17,477	1,419	8.12	19,690	1,680	8.53	18,464	1,536	8.32
Taxable securities	387,343	22,648	5.85	324,209	21,614	6.67	308,084	20,970	6.81
Tax-exempt securities	65,284	4,532	6.94	68,520	4,826	7.04	66,866	4,862	7.27
Federal funds sold and other	68,503	1,085	1.58	31,239	1,083	3.47	5,436	286	5.26
Total interest earning assets	1,642,907	109,355	6.66	1,502,164	114,834	7.64	1,488,344	118,473	7.96
Non-interest earning assets	111,249			93,804			95,682		
Total	$1,754,156			$1,595,968			$1,584,016		
Liabilities and Shareholders Equity									
Interest bearing liabilities:									
Demand deposits-interest bearing	$ 101,222	869	0.86	$ 90,762	1,196	1.32	$ 86,818	1,290	1.49
Savings deposits	374,313	7,444	1.99	242,242	5,918	2.44	266,863	8,561	3.21
Time deposits	537,217	21,087	3.93	621,578	34,896	5.61	625,575	36,385	5.82
Federal funds purchased and securities sold under agreements to repurchase	136,041	2,499	1.84	116,131	3,904	3.36	118,070	5,540	4.69
Note payable	1,335	38	2.85	740	47	6.35	292	25	8.56
Other borrowed funds	1,726	42	2.43	2,240	90	4.02	2,532	172	6.79
Federal Home Loan Bank advances	279,998	15,900	5.70	263,719	15,567	5.90	248,648	14,948	6.01
Corporation-obligated mandatorily redeemable capital securities of subsidiary trust	30,528	2,933	9.61	7,765	749	9.65			
Total interest bearing liabilities	1,461,380	50,812	3.48	1,345,177	62,367	4.64	1,348,798	66,921	4.96
Non-interest bearing liabilities:									
Demand deposits	146,598			115,857			112,185		
Accrued expenses and other liabilities	12,000			10,161			8,381		
Other liabilities	158,598			126,018			120,566		
Shareholders equity	134,178			124,773			114,652		
Total	$1,754,156			$1,595,968			$1,584,016		

Net interest earnings (FTE)		58,543			52,467			51,552	
Taxable equivalent adjustment		2,083			2,277			2,175	
Net interest income (per financial statements)		$ 56,460			$ 50,190			$ 49,377	
Net yield on interest earning assets			3.56%			3.49%			3.46%

(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%, 35% and 34% marginal federal tax rates in effect during 2002, 2001 and 2000 respectively.

(3) Loan fees are included in the interest reported for loans. Those fees amounted to $3,631, $2,835 and $2,326 in 2002, 2001 and 2000, respectively.

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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)	2002 compared to 2001 Due to Change in			2001 compared to 2000 Due to Change in		
	Volume	**Rate**	**Net**	**Volume**	**Rate**	**Net**
Increase (decrease) in FTE interest income:						
Taxable loans	**$ 3,705**	**$ (9,665)**	**$ (5,960)**	$ (2,582)	$ (2,606)	$ (5,188)
Tax-exempt loans	**(189)**	**(72)**	**(261)**	102	42	144
Taxable securities	**4,209**	**(3,175)**	**1,034**	1,098	(454)	644
Tax-exempt securities	**(228)**	**(66)**	**(294)**	120	(156)	(36)
Federal funds sold	**1,292**	**(1,290)**	**2**	1,358	(561)	797
Total interest income	**8,789**	**(14,268)**	**(5,479)**	96	(3,735)	(3,639)
Interest (decrease) in interest expense:						
Demand deposits interest bearing	**138**	**(465)**	**(327)**	59	(153)	(94)
Savings deposits	**3,227**	**(1,701)**	**1,526**	(790)	(1,853)	(2,643)
Time deposits	**(4,736)**	**(9,073)**	**(13,809)**	(232)	(1,257)	(1,489)
Federal funds purchased and securities sold under agreements to repurchase	**669**	**(2,074)**	**(1,405)**	(91)	(1,545)	(1,636)
Note payable	**38**	**(47)**	**(9)**	38	(16)	22
Other borrowed funds	**(21)**	**(27)**	**(48)**	(20)	(62)	(82)
Federal Home Loan Bank advances	**902**	**(569)**	**333**	906	(287)	619
Corporation-obligated mandatorily redeemable capital securities of subsidiary trust	**2,196**	**(12)**	**2,184**	749		749
Total interest expense	**2,413**	**(13,968)**	**(11,555)**	619	(5,173)	(4,554)
Total effect on FTE net interest income	**$ 6,376**	**$ (300)**	**$ 6,076**	$ (523)	$ 1,438	$ 915

(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.

The rate/volume analysis indicates that, on an FTE basis, the net interest income increase predominantly as a result of increased volume concentrated in both loans and securities, while rate changes had a nominally negative impact. In 2001, the improvement was attributable to improvement in the rate components, especially a decline in the cost of funding.

Provision For Loan Losses

The provision for loan losses totaled $6,159 during 2002, representing .55% of average loans. This exceeds the net charge-off rate of .47% of average loans in 2002 due to both the increase in the overall level of non-performing loans and the increase in average loan balances during the year. The allowance for loan losses represents 1.51% of loans at year-end 2002. 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.

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Non-Interest Income

The Corporation was well positioned to take advantage of the dramatically lower market rates in 2002 and 2001. Mortgage loan originations increased significantly, totally over $920 million and nearly $600 million in 2002 and 2001, respectively. Secondary market activities were also very strong and sales of residential mortgage loans totaled over $860 million and $520 million during the past two years. Gains from sale of mortgages realized totaled $10.5 million and $5.4 million during the same two periods. Gains on the sale of SBA loans generated an additional $600 and $400 in gains during the same two years. Mortgage activities were significantly less in 2000 when interest rates were higher and the Corporation did not have the staff or infrastructure to generate a high volume of mortgages. The gain on the sale of securities totaled $592 in 2002 and was primarily attributable to shortening the duration of the securities portfolio. 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. 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.

Service charges on deposit accounts improved significantly in both 2002 and 2001, increasing by 9.8% and 20.3% during the two years. 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 and an additional 1.1% increase in 2002. Service charges on deposits totaled $5,823 in 2002, $5,302 in 2001 and $4,406 in 2000. Trust fees were lower in both 2002 and 2001 as the market value of assets declined in both years. Trust fees totaled $2,715 in 2002, $2,870 in 2001 and $3,898 in 2000. Management added several new experienced, sales-focused professionals to the Trust line of business in 2001 and have active plans for expanding wealth management business relationships throughout the Corporation s market area.

Included in other operating income were valuation allowance charges for mortgage servicing rights. The valuation allowance charges totaled $2,984 in 2002, $810 in 2001 and $0 in 2000. Also included in other operating income was the amortization of mortgage servicing rights, which totaled $4,704 in 2002, $1,212 in 2001 and $765 in 2000.

Non-Interest Expense

Corporate expenses increased by 18% in 2002 and totaled $49,496. The increase included certain non-recurring expenses for merger-related activities and the banking center reconfiguration. Excluding those items, expenses would have totaled $47,266 and would have represented a 13.5% increase on a pro forma operating basis. The increase in costs was primarily attributable to an increase in salary and benefit costs. These cost increased due to a combination of factors including 1) a full year of expenses related to the Commerce acquisition and a partial year for the Stouffer-Herzog acquisition, 2) an increase in mortgage lending staff to facilitate the processing, underwriting, closing, sale and servicing of the increased volume of loans and 3) an increase in incentive payouts due to increased production activities. Salaries and benefits totaled $26,345 in 2002, $21,544 in 2001 and $20,817 in 2000. Expense control allowed for a 5% decline in costs from 2000 to 2001. On an operating basis, expenses were essentially flat between the two years. The two categories that realized increases in 2001, 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 resulted in a $158 reduction in amortization expense for goodwill in 2002, however that reduction was offset by increased core deposit and customer list intangible amortization resulting from the Commerce and Stouffer-Herzog acquisitions. The following table details the percentage change in each non-interest expense category over the past three years:

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Percentage Change	2002 over 2001	2001 over 2000
Salaries and benefits	**22%**	3%
Net occupancy	**5**	2
Equipment		(2)
Professional services	**20**	(49)
Assessment on deposits and other taxes	**(9)**	(8)
Amortization of goodwill & other intangibles	**26**	(32)
Other expenses	**4**	(13)

Income Taxes
The provision for income taxes was $6,230, $5,880 and $176 in 2002, 2001 and 2000, respectively. The effective tax rate for the Corporation was 25.7%, 25.5% and 2.8% 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.

Balance Sheet
The balance sheet totaled nearly $1.9 billion as of December 31, 2002. This represents a 12.8% increase in period end footings. Average assets increased by 9.9% during 2002, led by a 119% increase in average temporary investments, a 15% increase in average securities and a 4% increase in average loans. The increase in securities and temporary investments was due to a build up in liquidity for the planned sale of two banking centers with approximately $90 million in deposits. The sale was closed after year-end. Period end deposit balances increased by 6.4% in 2002, with core deposits, which include both interest-bearing and non interest-bearing demand deposits and savings accounts, increasing by 30.7%. The shift in balances towards core funding is a function of both the low interest rate environment, which tends to create a demand for these funds in the market as well as the increased internal focus placed on core deposit generation and retention. One particular product that was successful in 2002 was a premium priced Your Best Interest MMDA account. The success of the product allowed savings balances to increase by 46.6% during 2002.

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 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%. Over the long-term, financial institutions are expecting slower deposit growth rates due to increased competition from non-traditional alternatives, especially mutual funds. However, in the near-term financial institutions have an opportunity for deposit market share improvement due to the low interest rate environment.

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.

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The securities portfolio totaled $523,669 as of December 31, 2002 and is classified entirely as available-for-sale. U.S. agency and municipal holding remained relatively unchanged from the prior year-end. Corporate balances declined by over $20 million as holdings in this sector were deemphasized. Mortgage-backed securities increased by over $120 million during 2002 and included $100 million in a leveraging transaction completed just prior to year-end 2002. The leveraging transaction was funded primarily by FHLB advances and will provide an estimated 1.7% net spread to income with nominal interest rate risk. The securities portfolio totaled $417,496 as of December 31, 2001. 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.

The average yield on the portfolio is 6.0% as of December 31, 2002, down 70 basis points from the prior year-end. During 2002 and 2001, the Corporation realized gains on security sales of $592 and $642, respectively. During 2000, the Corporation realized $2,399 in net losses on the sale of securities, primarily during the restructuring activities. While rates have continued to remain low throughout the year, the Corporation now has an unrealized gain position for the portfolio of $12.0 million versus $5.4 million the prior year-end. It is anticipated that the Corporation will continue to move to shorten the average duration of the portfolio as rates are at historic lows.

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 2002.

Book Value	**2002**	**2002**	**2001**	**2000**
	Available-		**Available-**	**Available-**