

ALABAMA NATIONAL BANCORPORATION

Form 10-Q

August 09, 2004

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended June 30, 2004

OR

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

Commission File No. 0-25160

ALABAMA NATIONAL BANCORPORATION

(Exact Name of Registrant as Specified in Its Charter)

DELAWARE
(State of Incorporation)

63-1114426
(I.R.S. Employer Identification No.)

1927 FIRST AVENUE NORTH, BIRMINGHAM, ALABAMA 35203-4009

(Address of principal executive office)

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Registrant's telephone number, including area code: (205) 583-3600

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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

Yes No

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

Yes No

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

| <u>Class</u> | <u>Outstanding at August 6, 2004</u> |
|--------------------------------|--------------------------------------|
| Common Stock, \$1.00 Par Value | 16,837,550 |

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ALABAMA NATIONAL BANCORPORATION AND SUBSIDIARIES

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FORWARD-LOOKING INFORMATION

Statements contained in this Quarterly Report on Form 10-Q that are not historical facts are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. In addition, Alabama National Bancorporation (Alabama National), through its senior management, from time to time makes forward-looking public statements concerning its expected future operations and performance and other developments. Such forward-looking statements are necessarily estimates reflecting Alabama National's best judgment based upon current information and involve a number of risks and uncertainties, and various factors could cause results to differ materially from those contemplated by such forward-looking statements. Such factors could include those identified from time to time in Alabama National's Securities and Exchange Commission filings and other public announcements, including the factors described in Alabama National's Annual Report on Form 10-K for the year ended December 31, 2003. With respect to the adequacy of the allowance for loan and lease losses for Alabama National, these factors include the rate of growth in the economy, especially in the Southeast, the relative strength and weakness in the consumer and commercial credit sectors and in the real estate markets and the performance of the stock and bond markets. The forward-looking statements contained in this Quarterly Report speak only as of the date of this report, and Alabama National undertakes no obligation to revise these statements following the date of this Quarterly Report on Form 10-Q.

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements.****Financial Statements (Unaudited)****Alabama National BanCorporation and Subsidiaries****Consolidated Statements of Financial Condition****(In thousands, except share amounts)**

| | June 30, 2004 | December 31, 2003 |
|---|-----------------------------|-----------------------------|
| | <u> </u> | <u> </u> |
| Assets | | |
| Cash and due from banks | \$ 142,667 | \$ 123,086 |
| Interest-bearing deposits in other banks | 14,438 | 10,019 |
| Federal funds sold and securities purchased under resell agreements | 47,191 | 16,534 |
| Trading securities, at fair value | | 109 |
| Investment securities (fair values of \$530,483 and \$271,536) | 542,829 | 271,035 |
| Securities available for sale, at fair value | 632,939 | 539,192 |
| Loans held for sale | 19,466 | 16,415 |
| Loans and leases | 3,200,044 | 2,662,358 |
| Unearned income | (2,757) | (2,918) |
| | <u> </u> | <u> </u> |
| Loans and leases, net of unearned income | 3,197,287 | 2,659,440 |
| Allowance for loan and lease losses | (43,484) | (36,562) |
| | <u> </u> | <u> </u> |
| Net loans and leases | 3,153,803 | 2,622,878 |
| Property, equipment and leasehold improvements, net | 89,665 | 77,291 |
| Goodwill | 124,328 | 30,964 |
| Other intangible assets, net | 12,101 | 4,623 |
| Cash surrender value of life insurance | 63,241 | 59,425 |
| Receivable from investment division customers | 49,961 | 12,966 |
| Other assets | 46,820 | 35,575 |
| | <u> </u> | <u> </u> |
| Total assets | <u>\$ 4,939,449</u> | <u>\$ 3,820,112</u> |
| Liabilities and Stockholders Equity | | |
| Deposits: | | |
| Noninterest bearing | \$ 574,334 | \$ 404,755 |
| Interest bearing | 3,040,893 | 2,348,994 |
| | <u> </u> | <u> </u> |
| Total deposits | 3,615,227 | 2,753,749 |
| Federal funds purchased and securities sold under repurchase agreements | 372,029 | 358,393 |
| Treasury, tax and loan accounts | 792 | 1,431 |
| Accrued expenses and other liabilities | 44,966 | 41,577 |
| Payable for securities purchased for investment division customers | 47,544 | 11,967 |
| Short-term borrowings | 31,333 | 41,150 |
| Long-term debt | 403,888 | 332,427 |

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| | | |
|---|--------------|--------------|
| Total liabilities | 4,515,779 | 3,540,694 |
| Commitments and contingencies (Note B) | | |
| Common stock, \$1 par; 27,500,000 shares authorized; 15,419,936 and 12,838,844 shares issued at June 30, 2004 and December 31, 2003, respectively | 15,420 | 12,839 |
| Additional paid-in capital | 261,301 | 126,370 |
| Retained earnings | 154,519 | 140,028 |
| Accumulated other comprehensive (loss) income, net of tax | (7,570) | 181 |
| | 423,670 | 279,418 |
| Total stockholders' equity | | |
| Total liabilities and stockholders' equity | \$ 4,939,449 | \$ 3,820,112 |

See accompanying notes to unaudited consolidated financial statements.

Table of Contents**Alabama National BanCorporation and Subsidiaries****Consolidated Statements of Income (Unaudited)****(In thousands, except per share data)**

| | For the three months ended June 30, | |
|---|--|---------------|
| | 2004 | 2003 |
| Interest income: | | |
| Interest and fees on loans and leases | \$ 44,099 | \$ 35,947 |
| Interest on securities | 11,097 | 8,115 |
| Interest on deposits in other banks | 17 | 25 |
| Interest on trading securities | 17 | 29 |
| Interest on federal funds sold and securities purchased under resell agreements | 167 | 209 |
| | <u>55,397</u> | <u>44,325</u> |
| Interest expense: | | |
| Interest on deposits | 11,263 | 10,994 |
| Interest on federal funds purchased and securities sold under repurchase agreements | 963 | 861 |
| Interest on short-term borrowings | 285 | 442 |
| Interest on long-term debt | 3,252 | 2,655 |
| | <u>15,763</u> | <u>14,952</u> |
| Net interest income | 39,634 | 29,373 |
| Provision for loan and lease losses | 1,278 | 1,424 |
| | <u>38,356</u> | <u>27,949</u> |
| Noninterest income: | | |
| Securities gains | | 34 |
| Gain (loss) on disposition of assets | 57 | (82) |
| Service charges on deposit accounts | 4,520 | 3,491 |
| Investment services income | 3,273 | 6,372 |
| Securities brokerage and trust income | 4,197 | 3,905 |
| Gain on sale of mortgages | 3,491 | 4,615 |
| Bank owned life insurance | 683 | 648 |
| Insurance commissions | 779 | 854 |
| Other | 2,288 | 1,699 |
| | <u>19,288</u> | <u>21,536</u> |
| Total noninterest income | 19,288 | 21,536 |

See accompanying notes to unaudited consolidated financial statements.

Table of Contents**Alabama National BanCorporation and Subsidiaries****Consolidated Statements of Income (Unaudited) (Continued)****(In thousands, except per share data)**

| | For the three months ended June 30, | |
|--|--|------------------|
| | 2004 | 2003 |
| Noninterest expense: | | |
| Salaries and employee benefits | 18,992 | 16,566 |
| Commission based compensation | 4,784 | 6,649 |
| Occupancy and equipment expenses | 3,867 | 3,157 |
| Amortization of intangibles | 842 | 244 |
| Other | 9,127 | 7,721 |
| Total noninterest expense | 37,612 | 34,337 |
| Income before provision for income taxes | 20,032 | 15,148 |
| Provision for income taxes | 6,788 | 4,984 |
| Net income | \$ 13,244 | \$ 10,164 |
| Weighted average common shares outstanding: | | |
| Basic | 15,555 | 12,570 |
| Diluted | 15,806 | 12,745 |
| Earnings per common share: | | |
| Basic | \$ 0.85 | \$ 0.81 |
| Diluted | \$ 0.84 | \$ 0.80 |
| Cash dividends per common share | \$ 0.3125 | \$ 0.285 |

See accompanying notes to unaudited consolidated financial statements.

Table of Contents**Alabama National BanCorporation and Subsidiaries****Consolidated Statements of Income (Unaudited)****(In thousands, except per share data)**

| | For the six months ended June 30, | |
|---|--|---------------|
| | 2004 | 2003 |
| Interest income: | | |
| Interest and fees on loans and leases | \$ 84,312 | \$ 70,463 |
| Interest on securities | 19,852 | 16,450 |
| Interest on deposits in other banks | 28 | 60 |
| Interest on trading securities | 35 | 49 |
| Interest on federal funds sold and securities purchased under resell agreements | 300 | 333 |
| | <u>104,527</u> | <u>87,355</u> |
| Total interest income | 104,527 | 87,355 |
| Interest expense: | | |
| Interest on deposits | 21,479 | 22,140 |
| Interest on federal funds purchased and securities sold under repurchase agreements | 1,960 | 1,620 |
| Interest on short-term borrowings | 579 | 998 |
| Interest on long-term debt | 6,205 | 5,237 |
| | <u>30,223</u> | <u>29,995</u> |
| Total interest expense | 30,223 | 29,995 |
| Net interest income | 74,304 | 57,360 |
| Provision for loan and lease losses | 2,506 | 2,515 |
| | <u>71,798</u> | <u>54,845</u> |
| Net interest income after provision for loan and lease losses | 71,798 | 54,845 |
| Noninterest income: | | |
| Securities gains | | 39 |
| Gain (loss) on disposition of assets | 37 | (33) |
| Service charges on deposit accounts | 8,331 | 6,813 |
| Investment services income | 7,180 | 11,532 |
| Securities brokerage and trust income | 8,296 | 8,023 |
| Gain on sale of mortgages | 6,033 | 7,949 |
| Bank owned life insurance | 1,410 | 1,368 |
| Insurance commissions | 1,737 | 1,638 |
| Other | 3,904 | 2,952 |
| | <u>36,928</u> | <u>40,281</u> |
| Total noninterest income | 36,928 | 40,281 |

See accompanying notes to unaudited consolidated financial statements.

Table of Contents**Alabama National BanCorporation and Subsidiaries****Consolidated Statements of Income (Unaudited) (Continued)****(In thousands, except per share data)**

| | For the six months ended June 30, | |
|--|--|------------------|
| | 2004 | 2003 |
| Noninterest expense: | | |
| Salaries and employee benefits | 36,671 | 31,858 |
| Commission based compensation | 9,549 | 12,223 |
| Occupancy and equipment expenses | 7,365 | 6,370 |
| Amortization of intangibles | 1,324 | 477 |
| Other | 16,874 | 14,900 |
| Total noninterest expense | 71,783 | 65,828 |
| Income before provision for income taxes | 36,943 | 29,298 |
| Provision for income taxes | 12,392 | 9,609 |
| Net income | \$ 24,551 | \$ 19,689 |
| Weighted average common shares outstanding: | | |
| Basic | 14,751 | 12,546 |
| Diluted | 14,994 | 12,717 |
| Earnings per common share: | | |
| Basic | \$ 1.66 | \$ 1.57 |
| Diluted | \$ 1.64 | \$ 1.55 |
| Cash dividends per common share | \$ 0.625 | \$ 0.57 |

See accompanying notes to unaudited consolidated financial statements.

Table of Contents**Alabama National BanCorporation and Subsidiaries****Consolidated Statements of Comprehensive Income (Unaudited)****(In thousands)**

| | For the three months ended June 30, | |
|---|--|------------------|
| | 2004 | 2003 |
| Net income | \$ 13,244 | \$ 10,164 |
| Other comprehensive (loss) income: | | |
| Unrealized (losses) gains on securities available for sale arising during the period | (19,605) | 2,725 |
| Less: Reclassification adjustment for net gains included in net income | | 34 |
| | <u>(19,605)</u> | <u>2,691</u> |
| Other comprehensive (loss) income, before tax | (19,605) | 2,691 |
| (Benefit of) provision for income taxes related to items of other comprehensive (loss) income | (6,948) | 978 |
| | <u>(12,657)</u> | <u>1,713</u> |
| Other comprehensive (loss) income | (12,657) | 1,713 |
| Comprehensive income | <u>\$ 587</u> | <u>\$ 11,877</u> |

See accompanying notes to unaudited consolidated financial statements.

Table of Contents**Alabama National BanCorporation and Subsidiaries****Consolidated Statements of Comprehensive Income (Unaudited)****(In thousands)**

| | For the six months | |
|---|---------------------------|-------------|
| | ended June 30, | |
| | 2004 | 2003 |
| Net income | \$ 24,551 | \$ 19,689 |
| Other comprehensive (loss) income: | | |
| Unrealized (losses) gains on securities available for sale arising during the period | (11,985) | 3,183 |
| Less: Reclassification adjustment for net gains included in net income | | 39 |
| Other comprehensive (loss) income, before tax | (11,985) | 3,144 |
| (Benefit of) provision for income taxes related to items of other comprehensive (loss) income | (4,234) | 1,121 |
| Other comprehensive (loss) income | (7,751) | 2,023 |
| Comprehensive income | \$ 16,800 | \$ 21,712 |

See accompanying notes to unaudited consolidated financial statements.

Table of Contents**Alabama National BanCorporation and Subsidiaries****Consolidated Condensed Statements of Cash Flows (Unaudited)**

(In thousands)

| | For the six months | |
|---|--------------------|-------------------|
| | ended June 30, | |
| | 2004 | 2003 |
| Net cash flows provided by (used in) operating activities | \$ 26,424 | \$ (26,661) |
| Cash flows from investing activities: | | |
| Proceeds from calls and maturities of investment securities | 70,597 | 183,332 |
| Purchases of investment securities | (316,817) | (182,676) |
| Purchases of securities available for sale | (372,950) | (562,671) |
| Proceeds from sale of securities available for sale | 5,162 | 45,789 |
| Proceeds from calls and maturities of securities available for sale | 504,519 | 402,366 |
| Net increase in interest bearing deposits in other banks | (4,419) | (5,170) |
| Net (increase) decrease in federal funds sold and securities purchased under resell agreements | (29,314) | 32,952 |
| Net increase in loans and leases | (177,179) | (172,684) |
| Purchase acquisitions, net of cash acquired | 28,866 | (2,952) |
| Purchases of property, equipment and leasehold improvements | (7,990) | (3,515) |
| Proceeds from sale of other real estate owned and fixed assets | 734 | 3,876 |
| Net cash used in investing activities | (298,791) | (261,353) |
| Cash flows from financing activities: | | |
| Net increase in deposits | 312,531 | 331,920 |
| Net (decrease) increase in federal funds purchased and securities sold under agreements to repurchase | (25,963) | 54,564 |
| Net decrease in short-term borrowings and capital leases | (10,755) | (93,563) |
| Proceeds from long-term debt | 24,000 | 34,000 |
| Purchase of treasury stock | | (900) |
| Dividends on common stock | (9,619) | (7,059) |
| Other | 1,754 | 257 |
| Net cash provided by financing activities | 291,948 | 319,219 |
| Increase in cash and cash equivalents | 19,581 | 31,205 |
| Cash and cash equivalents, beginning of period | 123,086 | 99,561 |
| Cash and cash equivalents, end of period | \$ 142,667 | \$ 130,766 |
| Supplemental schedule of noncash investing and financing activities | | |
| Acquisition of collateral in satisfaction of loans | \$ 2,001 | \$ 4,397 |
| Adjustment to market value of securities available for sale, net of deferred income taxes | \$ (7,751) | \$ 2,023 |
| Assets acquired in business combinations net of cash received | \$ 745,639 | \$ 122,727 |

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| | | |
|--|------------|-----------|
| Liabilities assumed in business combinations | \$ 641,764 | \$ 99,956 |
|--|------------|-----------|

See accompanying notes to unaudited consolidated financial statements.

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ALABAMA NATIONAL BANCORPORATION AND SUBSIDIARIES

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE A BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months and six months ended June 30, 2004 are subject to year-end audit and are not necessarily indicative of the results of operations to be expected for the year ending December 31, 2004. These interim financial statements should be read in conjunction with the consolidated financial statements and footnotes thereto included in Alabama National's Form 10-K for the year ended December 31, 2003.

NOTE B COMMITMENTS AND CONTINGENCIES

Alabama National's subsidiary banks make loan commitments and incur contingent liabilities in the normal course of business, which are not reflected in the consolidated statements of condition. As of June 30, 2004, the total unfunded commitments which are not reflected in the consolidated statements of condition totaled \$919.3 million. A majority of these commitments will expire in less than one year.

Alabama National, in the normal course of business, is subject to various pending and threatened litigation. Although it is not possible to determine with certainty Alabama National's potential exposure from pending and threatened litigation, based on current knowledge and advice of legal counsel, management does not anticipate that the ultimate liability, if any, resulting from such litigation will have a material adverse effect on Alabama National's financial condition or results of operations.

NOTE C RECENTLY ISSUED PRONOUNCEMENTS

In December 2003, the FASB issued a revision to Statement No. 132, Employers' Disclosures about Pensions and Other Postretirement Benefits (Statement 132). Statement 132 requires enhanced disclosures for defined benefit pension plans. Statement 132 requires companies to provide more details about their plan assets, investment strategy, measurement dates, benefit obligations, cash flows, and components of net periodic benefit cost recognized during interim periods. The disclosures required by Statement 132 are effective for financial statements with fiscal years ending after December 15, 2003, except for disclosures regarding estimated future benefit payments. Disclosures regarding estimated future benefit payments will be required for fiscal years ending after June 15, 2004. The interim-period disclosures required by this statement are effective for interim periods beginning after December 15, 2003. See Note H Defined Benefit Pension Plan in the Notes to Consolidated Financial Statements for the disclosures required by this statement. As Statement 132 relates to changes in disclosures, its adoption did not have an impact on Alabama National's financial condition or results of operations.

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

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prohibits carrying over or creation of valuation allowances in the initial accounting of all loans acquired in a transfer that are within the scope of SOP 03-3. The prohibition of the valuation allowance carryover applies to the purchase of an individual loan, a pool of loans, a group of loans, and loans acquired in a purchase business combination. SOP 03-3 is effective for loans acquired in fiscal years beginning after December 15, 2004. Since the effective date for SOP 03-3 is for fiscal years beginning after December 15, 2004, Alabama National can not determine the impact on its financial condition or results of operations. Historically, the only loans and debt securities Alabama National has purchased have been in acquisitions.

On March 9, 2004, the SEC issued Staff Accounting Bulletin 105, Application of Accounting Principles to Loan Commitments, (SAB 105) to inform registrants of the Staff's view that the fair value of the recorded loan commitments should not consider the expected future cash flows related to the associated servicing of the future loan. The provisions of SAB 105 must be applied to loan commitments accounted for as derivatives that are entered into after March 31, 2004. The staff will not object to the application of existing accounting practices to loan commitments accounted for as derivatives that are entered into on or before March 31, 2004, with appropriate disclosures. On April 1, 2004, Alabama National adopted the provisions of SAB 105. Alabama National records the value of its mortgage loan commitments at fair market value for mortgages it intends to sell. Alabama National does not currently include, and was not including, the value of mortgage servicing or any other internally-developed intangible assets in the valuation of its mortgage loan commitments. Therefore, the adoption of SAB 105 did not have an impact on Alabama National's financial condition or results of operations.

In March 2004, the Emerging Issues Task Force reached a consensus on Issue 03-1, Meaning of Other Than Temporary Impairment (Issue 03-1). The Task Force reached a consensus on an other-than-temporary impairment model for debt and equity securities accounted for under Statement of Financial Accounting Standards No. 115, Accounting for Certain Investments in Debt and Equity Securities and cost method investments. The basic model developed by the Task Force in evaluating whether an investment within the scope of Issue 03-1 is other-than-temporarily impaired is as follows: Step 1: Determine whether the investment is impaired. An investment is impaired if its fair value is less than its cost. Step 2: Evaluate whether the impairment is other-than-temporary. Step 3: If the impairment is other-than-temporary, recognize an impairment loss equal to the difference between the investment's cost and its fair value. The three-step model used to determine other-than-temporary impairments shall be applied prospectively to all current and future investments in interim or annual reporting periods beginning after June 15, 2004. Alabama National does not anticipate that the adoption of Issue 03-1 will have a material impact on its financial condition or results of operations.

Management evaluates securities for other-than-temporary impairment no less frequently than quarterly, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) length of time and the extent to which fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of Alabama National to retain the investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

As of June 30, 2004, Alabama National has securities with gross unrealized losses totaling \$26.1 million. The losses for all securities are a direct result of rising interest rates and the effect that rising interest rates has on the value of debt securities and not the credit worthiness of the issuers. In addition, Alabama National has the ability and intent to hold these securities for a period of time sufficient to allow for a recovery in fair value. Therefore, Alabama National has not recognized any other-than-temporary impairments.

NOTE D EARNINGS PER SHARE

The following table reflects the reconciliation of the numerator and denominator of the basic earnings per share computation to the diluted earnings per share computation for the three months and six months ended June 30, 2004 and 2003.

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| | For the three months ended | | For the six months ended | |
|---|----------------------------|----------------|--------------------------|----------------|
| | June 30, | | June 30, | |
| | 2004 | 2003 | 2004 | 2003 |
| (In thousands, except per share data) | | | | |
| Basic Earnings Per Share: | | | | |
| Net income available to common shareholders | \$ 13,244 | \$ 10,164 | \$ 24,551 | \$ 19,689 |
| Weighted average basic common shares outstanding | 15,555 | 12,570 | 14,751 | 12,546 |
| Basic Earnings Per Share | \$ 0.85 | \$ 0.81 | \$ 1.66 | \$ 1.57 |
| Diluted Earnings Per Share: | | | | |
| Net income available to common shareholders | \$ 13,244 | \$ 10,164 | \$ 24,551 | \$ 19,689 |
| Weighted average common shares outstanding | 15,555 | 12,570 | 14,751 | 12,546 |
| Effect of dilutive securities | 251 | 175 | 243 | 171 |
| Weighted average diluted common shares outstanding | 15,806 | 12,745 | 14,994 | 12,717 |
| Diluted Earnings Per Share | \$ 0.84 | \$ 0.80 | \$ 1.64 | \$ 1.55 |

NOTE E SEGMENT REPORTING

Alabama National's reportable segments represent the distinct major product lines it offers and are viewed separately for strategic planning purposes by management. The following table is a reconciliation of the reportable segment revenues, expenses and net income (loss) to Alabama National's consolidated totals (in thousands).

| | Investment Services Division | Securities Brokerage & Trust Division | Mortgage Lending Division | Insurance Services Division | Retail and Commercial Banking | Corporate Overhead | Elimination Entries | Total |
|--|------------------------------------|---|---------------------------------|-----------------------------------|-------------------------------------|-----------------------|------------------------|--------------|
| Three months ended June 30, 2004: | | | | | | | | |
| Interest income | \$ | \$ 277 | \$ 273 | \$ | \$ 54,886 | \$ (28) | \$ (11) | \$ 55,397 |
| Interest expense | | 26 | 75 | | 15,024 | 649 | (11) | 15,763 |
| Net interest income | | 251 | 198 | | 39,862 | (677) | | 39,634 |
| Provision for loan and lease losses | | | | | 1,278 | | | 1,278 |
| Noninterest income | 3,273 | 4,197 | 3,335 | 779 | 7,685 | 19 | | 19,288 |
| Noninterest expense | 2,512 | 3,934 | 2,253 | 853 | 26,386 | 1,674 | | 37,612 |
| Net income (loss) before tax | \$ 761 | \$ 514 | \$ 1,280 | \$ (74) | \$ 19,883 | \$ (2,332) | \$ | \$ 20,032 |
| Total assets as of June 30, 2004 | \$ 50,110 | \$ 29,019 | \$ 20,771 | \$ 4,063 | \$ 4,826,007 | \$ 9,479 | | \$ 4,939,449 |
| Three months ended June 30, 2003: | | | | | | | | |
| Interest income | \$ | \$ 246 | \$ 795 | \$ | \$ 43,341 | \$ (28) | \$ (29) | \$ 44,325 |

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| | | | | | | | | |
|--|------------|-----------|-----------|----------|--------------|------------|---------|--------------|
| Interest expense | | 32 | 275 | 1 | 14,288 | 385 | (29) | 14,952 |
| Net interest income | | 214 | 520 | (1) | 29,053 | (413) | | 29,373 |
| Provision for loan and lease losses | | | | | 1,424 | | | 1,424 |
| Noninterest income | 6,372 | 3,905 | 4,937 | 854 | 5,467 | 1 | | 21,536 |
| Noninterest expense | 4,067 | 3,765 | 2,933 | 794 | 20,958 | 1,820 | | 34,337 |
| Net income (loss) before tax | \$ 2,305 | \$ 354 | \$ 2,524 | \$ 59 | \$ 12,138 | \$ (2,232) | \$ | \$ 15,148 |
| Total assets as of June 30, 2003 | \$ 129,445 | \$ 34,891 | \$ 99,596 | \$ 4,745 | \$ 3,616,973 | \$ 6,319 | | \$ 3,891,969 |
| Six months ended June 30, 2004: | | | | | | | | |
| Interest income | \$ | \$ 545 | \$ 475 | \$ | \$ 103,605 | \$ (57) | \$ (41) | \$ 104,527 |
| Interest expense | | 56 | 131 | | 28,864 | 1,213 | (41) | 30,223 |
| Net interest income | | 489 | 344 | | 74,741 | (1,270) | | 74,304 |
| Provision for loan and lease losses | | | | | 2,506 | | | 2,506 |
| Noninterest income | 7,180 | 8,296 | 5,989 | 1,737 | 13,691 | 35 | | 36,928 |
| Noninterest expense | 5,365 | 7,802 | 4,060 | 1,776 | 49,713 | 3,067 | | 71,783 |
| Net income (loss) before tax | \$ 1,815 | \$ 983 | \$ 2,273 | \$ (39) | \$ 36,213 | \$ (4,302) | \$ | \$ 36,943 |
| Six months ended June 30, 2003: | | | | | | | | |
| Interest income | \$ | \$ 467 | \$ 1,269 | \$ | \$ 85,729 | \$ (57) | \$ (53) | \$ 87,355 |
| Interest expense | | 61 | 467 | 2 | 28,752 | 766 | (53) | 29,995 |
| Net interest income | | 406 | 802 | (2) | 56,977 | (823) | | 57,360 |
| Provision for loan and lease losses | | | | | 2,515 | | | 2,515 |
| Noninterest income | 11,532 | 8,023 | 8,297 | 1,638 | 10,789 | 2 | | 40,281 |
| Noninterest expense | 7,463 | 7,643 | 4,911 | 1,553 | 40,994 | 3,264 | | 65,828 |
| Net income (loss) before tax | \$ 4,069 | \$ 786 | \$ 4,188 | \$ 83 | \$ 24,257 | \$ (4,085) | \$ | \$ 29,298 |

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Corporate overhead is comprised of compensation and benefits for certain members of management, merger related costs, interest expense on parent company debt, amortization of intangibles and other expenses.

At June 30, 2004, the carrying value of goodwill totaled \$124.3 million. The amounts attributable to the Retail and Commercial Banking segment and Insurance Services Division are \$121.6 million and \$2.7 million, respectively.

NOTE F MERGERS AND ACQUISITIONS

On June 4, 2004, Alabama National merged its wholly owned subsidiary, Peoples State Bank of Groveland, Florida (PSB) into another Alabama National subsidiary, Public Bank (Public). Each of these banks operated in the greater metropolitan Orlando area and the combined bank will operate under the Public Bank name.

Alabama National completed the acquisition of Cypress Bankshares, Inc. (Cypress) on February 20, 2004, and the acquisition of Indian River Banking Company (Indian River) on February 27, 2004. Under the terms of the respective merger agreements, each of Cypress Bank and Indian River National Bank will continue to operate as a wholly owned subsidiary of Alabama National under its existing name, management, and board of directors. The following table summarizes some details of the transactions.

| | <u>Cypress Bankshares, Inc.</u> | <u>Indian River Banking Company</u> |
|--------------------------------------|-------------------------------------|---|
| Location | Palm Coast, Florida | Vero Beach, Florida |
| Merger closing date | 2/20/2004 | 2/27/2004 |
| Common stock issued | 455,449 | 2,017,053 |
| Stock options assumed (as converted) | 52,130 | 123,430 |
| Additional cash consideration | \$1.9 million | \$5.1 million |
| Total purchase price | \$27.4 million | \$112.4 million |

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed for Cypress and Indian River at the respective dates of acquisition.

| | <u>Cypress Bankshares, Inc.</u> | <u>Indian River Banking Company</u> |
|--|-------------------------------------|---|
| | (Amounts in thousands) | |
| Cash | \$ 9,691 | \$ 26,178 |
| Securities | 26,111 | 241,905 |
| Federal funds sold and repurchase agreements | 959 | 384 |
| Net loans | 75,396 | 282,857 |
| Other assets | 7,636 | 9,247 |
| Goodwill | 17,686 | 74,272 |
| Core deposit intangible | 1,644 | 7,542 |

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| | | |
|---------------------------|-----------|------------|
| Total assets acquired | 139,123 | 642,385 |
| Deposits | 104,250 | 444,697 |
| Other liabilities | 7,484 | 85,333 |
| Total liabilities assumed | 111,734 | 530,030 |
| Net assets acquired | \$ 27,389 | \$ 112,355 |

The acquisitions of Cypress and Indian River resulted in the recognition of \$19.3 million and \$81.8 million of intangible assets, respectively. Alabama National allocated \$1.6 million and \$7.5 million of the total intangible created to core deposits of Cypress and Indian River, respectively. This allocation was based upon Alabama National's valuation of the core deposits of Cypress and Indian River. Among the factors considered in the valuation included: (1) the rate and maturity structure of the interest bearing liabilities, (2) estimated retention rates for each deposit liability category, (3) the current interest rate environment and (4) estimated noninterest income potential of acquired relationships. The core deposit intangible created is being amortized on an accelerated basis not to exceed seven years. The remaining intangible created was allocated to goodwill.

The following table presents the unaudited pro forma results of operations for Alabama National, as if the Millennium Bank (Millennium), Cypress and Indian River acquisitions had occurred at January 1, 2004 and 2003. The results for the three month period ended June 30, 2004 were not affected as each acquired bank was included in the results of operations for the entire period. The results for the six month period ended June 30, 2004 were adjusted for Indian River and Cypress only, as Millennium was included for the entire period. Since no consideration is given to the operational efficiencies and expanded products and services, the pro forma summary information does not necessarily reflect the results of operations as they would have been, if the respective acquisitions had occurred at the indicated dates (amounts in thousands, except per share data):

| | Three months ended | | Six months ended | |
|------------------------------|--------------------|-----------|------------------|------------|
| | June 30, | | June 30, | |
| | 2004 | 2003 | 2004 | 2003 |
| Total revenue ⁽¹⁾ | \$ 58,922 | \$ 58,941 | \$ 115,607 | \$ 113,438 |
| Net income | \$ 13,244 | \$ 11,532 | \$ 24,757 | \$ 22,435 |
| Basic EPS | \$ 0.85 | \$ 0.75 | \$ 1.60 | \$ 1.46 |
| Diluted EPS | \$ 0.84 | \$ 0.73 | \$ 1.57 | \$ 1.43 |

⁽¹⁾ Total revenue consists of net interest income plus noninterest income.

The following table presents the pro forma results of operations of Alabama National for the three and six months ended June 30, 2003, adjusted only for Cypress and Indian River (amounts in thousands, except per share data):

| | Three months ended | | Six months ended | |
|------------------------------|--------------------|------------|------------------|------------|
| | June 30, 2003 | | June 30, 2003 | |
| Total revenue ⁽¹⁾ | \$ 58,033 | \$ 111,241 | \$ 111,241 | \$ 111,241 |
| Net income | \$ 11,503 | \$ 22,221 | \$ 22,221 | \$ 22,221 |
| Basic EPS | \$ 0.76 | \$ 1.48 | \$ 1.48 | \$ 1.48 |
| Diluted EPS | \$ 0.75 | \$ 1.45 | \$ 1.45 | \$ 1.45 |

(1) Total revenue consists of net interest income plus noninterest income.

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On July 9, 2004, Alabama National completed the acquisition of Coquina Bank of Ormond Beach, Florida (Coquina). Alabama National issued 543,571 shares of common stock in exchange for all of the outstanding shares of Coquina common stock, an exchange ratio of 0.6326 shares of Alabama National common stock for each share of Coquina common stock. In addition to the common stock, Alabama National paid approximately \$1.98 million in cash consideration to Coquina shareholders who elected to receive cash rather than Alabama National common stock. As of July 9, 2004, Coquina had total assets, loans, deposits and equity of approximately \$114.6 million, \$90.4 million, \$100.5 million and \$9.8 million, respectively. Management has not yet finalized the determination of the fair values of the assets, liabilities and certain intangible assets of Coquina, but based on preliminary estimates the total intangibles created by the acquisition are approximately \$41.5 million.

NOTE G GOODWILL AND OTHER ACQUIRED INTANGIBLES

The changes in the carrying amounts of goodwill attributable to the Retail and Commercial Banking segment and the Insurance Services Division for the six months ended June 30, 2004 are as follows (in thousands):

| | Retail and Commercial Banking | Insurance Services Division |
|----------------------------|--|--|
| | <u> </u> | <u> </u> |
| Balance, January 1, 2004 | \$ 28,271 | \$ 2,693 |
| Acquired goodwill | 91,958 | |
| Other goodwill adjustments | 1,406 | |
| | <u> </u> | <u> </u> |
| Balance, June 30, 2004 | <u>\$ 121,635</u> | <u>\$ 2,693</u> |

Other goodwill adjustments relates to the refinement of the fair values assigned to the assets and liabilities of a previous acquisition.

Intangible assets as of June 30, 2004 and December 31, 2003 are as follows (in thousands):

| | As of June 30, 2004 | | |
|------------------------------------|--------------------------------------|-------------------------------------|-----------------------------------|
| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Value |
| | <u> </u> | <u> </u> | <u> </u> |
| Amortizing intangible assets | | | |
| Core deposit intangibles | \$ 17,124 | \$ (5,531) | \$ 11,593 |
| Other customer intangibles | 1,069 | (561) | 508 |
| | <u> </u> | <u> </u> | <u> </u> |
| Total amortizing intangible assets | <u>\$ 18,193</u> | <u>\$ (6,092)</u> | <u>\$ 12,101</u> |

As of December 31, 2003

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| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Value |
|---|--------------------------------------|-------------------------------------|-----------------------------------|
| Amortizing intangible assets: | | | |
| Core deposit intangibles | \$ 7,938 | \$ (4,342) | \$ 3,596 |
| Other customer intangibles | 1,453 | (426) | 1,027 |
| Total amortizing intangible assets | \$ 9,391 | \$ (4,768) | \$ 4,623 |

During the six months ended June 30, 2004 and 2003, Alabama National recognized \$1,324,000 and \$477,000 of other intangible amortization expense, respectively, and during the three months ended June 30, 2004 and 2003, Alabama National recognized \$842,000 and \$244,000 of other intangible expense, respectively. Based upon recorded intangible assets as of June 30, 2004, aggregate amortization expense for each of the next five years is estimated to be \$3.1 million, \$2.7 million, \$2.3 million, \$1.7 million and \$1.2 million, respectively. These amounts do not include amortization expense associated with the intangibles created in the July 9, 2004 acquisition of Coquina Bank.

NOTE H DEFINED BENEFIT PENSION PLAN

The following table provides certain information with respect to Alabama National's defined benefit pension plans for the periods indicated (amounts in thousands):

| | For the three months ended June 30, | | For the six months ended June 30, | |
|------------------------------------|--|---------------|--|---------------|
| | 2004 | 2003 | 2004 | 2003 |
| Service cost | \$ | \$ | \$ | \$ |
| Interest cost | 92 | 92 | 183 | 183 |
| Expected return on plan assets | (118) | (109) | (235) | (219) |
| Amortization of prior service cost | | | | |
| Amortization of transition asset | | (1) | | (1) |
| Amortization of net loss | 8 | 17 | 17 | 35 |
| Net periodic pension income | \$ (18) | \$ (1) | \$ (35) | \$ (2) |

As of June 30, 2004, Alabama National has not made any contributions to the defined benefit pension plan because the plan is fully funded and Alabama National does not anticipate making any contributions in the year ended December 31, 2004.

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If needed in the future, Alabama National will contribute any amounts necessary to satisfy funding requirements of the Employee Retirement Income Security Act.

NOTE I TREASURY STOCK REPURCHASE PLAN

On February 18, 2004, Alabama National renewed its share repurchase program that expired on December 31, 2003. The renewed plan authorizes the company to repurchase up to 300,000 shares of its common stock and will expire on December 31, 2004. There were no shares repurchased during the six months ended June 30, 2004.

NOTE J SUBSEQUENT EVENTS

On July 27, 2004, Alabama National completed an underwritten public offering of 850,000 shares of its common stock at a public offering price of \$54.20 per share. Alabama National received net proceeds of approximately \$43,181,400, after deducting the underwriting discount of \$2,648,600 and estimated offering expenses of \$240,000 payable by Alabama National.

Alabama National also granted the underwriters a 30-day option to purchase an additional 127,500 shares of common stock to cover over-allotments. On August 9, 2004 the underwriters exercised the over-allotment option in full and purchased all 127,500 shares of common stock subject to the option. Based on the underwriters' exercise of the over-allotment option in full, the aggregate net proceeds to Alabama National from the public offering are approximately \$49,694,610, after deducting underwriting discounts and estimated offering expenses.

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

Basis of Presentation

The following is a discussion and analysis of the consolidated financial condition of Alabama National and results of operations as of the dates and for the periods indicated. All significant intercompany accounts and transactions have been eliminated. The accounting and reporting policies of Alabama National conform with generally accepted accounting principles and with general financial services industry practices.

Many of the comparisons of financial data from period to period presented in the following discussion have been rounded from actual values reported in the financial statements. The percentage changes presented herein are based on a comparison of the actual values recorded in the financial statements, not the rounded values.

Alabama National acquired Millennium Bank on June 19, 2003, Cypress Bankshares, Inc. on February 20, 2004 and Indian River Banking Company on February 27, 2004, using the purchase method of accounting. Accordingly, the results of operations for Cypress Bank and Indian River National Bank are not included in the three or six month periods ended June 30, 2003, and only 11 days of Millennium Bank's results of operations are included in the 2003 periods. The three and six month periods ended June 30, 2004 include Millennium for the entire periods but only include the results of operations of Cypress and Indian River subsequent to the acquisition date for each.

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

Critical Accounting Policies and Estimates

Alabama National's accounting policies are critical to understanding the results of operations and financial position as reported in the consolidated financial statements. Significant accounting policies utilized by Alabama National are discussed in detail in the notes to the consolidated financial statements and in Management's Discussion and Analysis of Financial Condition and Results of Operations appearing in Alabama National's Annual Report on Form 10-K for the year ended December 31, 2003.

Performance Overview

Alabama National's net income was \$13.2 million for the second quarter of 2004 (the 2004 second quarter), compared to \$10.2 million for the second quarter of 2003 (the 2003 second quarter). Net income for the six months ended June 30, 2004 (the 2004 six months) was \$24.6 million, compared to \$19.7 million for the six months ended June 30, 2003 (the 2003 six months). Net income per diluted common share for the 2004 and 2003 second quarters was \$0.84 and \$0.80, respectively. For the 2004 six months, net income per diluted common share was \$1.64, compared to \$1.55 for the 2003 six months.

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The annualized return on average assets for Alabama National was 1.10% for the 2004 second quarter, compared to 1.15% for the 2003 second quarter. For the 2004 six months, the annualized return on average assets for Alabama National was 1.09%, compared to 1.15% for the 2003 six months. The annualized return on average stockholders' equity decreased for the 2004 second quarter to 12.55%, as compared to 16.51% for the 2003 second quarter. The annualized return on average stockholders' equity decreased for the 2004 six months to 12.80%, as compared to 16.36% for the 2003 six months. Return on average assets and return on average stockholders' equity have each been negatively affected by recent acquisitions due to the amount of goodwill and other intangible assets recorded, which amount increased the denominator in both of these ratio calculations. Book value per share at June 30, 2004 was \$27.48, an increase of \$5.72 from year-end 2003, due primarily to the impact of first quarter acquisitions. Alabama National declared cash dividends totaling \$0.625 per share on common stock during the 2004 six months, compared to \$0.57 per share declared on common stock during the 2003 six months.

Table of Contents**Net Income**

The primary reasons for the increased net income during the 2004 second quarter and 2004 six months, compared to the same periods in 2003, are an increase in net interest income and the acquisitions of Cypress and Indian River. Net interest income for the 2004 second quarter totaled \$39.6 million, a 34.9% increase over the \$29.4 million recorded in the 2003 second quarter. During the 2004 six months net interest income totaled \$74.3 million, a 29.5% increase compared to \$57.4 million recorded in the 2003 six months. The increased net interest income was offset by a slight decline in total noninterest income recorded during the 2004 second quarter and six months. During the 2004 second quarter, total noninterest income was \$19.3 million, a decrease of \$2.3 million as compared to the 2003 second quarter. For the 2004 six months, noninterest income was \$36.9 million, a decrease of 8.3% from \$40.3 million recorded in the 2003 six months. The income from the sale of mortgage loans and income from investment services experienced a fairly significant decrease in each period of 2004 as compared to the same periods in 2003. The revenue recorded in these two business segments during the 2003 second quarter and six months were both record levels for Alabama National.

Average earning assets for the 2004 second quarter and six months increased by \$1.15 billion and \$963.0 million, respectively, as compared to the same periods in 2003. Average interest-bearing liabilities increased by \$940.1 million and \$789.8 million during the 2004 second quarter and six months, respectively, as compared to the same periods in 2003. Recent acquisitions have contributed greatly to the increase in average earning assets and interest-bearing liabilities. The average taxable equivalent rate earned on assets was 5.08% and 5.12% for the 2004 second quarter and 2004 six months, respectively, compared to 5.48% and 5.60% for the 2003 second quarter and 2003 six months, respectively. The average rate paid on interest-bearing liabilities was 1.66% and 1.69% for the 2004 second quarter and 2004 six months, respectively, compared to 2.08% and 2.16% for the 2003 second quarter and 2003 six months, respectively. The net interest margin was 3.61% and 3.62% for the 2004 second quarter and 2004 six months, respectively, compared to 3.61% and 3.65% for the 2003 second quarter and 2003 six months, respectively. The net interest margin for the 2004 second quarter decreased by 1 basis point compared to the first quarter of 2004. The net interest margin has remained relatively unchanged for the last three quarters. As rates have remained low, the repricing opportunities for time deposits originated in higher interest rate environments continue to decrease, while rates on loans and leases have continued to decrease in the current low interest rate environment. The recent 25 basis point increase by the Federal Reserve should allow Alabama National to increase its net interest margin as the rates on variable rate loans will reprice more quickly than interest bearing transaction accounts and certificates of deposit. Despite the pressure on the net interest margin, Alabama National has experienced growth in its net interest income due to organic earning asset growth and recent acquisitions.

The following tables depict, on a taxable equivalent basis for the 2004 and 2003 second quarter and six months, certain information related to Alabama National's average balance sheet and its average yields on assets and average costs of liabilities. Such yields or costs are derived by dividing income or expense by the average daily balance of the associated assets or liabilities.

AVERAGE BALANCES, INCOME AND EXPENSES AND RATES**(Amounts in thousands, except yields and rates)**

| Three months ended June 30, | | | | | |
|-----------------------------|--------------------|----------------|--------------------|--------------------|----------------|
| 2004 | | | 2003 | | |
| Average Balance | Income/ Expense | Yield/ Cost | Average Balance | Income/ Expense | Yield/ Cost |
| Assets: | | | | | |

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Earning assets:

| | | | | | | |
|---------------------------------------|-------------------|-------------------|-------|-------------------|-------------------|-------|
| Loans and leases ⁽¹⁾⁽²⁾⁽³⁾ | \$ 3,194,216 | \$ 44,211 | 5.57% | \$ 2,394,732 | \$ 36,020 | 6.03% |
| Securities: | | | | | | |
| Taxable | 1,088,577 | 10,571 | 3.91 | 758,152 | 7,740 | 4.09 |
| Tax exempt ⁽²⁾ | 52,522 | 797 | 6.10 | 30,674 | 568 | 7.43 |
| Cash balances in other banks | 7,936 | 17 | 0.86 | 12,208 | 25 | 0.82 |
| Funds sold | 67,373 | 167 | 1.00 | 65,934 | 209 | 1.27 |
| Trading account securities | 1,381 | 17 | 4.95 | 2,700 | 29 | 4.31 |
| | <u> </u> | <u> </u> | | <u> </u> | <u> </u> | |
| Total earning assets ⁽²⁾ | 4,412,005 | 55,780 | 5.08 | 3,264,400 | 44,591 | 5.48 |
| | <u> </u> | <u> </u> | | <u> </u> | <u> </u> | |
| Cash and due from banks | 141,724 | | | 90,102 | | |
| Premises and equipment | 94,599 | | | 73,830 | | |
| Other assets | 253,477 | | | 157,238 | | |
| Allowance for loan losses | (43,188) | | | (34,038) | | |
| | <u> </u> | | | <u> </u> | | |
| Total assets | \$ 4,858,617 | | | \$ 3,551,532 | | |
| | <u> </u> | | | <u> </u> | | |

Liabilities:

Interest-bearing liabilities:

| | | | | | | |
|--|-------------------|-------------------|-------|-------------------|-------------------|-------|
| Interest-bearing transaction accounts | \$ 728,049 | \$ 1,319 | 0.73% | \$ 511,742 | \$ 1,239 | 0.97% |
| Savings deposits | 767,314 | 2,408 | 1.26 | 454,108 | 1,129 | 1.00 |
| Time deposits | 1,479,325 | 7,536 | 2.05 | 1,237,981 | 8,626 | 2.79 |
| Funds purchased | 384,820 | 963 | 1.01 | 300,939 | 861 | 1.15 |
| Other short-term borrowings | 64,036 | 285 | 1.79 | 96,653 | 442 | 1.83 |
| Long-term debt | 392,998 | 3,252 | 3.33 | 275,069 | 2,655 | 3.87 |
| | <u> </u> | <u> </u> | | <u> </u> | <u> </u> | |
| Total interest-bearing liabilities | 3,816,542 | 15,763 | 1.66 | 2,876,492 | 14,952 | 2.08 |
| | <u> </u> | <u> </u> | | <u> </u> | <u> </u> | |
| Demand deposits | 564,352 | | | 364,456 | | |
| Accrued interest and other liabilities | 53,204 | | | 63,594 | | |
| Stockholders' equity | 424,519 | | | 246,990 | | |
| | <u> </u> | | | <u> </u> | | |
| Total liabilities and stockholders' equity | \$ 4,858,617 | | | \$ 3,551,532 | | |
| | <u> </u> | | | <u> </u> | | |

| | | | | | | |
|--|--|-------------------|-------|-------------------|-------------------|-------|
| Net interest spread | | | 3.42% | | | 3.40% |
| | | <u> </u> | | <u> </u> | <u> </u> | |
| Net interest income/margin on a taxable equivalent basis | | 40,017 | 3.65% | | 29,639 | 3.64% |
| | | <u> </u> | | <u> </u> | <u> </u> | |
| Tax equivalent adjustment ⁽²⁾ | | 383 | | | 266 | |
| | | <u> </u> | | <u> </u> | <u> </u> | |
| Net interest income/margin | | \$ 39,634 | 3.61% | | \$ 29,373 | 3.61% |
| | | <u> </u> | | <u> </u> | <u> </u> | |

(1) Average loans include nonaccrual loans. All loans and deposits are domestic.

(2) Tax equivalent adjustments are based upon an assumed tax rate of 34%, and do not reflect the disallowance for Federal income tax purposes of interest expense related to certain tax exempt assets.

(3) Fees in the amount of \$1.8 million and \$1.5 million are included in interest and fees on loans for the three months ended June 30, 2004 and 2003, respectively.

AVERAGE BALANCES, INCOME AND EXPENSES AND RATES

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(Amounts in thousands, except yields and rates)

| | Six months ended June 30, | | | | | |
|--|---------------------------|--------------------|----------------|---------------------|--------------------|----------------|
| | 2004 | | | 2003 | | |
| | Average Balance | Income/ Expense | Yield/ Cost | Average Balance | Income/ Expense | Yield/ Cost |
| Assets: | | | | | | |
| Earning assets: | | | | | | |
| Loans and leases ⁽¹⁾⁽²⁾⁽³⁾ | \$ 3,031,870 | \$ 84,520 | 5.61% | \$ 2,329,948 | \$ 70,606 | 6.11% |
| Securities: | | | | | | |
| Taxable | 983,153 | 18,868 | 3.86 | 739,552 | 15,704 | 4.28 |
| Tax exempt ⁽²⁾ | 47,599 | 1,491 | 6.30 | 31,412 | 1,130 | 7.25 |
| Cash balances in other banks | 6,707 | 28 | 0.84 | 11,371 | 60 | 1.06 |
| Funds sold | 59,078 | 300 | 1.02 | 52,289 | 333 | 1.28 |
| Trading account securities | 1,593 | 35 | 4.42 | 2,434 | 49 | 4.06 |
| Total earning assets ⁽²⁾ | 4,130,000 | 105,242 | 5.12 | 3,167,006 | 87,882 | 5.60 |
| Cash and due from banks | 131,672 | | | 89,227 | | |
| Premises and equipment | 87,228 | | | 73,553 | | |
| Other assets | 218,530 | | | 150,307 | | |
| Allowance for loan losses | (41,172) | | | (33,598) | | |
| Total assets | \$ 4,526,258 | | | \$ 3,446,495 | | |
| Liabilities: | | | | | | |
| Interest-bearing liabilities: | | | | | | |
| Interest-bearing transaction accounts | \$ 666,699 | \$ 2,428 | 0.73% | \$ 505,412 | \$ 2,551 | 1.02% |
| Savings deposits | 679,707 | 3,643 | 1.08 | 430,245 | 2,177 | 1.02 |
| Time deposits | 1,416,340 | 15,408 | 2.19 | 1,198,762 | 17,412 | 2.93 |
| Funds purchased | 385,038 | 1,960 | 1.02 | 294,602 | 1,620 | 1.11 |
| Other short-term borrowings | 68,223 | 579 | 1.71 | 101,673 | 998 | 1.98 |
| Long-term debt | 372,195 | 6,205 | 3.35 | 267,661 | 5,237 | 3.95 |
| Total interest-bearing liabilities | 3,588,202 | 30,223 | 1.69 | 2,798,355 | 29,995 | 2.16 |
| Demand deposits | 506,548 | | | 343,568 | | |
| Accrued interest and other liabilities | 45,661 | | | 61,920 | | |
| Stockholders' equity | 385,847 | | | 242,652 | | |
| Total liabilities and stockholders' equity | \$ 4,526,258 | | | \$ 3,446,495 | | |
| Net interest spread | | | 3.43% | | | 3.44% |
| Net interest income/margin on a taxable equivalent basis | | 75,019 | 3.65% | | 57,887 | 3.69% |
| Tax equivalent adjustment ⁽²⁾ | | 715 | | | 527 | |
| Net interest income/margin | | \$ 74,304 | 3.62% | | \$ 57,360 | 3.65% |

-
- (1) Average loans include nonaccrual loans. All loans and deposits are domestic.
- (2) Tax equivalent adjustments are based upon an assumed tax rate of 34%, and do not reflect the disallowance for Federal income tax purposes of interest expense related to certain tax exempt assets.

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- (3) Fees in the amount of \$3.6 million and \$2.8 million are included in interest and fees on loans for the six months ended June 30, 2004 and 2003, respectively.

The following tables set forth, on a taxable equivalent basis, the effect which varying levels of earning assets and interest-bearing liabilities and the applicable rates had on changes in net interest income for each of the 2004 second quarter and six months compared to the 2003 second quarter and six months, respectively. For the purposes of these tables, changes which are not solely attributable to volume or rate are allocated to volume and rate on a pro rata basis.

ANALYSIS OF CHANGES IN NET INTEREST INCOME

(Amounts in thousands)

| | Three months ended June 30, 2004 Compared to 2003 | | |
|--|--|-------------------|------------------|
| | Variance Due to | | |
| | Volume | Yield/Rate | Total |
| Earning assets: | | | |
| Loans and leases | \$ 24,601 | \$ (16,410) | \$ 8,191 |
| Securities: | | | |
| Taxable | 5,050 | (2,219) | 2,831 |
| Tax exempt | 835 | (606) | 229 |
| Cash balances in other banks | (16) | 8 | (8) |
| Funds sold | 29 | (71) | (42) |
| Trading account securities | (36) | 24 | (12) |
| Total interest income | 30,463 | (19,274) | 11,189 |
| Interest-bearing liabilities: | | | |
| Interest-bearing transaction accounts | 1,600 | (1,520) | 80 |
| Savings and money market deposits | 929 | 350 | 1,279 |
| Time deposits | 7,300 | (8,390) | (1,090) |
| Funds purchased | 657 | (555) | 102 |
| Other short-term borrowings | (147) | (10) | (157) |
| Long-term debt | 2,692 | (2,095) | 597 |
| Total interest expense | 13,031 | (12,220) | 811 |
| Net interest income on a taxable equivalent basis | \$ 17,432 | \$ (7,054) | 10,378 |
| Taxable equivalent adjustment | | | (117) |
| Net interest income | | | \$ 10,261 |

ANALYSIS OF CHANGES IN NET INTEREST INCOME

(Amounts in thousands)

| | Six months ended June 30, 2004 Compared to 2003 | | |
|--|--|-------------------|------------------|
| | Variance Due to | | |
| | Volume | Yield/Rate | Total |
| Earning assets: | | | |
| Loans and leases | \$ 29,264 | \$ (15,350) | \$ 13,914 |
| Securities: | | | |
| Taxable | 7,224 | (4,060) | 3,164 |
| Tax exempt | 764 | (403) | 361 |
| Cash balances in other banks | (21) | (11) | (32) |
| Funds sold | 93 | (126) | (33) |
| Trading account securities | (25) | 11 | (14) |
| Total interest income | 37,299 | (19,939) | 17,360 |
| Interest-bearing liabilities: | | | |
| Interest-bearing transaction accounts | 1,485 | (1,608) | (123) |
| Savings and money market deposits | 1,331 | 135 | 1,466 |
| Time deposits | 6,581 | (8,585) | (2,004) |
| Funds purchased | 688 | (348) | 340 |
| Other short-term borrowings | (296) | (123) | (419) |
| Long-term debt | 3,009 | (2,041) | 968 |
| Total interest expense | 12,798 | (12,570) | 228 |
| Net interest income on a taxable equivalent basis | \$ 24,501 | \$ (7,369) | 17,132 |
| Taxable equivalent adjustment | | | (188) |
| Net interest income | | | \$ 16,944 |

The provision for loan and lease losses represents a charge to current earnings necessary to maintain the allowance for loan and lease losses at an appropriate level based on management's analysis of the loss in the loan and lease portfolio. The amount of the provision is a function of the level of loans and leases outstanding, the level of non-performing loans and adversely rated loans, historical loan and lease loss experience, the amount of loan and lease charge-offs during a given period, and current economic conditions. The provision for loan and lease losses was \$1.3 million and \$2.5 million for the 2004 second quarter and six months, respectively, compared to \$1.4 million and \$2.5 million recorded during the 2003 second quarter and six months, respectively. The allowance for loan and lease losses as a percentage of outstanding loans, net of unearned income (excluding loans held for sale), was 1.36% at June 30, 2004, compared to 1.37% at December 31, 2003.

Because of the inherent uncertainty of assumptions made during the assessment process, there can be no assurance that loan and lease losses in future periods will not exceed the allowance for loan and lease losses or that additional allocations to the allowance will not be required. See Asset Quality.

Total noninterest income for the 2004 second quarter was \$19.3 million, compared to \$21.5 million for the 2003 second quarter, a decrease of 10.4%. For the 2004 six months, noninterest income decreased to \$36.9 million, compared to \$40.3 million for the 2003 six months, a decrease of 8.3%. The major components of noninterest income include service charges on deposits, investment services revenue, securities brokerage and trust revenue, insurance commissions, fees relating to the origination and sale of mortgage loans, and income earned on bank owned life insurance. Service charges on deposits posted the most significant increase of any noninterest income component. Service charges on deposits for the 2004 second quarter and 2003 second quarter were \$4.5 million and \$3.5 million, respectively. For the 2004 six months, service charge

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income increased to \$8.3 million, from \$6.9 million for the 2003 six months. The primary reason for the increase in service charges is the impact of Alabama National's recent acquisitions, which contributed \$729,000 and \$979,000 of service charge income during the 2004 second quarter and six months, respectively.

Revenue from the investment division totaled \$3.3 million in the 2004 second quarter, a decrease of \$3.1 million, or 48.6%, as compared to \$6.4 million recorded in the 2003 second quarter. During the 2004 six months the investment division revenue totaled \$7.2 million, a decrease of \$4.4 million, or 37.7%, as compared to \$11.5 million in the 2003 six months. Since Cypress, Indian River and Millennium do not operate in this business, these mergers had no impact on investment services revenue. The revenue recorded by the investment division in the 2003 second quarter and six months was at record levels for this division. The revenue generated by the investment division is dependent upon the demand for fixed income securities by its customers, which are primarily correspondent community banks. Demand for these securities was high during the 2003 second quarter and six months due to increased liquidity of community banks resulting from decreased loan demand and increased cash flow from their existing securities portfolio. Although the activity for this division has moderated as interest rates have remained low, the investment division continues to add new customers and expand its market area. Securities brokerage and trust revenue increased modestly during the 2004 second quarter and six months as compared with the same periods of 2003. The increase in the securities brokerage and trust division revenue during each period of 2004 is attributable to continued expansion in the number of customers and total customer assets under management by these departments, as well as an increase in the number of registered representatives. The gain generated from the sale of mortgages decreased to \$3.5 million for the 2004 second quarter, from \$4.6 million in the 2003 second quarter, representing a 24.4% decrease. During the 2004 six months the gain from sale of mortgages decreased to \$6.0 million, from \$7.9 million during the 2003 six months, a decrease of 24.1%. The gain recorded from the sale of mortgages during the 2003 second quarter and six months was near record levels due to falling interest rates and the impact on mortgage refinancing activity. Since mortgage rates have recently shown modest

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increases, refinance activity has slowed and revenue from refinancing has decreased. Other noninterest income increased to \$2.3 million for the 2004 second quarter, compared to \$1.7 million during the 2003 second quarter. Other noninterest income increased to \$3.9 million during the 2004 six months, an increase of 32.2%, compared to \$3.0 million recorded in the 2003 six months. Contributing to this increase is revenue generated from debit card and credit card activity.

Noninterest expense was \$37.6 million for the 2004 second quarter, compared to \$34.3 million for the 2003 second quarter. For the 2004 six months, noninterest expense was \$71.8 million, compared to \$65.8 million for the 2003 six months. Noninterest expense includes salaries and employee benefits, commission based compensation, occupancy and equipment expenses, amortization of intangibles, and other expenses. Salaries and employee benefits were \$19.0 million for the 2004 second quarter, compared to \$16.6 million for the 2003 second quarter. For the 2004 six months, salaries and employee benefits were \$36.7 million, compared to \$31.9 million in the 2003 six months. The most significant reason for the increase in salaries and employee benefit expense is the impact of recent acquisitions, which accounted for \$2.4 million and \$3.2 million of the increase during the 2004 second quarter and six months, respectively. Commission based compensation was \$4.8 million for the 2004 second quarter, compared to \$6.6 million for the 2003 second quarter. For the 2004 six months, commission based compensation totaled \$9.5 million, compared to \$12.2 million in the 2003 six months. The decrease in commission based compensation recorded for each period of 2004 is attributable to decreased production in the mortgage and investment services divisions, as a significant portion of the compensation in these divisions is production-based. Occupancy and equipment expense totaled \$3.9 million in the 2004 second quarter and \$3.2 million in the 2003 second quarter. Occupancy and equipment expense totaled \$7.4 million in the 2004 six months and \$6.4 million in the 2003 six months. The primary reason for the increased occupancy and equipment expense for the 2004 second quarter and six months is due to Alabama National's recent acquisitions. Other noninterest expense increased to \$9.1 million in the 2004 second quarter, compared with \$7.7 million in the 2003 second quarter. Other noninterest expense was \$16.9 million in the 2004 six months and \$14.9 million in the 2003 six months.

Because of an increase in pre-tax income, income tax expense was \$6.8 million for the 2004 second quarter, compared to \$5.0 million for the 2003 second quarter. For the 2004 six months, income tax expense was \$12.4 million, compared to \$9.6 million for the 2003 six months. The effective tax rates for the 2004 second quarter and the 2004 six months were 33.9% and 33.5%, respectively, compared to 32.9% and 32.8% for the same periods of 2003. These effective tax rates are affected by items of income and expense that are not subject to federal or state taxation. The effective rate in the 2004 second quarter and six months is higher than the 2003 periods due to higher pre-tax income without a corresponding increase in income items not subject to federal or state taxation.

Earning Assets

Loans and leases comprised the largest single category of Alabama National's earning assets on June 30, 2004. Loans and leases, net of unearned income, were \$3.20 billion, or 64.7% of total assets at June 30, 2004, compared to \$2.66 billion, or 69.6% at December 31, 2003. Loans and leases grew \$537.8 million, or 20.2%, during the 2004 six months, compared to the 2003 year-end. Excluding the Indian River and Cypress acquisitions, loans and leases grew \$162.9 million, or 6.1% from December 31, 2003 balances. The following table details the composition of the loan and lease portfolio by category at the dates indicated:

COMPOSITION OF LOAN AND LEASE PORTFOLIO

(Amounts in thousands, except percentages)

| June 30, 2004 | | December 31, 2003 | |
|----------------------|-------------------------|--------------------------|-------------------------|
| Amount | Percent of Total | Amount | Percent of Total |

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| | | | | |
|---|---------------------|----------------|---------------------|----------------|
| Commercial, financial and agricultural | \$ 291,930 | 9.12% | \$ 265,923 | 9.99% |
| Real estate: | | | | |
| Construction | 644,113 | 20.13 | 530,024 | 19.91 |
| Mortgage - residential | 867,884 | 27.12 | 676,658 | 25.42 |
| Mortgage - commercial | 980,516 | 30.64 | 814,904 | 30.61 |
| Mortgage - other | 10,877 | .34 | 9,412 | .35 |
| Consumer | 91,810 | 2.87 | 74,137 | 2.78 |
| Lease financing receivables | 74,631 | 2.33 | 77,857 | 2.92 |
| Securities brokerage margin loans | 13,382 | .42 | 15,407 | .58 |
| Other | 224,901 | 7.03 | 198,036 | 7.44 |
| Total gross loans and leases | 3,200,044 | 100.00% | 2,662,358 | 100.00% |
| Unearned income | (2,757) | | (2,918) | |
| Total loans and leases, net of unearned income | 3,197,287 | | 2,659,440 | |
| Allowance for loan and lease losses | (43,484) | | (36,562) | |
| Total net loans and leases | \$ 3,153,803 | | \$ 2,622,878 | |

The carrying value of investment securities increased \$271.8 million during the 2004 six months from \$271.0 million at December 31, 2003. During the 2004 six months, Alabama National purchased \$316.8 million of investment securities, received \$70.6 million from maturities, including principal paydowns of mortgage backed securities, and acquired \$25.8 million of investment securities in connection with the two 2004 first quarter acquisitions.

The carrying value of securities available for sale increased \$93.7 million in the 2004 six months compared to year-end 2003. The first quarter acquisitions increased the carrying value of securities available for sale by \$242.3 million. During the 2004 six months, purchases of available for sale securities totaled \$373.0 million, and maturities, calls, and sales of available for sale securities totaled \$509.7 million. During the 2004 six months, the available for sale portfolio experienced an unrealized loss totaling \$12.0 million.

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Trading account securities, which had a balance of zero at June 30, 2004, are securities owned by Alabama National prior to sale and delivery to Alabama National's customers. It is the policy of Alabama National to limit positions in such securities to reduce its exposure to market and interest rate changes. Federal funds sold and securities purchased under agreements to resell totaled \$47.2 million at June 30, 2004 and \$16.5 million at December 31, 2003.

Deposits and Other Funding Sources

Deposits increased by \$861.5 million from December 31, 2003, to \$3.62 billion at June 30, 2004. Excluding the first quarter acquisitions, deposits increased \$246.5 million, or 6.8% compared with December 31, 2003 balances. Deposits continue to increase organically due to recent branch expansions, successful business development efforts by the Company and overall economic growth in the markets served by Alabama National. At June 30, 2004, deposits included \$186.9 million of brokered time deposits, compared to \$156.0 million at December 31, 2003.

Federal funds purchased and securities sold under agreements to repurchase totaled \$372.0 million at June 30, 2004, an increase of \$13.6 million from December 31, 2003. Short-term borrowings at June 30, 2004 totaled \$31.3 million, including a note payable to a third party bank of \$7.2 million and advances from the Federal Home Loan Bank (FHLB) totaling \$24.2 million.

Alabama National's short-term borrowings at June 30, 2004 and December 31, 2003 are summarized as follows:

SHORT-TERM BORROWINGS

(Amounts in thousands)

| | June 30, 2004 | December 31, 2003 |
|--|--------------------------|------------------------------|
| | <u> </u> | <u> </u> |
| Note payable to third party bank under secured master note agreement; rate varies with LIBOR and was 2.03% and 1.89125% at June 30, 2004 and December 31, 2003, respectively; collateralized by Alabama National's stock in subsidiary banks. Matures on May 31, 2005. | \$ 7,150 | \$ 1,650 |
| FHLB open ended notes payable; rate varies daily based on the FHLB Daily Rate Credit interest price and was 1.70% and 1.15% at June 30, 2004 and December 31, 2003, respectively; collateralized by FHLB stock and certain first real estate mortgages. | 14,040 | 24,500 |
| FHLB borrowings due at various maturities ranging from July 30, 2004 through December 4, 2004 at June 30, 2004; at December 31, 2003, maturities ranged from February 2, 2004 to December 4, 2004; bearing interest at fixed rates ranging from 1.79% to 6.44% and 1.79% to 5.715% at June 30, 2004 and December 31, 2003, respectively; collateralized by FHLB stock and certain first real estate mortgages. | 10,143 | 15,000 |
| | <u> </u> | <u> </u> |
| Total short-term borrowings. | <u>\$ 31,333</u> | <u>\$ 41,150</u> |

Alabama National's long-term debt at June 30, 2004 and December 31, 2003 is summarized as follows:

LONG-TERM DEBT

(Amounts in thousands)

| | June 30, 2004 | December 31, 2003 |
|--|--------------------------|------------------------------|
| FHLB borrowings due at various maturities ranging from November 10, 2005 through November 7, 2012 at June 30, 2004; maturities ranged from November 10, 2005 to October 23, 2012 at December 31, 2003; bearing interest at fixed rates ranging from 1.89% to 6.00% and 1.09% to 6.00% at June 30, 2004 and December 31, 2003, respectively; convertible to a variable rate at the option of the FHLB at dates ranging from July 7, 2004 to November 7, 2007; collateralized by FHLB stock and certain first real estate mortgages. | \$ 273,256 | \$ 258,000 |
| FHLB borrowing due September 12, 2006; rate varies quarterly with LIBOR and was 0.81875% and 0.52% at June 30, 2004 and December 31, 2003, respectively; on September 12, 2004 the advance will convert to a fixed rate of 2.54%; or the FHLB can convert the advance on September 12, 2004 to a variable rate advance; collateralized by FHLB stock and certain first real estate mortgages. | 28,000 | 28,000 |
| FHLB borrowings due at dates ranging from May 12, 2006 to November 5, 2008; rates vary quarterly with LIBOR and ranged from 1.18% to 1.26%; collateralized by FHLB stock and certain first real estate mortgages. | 49,000 | |
| Junior subordinated debentures payable to unconsolidated trusts due at dates ranging from December 18, 2031 to September 26, 2033; rates vary with LIBOR and ranged from 4.6363% to 5.13375% and 4.2125% to 4.77% at June 30, 2004 and December 31, 2003, respectively. | 53,610 | 46,393 |
| Capital leases payable. | 22 | 34 |
| Total long-term debt. | \$ 403,888 | \$ 332,427 |

Asset Quality

Nonperforming loans are comprised of loans past due 90 days or more and still accruing interest, loans accounted for on a nonaccrual basis and loans in which the terms have been restructured to provide a reduction or deferral of interest or principal because of a deterioration in the financial position of the borrower. At June 30, 2004, Alabama National had no loans past due 90 days or more that were still accruing interest. Accrual of interest is discontinued on a loan when management believes, after considering economic and business conditions and collection efforts that the borrower's financial condition is such that the collection of interest is doubtful. It is Alabama National's policy to place a delinquent loan on nonaccrual status when it becomes 90 days or more past due. When a loan is placed on nonaccrual status, all interest that is accrued on the loan is reversed and deducted from earnings as a reduction of reported interest. No additional interest is accrued on the loan balance until the collection of both principal and interest becomes reasonably certain. When a problem loan is finally resolved, there may ultimately be an actual writedown or charge-off of the principal balance of the loan which would necessitate additional charges to the allowance for loan and lease losses.

At June 30, 2004, nonperforming assets totaled \$10.3 million, compared to \$10.5 million at year-end 2003. Nonperforming assets as a percentage of loans plus other real estate were 0.32% at June 30, 2004, compared to 0.40% at December 31, 2003. The following table presents Alabama National's nonperforming assets for the dates indicated.

NONPERFORMING ASSETS

(Amounts in thousands, except percentages)

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| | June 30, 2004 | December 31, 2003 |
|---|------------------|----------------------|
| Nonaccrual loans | \$ 8,307 | \$ 9,817 |
| Restructured loans | | |
| Loans past due 90 days or more and still accruing | | |
| Total nonperforming loans | 8,307 | 9,817 |
| Other real estate owned | 1,969 | 699 |
| Total nonperforming assets | \$ 10,276 | \$ 10,516 |
| Allowance for loan and lease losses to period-end loans | 1.36% | 1.37% |
| Allowance for loan and lease losses to period-end nonperforming loans | 523.46 | 372.44 |
| Allowance for loan losses to period-end nonperforming assets | 423.16 | 347.68 |
| Net charge-offs to average loans ⁽¹⁾ | 0.08 | 0.13 |
| Nonperforming assets to period-end loans and other real estate owned | 0.32 | 0.40 |
| Nonperforming loans to period-end loans | 0.26 | 0.37 |

⁽¹⁾ - Excludes average loans held for sale

Net loan charge-offs for the 2004 six months totaled \$1.1 million, or 0.08% (annualized) of average loans and leases for the period (excluding loans held for sale). The allowance for loan and lease losses as a percentage of total loans, net of unearned income, was 1.36% at June 30, 2004, compared to 1.37% at December 31, 2003. The following table analyzes activity in the allowance for loan and lease losses for the periods indicated.

ANALYSIS OF THE ALLOWANCE FOR LOAN AND LEASE LOSSES

(Amounts in thousands)

| | Three months ended June 30, | | Six months ended June 30, | |
|--|--------------------------------|------------|------------------------------|--------------|
| | 2004 | 2003 | 2004 | 2003 |
| Allowance for loan and lease losses at beginning of period | \$ 42,392 | \$ 33,247 | \$ 36,562 | \$ 32,704 |
| Charge-offs: | | | | |
| Commercial, financial and agricultural | 1,540 | | 2,629 | 387 |
| Real estate - mortgage | 41 | 389 | 102 | 1,102 |
| Consumer | 209 | 201 | 388 | 505 |
| Total charge-offs | 1,790 | 590 | 3,119 | 1,994 |
| Recoveries: | | | | |
| Commercial, financial and agricultural | 341 | 172 | 421 | 276 |
| Real estate - mortgage | 223 | 81 | 272 | 178 |
| Consumer | 1,040 | 266 | 1,301 | 921 |
| Total recoveries | 1,604 | 519 | 1,994 | 1,375 |
| Net charge-offs | 186 | 71 | 1,125 | 619 |

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| | | | | |
|--|-------------------|-------------------|-------------------|-------------------|
| Provision for loan and lease losses | 1,278 | 1,424 | 2,506 | 2,515 |
| Additions to allowance through acquisitions | | 995 | 5,541 | 995 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Allowance for loan and lease losses at end of period | \$ 43,484 | \$ 35,595 | \$ 43,484 | \$ 35,595 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |

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The loan and lease portfolio is periodically reviewed to evaluate the outstanding loans and to measure both the performance of the portfolio and the adequacy of the allowance for loan and lease losses. This analysis includes a review of delinquency trends, actual losses and internal credit ratings. Based on this analysis, management considers the allowance for loan and lease losses at June 30, 2004 to be adequate to cover probable loan and lease losses in the portfolio as of that date. However, because of the inherent uncertainty of assumptions made during the evaluation process, there can be no assurance that loan and lease losses in future periods will not exceed the allowance for loan and lease losses or that additional allocations to the allowance will not be required.

Interest Rate Sensitivity

Alabama National monitors and manages the pricing and maturity of its assets and liabilities in order to diminish the potential adverse impact that changes in interest rates could have on net interest income. The principal monitoring technique employed by Alabama National is simulation analysis, which technique is augmented by gap analysis.

In simulation analysis, Alabama National reviews each individual asset and liability category and its projected behavior in various different interest rate environments. These projected behaviors are based upon management's past experiences and upon current competitive environments, including the various environments in the different markets in which Alabama National competes. Using this projected behavior and differing rate scenarios as inputs, the simulation analysis generates as output a projection of net interest income. Alabama National also periodically verifies the validity of this approach by comparing actual results with those that were projected in previous models. See **Market Risk**.

Another technique used by Alabama National in interest rate management is the measurement of the interest sensitivity gap, which is the positive or negative dollar difference between assets and liabilities that are subject to interest rate repricing within a given period of time. Interest rate sensitivity can be managed by repricing assets and liabilities, selling securities available for sale, replacing an asset or liability at maturity or by adjusting the interest rate during the life of an asset or liability.

Alabama National evaluates interest sensitivity risk and then formulates guidelines regarding asset generation and repricing, and sources and prices of off-balance sheet commitments in order to decrease interest sensitivity risk. Alabama National uses computer simulations to measure the net income effect of various interest rate scenarios. The modeling reflects interest rate changes and the related impact on net income over specified periods of time.

The following table illustrates Alabama National's interest rate sensitivity at June 30, 2004, assuming relevant assets and liabilities are collected and paid, respectively, based upon historical experience rather than their stated maturities.

INTEREST SENSITIVITY ANALYSIS

(Amounts in thousands, except ratios)

June 30, 2004

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| | Zero Through Three Months | After Three Through Twelve Months | One Through Three Years | Greater Than Three Years | Total |
|--|------------------------------------|---|----------------------------------|-----------------------------|---------------------|
| Assets: | | | | | |
| Earning assets: | | | | | |
| Loans ⁽¹⁾ | \$ 1,952,616 | \$ 463,368 | \$ 473,789 | \$ 318,673 | \$ 3,208,446 |
| Securities ⁽²⁾ | 53,757 | 95,708 | 231,183 | 773,608 | 1,154,256 |
| Trading securities | | | | | |
| Interest-bearing deposits in other banks | 14,438 | | | | 14,438 |
| Funds sold | 47,191 | | | | 47,191 |
| Total interest-earning assets | \$ 2,068,002 | \$ 559,076 | \$ 704,972 | \$ 1,092,281 | \$ 4,424,331 |
| Liabilities: | | | | | |
| Interest-bearing liabilities: | | | | | |
| Interest-bearing deposits: | | | | | |
| Demand deposits | \$ 390,855 | \$ | \$ | \$ 378,959 | \$ 769,814 |
| Savings and money market deposits | 404,889 | | | 410,021 | 814,910 |
| Time deposits ⁽³⁾ | 361,279 | 657,367 | 298,761 | 138,762 | 1,456,169 |
| Funds purchased | 372,029 | | | | 372,029 |
| Short-term borrowings ⁽⁴⁾ | 27,125 | 5,000 | | | 32,125 |
| Long-term debt | 261,237 | 81,393 | 32,500 | 28,758 | 403,888 |
| Total interest-bearing liabilities | \$ 1,817,414 | \$ 743,760 | \$ 331,261 | \$ 956,500 | \$ 3,848,935 |
| Period gap | \$ 250,588 | \$(184,684) | \$ 373,711 | \$ 135,781 | |
| Cumulative gap | \$ 250,588 | \$ 65,904 | \$ 439,615 | \$ 575,396 | \$ 575,396 |
| Ratio of cumulative gap to total earning assets | 5.66% | 1.49% | 9.94% | 13.01% | |

(1) Excludes nonaccrual loans of \$8.3 million.

(2) Excludes available for sale equity securities of \$21.5 million.

(3) Excludes matured certificates which have not been redeemed by the customer and on which no interest is accruing.

(4) Includes treasury, tax and loan account of \$0.8 million.

Alabama National generally benefits from increasing market rates of interest when it has an asset-sensitive gap and generally benefits from decreasing market rates of interest when it is liability sensitive. As shown in the table above, Alabama National is asset sensitive in all periods except for the after three through twelve months time frame, although it remains asset sensitive on a cumulative basis throughout all periods. The analysis presents only a static view of the timing and repricing opportunities, without taking into consideration that changes in interest rates do not affect all assets and liabilities equally. For example, rates paid on a substantial portion of core deposits may change contractually within a relatively short time frame, but those are viewed by management as significantly less interest sensitive than market-based rates such as those paid on non-core deposits. For this and other reasons, management relies more upon the simulation analysis (as noted above) in managing interest rate risk. Net interest income may be affected by other significant factors in a given interest rate environment, including changes in the volume and mix of earning assets and interest-bearing liabilities.

Table of Contents**Market Risk**

Alabama National's earnings are dependent, to a large degree, on its net interest income which is the difference between interest income earned on all earning assets, primarily loans and securities, and interest paid on all interest bearing liabilities, primarily deposits. Market risk is the risk of loss from adverse changes in market prices and rates. Alabama National's market risk arises primarily from inherent interest rate risk in its lending, investing and deposit gathering activities. Alabama National seeks to reduce its exposure to market risk through actively monitoring and managing its interest rate risk. Management relies upon static gap analysis to determine the degree of mismatch in the maturity and repricing distribution of interest earning assets and interest bearing liabilities which quantifies, to a large extent, the degree of market risk inherent in Alabama National's balance sheet. Gap analysis is further augmented by simulation analysis to evaluate the impact of varying levels of prevailing interest rates and the sensitivity of specific earning assets and interest bearing liabilities to changes in those prevailing rates. Simulation analysis consists of evaluating the impact on net interest income given changes from 200 basis points below (adjusted in the current period due to historically low interest rates) to 200 basis points above the current prevailing rates. Management makes certain assumptions as to the effect varying levels of interest rates have on certain earning assets and interest bearing liabilities, which assumptions consider both historical experience and consensus estimates of outside sources.

With respect to the primary earning assets, loans and securities, certain features of individual types of loans and specific securities introduce uncertainty as to their expected performance at varying levels of interest rates. In some cases, prepayment options exist whereby the borrower may elect to repay the obligation at any time. These prepayment options make anticipating the performance of those instruments difficult given changes in prevailing rates. At June 30, 2004, mortgage backed securities with a carrying value of \$847.6 million, or 17.2% of total assets, and essentially every loan and lease, net of unearned income (totaling \$3.20 billion, or 64.7% of total assets), carried such prepayment options. Management believes that assumptions used in its simulation analysis about the performance of financial instruments with such prepayment options are appropriate. However, the actual performance of these financial instruments may differ from management's estimates due to several factors, including the diversity and financial sophistication of the customer base, the general level of prevailing interest rates and the relationship to their historical levels, and general economic conditions. The difference between those assumptions and actual results, if significant, could cause the actual results to differ from those indicated by the simulation analysis.

Deposits totaled \$3.62 billion, or 73.2%, of total assets at June 30, 2004. Since deposits are the primary funding source for earning assets, the associated market risk is considered by management in its simulation analysis. Generally, it is anticipated that deposits will be sufficient to support funding requirements. However, the rates paid for deposits at varying levels of prevailing interest rates have a significant impact on net interest income and therefore, must be quantified by Alabama National in its simulation analysis. Specifically, Alabama National's spread, the difference between the rates earned on earning assets and rates paid on interest bearing liabilities, is generally higher when prevailing rates are higher. As prevailing rates decrease, the spread tends to compress, with severe compression at very low prevailing interest rates. This characteristic is called spread compression and adversely affects net interest income in the simulation analysis when anticipated prevailing rates are reduced from current rates. Management relies upon historical experience to estimate the degree of spread compression in its simulation analysis. Management believes that such estimates of possible spread compression are reasonable. However, if the degree of spread compression varies from that expected, the actual results could differ from those indicated by the simulation analysis.

The following tables illustrate the results of simulation analysis used by Alabama National to determine the extent to which market risk would affect net interest margin for the next twelve months if prevailing interest rates increased or decreased the specified amounts from current rates. Due to the current low interest rate environment, Alabama National has elected to model interest rate decreases of 25 and 50 basis points. (This would equate to federal funds rates of 0.75% and 0.50%, respectively, prior to the Federal Reserve's June 30, 2004 25 basis point increase in the federal funds rate.) The current rates paid on interest-bearing accounts cannot decrease below zero, yet rates earned on loans can experience a decrease in the falling rate scenarios, and the interest rate spread would therefore compress. As noted above, however, management does not anticipate having the ability to reduce liability costs as successfully if it were to experience a rate cut of a greater magnitude. As also noted above, this model uses estimates and assumptions in both balance sheet growth and asset and liability account rate reactions to changes in prevailing interest rates. Because of the inherent use of these estimates and assumptions in the simulation model used to derive this market risk information, the actual results of the future impact of market risk on Alabama National's net interest margin may differ from that found in the tables.

MARKET RISK

(Amounts in thousands)

| Change in Prevailing Interest Rates ⁽¹⁾ | As of June 30, 2004 | | As of December 31, 2003 | |
|--|-------------------------------|------------------------------|-------------------------------|------------------------------|
| | Net Interest Income Amount | Change from Income Amount | Net Interest Income Amount | Change from Income Amount |
| +200 basis points | \$ 183,413 | 2.63% | \$ 150,671 | 8.72% |
| +100 basis points | 182,130 | 1.91 | 144,794 | 4.48 |
| 0 basis points | 178,719 | | 138,592 | |
| -25 basis points | 178,427 | (0.16) | 137,755 | (0.60) |
| -50 basis points | 177,943 | (0.43) | 136,300 | (1.65) |

⁽¹⁾ Assumes an immediate rate change of this magnitude.

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Alabama National's level of asset sensitivity as indicated in this simulation model has decreased slightly from levels reported at December 31, 2003. This slight decrease in asset sensitivity was largely caused by the merger with Indian River, which has a lower loan to deposit ratio and a higher proportion of its earning assets in securities. Because a majority of these securities are fixed rate, they reduce the asset sensitivity as their coupon rates do not fluctuate in a changing rate environment.

Liquidity and Capital Adequacy

Alabama National's net loans and leases to deposit ratio was 88.4% at June 30, 2004, compared to 96.6% at year-end 2003. Alabama National's liquid assets as a percentage of total deposits were 5.7% at June 30, 2004, compared to 5.4% at year-end 2003. At June 30, 2004, Alabama National had unused federal funds lines of approximately \$182.4 million, unused lines at the Federal Home Loan Bank of \$1.02 billion and an unused credit line with a third party bank of \$22.9 million. The ability of Alabama National to use the entire amount of credit extended by the Federal Home Loan Bank depends on the available collateral to pledge for borrowings. Alabama National also has access to approximately \$56.3 million via a credit facility with the Federal Reserve Bank of Atlanta. At June 30, 2004 and year-end 2003, there were no outstanding borrowings under this Federal Reserve credit facility. Management analyzes the level of off-balance sheet assets such as unfunded loan commitments and outstanding letters of credit as they relate to the levels of cash, cash equivalents, liquid investments, and available funds lines in an attempt to minimize the possibility that a potential liquidity shortfall will exist. Based on this analysis, management believes that Alabama National has adequate liquidity to meet short-term operating requirements. However, no assurances can be given in this regard.

Alabama National's stockholders' equity increased by \$144.3 million from December 31, 2003, to \$423.7 million at June 30, 2004. This increase was attributable to the following components (in thousands):

| | |
|---|------------|
| Net income | \$ 24,551 |
| Dividends | (9,619) |
| Issuance of stock for option exercises and other stock based compensation | 1,601 |
| Issuance of stock in purchase business combinations | 134,424 |
| Additional paid in capital related to stock based compensation | 1,046 |
| Change in unrealized gain or loss on securities available for sale, net of deferred taxes | (7,751) |
| | <hr/> |
| Net increase | \$ 144,252 |
| | <hr/> |

Subsequent to the June 30, 2004 quarter end, Alabama National completed an underwritten public offering of 977,500 shares of common stock (including 127,500 shares subject to an over-allotment option) and received net proceeds of approximately \$49,694,610 after deducting underwriting discounts and estimated offering expenses, improving Alabama National's financial position. See Note J to the accompanying financial statements.

A strong capital position is vital to the continued profitability of Alabama National because it promotes depositor and investor confidence and provides a solid foundation for future growth of the organization. The capital of Alabama National and its subsidiary banks (the Banks) exceeded all prescribed regulatory capital guidelines at June 30, 2004. Under the capital guidelines of their regulators, Alabama National and the Banks are currently required to maintain a minimum risk-based total capital ratio of 8%, with at least 4% being Tier 1 capital. Tier 1 capital consists of common stockholders' equity, qualifying perpetual preferred stock, and minority interests in equity accounts of consolidated subsidiaries, less goodwill. In addition, Alabama National and the Banks must maintain a minimum Tier 1 leverage ratio (Tier 1 capital to total assets) of at least 3%, but this minimum ratio is increased by 100 to 200 basis points for other than the highest rated institutions. The following table sets forth the risk-based and leverage ratios of Alabama National and each Bank at June 30, 2004:

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| | <u>Tier 1 Risk Based</u> | <u>Total Risk Based</u> | <u>Tier 1 Leverage</u> |
|---|------------------------------|-----------------------------|----------------------------|
| Alabama National BanCorporation | 10.22% | 11.47% | 7.36% |
| National Bank of Commerce of Birmingham | 9.88 | 11.03 | 7.30 |
| Alabama Exchange Bank | 14.83 | 16.08 | 7.41 |
| Bank of Dadeville | 12.87 | 14.13 | 7.19 |
| Citizens & Peoples Bank, N.A. | 9.02 | 10.27 | 7.16 |
| Community Bank of Naples, N.A. | 9.56 | 10.81 | 7.64 |
| First American Bank | 9.81 | 11.06 | 7.91 |
| First Citizens Bank | 14.63 | 15.75 | 7.04 |
| First Gulf Bank | 9.58 | 10.83 | 6.74 |
| Georgia State Bank | 10.10 | 11.18 | 6.72 |
| Public Bank | 11.33 | 12.58 | 7.97 |
| Millennium Bank | 11.05 | 12.30 | 7.48 |
| Cypress Bank | 9.44 | 10.68 | 7.09 |
| Indian River National Bank | 10.52 | 11.77 | 6.15 |
| Required minimums | 4.00 | 8.00 | 4.00 |

On February 18, 2004, Alabama National renewed its share repurchase program that expired on December 31, 2003. The renewed plan authorizes the company to repurchase up to 300,000 shares of its common stock and will expire on December 31, 2004. There were no shares repurchased during the six months ended June 30, 2004.

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Item 3 Quantitative and Qualitative Disclosures about Market Risk.

The information required by this item is contained in Item 2 herein under the headings Interest Rate Sensitivity and Market Risk .

Item 4 Controls and Procedures.

As of June 30, 2004, the end of the quarter covered by this report, Alabama National carried out an evaluation, under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of Alabama National's disclosure controls and procedures pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that Alabama National's disclosure controls and procedures are effective in timely alerting them to material information relating to Alabama National that is required to be included in its periodic filings with the Securities and Exchange Commission.

There was no significant change in Alabama National's internal controls over financial reporting during the quarter ended June 30, 2004 that has materially affected, or is reasonably likely to materially affect, Alabama National's internal controls over financial reporting.

Part II. OTHER INFORMATION

Item 4 Submission of Matters to a Vote of Security-Holders.

Alabama National held its Annual Meeting of Stockholders on May 5, 2004. At the meeting, the stockholders of Alabama National were asked to vote on several matters, including the election of 15 directors to serve until the next annual meeting of stockholders. The results of the stockholder voting on all matters submitted to a stockholder vote are summarized as follows:

Proposal 1 - Election of Directors:

| | VOTES FOR | WITHHOLD AUTHORITY |
|----------------------|----------------------|-------------------------------|
| W. Ray Barnes | 12,665,869 | 195,029 |
| Dan M. David | 12,564,732 | 296,166 |
| John V. Denson | 12,479,065 | 381,833 |
| Griffin A. Greene | 12,666,945 | 193,953 |
| John H. Holcomb, III | 12,543,442 | 317,456 |
| John D. Johns | 12,663,258 | 197,640 |
| John J. McMahan, Jr. | 12,474,372 | 386,526 |
| C. Phillip McWane | 12,474,467 | 386,431 |

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| | | |
|-----------------------|------------|-----------|
| William D. Montgomery | 12,665,869 | 195,029 |
| Richard Murray, IV | 12,656,632 | 295,266 |
| Victor E. Nichol, Jr. | 12,564,977 | 295,921 |
| C. Lloyd Nix | 12,655,390 | 205,508 |
| G. Ruffner Page, Jr. | 12,566,072 | 294,826 |
| John Plunk | 10,806,899 | 2,053,999 |
| W. Stancil Starnes | 10,728,993 | 2,131,905 |

Proposal 2 - Adoption of the Alabama National BanCorporation Performance Share and Deferral Plan for Non-Employee Directors of Affiliate Banks:

| <u>VOTES FOR</u> | <u>VOTES AGAINST</u> | <u>ABSTAIN</u> |
|----------------------|--------------------------|----------------|
| 10,487,811 | 417,253 | 56,191 |

Proposal 3 - Ratification of Adoption of the Alabama National BanCorporation Plan for the Deferral of Compensation by Key Employees:

| <u>VOTES FOR</u> | <u>VOTES AGAINST</u> | <u>ABSTAIN</u> |
|----------------------|--------------------------|----------------|
| 10,625,595 | 281,471 | 54,189 |

Proposal 4 - Ratification of Appointment of Independent Registered Public Accounting Firm:

| <u>VOTES FOR</u> | <u>VOTES AGAINST</u> | <u>ABSTAIN</u> |
|----------------------|--------------------------|----------------|
| 12,674,691 | 168,254 | 17,683 |

Item 6 - Exhibits and Reports on Form 8-K.

(a) Exhibits.

| | |
|--------------|--|
| Exhibit 3.1 | Restated Certificate of Incorporation (Filed as an Exhibit to Alabama National's Quarterly Report on Form 10-Q for the quarter ended March 31, 2003 and incorporated herein by reference). |
| Exhibit 3.2 | Amended and Restated Bylaws (filed as an Exhibit to Alabama National's Annual Report on Form 10-K for the year ended December 31, 2003 and incorporated herein by reference). |
| Exhibit 10.1 | Eighth Amendment to the Credit Agreement between Alabama National BanCorporation and AmSouth Bank dated May 31, 2004. |
| Exhibit 10.2 | Sixth Note Modification to the Credit Agreement between Alabama National BanCorporation and AmSouth Bank dated May 31, 2004. |
| Exhibit 31.1 | - Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |

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| | |
|--------------|---|
| Exhibit 31.2 | |
| - | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| Exhibit 32.1 | Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

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(b) Reports on Form 8-K.

Form 8-K to report First Quarter Earnings, furnished on April 21, 2004.

SIGNATURES

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

ALABAMA NATIONAL BANCORPORATION

Date: August 9, 2004

/s/ John H. Holcomb, III
John H. Holcomb, III, its Chairman and Chief Executive Officer

Date: August 9, 2004

/s/ William E. Matthews, V.
William E. Matthews, V., its Executive Vice President and
Chief Financial Officer