

## **Independent Auditors' Report**

To the Stockholders and Board of Directors  
Southern Development Bancorporation, Inc.

We have audited the accompanying consolidated balance sheets of Southern Development Bancorporation, Inc. as of December 31, 2000 and 1999, and the related consolidated statements of income, changes in stockholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. The consolidated financial statements for the year ended December 31, 1998 were audited by other auditors whose report thereon, dated February 25, 1999, expressed an unqualified opinion on those statements.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Southern Development Bancorporation, Inc. as of December 31, 2000 and 1999, and the consolidated results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The accompanying consolidating information on pages 19 and 20 has been subjected to the auditing procedures applied in the audit of the 2000 consolidated financial statements and is presented for purposes of additional analysis of the consolidated financial statements rather than to present financial position and results of operations of the individual companies. Accordingly, we do not express such an opinion on the financial position and results of operations of the individual companies. However, in our opinion, the consolidating information on pages 19 and 20 is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

Little Rock, Arkansas  
March 9, 2001, except for Note Two, as to  
which the date is March 26, 2001

**SOUTHERN DEVELOPMENT BANCORPORATION, INC.**  
**CONSOLIDATED BALANCE SHEETS**

	December 31,	
	2000	1999
<b>Assets</b>		
Cash and due from banks	\$ 13,965,424	\$ 10,580,168
Federal funds sold	5,100,000	17,590,000
Total cash and cash equivalents	19,065,424	28,170,168
Interest bearing deposits in other banks	100,000	-
Investment securities	57,686,452	58,531,321
Loans:		
Commercial, financial and agricultural	38,702,665	26,678,502
Real estate	69,019,116	69,594,205
Installment	18,889,414	21,466,738
Development	31,443,034	26,241,490
Allowance for loan losses	(1,949,166)	(1,942,437)
Net loans	156,105,063	142,038,498
Premises and equipment, net	6,198,653	6,537,992
Rental real estate	2,616,584	2,739,679
Excess cost over fair value of assets acquired	4,350,817	4,746,392
Other assets	6,128,250	6,018,326
<b>Total Assets</b>	<b>\$252,251,243</b>	<b>\$248,782,376</b>
<b>Liabilities</b>		
Deposits:		
Non-interest bearing demand	\$ 24,685,360	\$ 25,225,638
Interest-bearing demand	60,089,781	60,172,479
Savings	14,155,830	13,788,518
Time deposits less than \$100,000	69,020,430	71,801,463
Time deposits greater than or equal to \$100,000	45,776,082	42,817,462
<b>Total deposits</b>	213,727,483	213,805,560
Federal funds purchased and securities sold under agreements to repurchase	1,717,000	200,000
Federal Home Loan Bank advances and other short-term borrowings	1,457,626	1,301,454
Notes payable	9,991,696	10,305,062
Other liabilities	2,168,541	1,970,022
<b>Total liabilities</b>	229,062,346	227,582,098
<b>Stockholders' Equity</b>		
Common stock, \$1 par value; 200,000 shares authorized; shares issued and outstanding:		
Series A-1, 34,711 in 2000 and 1999	34,711	34,711
Series A-2, 41,658 in 2000 and 1999	41,658	41,658
Series A-3, 67,398 in 2000 and 62,398 in 1999	67,398	62,398
Capital surplus	19,337,110	18,342,110
Retained earnings	3,651,151	3,223,301
Accumulated other comprehensive income (loss)	56,869	(503,900)
<b>Total stockholders' equity</b>	23,188,897	21,200,278
<b>Total Liabilities and Stockholders' Equity</b>	<b>\$252,251,243</b>	<b>\$248,782,376</b>

See accompanying notes to consolidated financial statements.

**SOUTHERN DEVELOPMENT BANCORPORATION, INC.**  
**CONSOLIDATED STATEMENTS OF INCOME**

	Years Ended December 31,		
	2000	1999	1998
<b>Interest Income</b>			
Loans, including fees	\$14,262,187	\$13,413,692	\$10,330,355
Investment securities:			
Taxable	3,417,765	3,061,271	2,025,418
Tax exempt	272,089	234,741	171,423
Federal funds sold and other	476,606	573,469	382,256
Total interest income	<u>18,428,647</u>	<u>17,283,173</u>	<u>12,909,452</u>
<b>Interest expense</b>			
Deposits	7,793,274	7,363,954	5,666,309
Other	1,184,686	876,099	544,717
Total interest expense	<u>8,977,960</u>	<u>8,240,053</u>	<u>6,211,026</u>
Net interest income	9,450,687	9,043,120	6,698,426
Provision for loan losses	1,426,596	670,091	538,762
Net interest income after provision for loan losses	8,024,091	8,373,029	6,159,664
<b>Other income</b>			
Service charges on deposit accounts	1,727,747	1,304,024	650,113
Investment securities losses	(6,862)	(68,419)	(6,840)
Fees, commissions and other	1,322,629	1,523,466	932,525
	<u>3,043,514</u>	<u>2,759,071</u>	<u>1,575,798</u>
<b>Other expense</b>			
Salaries and employee benefits	5,798,105	5,337,781	3,484,916
Net occupancy and equipment expense	1,465,376	1,278,212	909,829
Amortization of excess cost of assets acquired	395,575	421,910	196,179
Charitable contribution to affiliated company	225,000	225,000	100,000
Other	2,633,571	3,307,689	2,638,326
	<u>10,517,627</u>	<u>10,570,592</u>	<u>7,329,250</u>
Income before income taxes	549,978	561,508	406,212
Income taxes	122,128	148,661	109,542
<b>Net income</b>	<u><u>\$ 427,850</u></u>	<u><u>\$ 412,847</u></u>	<u><u>\$ 296,670</u></u>

See accompanying notes to consolidated financial statements.

**SOUTHERN DEVELOPMENT BANCORPORATION, INC.**

**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**

	Common Stock		Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
	Shares	Amount				
Balance at January 1, 1998	73,335	\$ 73,335	\$ 7,651,937	\$2,513,784	\$ 84,740	\$10,323,796
Net income	-	-	-	296,670	-	296,670
Common stock issued	47,759	47,759	7,812,324	-	-	7,860,083
Other comprehensive income	-	-	-	-	40,906	40,906
Balance on December 31, 1998	121,094	121,094	15,464,261	2,810,454	125,646	18,521,455
Net income	-	-	-	412,847	-	412,847
Common stock issued	17,673	17,673	2,877,849	-	-	2,895,522
Other comprehensive loss	-	-	-	-	(629,546)	(629,546)
Balance at December 31, 1999	138,767	138,767	18,342,110	3,223,301	(503,900)	21,200,278
Net income	-	-	-	427,850	-	427,850
Common stock issued	5,000	5,000	995,000	-	-	1,000,000
Other comprehensive income	-	-	-	-	560,769	560,769
<b>Balance at December 31, 2000</b>	<b>143,767</b>	<b>\$143,767</b>	<b>\$19,337,110</b>	<b>\$3,651,151</b>	<b>\$ 56,869</b>	<b>\$23,188,897</b>

See accompanying notes to consolidated financial statements.

**SOUTHERN DEVELOPMENT BANCORPORATION, INC.**  
**CONSOLIDATED STATEMENT OF CASH FLOWS**

	<b>Years Ended December 31,</b>		
	<b>2000</b>	<b>1999</b>	<b>1998</b>
<b>Operating Activities</b>			
Net income	\$ 427,850	\$ 412,847	\$ 296,670
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	1,426,596	670,091	538,762
Depreciation	657,035	698,457	620,111
Amortization	395,575	421,910	196,179
Write-down of impaired assets	-	163,194	495,374
Deferred income tax benefit	(61,963)	(58,934)	(167,515)
Net losses on sales of investment securities	6,862	68,419	6,840
Net (increase) decrease in other assets	(47,961)	(1,013,884)	165,791
Net (decrease) increase in other liabilities	(123,019)	25,337	215,148
Net cash provided by operating activities	<u>2,680,975</u>	<u>1,387,437</u>	<u>2,367,360</u>
<b>Investing Activities</b>			
Net increase in interest bearing deposits in other banks	(100,000)	-	-
Purchases of investment securities	(14,729,277)	(30,330,909)	(22,420,507)
Proceeds from sales, maturities and calls of investment securities	16,449,591	26,447,514	26,062,940
Net (increase) decrease in loans	(15,493,161)	78,951	(2,302,893)
Net purchases of premises and equipment	(214,687)	(853,839)	(633,744)
Acquisitions of subsidiaries, net of funds received	-	(1,462,196)	4,092,970
Other	20,086	20,515	21,800
Net cash (used in) provided by investing activities	<u>(14,067,448)</u>	<u>(6,099,964)</u>	<u>4,820,566</u>
<b>Financing Activities</b>			
Net (decrease) increase in deposits	(78,077)	2,994,558	746,779
Net increase in federal funds purchased and securities sold under agreements to repurchase	1,517,000	-	-
Net increase (decrease) in Federal Home Loan Bank borrowings	156,172	(151,528)	-
Proceeds from issuance of long-term debt	-	3,042,195	6,158,990
Repayment of long-term debt	(313,366)	(4,014,895)	(1,766,883)
Net proceeds from issuance of common stock	1,000,000	2,895,522	7,860,083
Net cash provided by financing activities	<u>2,281,729</u>	<u>4,765,852</u>	<u>12,998,969</u>
Net (decrease) increase in cash and cash equivalents	(9,104,744)	53,325	20,186,895
Cash and cash equivalents at beginning of year	<u>28,170,168</u>	<u>28,116,843</u>	<u>7,929,948</u>
Cash and cash equivalents at end of year	<u>\$19,065,424</u>	<u>\$28,170,168</u>	<u>\$28,116,843</u>
<b>Supplemental Disclosures</b>			
Interest paid	\$9,239,349	\$8,032,997	\$5,774,657
Income taxes paid	160,000	434,346	322,500

See accompanying notes to consolidated financial statements

## **SOUTHERN DEVELOPMENT BANCORPORATION, INC.**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2000 and 1999**

#### **NOTE ONE - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

##### **Nature of operations**

Southern Development Bancorporation, Inc. (the "Company") was incorporated in 1986 for the purpose of engaging in activities which foster economic development in economically disadvantaged rural and other less developed communities in the State of Arkansas.

The Company operates five wholly-owned subsidiaries, Elk Horn Bank & Trust Company ("EHB"), a state chartered financial institution located in Arkadelphia, Arkansas; First National Bank of Phillips County ("FNB"), a nationally chartered financial institution located in Helena, Arkansas; Delta State Bank ("DSB"), a state chartered financial institution located in Elaine, Arkansas; Opportunity Lands Corporation ("OLC"), a real estate development corporation engaged in low and moderate-income real estate development activities in rural communities throughout Arkansas; and Southern Data Center, Inc. ("SDC"), a data processing organization incorporated on November 21, 2000 to provide data processing services to the Company and its subsidiary organizations.

Southern Development Mortgage, Inc. ("SDM"), a wholly owned subsidiary of EHB, originates mortgage loans to single family residential home buyers, and is a Title II Nonsupervised Mortgagee under U.S. Department of Housing and Urban Development regulations.

##### **Consolidation**

The consolidated financial statements include the accounts of the Company, EHB, FNB, DSB OLC, and SDC. All significant intercompany accounts and transactions have been eliminated in consolidation.

##### **Use of estimates**

The consolidated financial statements are prepared in accordance with generally accepted accounting principles that require management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

##### **Trust department assets**

Property, other than cash deposits, held by the Company in a fiduciary or agency capacity for its customers is not included in the accompanying consolidated balance sheets, since such items are not assets of the Company.

##### **Cash and cash equivalents**

The Company considers cash, due from banks and federal funds sold to be cash and cash equivalents for purposes of the Consolidated Statements of Cash Flows. Federal funds sold generally mature within one to four days from the transaction date. In certain instances, the Company's federal funds sold and deposits with correspondent banks may significantly exceed the Federal Deposit Insurance Corporation's insurance

limit. It is the Company's policy to only sell funds and place deposits with institutions it considers to be of high credit quality.

### **Investment securities**

Investment securities are classified as available-for-sale and consist of securities the Company intends to hold for an indefinite period of time, but not necessarily to maturity. Investment securities available-for-sale are carried at fair value, with unrealized gains and losses, net of deferred income taxes, reported as increases or decreases in accumulated other comprehensive income, a separate component of stockholders' equity.

The amortized cost of investment securities is adjusted for amortization of premiums and accretion of discounts to maturity, or in the case of mortgage or asset-backed securities, over the life of the security. Such amortization and accretion is included in interest income. Realized gains and losses and declines in value judged to be other than temporary are included in current earnings. The cost of securities sold for purposes of recognizing gains or losses is based on the specific identification method.

### **Loans and allowance for loan losses**

Loans are reported at the principal amount outstanding, net of the allowance for loan losses. When loans are originated, collateral is obtained based on management's credit assessment of the customer. Interest income on loans is calculated using the simple interest method on daily balances of the principal amount outstanding.

The accrual of interest is discontinued on loans that are greater than ninety days delinquent or for which collection is doubtful. Loans on which the accrual of interest has been discontinued are designated as nonaccrual loans and income on such loans is recognized only to the extent that cash is received and where the future collection of principal is probable. Nonaccrual loans totaled approximately \$3,908,000 and \$4,070,000 at December 31, 2000 and 1999, respectively.

The allowance for loan losses is maintained at a level that in management's judgment is adequate to absorb credit losses inherent in the loan portfolio. The amount of the allowance is based on management's evaluation of various factors affecting the loan portfolio including the nature of the portfolio, credit concentrations, trends in historical loss experience, specific impaired loans, and economic conditions. Allowances for impaired loans are generally determined based on collateral values or the present value of expected future cash flows. The allowance is increased by a provision for loan losses that is charged to expense and reduced by loan charge-offs, net of recoveries. Changes in the allowance relating to impaired loans are charged or credited to the provision for loan losses. Because of uncertainties associated with the estimation process, it is reasonably possible that management's estimate of credit losses inherent in the loan portfolio and the related allowance may change in the near term.

### **Premises and equipment**

Premises and equipment are stated at cost, less accumulated depreciation. Depreciation is computed on a straight-line basis over the estimated useful lives of the assets.

### **Rental real estate**

Rental real estate is stated at cost, less accumulated depreciation with depreciation computed on a straight-line basis over the estimated useful lives of the assets. Rental income is recognized when earned. The Company leases residential real estate under operating leases with terms of one year or less. The Company leases non-residential real estate under various agreements with terms generally ranging from one to three-years, which are accounted for as operating leases. Future minimum noncancellable lease payments receivable at December 31, 2000 were not significant.

### **Impairment of Long-lived assets**

Impairment losses on long-lived assets to be held and used are recognized whenever events or changes in circumstances result in the carrying value of assets exceeding the sum of the expected future cash flows. Measurement and recognition of impairment losses is based on the difference between fair value and book value of long-lived assets. Long-lived assets to be disposed of are reported at the lower of book value or fair value less cost to sell.

### **Other Real Estate Owned**

Other real estate owned is classified in other assets and includes property received in satisfaction of debt. Other real estate owned is initially recorded and subsequently carried at the lower of cost or fair value less estimated selling cost. Any valuation adjustments required at the date of transfer are charged to the allowance for loan losses. Subsequently, unrealized losses and realized gains and losses on sales of other real estate owned are typically included in other expense. Operating results from other real estate are recorded in other noninterest expense.

### **Excess of cost over fair value of net assets acquired**

Cost in excess of fair value of underlying net tangible assets acquired was \$6,426,154 at December 31, 2000 and 1999, respectively, and is being amortized using the straight-line method over a time period ranging from 15 to 22.5 years.

### **Grant income**

The Company has received various interest-free loans from the City of Pine Bluff, Arkansas and the Arkansas Development Finance Authority to finance the rehabilitation of low income, single and multi-family residences in Pine Bluff and Helena, Arkansas. Subject to certain conditions, the loans are being forgiven ratably over five to ten year periods. The Company is recognizing grant income, using the straight-line method over the ten-year period, as the loans are forgiven. The Company has the ability and management has the intent to retain ownership of financed projects until the loans have been forgiven in full.

### **Income taxes**

The Company and its subsidiaries file consolidated federal and state income tax returns. It is the Company's practice to have its subsidiaries pay to or receive from the Company amounts based on the separately determined taxable income or loss of the subsidiaries.

Deferred taxes are provided based on the provisions of Statement of Financial Accounting Standards, ("SFAS") Number 109, *Accounting for Income Taxes*. SFAS 109 requires recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax liabilities and assets are determined based on the difference between the financial statement and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse.

### **Reclassifications**

Certain 1999 and 1998 amounts have been reclassified to conform to the 2000 presentation.

## NOTE TWO – BUSINESS COMBINATIONS

During 1998 and 1999, the Company acquired 100% of the outstanding common stock of First Delta Corporation in exchange for cash of \$14,620,589. The acquisition was accounted for as a purchase and, as such, the operations of the Company include the operations of FDC, FNB and DSB from the original date of acquisition.

On January 2, 2001, the Company received approval from the Office of the Comptroller of the Currency to merge Delta State Bank with and into First National Bank of Phillips County. Both banking organizations are wholly owned subsidiaries of the Company and the merger will be accounted for at historical cost in a manner similar to pooling-of-interest accounting. The Company anticipates that the merger will be consummated prior to April 30, 2001.

On March 20, 2001, the Company executed an agreement to acquire 100% of the common stock of Delta Bank & Trust of Drew, Mississippi for \$1,762,500 in cash. This transaction will be accounted for as a purchase and, as such, the operations of Delta Bank & Trust will be included in the Company's operations from the date of purchase. This transaction is subject to approval from the appropriate regulatory authorities.

On March 20, 2001 and March 26, 2001, the Company entered into agreements to acquire the assets and assume the liabilities of seven branch bank operations currently owned by Union Planters Bank, N.A. for \$3,976,131 in cash. The branches to be acquired are located in the Arkansas and Mississippi Delta region. These transactions will be accounted for as a purchase and, as such, the bank branch operations will be included in the Company's operations from the date of purchase. These transactions are subject to approval by the appropriate regulatory authorities.

## NOTE THREE - INVESTMENT SECURITIES

At December 31, 2000 and 1999, investment securities available-for-sale consisted of the following:

	<b>December 31, 2000</b>			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government agency securities	\$38,767,622	\$223,242	\$116,943	\$38,893,921
State and municipal obligations	5,383,225	4,765	8,597	5,379,393
Mortgage and asset-backed securities	11,847,890	-	16,302	11,831,588
Other	1,581,550	-	-	1,581,550
	<u>\$57,600,287</u>	<u>\$228,007</u>	<u>\$141,842</u>	<u>\$57,686,452</u>
	<b>December 31, 1999</b>			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government agency securities	\$45,261,521	\$ 6,291	\$695,481	\$44,572,331
State and municipal obligations	5,039,188	50,098	84,897	5,004,389
Mortgage and asset-backed securities	7,804,206	33,381	105,536	7,732,051
Other	1,222,550	-	-	1,222,550
	<u>\$59,327,465</u>	<u>\$89,770</u>	<u>\$885,914</u>	<u>\$58,531,321</u>

The components of gains and losses on sales of investment securities are as follows:

	Years Ended December 31,		
	2000	1999	1998
Gross gains on sales of securities	\$ -	\$ -	\$ 26,314
Gross losses on sales of securities	(6,862)	(68,419)	(33,154)
Gains (losses) on sales of securities	<u>\$(6,862)</u>	<u>\$(68,419)</u>	<u>\$ (6,840)</u>

Investment securities with a carrying value of approximately \$42,057,000 and \$41,105,000 were pledged as collateral to secure public deposits and for other purposes at December 31, 2000 and 1999, respectively. Accumulated other comprehensive income consists entirely of unrealized gains and losses on investment securities available-for-sale, net of the related deferred income tax effect of \$67,330, \$292,243 and \$67,330 at December 31, 2000, 1999 and 1998, respectively.

The amortized cost and estimated fair value of investment securities at December 31, 2000, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Estimated Fair Value
Due in one year or less	\$12,909,597	\$12,849,297
Due after one year through five years	29,078,516	29,253,326
Due after five years through ten years	1,694,851	1,677,550
Due after ten years	2,069,433	2,074,691
Mortgage and other asset backed securities	11,847,890	11,831,588
	<u>\$57,600,287</u>	<u>\$57,686,452</u>

#### **NOTE FOUR –ALLOWANCE FOR LOAN LOSSES AND NONPERFORMING LOANS**

Transactions in the allowance for loan losses are summarized below for the years ended December 31:

	2000	1999	1998
Balance at January 1	\$1,942,437	\$1,991,090	\$1,837,189
Provision for loan losses	1,426,596	670,091	538,762
Charge-offs	(1,609,563)	(843,579)	(513,893)
Recoveries	189,696	124,835	129,032
Net charge-offs	<u>(1,419,867)</u>	<u>(718,744)</u>	<u>(384,861)</u>
Balance at December 31	<u>\$1,949,166</u>	<u>\$1,942,437</u>	<u>\$1,991,090</u>

The Company had loans totaling \$6,703,992 and \$6,290,358 that were specifically classified as impaired at December 31, 2000 and 1999, respectively. Loans totaling \$454,533 and \$1,385,351 had related specific allocations within the allowance for loan losses totaling \$286,061 and \$632,485 at December 31, 2000 and 1999, respectively. The average recorded investment in impaired loans during 2000 and 1999 was approximately \$6,497,000 and \$5,400,000, respectively.

## NOTE FIVE – PREMISES AND EQUIPMENT

Premises and equipment consists of the following at December 31:

	2000	1999
Land	\$ 632,075	\$ 614,936
Building and building improvements	6,167,139	6,387,795
Furniture, fixtures and equipment	4,364,748	4,580,252
	<u>11,163,962</u>	<u>11,582,983</u>
Less accumulated depreciation	(4,965,309)	(5,044,991)
	<u>\$ 6,198,653</u>	<u>\$ 6,537,992</u>

## NOTE SIX – NOTES PAYABLE

Notes payable at December 31 are summarized as follows:

	2000	1999
<b>Southern Development Bancorporation-Parent Company</b>		
\$9,605,000 line of credit with an unrelated financial institution; interest payable quarterly at a variable interest rate of prime less .5% (9.00% at December 31, 2000); maturity date of December 15, 2000; secured by common stock of EHB and FNB	\$7,735,000	\$ 7,735,000
Senior, unsecured note payable to a private foundation; interest due quarterly at a per annum interest rate of 1.00%; principal due in annual installments of \$125,000, with final payment of \$1,000,000 due at maturity on May 3, 2002	1,125,000	1,250,000
Unsecured capital notes; due at maturity on August 25, 2001 and 2004; interest due annually; per annum interest rates range from 7.50% to 9.00%	<u>343,280</u>	<u>343,280</u>
	9,203,280	9,328,280
<b>Opportunity Lands Corporation</b>		
Note payable to an unrelated financial institution; principal and interest payable monthly; per annum interest rate of 7.75%; maturity date of October 26, 2001; secured by real estate	470,480	519,714
Note payable to Arkansas Enterprise Group; principal and interest payable monthly; per annum interest rate of 8.00%, maturity date of February 14, 2001; secured by equipment, inventory and real estate	117,248	130,581
Note payable to the Arkansas Development Finance Authority; principal and interest payable monthly; per annum interest rate of 6.00%; maturity date of December 31, 2003, secured by real estate	95,739	105,136
Various notes payable to the Arkansas Development Finance Authority and the City of Pine Bluff; principal forgiven annually, zero per annum interest rate, secured by real estate	<u>104,949</u>	<u>221,351</u>
	788,416	976,782
Total Notes Payable	<u>\$9,991,696</u>	<u>\$10,305,062</u>

The senior unsecured note payable places certain restrictions on the Company, including restrictions on dividend payments and the maintenance of certain capital ratios by both the Company and its banking

subsidiaries (the “Banks”). The Company and the Banks were in compliance with all such restrictions at December 31, 2000.

In January 2001, the Company entered into a \$12 million line of credit agreement with an unrelated bank. This line of credit agreement bears interest at .75% below prime, matures on January 2, 2013 and was used to pay-off substantially all of Opportunity Lands Corporation’s outstanding debt as well as the \$9.6 million line of credit agreement reflected above. The Company’s initial advance on this line of credit agreement was \$8.8 million. The \$12 million line of credit agreement is secured by all of the capital stock of EHB and FNB

Annual principal payments on notes payable from 2001 through 2005, after giving effect to the revised repayment terms and conditions of the \$12 million line of credit agreement are approximately \$156,000, \$1,000,000, -0-, \$312,000, -0- and \$8,848,000 thereafter.

**NOTE SEVEN – STOCKHOLDERS’ EQUITY**

The Company has three series of Common Stock: Series A-1, nonvoting, convertible; Series A-2, voting; and Series A-3, nonvoting, nonconvertible. Shares of Series A-1 Common Stock are convertible into shares of Series A-2 Common Stock subject to the conditions set forth below. The three series of Common Stock are equivalent in all respects other than voting and conversion rights and are on parity with each other. The Company also has 1,000 shares of \$1 per share preferred stock authorized, with none outstanding.

Shares of Series A-1 Common Stock are convertible at the option of the holder into Series A-2 Common Stock on a one-for-one basis. Shares of Series A-1 Common Stock do not become convertible into shares of Series A-2 Common Stock for five years from the date of issue. In addition, no conversion of shares of Series A-1 Common Stock will be permitted if the conversion would cause the holder of such shares to become a bank holding company within the meaning of Section 2(a) of the Bank Holding Company Act of 1956, as amended, or the Arkansas Bank Holding Company Act.

In compliance with national bank regulations, the Company has issued non-recourse notes receivable totaling \$16,170 with directors of FNB for purchase of directors' qualifying shares in the Company. These notes receivable are netted against capital surplus in the consolidated financial statements.

On December 31, 2000 and February 28, 2001, Elk Horn Bank & Trust Company and First National Bank of Phillips County paid non-cash property dividends totaling \$206,620 and \$499,285, respectively, to the Company. The banks’ property was dividended at its estimated fair market value and was comprised primarily of data processing equipment. The Company capitalized Southern Data Center, Inc. with \$37,101 of its own data processing equipment plus the similar equipment received from EHB and FNB, as stated above.

**NOTE EIGHT – INCOME TAXES**

The components of income tax expense consists of the following for the years ended December 31:

	<u>2000</u>	<u>1999</u>	<u>1998</u>
Income tax expense (benefit):			
Current			
Federal	\$184,091	\$217,447	\$252,935
State	-	(9,852)	24,122
	<u>184,091</u>	<u>207,595</u>	<u>277,057</u>
Deferred - Federal	<u>(61,963)</u>	<u>(58,934)</u>	<u>(167,515)</u>
	<u>\$122,128</u>	<u>\$148,661</u>	<u>\$109,542</u>

The income tax provision computed at the federal statutory rate on pretax income differs from the reported tax provision primarily due to tax-exempt interest income, low-income housing credits, and amortization of cost in excess of fair value of net assets acquired.

The components of net deferred tax assets are as follows at December 31:

	<u>2000</u>	<u>1999</u>
Deferred tax assets:		
Allowance for loan losses	\$ 405,801	\$ 449,111
Low income housing and rehabilitation credits	339,496	305,593
Net unrealized loss on available-for-sale securities	-	292,243
Charitable contribution carryover	114,877	53,745
Other	110,489	115,462
	<u>970,663</u>	<u>1,216,154</u>
Deferred tax liabilities:		
Goodwill allocated to fixed assets	456,652	468,816
Excess income tax depreciation	72,902	62,357
Other	123,095	107,392
	<u>652,649</u>	<u>638,565</u>
Net deferred tax asset	<u>\$318,014</u>	<u>\$ 577,589</u>

Included in deferred tax assets at December 31, 2000 and 1999 are \$339,496 and \$305,593, respectively, in tax credits that cannot be utilized currently by the consolidated group. These unused tax credits expire in 2009 through 2012. Management believes that sufficient taxable income will be generated in future periods to utilize the tax credits before their expiration dates. Accordingly, a valuation allowance has not been established.

#### **NOTE NINE – EMPLOYEE BENEFIT PLANS**

The Company maintains a retirement savings and profit sharing plan covering substantially all employees meeting certain age and length of service requirements. Under the plan, for each participant's salary deferral contribution of up to 6% of total compensation, the Company makes a 50% matching contribution. The Plan also provides for annual discretionary employer profit-sharing contributions based on a percentage of each employee's base salary. Company contributions to the plan were \$307,320, \$279,796 and \$153,097 for the years ended December 31, 2000, 1999 and 1998, respectively.

#### **NOTE TEN – COMMITMENTS AND CONCENTRATIONS**

In the normal course of business, the Company has various commitments outstanding, including commitments to extend credit, standby letters of credit and mortgage loans in the process of origination which are not reflected in the accompanying consolidated financial statements. The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instruments for such commitments is represented by the contractual or notional amount of those instruments.

The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies but may include real estate, accounts receivable, inventory, property and equipment, and income-producing commercial properties. The Company uses the same credit policies in making such commitments as it does for instruments that are included in the consolidated balance sheet.

The Company's commitments consisted of the following at December 31:

	2000	1999
Unfunded commitments to extend credit	\$31,290,000	\$11,369,000
Standby letters of credit	410,000	460,000
Mortgage loans in process of origination	409,000	214,000
	<u>\$32,109,000</u>	<u>\$12,043,000</u>

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party and are primarily issued to support public and private borrowing arrangements and similar transactions. Because these instruments have fixed maturity dates, and often expire without being drawn upon, they do not generally present any significant liquidity risk to the Company. Mortgage loans in the process of origination represent amounts that the Company plans to fund within a period of approximately 60 days and which are intended for sale to investors in the secondary market.

At December 31, 2000 and 1999, the Company had development loans outstanding of \$31,443,034 and \$26,241,490, respectively. Loans are considered development loans if (i) the loan was made in conjunction with a government guarantee program, such as those sponsored by the Small Business Administration, (ii) loans made in underserved or undeveloped markets and loans to minority-owned businesses, women-owned businesses, or businesses necessary to enhance a communities infrastructure, (iii) loans that provide economic enhancement to rural or underserved markets by creating or maintaining local jobs and business activities, (iv) loans less than \$25,000, excluding consumer loans, (v) loans which support low to moderate-income housing initiatives and (vi) agricultural loans of \$250,000 or less or which meet any of the above criteria. In general, development loans provide working capital to new or undercapitalized businesses and carry a higher degree of risk than a traditional bank loan.

The Company, EHB and FNB are designated as Community Development Financial Institutions by the United States Treasury Department's Community Development Financial Institutions Fund (the "Fund"). Financial assistance in the form of equity contributions from the Fund have been received in order to assist the Company in expanding its development lending activities in the region of eastern Arkansas commonly referred to as the Arkansas Delta. The Company, by accepting this assistance, has executed an Assistance Agreement that imposes certain performance goals, consisting primarily of benchmark levels of development lending to geographically and economically targeted individuals, as defined in the agreement. Failure to meet these performance goals may subject the Company to reduced levels of future funding or, under certain circumstances, require assistance received by the Fund to be repaid. Management believes the Company has achieved performance goals that will permit it to retain assistance received through December 31, 2000 and that it will qualify for future assistance from the Fund.

#### **NOTE ELEVEN – REGULATORY REQUIREMENTS AND RESTRICTIONS**

In the normal course of business the Company and its subsidiaries enter into agreements, or are subject to regulatory requirements, that result in cash, debt and dividend restrictions. A summary of the most restrictive items follows:

The Company's banking subsidiaries are required to maintain average reserve balances with the Federal Reserve Bank. At December 31, 2000, the Company's required average reserve balance was approximately \$2,270,000.

Under current Federal Reserve regulations, the banking subsidiaries are limited in the amount they may loan to an affiliated organization, including the Company. Loans to a single affiliate may not exceed 10% and loans to all affiliates may not exceed 20% of the bank's capital, surplus and undivided profits plus the

allowance for loan losses less intangible assets. Based on these limitations, approximately \$2.6 million was available for loan to the Company at December 31, 2000.

The approval of the Comptroller of the Currency for the Company's national bank subsidiary and the Arkansas State Banking Department for the Company's state bank subsidiaries is required if the total of all dividends declared by the national bank subsidiary in any calendar year exceeds the bank's net income for that year combined with its retained net income for the preceding two calendar years. Dividends paid by the state bank subsidiaries are limited to 75% of current year net income plus 75% of prior year retained net income. As a result of dividend restrictions, approximately \$848,000 of consolidated net assets of the Company's banking subsidiaries was available for transfer to the Company in the form of cash dividends at December 31, 2000.

The Company and its banking subsidiaries are subject to various regulatory capital requirements administered by federal banking agencies. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and its banking subsidiaries must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classifications are also subject to qualitative judgments by bank regulators about components, risk weightings, and other factors. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary actions by bank regulators that, if undertaken, could have a direct material effect on the Company's financial statements.

The Company and its banking subsidiaries are required to maintain minimum Tier 1 leverage capital, Tier 1 risk based capital and total risk-based capital ratios of 3%, 4% and 8%, respectively. The Company and its subsidiary banks meet all capital adequacy requirements to which they are subject.

At December 31, 2000 and 1999, the Company and its subsidiary banks were categorized as well capitalized under the regulatory framework for prompt corrective action. To be well capitalized, the banking subsidiaries must maintain a Tier 1 leverage ratio, Tier 1 capital ratio and total risk-based capital ratio of no less than 5%, 6% and 10%, respectively.

The following table presents both the actual and minimum capital ratios for the Company and its banking subsidiaries on December 31:

	2000	1999	Required
Tier 1 Leverage Capital Ratios:			
<b>Southern Development Bancorporation</b>	7.74%	7.19%	3.00%
Elk Horn Bank & Trust Company	8.89%	8.55%	4.00%
First National Bank of Phillips County	10.37%	9.99%	4.00%
Delta State Bank	8.88%	7.51%	4.00%
Tier 1 Risk Based Capital Ratios:			
<b>Southern Development Bancorporation</b>	10.95%	10.87%	4.00%
Elk Horn Bank & Trust Company	11.92%	12.38%	4.00%
First National Bank of Phillips County	15.53%	14.12%	4.00%
Delta State Bank	26.94%	18.85%	4.00%
Total Capital to Risk Weighted Assets Ratios:			
<b>Southern Development Bancorporation</b>	12.09%	12.10%	8.00%
Elk Horn Bank & Trust Company	13.04%	13.72%	8.00%
First National Bank of Phillips County	16.68%	15.10%	8.00%
Delta State Bank	27.94%	20.11%	8.00%

## **NOTE TWELVE – RELATED PARTY TRANSACTIONS**

The Company engages in banking transactions with its executive officers and directors in the ordinary course of business. Such transactions have been on similar terms, including interest rates and collateral on loans, as those prevailing at the time for comparable transactions with others. In management's opinion, these loans do not involve more than normal risk of collectability or other potentially unfavorable aspects. Loans made to such borrowers (including companies in which they are principal owners) amounted to \$10,888,726 and \$8,981,325 at December 31, 2000 and 1999, respectively.

During 2000, 1999 and 1998, the Company received rental income of \$18,060, \$18,420 and \$30,480, respectively, and management fee income of \$99,120, \$150,292 and \$173,640, respectively, from Arkansas Enterprise Group ("AEG"), a 501(c)(3) non-profit organization and a stockholder of the Company. The Company made charitable contributions to AEG of \$225,000, \$225,000 and \$100,000 in 2000, 1999 and 1998 respectively.

AEG and its wholly owned subsidiary, Southern Ventures, Inc. maintained cash deposits with the Company's subsidiary banks of \$2,474,642 and \$1,308,181, respectively, at December 31, 2000 and \$2,592,026 and \$1,748,137, respectively, at December 31, 1999. Additionally, the Company had loans from AEG totaling \$117,248 and \$130,581 at December 31, 2000 and 1999, respectively.

## **NOTE THIRTEEN – FAIR VALUE OF FINANCIAL INSTRUMENTS**

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. The valuation techniques are significantly affected by assumptions used, including discount rates and estimates of future cash flows. In that regard, derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of a financial instrument. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts. Also, the fair value estimates presented are based on pertinent information available to management as of December 31, 2000 and 1999.

**Investment securities** - Fair values are based on quoted market prices. If a quoted market price is not available, fair value is estimated using market prices for similar securities.

**Loans** - Fair value is estimated by discounting future cash flows using the current rates at which similar loans would be made to borrowers of similar credit quality and for similar remaining maturities.

**Deposit liabilities** - The fair value of demand and savings deposits is equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). Fair values for variable rate time deposits approximate their fair value at the reporting date. Fair values for fixed rate time deposits are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on those deposits.

**Notes payable** - Fair value is estimated using discounted cash flow analyses, based on the Company's current incremental borrowing rate for similar types of borrowing arrangements.

**Off-balance-sheet instruments** - Fair value is estimated using the fees currently charged to enter into similar arrangements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties' credit standing for loan commitments and letters of credit and the estimated amount the Company would receive or pay to terminate or replace the contract at current market rates for the remainder of the off-balance sheet instruments. For fixed rate loan commitments, fair value also considers the difference between current levels of interest rates and committed rates. The fair value of off-balance-sheet instruments at December 31, 2000 and 1999 is estimated to equal their contractual amounts.

Many of the Company's assets and liabilities are short-term financial instruments whose carrying values reported in the consolidated financial statements approximate fair value. These items include cash and cash equivalents, interest-bearing deposits in other banks, federal funds purchased and securities sold under agreements to repurchase and accrued interest receivable and payable. The following table summarizes the estimated fair value of the Company's remaining on-balance sheet financial instruments as of December 31:

	2000		1999	
	Carrying Value	Fair Value	Carrying Value	Fair Value
<b>Financial Assets:</b>				
Investment securities	\$57,686,452	\$57,686,452	\$ 58,531,321	\$ 58,531,321
Loans, net of allowance			142,038,498	140,242,416
<b>Financial liabilities:</b>				
Deposits			213,805,560	213,991,007
Notes payable			9,991,696	9,693,174

#### NOTE 14 – SOUTHERN DEVELOPMENT BANCORPORATION, INC. (PARENT COMPANY)

The following is a condensed balance sheet of the parent company at December 31:

	2000	1999
<b>Assets</b>		
Cash held at subsidiary banks	\$ 1,103,406	\$ 1,280,516
Investment in consolidated subsidiaries:		
Bank subsidiaries	27,290,665	25,490,594
Nonbank subsidiaries	2,398,858	2,213,464
Property and equipment	97,982	121,222
Other	1,616,718	1,910,322
	<u>\$32,507,629</u>	<u>\$31,016,118</u>
<b>Liabilities and Stockholders' Equity</b>		
Notes payable	\$ 9,203,280	\$ 9,328,280
Other	115,452	487,560
Stockholders' equity	23,188,897	21,200,278
	<u>\$32,507,629</u>	<u>\$31,016,118</u>

The following is a condensed income statement of the parent company for the three-year period ended December 31:

	2000	1999	1998
<b>Income</b>			
Dividends from bank subsidiaries	\$ 694,110	\$1,760,000	\$800,000
Other	386,973	553,020	403,559
Total income	<u>1,081,083</u>	<u>2,313,020</u>	<u>1,203,559</u>
<b>Expenses</b>			
Interest expense	707,155	635,616	264,810
Goodwill amortization	121,022	121,022	115,569
Charitable contribution to AEG	225,000	225,000	100,000
Other	1,540,526	1,493,033	976,334
Total expense	<u>2,593,703</u>	<u>2,474,671</u>	<u>1,456,713</u>
Net loss before income tax benefit and equity in undistributed earnings of subsidiaries	(1,512,620)	(161,651)	(253,154)
Income tax benefit	(753,886)	(639,174)	(361,143)
Equity in undistributed earnings (loss) of subsidiaries	1,186,584	(64,676)	188,681
<b>Net Income</b>	<u>\$ 427,850</u>	<u>\$412,847</u>	<u>\$296,670</u>

The following is a condensed statement of cash flows for the parent company for the three-year period ended December 31:

	<u>2000</u>	<u>1999</u>	<u>1998</u>
<b>Operating Activities</b>			
Net income	\$ 427,850	\$ 412,847	\$ 296,670
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity in undistributed (earnings) loss of subsidiaries	(1,186,584)	64,676	(188,681)
Depreciation and amortization	163,075	148,167	143,232
Deferred taxes (benefit)	(51,993)	(5,150)	55,307
Net decrease (increase) in other assets	224,567	(260,619)	(84,442)
Net (decrease) increase in other liabilities	(372,108)	232,292	133,375
Net cash (used in) provided by operating activities	<u>(795,193)</u>	<u>592,213</u>	<u>355,461</u>
<b>Investing Activities</b>			
Net purchases of premises and equipment	(18,805)	(64,985)	(25,410)
Acquisitions of subsidiaries, net of funds received	-	(1,462,196)	(13,158,573)
Capital contribution to subsidiary	(238,112)	(2,595,767)	(400,000)
Net cash used in investing activities	<u>(256,917)</u>	<u>(4,122,948)</u>	<u>(13,583,983)</u>
<b>Financing Activities</b>			
Repayment of notes payable	(125,000)	(125,000)	(760,000)
Proceeds from issuance of notes payable	-	1,610,000	5,825,000
Net proceeds from issuance of common stock	1,000,000	2,895,522	7,860,083
Net cash provided by financing activities	<u>875,000</u>	<u>4,380,522</u>	<u>12,925,083</u>
Net (decrease) increase in cash and cash equivalents	(177,110)	849,787	(303,439)
Cash and cash equivalents at beginning of year	<u>1,280,516</u>	<u>430,729</u>	<u>734,168</u>
Cash and cash equivalents at end of year	<u>\$1,103,406</u>	<u>\$1,280,516</u>	<u>\$430,729</u>