Bancorp, Inc.
Form 10-Q
August 04, 2009
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended: June 30, 2009

OR

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

For the transition period from: to

Commission file number: 51018

THE BANCORP, INC.

(Exact name of registrant as specified in its charter)

Delaware	**23-3016517**
(State or other jurisdiction of	*(IRS Employer*
incorporation or organization)	*Identification No.)*

409 Silverside Road

Wilmington, DE 19809

(Address of principal executive offices)

(Zip code)

Registrant s telephone number, including area code: (302) 385-5000

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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

(Check one):

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨	Smaller reporting company	¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ¨ No x

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

As of July 25, 2009, there were 14,563,919 outstanding shares of Common Stock, $1.00 par value.

Table of Contents

THE BANCORP, INC

Form 10-Q Index

	Page
Part I Financial Information	
Item 1. Financial Statements:	2
Consolidated Balance Sheets June 30, 2009 (unaudited) and December 31, 2008	3
Unaudited Consolidated Income Statements Six months ended June 30, 2009 and 2008	4
Unaudited Consolidated Statements of Changes in Shareholders Equity Six months ended June 30, 2009	5
Unaudited Consolidated Statements of Cash Flows Six months ended June 30, 2009 and 2008	6
Unaudited Notes to Consolidated Financial Statements	7
Item 2. Management s discussion and Analysis of Financial Condition and Results of Operations	20
Item 3. Quantitative and Qualitative Disclosures About Market Risk	33
Item 4. Controls and Procedures	33
Part II Other Information	
Item 4. Submission of Matters to a Vote of Security Holders	33
Item 6. Exhibits	34
Signatures	34

Table of Contents

PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

THE BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

	June 30, 2009 (unaudited)	December 31, 2008
	(dollars in thousands)	
ASSETS		
Cash and cash equivalents		
Cash and due from banks	$ 69,950	$ 90,744
Interest bearing deposits	2,047	1,033
Federal funds sold	12,102	87,729
Total cash and cash equivalents	84,099	179,506
Investment securities, available-for-sale, at fair value	119,781	82,929
Investment securities, held-to-maturity (fair value $17,369 and $18,408, respectively)	23,542	23,529
Loans, net of deferred loan costs	1,459,965	1,449,349
Allowance for loan and lease losses	(18,080)	(17,361)
Loans, net	1,441,885	1,431,988
Premises and equipment, net	8,129	8,279
Accrued interest receivable	7,499	7,799
Intangible assets, net	10,505	11,005
Other real estate owned		4,600
Deferred tax asset, net	23,017	22,847
Other assets	13,121	19,893
Total assets	$ 1,731,578	$ 1,792,375
LIABILITIES		
Deposits		
Demand (non-interest bearing)	$ 410,663	$ 340,013
Savings, money market and interest checking	903,514	804,502
Time deposits	155,888	357,831
Time deposits, $100,000 and over	20,420	23,016
Total deposits	1,490,485	1,525,362
Securities sold under agreements to repurchase	2,394	9,419
Short-term borrowings	41,000	61,000
Accrued interest payable	406	2,475
Subordinated debentures	13,401	13,401
Other liabilities	2,613	315

Total liabilities	1,550,299	1,611,972
SHAREHOLDERS EQUITY		
Preferred stock - authorized 5,000,000 shares, series A, $0.01 par value; 108,136 shares issued and outstanding at June 30, 2009 and December 31, 2008;	1	1
Series B, $1,000 liquidation value, 45,220 shares issued and outstanding at June 30, 2009 and December 31, 2008	38,610	39,028
Common stock - authorized, 20,000,000 shares of $1.00 par value; 14,563,919 shares issued and outstanding at June 30, 2009 and December 31, 2008	14,563	14,563
Additional paid-in capital	146,293	145,156
Accumulated deficit	(17,029)	(17,517)
Accumulated other comprehensive loss	(1,159)	(828)
Total shareholders equity	181,279	180,403
Total liabilities and shareholders equity	$ 1,731,578	$ 1,792,375

The accompanying notes are an integral part of these statements.

Table of Contents

THE BANCORP, INC. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENT OF OPERATIONS

	For the three months ended June 30,		For the six months ended June 30,	
	2009	2008	2009	2008
	(dollars in thousands, except per share data)			
Interest income				
Loans, including fees	$ 18,259	$ 21,942	$ 36,503	$ 45,231
Investment securities	1,781	1,432	2,858	3,038
Interest bearing deposits	2		5	
Federal funds sold	26	134	119	482
	20,068	23,508	39,485	48,751
Interest expense				
Deposits	3,701	9,260	7,915	20,370
Securities sold under agreements to repurchase	5	12	16	26
Short-term borrowings	171	1,079	220	2,053
Subordinated debt	222	236	449	485
	4,099	10,587	8,600	22,934
Net interest income	15,969	12,921	30,885	25,817
Provision for loan and lease losses	2,500	3,350	5,500	4,700
Net interest income after provision for loan and lease losses	13,469	9,571	25,385	21,117
Non-interest income				
Service fees on deposit accounts	359	388	636	537
Merchant credit card deposit fees	172	285	404	555
Stored value processing fees	1,681	1,956	4,040	4,487
Gain on sales of securities	670		670	
Other than temporary impairment on securities available for sale		(8,275)		(8,275)
Leasing income	410	74	471	290
ACH processing fees	138	62	264	120
Other	373	259	646	511
Total non-interest income (loss)	3,803	(5,251)	7,131	(1,775)
Non-interest expense				
Salaries and employee benefits	5,628	5,165	11,763	10,116
Occupancy expense	1,357	1,176	2,704	2,251
Data processing expense	1,758	1,070	3,486	2,046
Advertising	262	191	508	378
Professional fees	915	803	1,530	1,323
Amortization of intangibles	250	250	500	500
Loss on sale of other real estate owned	1,700		1,700	
FDIC insurance	1,387	202	1,681	374
Other	2,276	2,353	4,914	4,584
Total non-interest expense	15,533	11,210	28,786	21,572

Net income (loss) before income tax		1,739		(6,890)		3,730		(2,230)
Income tax expense (benefit)		632		(2,619)		1,413		(785)
Net income (loss)		1,107		(4,271)		2,317		(1,445)
Less preferred stock dividends and accretion		(982)		(16)		(1,829)		(33)
Loss allocated to Series A preferred shareholders				31				10
Net income (loss) available to common shareholders	$	125	$	(4,256)	$	488	$	(1,468)
Net income (loss) per share - basic	$	0.01	$	(0.29)	$	0.03	$	(0.10)
Net income (loss) per share - diluted	$	0.01	$	(0.29)	$	0.03	$	(0.10)

The accompanying notes are an integral part of these statements.

Table of Contents

THE BANCORP INC. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY

For the six months ended June 30, 2009

(dollars in thousands)

	Common Stock	Preferred Stock	Additional paid-in capital	Retained earnings (Accumulated deficit)	Accumulated other comprehensive loss	Comprehensive income	Total
Balance at December 31, 2008	$ 14,563	$ 39,029	$ 145,156	$ (17,517)	$ (828)		$ 180,403
Net Income				2,317		$ 2,317	2,317
Cash dividends on preferred shares				(1,163)			(1,163)
Common stock warrant		(1,084)	1,084				
Accretion of series B preferred shares		666		(666)			
Stock-based compensation expense			53				53
Other comprehensive loss, net of reclassification adjustments and tax					(331)	(331)	(331)
						$ 1,986	
Balance at June 30, 2009	$ 14,563	$ 38,611	$ 146,293	$ (17,029)	$ (1,159)		$ 181,279

The accompanying notes are an integral part of these statements.

Table of Contents

THE BANCORP, INC. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENT OF CASH FLOWS

(dollars in thousands)

	For the six months ended June 30,	
	2009	**2008**
Operating activities		
Net income (loss)	$ 2,317	$ (1,445)
Adjustments to reconcile net income (loss) to net cash provided by operating activities		
Depreciation and amortization	1,935	1,698
Provision for loan and lease losses	5,500	4,700
Net amortization of investment securities discounts/premiums	29	172
Gain on sales of investment securities	(670)	
Stock-based compensation expense	53	43
Mortgage loans originated for sale	(5,582)	(4,835)
Sales of mortgage loans originated for resale	5,194	4,851
Gain on sales of mortgage loans originated for resale	(24)	(16)
Gain on sales of fixed assets	(39)	(9)
Other than temporary impairment on securities available for sale		8,275
Loss on sale of other real estate owned	1,700	
Decrease in accrued interest receivable	34	1,360
(Decrease) in interest payable	(2,069)	(100)
Decrease (increase) in other assets	6,711	(8,658)
Increase (decrease) in other liabilities	2,128	(324)
Net cash provided by operating activities	17,217	5,712
Investing activities		
Purchase of investment securities available for sale	(111,400)	(12,339)
Proceeds from redemptions and repayment on securities available for sale	45,418	4,160
Proceeds from the sales of investment securities available for sale	29,522	
Proceeds from the sale of other real estate owned	2,900	
Net increase in loans	(14,980)	(141,450)
Proceeds from sales of fixed assets	75	62
Purchases of premises and equipment	(1,264)	(1,115)
Net cash used in investing activities	(49,729)	(150,682)
Financing activities		
Net increase (decrease) in deposits	(34,877)	36,049
Net decrease in securities sold under agreements to repurchase	(7,025)	(1,841)
(Repayment) proceeds from short term borrowings	(20,000)	80,000
Dividends paid on Series A and B preferred stock	(993)	(33)
Net cash provided by (used in) financing activities	(62,895)	114,175
Net decrease in cash and cash equivalents	(95,407)	(30,795)
Cash and cash equivalents, beginning of year	179,506	82,158

Cash and cash equivalents, end of year	$ 84,099	$ 51,363
Supplemental disclosure:		
Interest paid	$ 10,670	$ 23,118
Taxes paid	$ 352	$ 4,407

The accompanying notes are an integral part of these statements.

Table of Contents

THE BANCORP, INC. AND SUBSIDIARY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Significant Accounting Policies

Basis of Presentation

The financial statements of The Bancorp, Inc. (the Company) as of June 30, 2009 and for the three and six month periods ended June 30, 2009 and 2008 are unaudited. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted in this Form 10-Q pursuant to the rules and regulations of the Securities and Exchange Commission. However, in the opinion of management, these interim financial statements include all necessary adjustments to fairly present the results of the interim periods presented. The unaudited interim consolidated financial statements should be read in conjunction with the audited financial statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2008. The results of operations for the three and six month periods ended June 30, 2009 may not necessarily be indicative of the results of operations for the full year ending December 31, 2009.

Note 2. Stock-based Compensation

The Company accounts for its stock options and stock appreciation rights under Statement of Financial Accounting Standards (SFAS) No. 123(R), *Share-based Payment*, that addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise s equity instruments or that may be settled by the issuance of such equity instruments. Under SFAS No. 123(R), all forms of share-based payments to employees, including employee stock options and phantom stock units, are treated the same as other forms of compensation by recognizing the related cost in income. The expense of the award generally is measured at fair value at the grant date. The impact of SFAS 123(R) is reflected in the net earnings and related per share amounts for the quarters ended June 30, 2009 and 2008. At June 30, 2009, the Company had two stock-based compensation plans, which are more fully described in its Form 10-K report.

The fair value of each grant of stock option and stock appreciation rights is estimated on the date of the grant using the Black-Scholes option-pricing model. The significant assumptions utilized in applying the Black-Scholes option pricing model are the risk-free interest rate, expected term, dividend yield, and expected volatility. The risk-free interest rate is the implied yield currently available on U.S. Treasury zero-coupon issues with a remaining term equal to the expected term used in the assumption for the model. The expected term of an option or stock appreciation right is based on historical experience of similar awards. The dividend yield is determined by dividing per share and stock appreciation rights unit dividends by the grant date stock price. The expected volatility is based on the volatility of the Company s stock price over a historical period comparable to the expected term. The Company did not grant any stock options or stock appreciation rights in 2009, but granted stock appreciation rights for 60,000 shares of common stock in 2008. The weighted-average assumptions used in the Black-Sholes valuation model are shown below.

	For the six months ended June 30, 2009	For the six months ended June 30, 2008
Risk-free interest rate		2.65%
Expected dividend yield		0.00%
Expected volatility		42.79%
Expected lives (years)		5.5 years

Table of Contents

As of June 30, 2009, there was $216,460 of total unrecognized compensation cost related to unvested share-based compensation arrangements granted under the plans; that cost is expected to be recognized over a period of 1.75 years. There were no stock options exercised for the six month periods ending June 30, 2009 and 2008. Included in net income for the six months ended June 30, 2009 and 2008 was compensation expense of $52,728 and $43,183, respectively. The following tables are a summary of activity in the plans as of June 30, 2009 and changes during the period then ended:

	For the six months ended June 30, 2009			
	Shares	Weighted average exercise price	Weighted-average remaining contractual term (years)	Aggregate intrinsic value
	(dollars in thousands except per share data)			
Outstanding at January 1, 2009	1,503,737	$ 12.12		
Granted				
Exercised				
Cancelled/forfeited	28,873	13.11		
Outstanding at June 30, 2009	1,474,864	$ 12.10	4.07	$
Exercisable at June 30, 2009	1,464,864		4.04	$

Stock appreciation rights:	Shares	Weighted-average price	Average remaining contractual term
Outstanding at beginning of the year	60,000	$ 11.41	
Granted			
Exercised			
Forfeited			
Outstanding at end of period	60,000	$ 11.41	2.75

Note 3. Earnings Per Share

Basic earnings per share for a particular period of time is calculated by dividing net income by the weighted average number of common shares outstanding during that period.

Diluted earnings per share is calculated by dividing net income by the weighted average number of common shares and common share equivalents. The Company s only outstanding common share equivalents are stock appreciation rights and options to purchase its common stock.

Table of Contents

The following table shows the Company s earnings (loss) per share for the periods presented:

	For the three months ended June 30, 2009		
	Income (numerator)	Shares (denominator)	Per share amount
	(dollars in thousands except per share data)		
Basic earnings per share			
Net income available to common shareholders	$ 125	14,563,919	$ 0.01
Effect of dilutive securities			
Common stock warrants		787,924	
Diluted earnings per share			
Net income available to common shareholders plus assumed conversions	$ 125	15,351,843	$ 0.01

Stock options for 1,474,864 shares and stock appreciation rights for 60,000 shares, exercisable at prices between $10.00 and $25.43 per share, were outstanding at June 30, 2009 but were not included in the dilutive shares because the per share excise price was greater than the per share market price.

	For the six months ended June 30, 2009		
	Income (numerator)	Shares (denominator)	Per share amount
	(dollars in thousands except per share data)		
Basic earnings per share			
Net income available to common shareholders	$ 488	14,563,919	$ 0.03
Effect of dilutive securities			
Common stock warrants		471,286	
Diluted earnings per share			
Net income available to common shareholders plus assumed conversions	$ 488	15,035,205	$ 0.03

Stock options for 1,474,864 shares and stock appreciation rights for 60,000 shares, exercisable at prices between $10.00 and $25.43 per share, were outstanding at June 30, 2009 but were not included in the dilutive shares because the per share excise price was greater than the per share market price.

	For the three months ended June 30, 2008		
	Income (numerator)	Shares (denominator)	Per share amount
	(dollars in thousands except per share data)		
Basic loss per share			
Net loss available to common shareholders	$ (4,256)	14,563,218	$ (0.29)
Effect of dilutive securities			
Stock options			
Diluted loss per share			
Net loss available to common shareholders plus assumed conversions	$ (4,256)	14,563,218	$ (0.29)

9

Table of Contents

Stock options for 1,503,737 shares and stock appreciation rights for 60,000 shares, exercisable at prices between $10.00 and $25.43 per share, were outstanding at June 30, 2008 but were not included in the dilutive shares because the per share excise price was greater than the per share market price.

	For the six months ended June 30, 2008		
	Income (numerator)	Shares (denominator)	Per share amount
	(dollars in thousands except per share data)		
Basic loss per share			
Net income available to common shareholders	$ (1,468)	14,562,434	$ (0.10)
Effect of dilutive securities			
Stock options			
Diluted loss per share			
Net loss available to common shareholders plus assumed conversions	$ (1,468)	14,562,434	$ (0.10)

Stock options for 1,503,737 shares and stock appreciation rights for 60,000 shares, exercisable at prices between $10.00 and $25.43 per share, were outstanding at June 30, 2008 but were not included in the dilutive shares because the per share excise price was greater than the per share market price.

Note 4. Investment securities

The amortized cost, gross unrealized gains and losses, and fair values of the Company s investment securities available-for-sale at June 30, 2009 and December 31, 2008 are summarized as follows (dollars in thousands):

	June 30, 2009			
Available for sale	**Amortized cost**	**Gross unrealized gains**	**Gross unrealized losses**	**Fair value**
U.S. Government agency securities	$ 7,000	$ 490	$	$ 7,490
State and municipal securities	38,892	714	(15)	39,591
Mortgage-backed securities	66,106	298	(944)	65,460
Other securities	1,030		(355)	675
Federal Home Loan and Atlantic Central Bankers Bank stock	6,565			6,565
	$ 119,593	$ 1,502	$ (1,314)	$ 119,781

	June 30, 2009			
Held to maturity	**Amortized cost**	**Gross unrealized gains**	**Gross unrealized losses**	**Fair value**
Other securities	$ 23,542	$	$ (6,173)	$ 17,369
	$ 23,542	$	$ (6,173)	$ 17,369

Table of Contents

Available for sale	December 31, 2008 Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
U.S. Government agency securities	$ 59,982	$ 894	$	$ 60,876
Mortgage-backed securities	15,102	380	(461)	15,021
Other securities	807		(96)	711
Federal Home Loan and Atlantic Central Bankers Bank stock	6,321			6,321
	$ 82,212	$ 1,274	$ (557)	$ 82,929

Held to maturity	December 31, 2008 Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Other securities	$ 23,529	$	$ (5,121)	$ 18,408
	$ 23,529	$	$ (5,121)	$ 18,408

The fair value of our investment portfolio is based on quoted market prices and from the calculation of the present value of cash flows from securities. Our available-for-sale securities are based on quoted market prices while our held-to-maturity securities are based on the present value of cash flows, which discounts expected cash flows from principal and interest of securities using yield to maturity at the measurement date.

On a quarterly basis, the Company evaluates the investment portfolio for other than temporary impairment. An investment is impaired if the fair value of the investment is less than its amortized cost basis. An impairment in a debt security is considered to be other-than-temporary if there is a credit loss exist, which defines as the difference between the present value of the cash flow expected to be collected and the amortized cost basis, for the security or if either of following condition is met: an entity that hold a security has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The Company believes that the decrease in values of the held to maturity securities is driven by interest rate and the current economic conditions, however, the Company does believe that the declines are temporary. The Company has the ability to continue to hold the securities to their maturity.

The amortized cost and fair value of the Company s investment securities at June 30, 2009, by contractual maturity, are shown below (dollars in thousands). Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay debt securities with or without call or prepayment penalties.

	Available for sale		Held to maturity	
	Amortized cost	Fair value	Amortized cost	Fair value
Due before one year	$	$	$	$
Due after one year through five years	2,089	1,765		
Due after five years through ten years	482	490		
Due after ten years	110,457	110,961	23,542	17,369
Federal Home Loan and Atlantic Central Bankers Bank stock	6,565	6,565		
	$ 119,593	$ 119,781	$ 23,542	$ 17,369

At June 30, 2009 and December 31,2009, investment securities with a book value of approximately $12.4 and $30.9 million, respectively, were pledged to secure securities sold under repurchase agreements and Federal Home Loan Bank advances as required or permitted by law. Gross gains on sales of securities in the first six months of 2009 amounted to $670,000. There were no gains or losses on securities in the first six months of 2008.

The table below indicates the length of time individual securities had been in a continuous unrealized loss position at June 30, 2009 (dollars in thousands):

June 30, 2009		Less than 12 months		12 months or longer		Total	
Available for sale	Number of securities	Fair Value	Unrealized losses	Fair Value	Unrealized losses	Fair Value	Unrealized losses
Description of Securities							
U.S. Government agency securities		$	$	$	$	$	$
State and Municipal securities	3	4,675	(15)			4,675	(15)
Mortgage-backed securities	14	39,096	(513)	845	(431)	39,941	(944)
Other securities	1			675	(355)	675	(355)
Total temporarily impaired investment securities	18	$ 43,771	$ (528)	$ 1,520	$ (786)	$ 45,291	$ (1,314)

June 30, 2009		Less than 12 months		12 months or longer		Total	
Held to Maturity	Number of securities	Fair Value	Unrealized losses	Fair Value	Unrealized losses	Fair Value	Unrealized losses
Description of Securities							
Other securities	8	$ 5,476	$ (1,380)	$ 11,893	$ (4,793)	$ 17,369	$ (6,173)
Total temporarily impaired investment securities	8	$ 5,476	$ (1,380)	$ 11,893	$ (4,793)	$ 17,369	$ (6,173)

The table below indicates the length of time securities had been in a continuous unrealized loss position at December 31, 2008 (dollars in thousands):

December 31, 2008		Less than 12 months		12 months or longer		Total	
Available for sale	Number of securities	Fair Value	Unrealized losses	Fair Value	Unrealized losses	Fair Value	Unrealized losses
Description of Securities							
Mortgage-backed securities	11	$	$	$ 1,079	$ (461)	$ 1,079	$ (461)
Other securities	1		$	711	(96)	711	(96)

Total temporarily impaired investment securities	12	$	$	$ 1,790	$ (557)	$ 1,790	$ (557)

December 31, 2008		Less than 12 months		12 months or longer		Total	
Held to Maturity	**Number of securities**	**Fair Value**	**Unrealized losses**	**Fair Value**	**Unrealized losses**	**Fair Value**	**Unrealized losses**
Description of Securities							
Other securities	8	$ 1,439	$ (430)	$ 16,969	$ (4,691)	$ 18,408	$ (5,121)
Total temporarily impaired investment securities	8	$ 1,439	$ (430)	$ 16,969	$ (4,691)	$ 18,408	$ (5,121)

Management has evaluated the securities in the above tables and has concluded that none of these securities have impairments that is other than temporary. In its evaluation, management considered the types of securities and what the credit rating was on the securities. Most of the securities that are in an unrealized loss position are in a loss position because of changes in interest rates since the securities were purchased. The securities that have been in an unrealized loss position for 12 months or longer include mortgage-backed securities and other securities whose market values are sensitive to interest rates and changes in credit quality. The Company s unrealized loss for the debt securities which include single issue trust preferred securities is related to general market conditions and the resultant lack of liquidity in the market. The severity of the impairments in relation to the carrying amounts of the individual investments is consistent with market developments. The Company s analysis for each investment performed at the security level, shows that the credit quality of the individual bonds ranges from good to deteriorating. Credit risk does exist and an individual issuer in a pool could default which could affect the ultimate collectability of contractual amounts. The Company concluded, as a result of its review, that other-than-temporary impairment did not exist at June 30, 2009 due to the securities continuing performance.

Note 5. Loans

Major classifications of loans are as follows (dollars in thousands):

	June 30, 2009	December 31, 2008
Commercial	$ 363,524	$ 353,219
Commercial mortgage	522,510	488,986
Construction	255,504	305,889
Total commercial loans	1,141,538	1,148,094
Direct financing leases, net	80,774	85,092
Residential mortgage	64,934	57,636
Consumer loans and others	170,999	157,446
	1,458,245	1,448,268
Deferred loan costs	1,720	1,081
Total loans, net of deferred loan costs	$ 1,459,965	$ 1,449,349
Supplemental loan data:		
Construction 1-4 family	$ 124,443	$ 163,718
Construction commercial, acquisition and development	131,061	142,171
	$ 255,504	$ 305,889

12

The Company identifies a loan as impaired when it is probable that interest and principal will not be collected according to the contractual terms of the loan agreement. The balance of impaired loans was $8.7 million on June 30, 2009. The specific valuation allowance allocated to these impaired loans was $1.4 million. The balance of impaired loans was $8.7 million at December 31, 2008. The specific valuation allowance allocated to these impaired loans was $3.1 million.

The Company recognizes income on impaired loans on the cash basis when the loans are both current and the collateral on the loan is sufficient to cover the outstanding obligation to the Company. If these factors do not exist, the Company will not recognize income on such loans.

The following table summarizes the Company s non-performing loans (dollars in thousands):

	June 30, 2009	December 31, 2008
Non-accrual loans	$ 8,716	$ 8,729
Loans past due 90 days or more	21,779	4,055
Total non-performing loans	$ 30,495	$ 12,784

Changes in the allowance for loan and lease losses are as follows (dollars in thousands):

	Six months ended June 30,		For the year Ended December 31,
	2009	2008	2008
Balances at the beginning of the year	$ 17,361	$ 10,233	$ 10,233
Charge-offs	(5,047)	(698)	(5,533)
Recoveries	266	10	161
Provision charged to operations	5,500	4,700	12,500
Balance at end of year	$ 18,080	$ 14,245	$ 17,361

Note 6. Transactions with affiliates

The Company subleases office space in Philadelphia, Pennsylvania to RAIT Financial Trust (RAIT). The Chairman of RAIT is the Chairman and Chief Executive Officer of the Company s wholly-owned banking subsidiary, The Bancorp Bank (the Bank), and is the

Table of Contents

Chief Executive Officer of the Company. Under the sublease, RAIT pays the Company rent equal to 44% of the rent paid by the Company and an allocation of common area expenses. RAIT was charged rent of $160,800 and $199,000 for the six-month periods ended June 30, 2009 and 2008, respectively.

The Company maintains deposits for various affiliated companies totaling approximately $14.8 million and $24.9 million as of June 30, 2009 and December 31, 2008, respectively. The majority of these deposits are short-term in nature and rates are consistent with market rates.

The Company has entered into lending transactions in the ordinary course of business with directors, officers, principal stockholders, and affiliates of such persons on the same terms as those prevailing for comparable transactions with other borrowers. At June 30, 2009, these loans were current as to principal and interest payments and, in the opinion of management, do not involve more than normal risk of collectability. At June 30, 2009, loans to these related parties amounted to $11.4 million.

The Bank participates in one loan at June 30, 2009 that was originated by RAIT. The outstanding principal balance of the loan was $21.3 million at June 30, 2009.

Note 7. Fair Value Measurements

Financial instruments recorded at fair value in the Company s financial statements, SFAS No. 107, *Disclosures about Fair Value of Financial Instruments*, requires disclosure of the estimated fair value of an entity s assets and liabilities considered to be financial instruments. For the Company, as for most financial institutions, the majority of its assets and liabilities are considered to be financial instruments. However, many of such instruments lack an available trading market as characterized by a willing buyer and willing seller engaging in an exchange transaction. Also, it is the Company s general practice and intent to hold its financial instruments to maturity whether or not categorized as available for sale and not to engage in trading or sales activities, except for certain loans. For fair value disclosure purposes, the Company utilized certain fair value measurement criteria as required under SFAS No. 157 and explained below.

Estimated fair values have been determined by the Company using the best available data and an estimation methodology suitable for each category of financial instruments. Changes in the assumptions or methodologies used to estimate fair values may materially affect the estimated amounts. Also, there may not be reasonable comparability between institutions due to the wide range of permitted assumptions and methodologies in the absence of active markets. This lack of uniformity gives rise to a high degree of subjectivity in estimating financial instrument fair values.

For cash and cash equivalents, including cash and due from banks and federal funds sold, the recorded book values of $84.1 million and $179.5 million as of June 30, 2009 and December 31, 2008, respectively, approximate fair values. The estimated fair values of investment securities are based on quoted market prices, if available, or by an estimated methodology based on management s inputs. The fair value of the Company s investment securities held-to-maturity are based on using unobservable inputs that are the best information available in the circumstances.

The net loan portfolio at June 30, 2009 and December 31, 2008 has been valued using the present value of discounted cash flow where market prices were not available. The discount rate used in these calculations is the estimated current market rate adjusted for credit risk. The carrying value of accrued interest approximates fair value.

The estimated fair values of demand deposits (i.e., interest-and noninterest-bearing checking accounts, savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). The fair values of certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered to a schedule of aggregated expected monthly time deposit maturities. Based upon time deposit maturities at June 30, 2009, the carrying values approximate their fair values. The carrying amount of accrued interest payable approximates its fair value. The fair value of subordinated debt that floats with the London Interbank Offered Rate is estimated to equal the carrying amount.

	June 30, 2009		December 31, 2008	
	Carrying amount	**Estimated fair value**	**Carrying amount**	**Estimated fair value**
	(dollars in thousands)			
Cash and cash equivalents	$ 84,099	$ 84,099	$ 179,506	$ 179,506
Investment securities available-for-sale	119,781	119,781	82,929	82,929
Investment securities held-to-maturity	23,542	17,369	23,529	18,408
Loans receivable, net	1,459,965	1,428,482	1,449,349	1,441,195
Certificates of deposit	176,308	176,064	380,847	381,395
Subordinated debentures	13,401	9,906	13,401	9,364
Securities sold under agreements to repurchase	2,394	2,394	9,419	9,419
Short term borrowings	41,000	41,000	61,000	61,000

The Fair value of commitments to extend credit is estimated based on the amount of unamortized deferred loan commitment fees. The fair value of letters of credit is based on the amount of unearned fees plus the estimated cost to terminate the letters of credit. Fair values of unrecognized financial instruments including commitments to extend credit and the fair value of letters of credit are considered immaterial.

In addition, SFAS No. 157, *Fair Value Measurements*, (a) establishes a common definition for fair value to be applied to assets and liabilities, where required or permitted by accounting standards; (b) establishes a framework for measuring fair value; and (c) expands disclosures concerning fair value measurements. SFAS No. 157 does not extend the required use of fair value to any new circumstances. Fair value measurements are established according to a three level hierarchy, using the highest level possible (Level 1) if such inputs are available. Level 1 valuation is based on quoted market prices for identical assets or liabilities to which the Company has access at the measurement date. Level 2 valuation is based on other observable inputs for the asset or liability, either directly or indirectly. This includes quoted prices for similar assets in active or inactive markets, inputs other than quoted prices that are observable for the asset or liability such as yield curves, volatilities, prepayment speeds, credit risks, default rates, or inputs that are derived principally from or corroborated through observable market data by market-corroborated reports. Level 3 valuation is based on unobservable inputs that are the best information available in the circumstances. Assets measured at fair value on a recurring basis, segregated by fair value hierarchy level, are summarized below:

Fair Value Measurements at Reporting Date Using

June 30, 2009	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)

BancGroup occasionally enters into over-the-counter option contracts on bonds in its securities portfolio. SFAS 133 requires that the fair value of these option contracts be recorded in the financial statements. However, there were no option contracts outstanding at March 31, 2005.

Note K: Stock-Based Compensation

SFAS No. 123, *Accounting for Stock-Based Compensation*, defines a fair value based method of accounting for an employee stock option or similar equity instrument. However, SFAS No. 123 allows an entity to continue to measure compensation costs for those plans using the intrinsic value based method of accounting prescribed

16

Table of Contents

THE COLONIAL BANCGROUP, INC. AND SUBSIDIARIES

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (Continued)

by APB Opinion No. 25, *Accounting for Stock Issued to Employees*. Entities electing to remain with the accounting in Opinion No. 25 must make pro forma disclosures of net income and earnings per share as if the fair value based method of accounting defined in SFAS No. 123 had been applied. Under the fair value based method, compensation cost is measured at the grant date based on the value of the award and is recognized over the service period, which is usually the vesting period. Under the intrinsic value based method, compensation cost is the excess, if any, of the quoted market price of the stock at the grant date or other measurement date over the amount an employee must pay to acquire the stock. BancGroup has elected to continue to measure compensation cost for its stock option plans under the provisions in Opinion No. 25 and has calculated the fair value of outstanding options for purposes of pro forma disclosure utilizing the Black-Scholes method.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company s employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

The majority of the Company s options granted vest ratably over a period of five years; therefore for purposes of pro forma disclosures, the compensation expense related to these options has been allocated over the vesting period.

The Company s actual and pro forma information follows (in thousands except per share data):

	Three Months Ended March 31,	
	2005 (Restated)	**2004 (Restated)**
Net income:		
As reported	**$ 48,188**	$ 42,856
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of tax	**(395)**	(359)
Pro forma net income	**$ 47,793**	$ 42,497

	Three Months Ended March 31,	
	2005 (Restated)	**2004 (Restated)**
Basic earnings per share:		
As reported	**$ 0.35**	$ 0.34
Pro forma	**$ 0.34**	$ 0.33
Diluted earnings per share		
As reported	**$ 0.34**	$ 0.34
Pro forma	**$ 0.34**	$ 0.33

Note L: Pension Plan

BancGroup and subsidiaries are participants in a pension plan that covers most employees who have met certain age and length of service requirements. The plan provides benefits based on final average earnings, covered compensation, and years of benefit service. Actuarial computations for financial reporting purposes are

Table of Contents

THE COLONIAL BANCGROUP, INC. AND SUBSIDIARIES

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (Continued)

based on the projected unit credit method. The measurement date is March 31. Based on current actuarial projections, BancGroup will not be required to make a contribution to the plan in 2005. However, BancGroup assesses the funded status of the plan quarterly and may, at its discretion, make contributions even when not required. Currently, BancGroup does not expect to make a material contribution during 2005.

Employee pension benefit plan status at March 31:

	Three Months Ended March 31,	
	2005	**2004**
	(In thousands)	
Components of net periodic benefit cost		
Service cost	**$ 1,845**	$ 1,414
Interest cost	**1,156**	936
Expected return on plan assets	**(1,220)**	(1,011)
Amortization of transition asset		(1)
Amortization of prior service cost	**2**	2
Amortization of actuarial loss	**312**	187
Net quarterly benefit cost	**$ 2,095**	$ 1,527

Note M: Securities

The following table reflects gross unrealized losses and market value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at March 31, 2005.

	Less than 12 months		12 months or more		Total	
Description of Securities	**Market Value**	**Unrealized Losses**	**Market Value**	**Unrealized Losses**	**Market Value**	**Unrealized Losses**

			(In thousands)			
U.S. Treasury obligations and direct obligations of U.S. Government agencies	$ 17,688	$ (381)	$ 165,833	$ (9,332)	$ 183,521	$ (9,713)
Federal Agency mortgage-backed securities	65,300	(1,049)	191,915	(10,886)	257,215	(11,935)
Federal Agency collateralized mortgage obligations	989,114	(20,433)	80,296	(2,904)	1,069,410	(23,337)
Private collateralized mortgage obligations	1,617,120	(29,279)	249,495	(7,906)	1,866,615	(37,185)
Corporate notes	2,021	(8)			2,021	(8)
Total temporarily impaired securities	$ 2,691,243	$ (51,150)	$ 687,539	$ (31,028)	$ 3,378,782	$ (82,178)

The securities above consist of Treasury notes and government agency debentures, agency collateralized mortgage obligations (CMO s) and mortgage-backed securities, AAA-rated private CMO s, and corporate notes. As of March 31, 2005, there were 178 securities carried at an unrealized loss relating to the level of interest rates prevailing in the market. Because of the creditworthiness of the issuers and because the future direction of interest rates is unknown, the impairments are deemed to be temporary. The severity and duration of such

Table of Contents

THE COLONIAL BANCGROUP, INC. AND SUBSIDIARIES

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS (Continued)

impairments are determined by the level of interest rates set by the market. Additionally, BancGroup has the ability to retain these securities until maturity when full repayment would be received. There are also no known current funding needs which would require their liquidation.

Note N: Sales and Servicing of Financial Assets

During the first quarter of 2005, the Company structured a facility in which it sold certain mortgage warehouse loans and mortgage loans held for sale to a wholly-owned SPE which then sold interests in those assets to third-party commercial paper conduits. Refer to Note B for further information regarding accounting for these transactions.

Total cash proceeds from the sales of interests in these assets to the conduits during the first quarter of 2005 were $750 million, attributable to $435 million of mortgage warehouse loans and $315 million of loans held for sale. Based on the structure of these transactions, the Company s only retained interest is the assets retained in the SPE as a first risk of loss position. No gain or loss was recorded at the time of sale. The Company receives servicing income based on a percentage of the outstanding balance of assets sold. During the first quarter of 2005, the Company accrued approximately $400,000 of noninterest income related to these transactions, of which $188,000 was servicing income, but no cash was received.

The following table presents a summary of the components of managed financial assets, representing both owned and sold assets, along with quantitative information about delinquencies and net credit losses:

	As of March 31, 2005		Three Months Ended March 31, 2005	
	Principal Balance	Loans past due 30 days or more	Average Balance	Net Credit Losses
	(In thousands)			
Loans				
Assets managed	$ 13,858,517	$ 62,795	$ 13,225,137	$ 7,015
less: interests sold	434,976		38,712	
Assets held in portfolio	$ 13,423,541	$ 62,795	$ 13,186,425	$ 7,015
Loans held for sale				

Assets managed	$	963,667	$		$	756,110	$	
less: interests sold		315,024				36,288		
Assets held in portfolio	$	648,643	$		$	719,822	$	

Note O: Variable Interest Entities

As discussed in Note N, the Company sells certain financial assets to a wholly-owned SPE which then sells interests in those assets to third-party commercial paper conduits. While the Company has a variable interest in these conduits, it is not considered to be the primary beneficiary, as the Company does not retain the majority of the expected losses or returns. The third-party conduits had approximately $27.4 billion in capital outstanding at March 31, 2005. The Company s maximum exposure to loss at March 31, 2005 as a result of its involvement with these non-consolidated conduits is $50 million, which is the amount that would be paid by the Company in the event of credit-related defaults.

There has been no material change in the Company s other variable interest entities. Refer to the Company s 2004 Annual Report on Form 10-K/A for additional information.

Table of Contents

Item 2. Management s Discussion And Analysis Of Financial Condition And Results Of Operations

RESTATEMENT

The Colonial BancGroup, Inc. is restating its financial statements and other financial information to correct errors related to the Company s derivative accounting under Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS No. 133).

In 2005 and prior years, the Company entered into interest rate swap agreements on brokered certificates of deposit (CD swaps) and junior subordinated debt (junior subordinated debt swaps) that were accounted for as fair value hedges under SFAS No. 133. The Company elected a method of fair value hedge accounting, commonly referred to as the abbreviated method of hedge accounting described in paragraph 65 of SFAS No. 133, which allowed the Company to assume no ineffectiveness in these transactions as long as critical terms did not change. The Company recently concluded that the CD swaps and junior subordinated debt swaps did not qualify for these methods in the periods covered by this restatement. In retrospect, the CD swaps did not comply due to the death puts contained in the brokered CDs, which allow the estate of the CD holder to require the bank to redeem the CD in the event of the CD holder s death. In addition, the junior subordinated debt swaps did not comply due to interest deferral features present in the junior subordinated debt. Hedge accounting under SFAS No. 133 is not allowed retrospectively because the hedge documentation required for the long-haul method was not in place at the inception of the hedge. Eliminating the application of fair value hedge accounting reverses the fair value adjustments that have been made to the brokered certificates of deposit and junior subordinated debt and results in all fair value changes for the interest rate swaps being recognized in noninterest income. Additionally, the net cash settlement payments received during each of the affected periods for these interest rate swaps were reclassified from interest expense on brokered certificates of deposit and junior subordinated debt to noninterest income. Adjustments were also made for other non-significant items.

For additional information on the restatement see Note A, Restatement, in the Notes to the Unaudited Condensed Consolidated Financial Statements.

Table of Contents

Forward-Looking Statements

This discussion and analysis contains statements that are considered forward-looking statements within the meaning of the federal securities laws. See page 1 for additional information regarding forward-looking statements.

Critical Accounting Policies

Accounting policies considered relatively more critical due to either the subjectivity involved in the estimate and/or the potential impact that changes in the estimates can have on the reported financial results include the accounting for the allowance for loan losses and the assessment of goodwill impairment. Information concerning these policies is included in the Critical Accounting Policies section of Management s Discussion and Analysis in BancGroup s 2004 Annual Report on Form 10-K/A. There were no significant changes in these accounting policies during the first three months of 2005.

Overview

The Colonial BancGroup, Inc. is a $20 billion financial services company providing diversified services including retail and commercial banking, wealth management services, mortgage banking and insurance through its branch network, private banking offices or officers, ATMs and the internet as well as other distribution channels to consumers and businesses. At March 31, 2005, BancGroup s branch network consisted of 306 offices in Florida, Alabama, Georgia, Nevada, Tennessee and Texas.

BancGroup is primarily a Florida bank with more of its assets in Florida than in any other state. The following is a summary of approximate assets, deposits and branches by state as of March 31, 2005 on a pro forma basis with the FFLC acquisition which is anticipated to close in the second quarter of 2005.

	% of total Assets	% of total Deposits (Restated)	Branches
Florida	52%	58%	159
Alabama	19%	27%	115
Georgia	6%	5%	20
Texas	5%	4%	12
Nevada	4%	4%	13
Corporate/Other	14%	2%	3
Total	100%	100%	322

BancGroup reported record net income for the quarter ended March 31, 2005 of $48.2 million, a 12% increase over the $42.9 million recorded for the same period of the previous year. Diluted earnings per share was $0.34 per share for the quarter ended March 31, 2005 and 2004.

Table of Contents

Financial Condition

Changes in selected components of the Company s balance sheet from December 31, 2004 to March 31, 2005 (as restated) are as follows:

	December 31, 2004 to March 31, 2005 Increase (Decrease)	
	Amount	%
	(Dollars in thousands)	
Securities available for sale and investment securities	$ 41,050	1.1%
Loans held for sale	(29,853)	(4.4)%
Total loans, net:		
Mortgage warehouse loans	(451,304)	(40.5)%
All other loans, net of unearned income	1,017,034	8.7%
Total loans, net of unearned income	565,730	4.4%
Total assets	1,105,908	5.9%
Non-time deposits	720,875	9.6%
Total deposits	1,120,168	9.4%
Short-term borrowings	(249,368)	(7.7)%
Long-term debt	24,450	1.1%
Shareholders equity	227,279	16.3%

Securities

Securities available for sale and investment securities totaled $3.69 billion or 18.5% of total assets at March 31, 2005 compared to $3.65 billion or 19.3% of total assets at December 31, 2004. At March 31, 2005, the Company s securities had an effective duration of 3.98 years. Approximately $40.6 million in securities were sold during the quarter at a net realized loss of approximately $1.2 million. Unrealized net losses on securities available for sale changed from a pretax loss of $14.2 million at December 31, 2004 to a pretax loss of $77.4 million at March 31, 2005 due to increases in market rates.

Loans and Loans Held for Sale

To increase sources of liquidity, Colonial entered into a transaction during the first quarter of 2005 whereby interests in certain assets generated by its mortgage warehouse lending unit are sold to third-party conduits financed by the issuance of asset backed commercial paper. This transaction allows Colonial to continue to manage its customer relationships while increasing balance sheet capacity for higher yielding assets. At March 31, 2005, Colonial had sold interests in its mortgage warehouse loans and loans held for sale of $435 million and $315 million, respectively, and had unused funding capacity of $250 million. Mortgage warehouse loans ended the quarter at $664 million compared to $1.1 billion at the end of 2004.

Loans held for sale is made up of three components: mortgage warehouse, retail mortgages, and non-mortgage loans held for sale. Total loans held for sale decreased $30 million from December 31, 2004 primarily due to a decrease of $45 million in the mortgage warehouse component as a result of the previously discussed sale. The purpose of the mortgage warehouse component of loans held for sale is to accommodate the funding needs of mortgage company customers, therefore these balances as well as the retail mortgage balances fluctuate as demand for residential mortgages changes.

Total loans, excluding mortgage warehouse lending, increased by $1.0 billion from the end of 2004. Excluding the Union Bank acquisition and mortgage warehouse lending, total loans grew $366 million or 12.5% annualized from the end of 2004. This growth was spread geographically with 48% from Florida, 24% from

Table of Contents

Alabama, 14% from Georgia, 15% from Texas, 3% from other offset by a 4% decline in Nevada. The Nevada region experienced unusually large payoffs in commercial real estate in the first quarter.

The following table reflects the Company s loan mix.

Gross Loans By Category

	March 31, 2005	December 31, 2004
	(Dollars in thousands)	
Commercial, financial, and agricultural	$ 1,079,178	$ 1,007,686
Real estate-commercial	4,465,887	4,265,700
Real estate-construction	4,535,815	3,925,972
Residential-real estate	2,376,828	2,223,889
Consumer	188,042	187,315
Mortgage warehouse	663,619	1,114,923
Other	114,172	132,326
Total loans, net of unearned income	$ 13,423,541	$ 12,857,811

Management believes that its existing distribution of commercial real estate and construction loans, whether grouped geographically, by industry, or by borrower, reduces BancGroup s risk exposure. The current distribution of commercial real estate and construction loans remains diverse in location, size, and collateral function. This diversification, in addition to our emphasis on quality underwriting, serves to reduce the risk of losses. The following charts reflect the geographic diversity and property type distribution of construction and commercial real estate loans at March 31, 2005.

	Construction	% of Total	Commercial Real Estate	% of Total
	(Dollars in thousands)			
Average Loan Size	$ 675		$ 622	
Geographic Diversity				
Florida	$ 2,450,539	54.0%	$ 2,394,194	53.6%
Alabama	525,877	11.6%	771,021	17.3%
Georgia	510,016	11.2%	472,236	10.6%
Texas	497,638	11.0%	266,617	6.0%
Nevada	340,794	7.5%	223,740	5.0%
Other	210,951	4.7%	338,079	7.5%
Total	$ 4,535,815	100.0%	$ 4,465,887	100.0%

	% of Property Type Distribution to			% of Property Type Distribution to	
	Construction Portfolio	Total Portfolio		Commercial Real Estate	Total Portfolio
Residential Development and Lots	26.7%	9.0%	Retail	25.6%	8.4%
Land Only	19.6%	6.6%	Office	18.9%	6.3%
Residential Home Construction	17.4%	5.9%	Multi-Family	12.3%	4.1%
Condominium	11.5%	3.9%	Warehouse	11.9%	4.0%
Retail	8.1%	2.7%	Other*	9.0%	3.0%
Other*	5.8%	2.0%	Healthcare	7.1%	2.4%
Commercial Development	4.5%	1.5%	Lodging	7.0%	2.3%
Office	3.9%	1.3%	Church or School	3.8%	1.3%
Multi-Family	2.5%	0.9%	Recreation	2.9%	1.0%
			Industrial	1.5%	0.5%
Total Construction	100.0%	33.8%	**Total Commercial Real Estate**	100.0%	33.3%

* Other includes all loans in categories smaller than the lowest percentages shown above.

Table of Contents

Selected Characteristics of the 75 Largest Construction and Commercial Real Estate Loans

	Construction	Commercial Real Estate
75 Largest Loans Total (in thousands)	$ 1,205,073	$ 780,699
% of 75 largest loans to category total	26.6%	17.5%
Average Loan to Value Ratio (75 largest loans)	69.1%	67.7%
Average Debt Coverage Ratio (75 largest loans)	N/A	1.38x

Commercial real estate and construction loans combined had growth, excluding acquisitions, of $332 million or 4.1% from December 31, 2004 to March 31, 2005. Geographically, the Florida locations continue to contribute most of the growth in these particular portfolios. The acquisition of Union in Florida in February 2005 contributed an additional $478 million to these portfolios. Colonial continues to focus its commercial real estate and construction growth efforts on high quality properties owned and/or developed by experienced customers with whom we have established relationships. Substantially all construction and commercial real estate loans have personal guarantees of the principals involved.

Residential real estate loans represent approximately 18% and 17% of total loans at March 31, 2005 and December 31, 2004, respectively. These loans are primarily adjustable rate first and second mortgages on single-family, owner-occupied properties.

BancGroup s mortgage warehouse lending division provides lines of credit collateralized by residential mortgage loans to mortgage origination companies. Mortgage warehouse loans outstanding at March 31, 2005 and December 31, 2004 were $664 million and $1.1 billion with unfunded commitments of $702 million and $771 million, respectively.

The Company has 46 credits with commitments (funded and unfunded) of $885 million that fall within the bank regulatory definition of a Shared National Credit (generally defined as a total loan commitment in excess of $20 million that is shared by three or more lenders). The largest outstanding amount to any single borrower is $81 million (which is a mortgage warehouse lending credit), with the smallest credit being approximately $20,000. At March 31, 2005, $550 million of these commitments were funded.

Although by definition these commitments are considered Shared National Credits, BancGroup s loan officers have established long-term relationships with most of these borrowers. These commitments are comprised of the following:

65% - mortgage warehouse lines to 19 large institutions,

33% - 26 commercial real estate credit facilities to companies with headquarters located within Colonial s existing markets, and

2% - one operating facility to a large national insurance company.

Management believes that these are sound participations involving credits that are consistent with Colonial Bank s lending philosophy and meet its conservative underwriting guidelines.

Table of Contents

Summary Of Loan Loss Experience

	Three Months Ended	
	March 31, 2005	March 31, 2004
	(Dollars in thousands)	
Allowance for loan losses January 1	$ 148,802	$ 138,549
Charge-offs:		
Commercial, financial, and agricultural	5,425	1,627
Real estate commercial	2,253	2,450
Real estate construction	1,372	86
Real estate residential	577	696
Consumer	541	540
Other	361	1,898
Total charge-offs	10,529	7,297
Recoveries:		
Commercial, financial, and agricultural	1,741	483
Real estate commercial	886	135
Real estate construction	1	50
Real estate residential	151	125
Consumer	341	283
Other	394	214
Total recoveries	3,514	1,290
Net charge-offs	7,015	6,007
Provision for loan losses	5,929	7,934
Allowance added from bank acquisitions	5,918	
Allowance for loan losses end of period	$ 153,634	$ 140,476
Net charge-offs as a percentage of average net loans (annualized basis):		
Quarter to date	0.21%	0.21%
Year to date	0.21%	0.21%

Nonperforming Assets

BancGroup classifies problem loans into four categories: nonaccrual, past due, renegotiated and other potential problems. When management determines that a loan no longer meets the criteria for a performing loan and collection of interest appears doubtful, the loan is placed on nonaccrual status. Loans are generally placed on nonaccrual if full collection of principal and interest becomes unlikely (even if all payments are current) or if the loan is delinquent in principal or interest payments for 90 days or more, unless the loan is well secured and in the process of collection. BancGroup s policy is to charge off consumer installment loans 120 days past due unless they are in the process of foreclosure and are adequately collateralized. Management closely monitors all loans that are contractually 90 days past due, renegotiated or nonaccrual. These loans are summarized as follows:

	March 31, 2005	December 31, 2004
	(Dollars in thousands)	
Aggregate loans for which interest is not being accrued	$ 28,996	$ 26,983
Aggregate loans renegotiated to provide a reduction or deferral of interest or principal because of deterioration in the financial condition of the borrower	182	191
Total nonperforming loans*	29,178	27,174
Other real estate owned and repossessions	8,229	9,865
Loans held for sale	1,262	
Total nonperforming assets*	$ 38,669	$ 37,039
Allowance as a percent of nonperforming assets*	397%	402%

Table of Contents

	March 31, 2005	December 31, 2004
	(Dollars in thousands)	
Aggregate loans contractually past due 90 days for which interest is being accrued	$ 5,651	$ 8,096
Net charge-offs quarter-to-date	$ 7,015	$ 3,644
Net charge-offs year-to-date	$ 7,015	$ 23,598
Total nonperforming assets as a percent of net loans and other real estate	0.29%	0.29%
Allowance as a percent of net loans	1.14%	1.16%
Allowance as a percent of nonperforming loans*	527%	548%

* Does not include loans contractually past due 90 days or more which are still accruing interest.

Fluctuations from year to year in the balances of nonperforming assets are attributable to several factors including changing economic conditions in various markets, nonperforming assets obtained in various acquisitions and the disproportionate impact of larger (over $5,000,000) individual credits.

In addition to the loans reported as nonperforming loans above, management, through its loan officers, internal credit review staff and external examinations by regulatory agencies, has identified approximately $252.7 million of loans, which have been placed on a classified loan list excluding nonaccrual, other real estate, repossessions and loans that are contractually 90 days past due. The status of all material classified loans is reviewed at least monthly by loan officers, quarterly by BancGroup s centralized credit administration function and annually by regulatory agencies. In connection with such reviews, collateral values are updated where considered necessary as loans are deemed impaired. If collateral values are judged insufficient or other sources of repayment are deemed inadequate, the amount of reserve held is increased or the loan is reduced to estimated recoverable amounts. As of March 31, 2005, substantially all of these classified loans are current with their existing repayment terms. Management believes that classification of such loans well in advance of their reaching a delinquent status allows the Company the greatest flexibility in correcting problems and providing adequate reserves. Given the reserves and the demonstrated ability of the borrowers to comply with the existing repayment terms, management believes any exposure from these loans has been adequately addressed at the present time.

The above nonperforming loans represent all material credits for which management has significant doubts as to the ability of the borrowers to comply with the loan repayment terms. Management also expects that the resolution of these problem credits as well as other performing loans will not materially impact future operating results, liquidity or capital resources.

A loan is considered impaired, based on current information and events, if it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. As mentioned previously, Colonial s credit risk management area performs detailed verification and testing to ensure appropriate identification of impaired loans and that proper reserves are held on these loans. The recorded investment in impaired loans at March 31, 2005 and December 31, 2004 was $25.4 million and $24.8 million, respectively, and these loans had a corresponding valuation allowance of $4.5 million and $8.0 million, respectively.

Asset/Liability Management

Asset/liability management involves the evaluation, monitoring and management of interest rate risk, liquidity and funding. The Board of Directors has overall responsibility for Colonial s asset/liability management policies. To ensure adherence to these policies, the Asset and Liability Committee (ALCO) establishes and monitors guidelines to control the sensitivity of earnings to changes in interest rates. The guidelines apply to both on and off-balance sheet positions. The goal of the ALCO process is to maximize earnings while carefully controlling interest rate risk.

26

Table of Contents

Interest Rate Sensitivity

Interest rate risk, and its potential effects on earnings, are inherent in the operations of a financial institution. We are subject to interest rate risk because:

- Assets and liabilities may mature or re-price at different times (for example, if assets re-price faster than liabilities and interest rates are generally falling, earnings will initially decline);
- Assets and liabilities may re-price at the same time but by different amounts (for example, when the general level of interest rates is falling, we may reduce rates paid on checking and savings deposit accounts by an amount that is less than the general decline in market interest rates;
- Short-term and long-term market interest rates may change by different amounts (i.e., the shape of the yield curve may affect new loan yields and funding costs differently); or
- The remaining maturity of various assets or liabilities may shorten or lengthen as interest rates change (for example, if long-term mortgage interest rates decline sharply, mortgage-backed securities held in the securities available for sale portfolio may prepay significantly earlier than anticipated which could reduce portfolio income). In addition, interest rates may have an indirect impact on loan demand, credit losses, mortgage origination volume, the value of the pension liability and other sources of earnings.

Asset/liability management activities include lending, accepting and placing deposits, investing in securities, issuing debt and mitigating interest rate risk. Sensitivity of earnings to interest rate changes arises when yields on assets change in a different time period or in a different amount from that of interest cost on liabilities. To mitigate interest rate risk, the structure of the balance sheet is managed so that movements of interest rates on assets and liabilities are highly correlated in a manner intended to allow Colonial s interest bearing assets and liabilities to contribute to earnings even in periods of volatile interest rates.

Colonial employs the following measurement techniques in the management of interest rate risk: simulation of earnings and simulation of the economic value of equity. These techniques are complementary and are used in concert to provide a comprehensive interest rate risk management capability.

Simulation of earnings is the primary tool used to measure the sensitivity of earnings to interest rate changes. Using computer modeling techniques, Colonial is able to measure the potential impact of different interest rate assumptions on pre-tax earnings. All on-balance sheet positions, including derivative financial instruments, are included in the model simulation.

The following table represents the output from the Company s simulation model based on the balance sheet at March 31, 2005, when the Fed Funds Rate was 2.75%. The table measures the impact on net interest income of an immediate and sustained change in all market interest rates in 100 basis point increments for the twelve calendar months following the date of the change. This twelve-month projection of net interest income under these scenarios is compared to the twelve-month net interest income projection with rates unchanged.

	Fed Funds Rate	Percentage Change in 12 Month Projected Net Interest Income vs. Net Interest Income assuming no rate change(1) (Restated)
Basis Points change		
+200	4.75%	3.0%
+100	3.75	2.1
No Rate Change	2.75	
-100	1.75	(2.5)

(1) The computation of prospective effects of hypothetical interest rate changes are based on numerous assumptions, including relative levels of market interest rates, estimates of rates on loans and deposits given these rate changes, the ability to maintain interest rate floors on

27

Table of Contents

loans as market rates decline, deposit decay rates and loan/investment prepayments. Further, the computations do not take into account changes to the slope of the yield curve, changes in the relative relationship of various market rates, changes in the volume or mix of asset and liabilities on the balance sheet nor do they contemplate any actions BancGroup could undertake in response to changes in interest rates.

Liquidity

Liquidity is the ability of an organization to meet its financial commitments and obligations on a timely basis. These commitments and obligations include credit needs of customers, withdrawals by depositors, repayment of debt when due and payment of operating expenses and dividends. Management of liquidity also includes management of funding sources and their utilization based on current, future and contingency needs. Maintaining and managing adequate liquidity and funding is another prominent focus of ALCO.

Deposit growth is a primary focus of BancGroup s funding and liquidity strategy. Colonial s average non-time deposits grew by $1.8 billion, or 30% (19% excluding acquisitions) over the first quarter of 2004. Total average deposits for the first quarter of 2005 increased $2.4 billion or 24% (15% excluding acquisitions) over the first quarter of 2004. These increases improved the percentage of total average deposits to total average liabilities to 69% for the first quarter of 2005 compared to 67% for the first quarter of 2004.

As part of its planning for future funding needs, BancGroup has worked to expand the availability of wholesale funding sources in addition to continued emphasis on deposit growth and the sale of interests in mortgage warehouse loans. Wholesale funding sources include availability from the Federal Home Loan Bank of Atlanta, borrowings collateralized by securities and loans, fed funds purchased and brokered CD s. Of total wholesale funding sources estimated to be available to the Company, BancGroup utilized 50% at March 31, 2005 compared to 51% at March 31, 2004.

Capital Adequacy and Resources

Management is committed to maintaining capital at a level sufficient to protect shareholders and depositors, provide for reasonable growth and fully comply with all regulatory requirements. Management s strategy to achieve these goals is to retain sufficient earnings while providing a reasonable return to shareholders in the form of dividends and return on equity. The Company s dividend payout target range is 35-45% of net income. Dividend rates are determined by the Board of Directors in consideration of several factors including current and projected capital ratios, liquidity and income levels and other bank dividend yields and payment ratios.

The amount of a cash dividend, if any, rests with the discretion of the Board of Directors of BancGroup as well as upon applicable statutory constraints such as the Delaware law requirement that dividends may be paid only out of capital surplus and net profits for the fiscal year in which the dividend is declared and the preceding fiscal year.

BancGroup also has access to equity capital markets through both public and private issuances. Management considers these sources and related return in addition to internally generated capital in evaluating future expansion or acquisition opportunities.

The Federal Reserve Board has issued guidelines identifying minimum Tier I leverage ratios relative to total assets and minimum capital ratios relative to risk-adjusted assets. The minimum leverage ratio is 3% for bank holding companies that meet certain specified criteria, including that they have the highest regulatory rating. A minimum leverage ratio of 4% is required for all bank holding companies not meeting these criteria. Higher capital ratios may be required for any bank holding company if warranted by its particular circumstance or risk profile. The minimum risk adjusted capital ratios established by the Federal Reserve are 4% for Tier I and 8% for

Table of Contents

total capital. BancGroup s actual capital ratios and the components of capital and risk adjusted asset information (subject to regulatory review) as of March 31, 2005 are stated below:

Capital	**(In thousands, restated)**
Tier I Capital:	
Shareholders equity (excluding unrealized gains/losses on securities available for sale and intangibles plus Trust Preferred Securities)(1)	$ 1,406,972
Tier II Capital:	
Allowable loan loss reserve	153,634
Subordinated debt	214,635
45% of net unrealized gains on available for sale equity securities	522
Total Capital	$ 1,775,763
Risk-Adjusted Assets	$ 15,981,737
Quarterly average assets (excluding intangibles and unrealized gains/losses on securities available for sale)	$ 19,068,751

	March 31, 2005 (Restated)	**December 31, 2004 (Restated)**
Tier I Leverage Ratio	7.38%	7.16%
Risk-Adjusted Capital Ratios:		
Tier I Capital Ratio	8.80%	8.80%
Total Capital Ratio	11.11%	11.39%

(1) Due to the adoption of FIN 46, BancGroup no longer reflects trust preferred securities on its consolidated statement of condition, but rather reflects these securities as junior subordinated debentures. However, under current regulatory guidelines, these securities continue to qualify for Tier 1 Capital treatment.

Net Interest Income

Net interest income represents the difference, or spread, between interest and fee income generated from earning assets and the interest expense paid on deposits and borrowed funds. Interest rate volatility, which impacts the volume and mix of earning assets and interest-bearing liabilities as well as their rates, can significantly impact net interest income.

Net interest income on a tax-equivalent basis increased 26.6% or $34.3 million to $163.4 million for the quarter ended March 31, 2005 from $129.0 million for the quarter ended March 31, 2004.

The Average Volume and Rates and Analysis of Interest Increases/(Decreases) tables present the individual components of net interest income and the net interest margin. Discussion of the changes in these components is provided following the tables.

Table of Contents

Average Volume and Rates

(Unaudited)

	Three Months Ended March 31,					
	2005			2004		
	Average Volume	Interest	Rate	Average Volume	Interest	Rate
	(Dollars in thousands, restated)					
ASSETS:						
Interest earning assets(1):						
All other loans, net of unearned income(2)	$ 12,216,381	$ 186,468	6.18%	$ 10,590,340	$ 145,189	5.51%
Mortgage warehouse loans	970,044	11,367	4.75%	883,301	8,631	3.93%
Loans held for sale(2)	719,822	9,531	5.29%	335,875	4,512	5.37%
Investment securities and securities available for sale(2)	3,840,355	43,755	4.56%	3,150,977	35,848	4.55%
Other interest earning assets	330,781	3,143	3.85%	28,556	79	1.11%
Total interest earning assets	18,077,383	$ 254,264	5.68%	14,989,049	$ 194,259	5.20%
Non-earning assets(2)	1,521,357			1,142,137		
Total assets	$ 19,598,740			$ 16,131,186		
LIABILITIES AND SHAREHOLDERS EQUITY:						
Interest bearing liabilities:						
Interest bearing non-time deposits	$ 5,207,921	$ 14,328	1.12%	$ 4,107,877	$ 8,501	0.83%
Time deposits	4,539,549	32,527	2.91%	3,921,025	25,478	2.61%
Short-term borrowings	3,259,642	18,647	2.32%	2,631,120	6,495	0.99%
Long-term debt(2)	2,312,930	25,404	4.44%	2,222,432	24,764	4.48%
Total interest bearing liabilities	15,320,042	$ 90,906	2.40%	12,882,454	$ 65,238	2.04%
Noninterest bearing demand deposits	2,644,307			1,933,555		
Other liabilities(2)	118,265			114,476		
Total liabilities	18,082,614			14,930,485		
Shareholders equity	1,516,126			1,200,701		
Total liabilities and shareholders equity	$ 19,598,740			$ 16,131,186		
RATE DIFFERENTIAL			3.28%			3.16%
NET INTEREST INCOME AND NET YIELD ON INTEREST-EARNING ASSETS		$ 163,358	3.64%		$ 129,021	3.45%

(1) Interest earned and average rates on obligations of states and political subdivisions are reflected on a tax equivalent basis. Tax equivalent interest earned is: actual interest earned times 145%. The taxable equivalent adjustment has given effect to the disallowance of interest

expense deductions, for federal income tax purposes, related to certain tax-free assets.

(2) Unrealized gains(losses) on available for sale securities and the adjustments for mark to market valuations on hedged assets and liabilities have been classified in either nonearning assets or other liabilities.

Table of Contents

Analysis of Interest Increases/(Decreases)

(Unaudited)

	Three Months Ended March 31, 2005 Change from March 31, 2004		
		Attributed to(1)	
	Total	**Volume**	**Rate**
	(Dollars in thousands, restated)		
INTEREST INCOME:			
All other loans, net of unearned income	$ 41,279	$ 23,036	$ 18,243
Mortgage warehouse loans	2,736	876	1,860
Loans held for sale	5,019	5,087	(68)
Investment securities and securities available for sale	7,907	7,828	79
Other interest earning assets	3,064	2,485	579
Total interest income	60,005	39,312	20,693
INTEREST EXPENSE:			
Interest bearing deposits	5,827	2,528	3,299
Time deposits	7,049	4,078	2,971
Short-term borrowings	12,152	1,835	10,317
Long-term debt	640	887	(247)
Total interest expense	25,668	9,328	16,340
Net interest income	$ 34,337	$ 29,984	$ 4,353

(1) Increases (decreases) are attributed to volume changes and rate changes on the following basis: Volume Change equals change in volume times old rate. Rate Change equals change in rate times old volume. The Rate/Volume Change equals change in volume times change in rate, and it is allocated between Volume Change and Rate Change at the ratio that the absolute value of each of those components bear to the absolute value of their total.

For the first quarter 2005, as compared to the same period in 2004, average earning assets increased 20.6% or $3.1 billion to $18.1 billion compared to $15.0 billion for the first quarter 2004. This increase was due to a $1.7 billion increase in average loans, a $384 million increase in average loans held for sale and a $689.4 million increase in the average investment portfolio. Overall for the first quarter 2005 versus 2004, the increase in interest income was $60.0 million.

Net interest margin increased for the 6th consecutive quarter to 3.64% or 19 basis points over 3.45% in the first quarter of 2004. The average yield on interest earning assets increased 48 basis points, while the average cost of interest-bearing liabilities increased 36 basis points compared to the first quarter of 2004.

Between March of 2004 and March of 2005, the Federal Reserve raised the target federal funds rate seven times for a total increase of 175 basis points. Colonial raised its prime rate in conjunction with each increase in the target federal funds rate.

Approximately 80% of Colonial s loan portfolio is variable or adjustable rate and increases in rate when market rates rise. As a result, loan yields, excluding mortgage warehouse loans and loans held for sale, increased 67 basis points during the first quarter of 2005 over the first quarter of 2004 while the yield on mortgage warehouse loans increased 82 basis points.

The yield on loans held for sale decreased 8 basis points due to the impact of demand on this product. The average yield on securities remained relatively constant at 4.56% in the first quarter of 2005 compared to 4.55% in the first quarter of 2004.

As discussed previously, in March 2005, Colonial sold interests in certain mortgage warehouse loans and loans held for sale to commercial paper conduits. As a result of this transaction, average mortgage warehouse

Table of Contents

loans decreased $39 million and loans held for sale decreased $36 million for the quarter. The transaction decreased net interest income by approximately $433,000, which was substantially offset by an increase in noninterest income of approximately $400,000. The transaction had minimal impact on net interest margin during the quarter due to the short duration it was outstanding, but is expected to be accretive to the margin during the rest of 2005.

The overall funding costs increase of 36 basis points from the first quarter 2004 was primarily due to a 133 basis point increase in the rate on short-term borrowings as a result of the previously mentioned increases in the target federal funds rate. The average rate on interest bearing deposits increased 25 basis points over the first quarter 2004.

Total average deposits growth of $2.4 billion or 24.4% ($1.5 billion or 15.5% excluding acquisitions) over the first quarter of 2004 has lessened the Company s dependence on borrowings, which contributes favorably to Colonial s risk profile and is expected to assist in containing funding costs in a rising rate environment.

In March 2005, Colonial prepaid $200 million in long-term Federal Home Loan Bank (FHLB) advances bearing interest at a weighted average rate of 4.98% resulting in a prepayment fee of $2.29 million reflected as net losses on the early extinguishment of debt. The advances were refinanced with shorter term borrowings at lower rates. In the first quarter of 2004, Colonial recognized $6.2 million in net losses on the early extinguishment of $462 million in FHLB advances which bore interest at an average rate of 4.37%.

Loan Loss Provision

The provision for loan losses for the three months ended March 31, 2005 was $5.9 million compared to $7.9 million for the same period in 2004. Net charge-offs were $7.0 million, or 0.21% annualized as a percent of average net loans, for the three months ended March 31, 2005 compared to $6.0 million, or 0.21% annualized as a percent of average net loans, for the same period in 2004. Less provision was required in the quarter due to the resolution of several impaired credits which had necessitated higher reserve levels.

Noninterest Income

Noninterest income, excluding gains/losses on securities and derivatives and the net cash settlement of derivatives, increased $6.5 million, or 22.2%, for the three months ended March 31, 2005 compared to the same period in 2004. Sources of noninterest income include service charges on deposit accounts, financial planning services, electronic banking services, mortgage banking, securities losses/gains, net cash settlements of swap derivatives, and changes in fair value of swap derivatives.

Service charges on deposit accounts decreased $553,000, or 3.9%, for the three months ended March 31, 2005 over the same period in 2004. These decreases are primarily the result of a reduction of non sufficient funds fees and a higher percentage of commercial deposit fees paid by balance in the first quarter of 2005 than in the prior year.

Financial planning services include discount brokerage, investment sales, asset management, trust services and insurance sales including term, universal, whole life and long-term care. Total financial planning services income increased $768,000, or 24.6%, for the three months ended March 31, 2005 from the same period in 2004. This increase is primarily due to increased sales of securities and annuity products, as well as increased revenues from trust services which more than offset declines in insurance sales.

Electronic banking services enable our customers to bank when and where they want. Electronic banking includes an ATM network, business and personal check cards and internet banking with bill pay service. Noninterest income from electronic banking services increased $687,000, or 24.4%, for the three months ended March 31, 2005, compared to the same period in 2004. This increase is primarily the result of deposit growth, increased check card activities and usage, an increase in Visa s interchange fee rate, and an increase in usage of the Company s internet banking product.

Table of Contents

Net losses on the sale of securities for the quarter ended March 31, 2005 were $1.2 million compared to a net gain of $7.4 million for the same period in 2004.

The change in fair value of swap derivatives for the quarter ended March 31, 2005 decreased $14.1 million compared to the same period in 2004 due to changes in interest rates underlying the swap derivatives.

Income from bank owned life insurance and other income increased $1.2 million and $3.8 million, respectively, for the three months ended March 31, 2005 as compared to the same period in 2004. The increase in other income was primarily from letter of credit fees, mortgage warehouse lending fees, customer and official check fees, the sale of the Company s interest in the PULSE network and income from BancGroup s joint ventures and Goldleaf Technologies subsidiary.

Noninterest Expense

Noninterest expense, excluding losses on the early extinguishment of debt of $2.3 million and $6.2 million for the first quarter of 2005 and 2004, respectively, increased $16.6 million or 17.0% for the quarter ended March 31, 2005 as compared to the same period in 2004. Annualized noninterest expense, excluding net losses on the early extinguishment of debt, to average assets reached its lowest level since the fourth quarter of 2002 at 2.34% for the three months ended March 31, 2005, as compared to 2.43% for the same period in 2004. From the first quarter of 2004 to the end of the first quarter of 2005, BancGroup added 42 new locations, nine new branches and 33 branches through acquisitions. The impact of new branches and acquisition related expenses increased total noninterest expense 8% from the first quarter of 2004. The remaining increase includes investments in our people, product and service offerings and technology.

Salaries and benefits increased $10.3 million for the three months ended March 31, 2005 over the same period in 2004. The salary and employee benefits increase resulted from new branches, normal salary increases, addition of employees in key strategic areas, increases in health benefit costs and increased incentive plan compensation.

Occupancy and equipment expense for the three months ended March 31, 2005 increased $2.4 million when compared to the same period in 2004. The increase was primarily the result of new branches, as well as additional occupancy and equipment expenses from expansion of operational support functions and continued technology enhancements.

The increase in amortization of intangible assets was due to the acquisition of Union Bank in February 2005 and P.C.B. Bancorp, Inc. in May 2004. Merger related expenses of $1.1 million for the quarter ended March 31, 2005 were also the result of the Union Bank acquisition. Refer to Note E for further discussion of the Union Bank acquisition.

The $2.3 million and $6.2 million in net losses on the early extinguishment of debt for the quarter ended March 31, 2005 and 2004, respectively, was a result of the early payoff of FHLB advances and other borrowings. Refer to the *Net Interest Income* section for further discussion.

The increase in other expense of $1.6 million for the three months ended March 31, 2005 over the same period in 2004 was primarily the result of new branches and expenses of various equity investments, as well as a net increase in normal operating expenses.

Provision For Income Taxes

BancGroup s provision for income taxes is based on an approximate 33.0% and 34.2%, estimated annual effective tax rates for the years ended 2005 and 2004, respectively. The provisions for income taxes for the three months ended March 31, 2005 and 2004 were $23.8 million and $22.3 million, respectively.

33

Table of Contents

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The information required by this item is included in Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.

Item 4. Controls and Procedures

(a) Restatement.

In the course of regular review procedures, our accounting staff identified errors with respect to the Company s use of hedge accounting for certain transactions in accordance with generally accepted accounting principles, including Statement of Financial Accounting Standards No. 133 (SFAS 133) and its related interpretations. The errors were in accounting for interest rate swaps for brokered certificates of deposit and junior subordinated debt. Upon initial application these swaps were viewed as eligible for the abbreviated method of documenting effectiveness of the swaps as hedges. Because these swaps were retrospectively determined not to qualify for the abbreviated method of documentation, we were required to, but did not, test periodically for effectiveness. Adjustments to correct the accounting for these transactions are included in our restated consolidated financial statements.

The accounting staff reported their findings to management, to PricewaterhouseCoopers LLP and to the Audit Committee of the Board of Directors. After initial discussions with the Audit Committee, management reviewed these matters in further detail, and after completing its analysis on December 29, 2005, recommended to the Audit Committee and the Executive Committee of the Board of Directors that previously reported financial results be restated to reflect correction of these errors. The Executive Committee of the Board of Directors and the Audit Committee of the Board of Directors determined at their joint meeting on December 29, 2005, that previously reported results for The Colonial BancGroup Inc. s Annual Report on Form 10-K for the year ended December 31, 2004 and Quarterly Reports on Form 10-Q for the quarters ended March 31, June 30 and September 30, 2005 should be restated to eliminate hedge accounting for these swaps and, in light of the restatement, that the financial statements and other information referred to above should no longer be relied upon.

(b) Evaluation of Disclosure Controls and Procedures

In connection with the restatement, under the direction of our Chief Executive Officer and Chief Financial Officer, we reevaluated our disclosure controls and procedures as of March 31, 2005. We identified a material weakness in our internal control over financial reporting with respect to accounting for hedge transactions.

Solely as a result of this material weakness, we concluded that our disclosure controls and procedures were not effective as of March 31, 2005.

(c) Changes in Internal Control over Financial Reporting

As previously reported, there was no change in our internal control over financial reporting during the quarter ended March 31, 2005, that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

Item 1. Legal Proceedings See Notes to the Unaudited Condensed Consolidated Financial Statements Note C Contingencies

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds N/A

On February 10, 2005, BancGroup issued 2,903,402 shares of its common stock to UB Financial Corporation as partial consideration for all of the shares of Union Bank of Florida. When issued, these shares had not been registered with the Securities Exchange Commission or with any state securities department. The BancGroup common stock was issued pursuant to the exemption afforded under Section 4(2) of the Securities Act of 1933, as amended. The acquisition of Union Bank of Florida is more fully described in Note E to the Financial Statements included within this report. The BancGroup common stock was subsequently registered for a possible public distribution by UB Financial Corporation or its shareholders on a Registration Statement on Form S-3 (File No. 333-121707) which became effective on February 11, 2005.

Item 3. Defaults Upon Senior Securities N/A

Item 4. Submission of Matters to a Vote of Security Holders N/A

Item 5. Other Information N/A

Item 6. Exhibits.

Exhibits required by Item 601 of Regulation S-K

Exhibit	
31.1	Rule 13a-14(a)/15d-14(a) Certifications of the Chief Executive Officer
31.2	Rule 13a-14(a)/15d-14(a) Certifications of the Chief Financial Officer
32.1	Rule 13a-14(b) Certifications of the Chief Executive Officer
32.2	Rule 13a-14(b) Certifications of the Chief Financial Officer

Table of Contents

SIGNATURE

Pursuant to the requirements of Section 13 or 15(d) 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, in the City of Montgomery, Alabama, on the 13th day of February, 2006.

THE COLONIAL BANCGROUP, INC.

By: /s/ SARAH H. MOORE

Sarah H. Moore

Chief Financial Officer

36