

SECURITIES AND EXCHANGE COMMISSION

FORM 10QSB

Optional form for quarterly and transition reports of small business issuers under section 13 or 15(d)

Filing Date: **2002-05-14** | Period of Report: **2002-03-31**
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FILER

STATE OF FRANKLIN BANCSHARES INC

CIK: **1066626** | IRS No.: **621607709** | State of Incorporation: **TN** | Fiscal Year End: **1231**
Type: **10QSB** | Act: **34** | File No.: **000-24675** | Film No.: **02646420**
SIC: **6022** State commercial banks

Mailing Address
1907 NORTH ROAN STREET
JOHNSON CITY TN 37604

Business Address
1907 NORTH ROAN STREET
JOHNSON CITY TN 37604
4239263300

U. S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

FORM 10-QSB

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED: MARCH 31, 2002

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

COMMISSION FILE NUMBER: 0-24675

STATE OF FRANKLIN BANCSHARES, INC.

(EXACT NAME OF SMALL BUSINESS ISSUER AS SPECIFIED IN ITS CHARTER)

TENNESSEE

(STATE OF INCORPORATION)

62-1607709

(I.R.S. EMPLOYER
IDENTIFICATION NO.)

1907 NORTH ROAN STREET, JOHNSON CITY, TENNESSEE, 37601

(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

(423) 926-3300

(ISSUER'S TELEPHONE NUMBER, INCLUDING AREA CODE)

NONE

(FORMER NAME, ADDRESS AND FISCAL YEAR, IF CHANGED SINCE LAST REPORT)

INDICATE BY CHECK MARK WHETHER THE ISSUER: (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

1,465,512

(OUTSTANDING SHARES OF THE ISSUER'S COMMON STOCK AS OF MAY 10, 2002)

TRANSITIONAL SMALL BUSINESS DISCLOSURE FORMAT (CHECK ONE):

YES NO X

STATE OF FRANKLIN BANCSHARES, INC

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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STATE OF FRANKLIN BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

MARCH 31,

DECEMBER 31,

ASSETS	2002 - UNAUDITED	2001 - AUDITED
<S>	<C>	<C>
Cash and Due from Banks	\$ 3,716,917	5,252,689
Federal Funds Sold	10,600,000	28,590,000
Short-Term Interest Bearing Deposits	301,479	57,649
Investments - HTM		
(Estimated Market 2002 - \$18,290,569 and 2001 - \$9,636,374)	18,576,734	9,676,885
Investments - AFS	67,795,685	63,780,481
Loans Held for Sale	1,456,479	2,548,370
Loans and Leases Receivable	144,941,901	139,090,332
Less: Allowance for Loan and Lease Losses	(1,344,196)	(1,473,855)
Loans and Leases Receivable, Net	143,597,705	137,616,477
Accrued Interest Receivable, Net	1,991,814	1,364,280
Land, Buildings & Equip at Cost Less Accum Depr of \$1,384,216 in 2002 and \$1,260,895 in 2001	5,451,456	5,319,180
Prepaid Expense and Accounts Receivable	79,103	119,647
Deferred Tax Assets	624,041	709,103
FHLB Stock	2,185,600	2,161,700
Other Real Estate Owned	870,910	449,988
Other Assets	233,981	239,000
TOTAL ASSETS	\$ 257,481,904	257,885,449
=====		
LIABILITIES AND STOCKHOLDERS' EQUITY		
=====		
LIABILITIES:		
Interest-Free Deposits	\$ 9,302,202	18,216,284
Interest-Bearing Deposits	188,897,692	181,920,790
Advances by Borrowers for Taxes and Insurance	173,637	99,414
Accrued Interest on Deposits	186,379	179,897
Accounts Payable and Accrued Expenses	641,434	420,784
FHLB Long-Term Advances	30,494,461	30,240,995
Deferred Credits on REO	144,337	21,448
TOTAL LIABILITIES	\$ 229,840,142	231,099,612
=====		
Guaranteed Preferred Beneficial Interest in Subordinated Debentures	8,000,000	8,000,000
STOCKHOLDERS' EQUITY:		
Common Stock, \$1.00 Par Value	1,465,512	1,465,512
Paid-in Capital	14,251,461	14,251,461
Accumulated Other Comprehensive Income	(221,686)	(368,029)
Retained Earnings	5,176,515	4,526,987
Less: Employee Stock Ownership	(1,030,040)	(1,090,094)
TOTAL STOCKHOLDERS' EQUITY	\$ 19,641,762	18,785,837
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 257,481,904	257,885,449
=====		

</TABLE>

The accompanying notes are an integral part of the consolidated financial statements.

<TABLE>
<CAPTION>

STATE OF FRANKLIN BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF INCOME

THREE MONTHS ENDED MARCH 31,

INTEREST INCOME:	2002 - UNAUDITED	2001 - UNAUDITED
<S>	<C>	<C>

Interest and Fees on Loans	\$ 2,722,711	3,016,603
Other Interest Income	1,254,219	975,424
TOTAL INTEREST INCOME	3,976,930	3,992,027
INTEREST EXPENSE:		
Interest on Deposits	1,440,906	2,164,843
Interest on Short-Term Debt	1	84,776
Interest on Long-Term Debt	368,767	305,617
Interest on Subordinated Debentures	124,208	-
TOTAL INTEREST EXPENSE	1,933,882	2,555,236
NET INTEREST INCOME BEFORE PROVISION FOR LOAN LOSS	2,043,049	1,436,791
PROVISION FOR LOAN LOSSES	(147,500)	(78,277)
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSS	1,895,549	1,358,514
OTHER INCOME:		
Other Fees and Service Charges	113,399	107,134
Net Gain on Loans Sold	91,692	28,347
Insurance Commission Income	18,958	3,322
Rental Income, Net	23,385	16,237
TOTAL OTHER INCOME	247,434	155,040
OTHER EXPENSES:		
Compensation and Related Benefits	596,826	429,037
Occupancy Expenses	86,706	72,769
Furniture and Equipment Expense	111,536	81,102
Advertising	30,968	23,677
Data Processing Expense	126,445	113,480
Other	391,702	203,196
TOTAL OTHER EXPENSES	1,344,183	923,261
INCOME BEFORE INCOME TAX	798,799	590,293
PROVISION FOR INCOME TAXES	(149,271)	(178,407)
NET INCOME	\$ 649,528	411,886
EARNINGS PER SHARE:		
BASIC	\$ 0.47	0.30
DILUTED	0.44	0.29
WEIGHTED AVERAGE SHARES OUTSTANDING:		
BASIC	1,378,208	1,366,126
DILUTED	1,469,566	1,424,281

</TABLE>

The accompanying notes are an integral part of the consolidated financial statements.

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<TABLE>
<CAPTION>

STATE OF FRANKLIN BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
FOR THREE MONTHS ENDED MARCH 31, 2002 (UNAUDITED) AND YEAR ENDED DECEMBER 31, 2001 (AUDITED)

Common	Paid-In	Accumulated Other Comprehensive	Retained	Employee Stock
--------	---------	---------------------------------------	----------	-------------------

	Stock	Capital	Income	Earnings	Ownership	Total
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Balance at December 31, 2000	1,465,512	14,251,461	89,677	2,569,576	(1,151,623)	17,224,603
ESOP Shares Allocated	--	--	--	--	61,529	61,529
Comprehensive Income						
Other Comprehensive Income,						
Net of Tax:						
Unrealized Gains on Securities						
Available-For-Sale:						
Unrealized Holding Losses						
Arising During the Period						
(Net of \$251,218 Income Tax)	--	--	(401,015)	--	--	(401,015)
Less: Reclassification Adjustment						
(Net of \$34,746 Income Tax)	--	--	(56,691)	--	--	(56,691)
						(457,706)
Net Income	--	--	--	1,957,411	--	1,957,411
Total Comprehensive Income	--	--	--	--	--	1,499,705
Balance at December 31, 2001	1,465,512	14,251,461	(368,029)	4,526,987	(1,090,094)	18,785,837
ESOP Shares Allocated	--	--	--	--	60,054	60,054
Comprehensive Income						
Other Comprehensive Income,						
Net of Tax:						
Unrealized Gains on Securities						
Available-For-Sale:						
Unrealized Holding Losses						
Arising During the Period						
(Net of \$85,383 Income Tax)	--	--	148,177	--	--	148,177
Less: Reclassification Adjustment						
(Net of \$1,124 Income Tax)	--	--	(1,834)	--	--	(1,834)
						146,343
Net Income	--	--	--	649,528	--	649,528
Total Comprehensive Income	--	--	--	--	--	795,871
Balance at March 31, 2002	1,465,512	14,251,461	(221,686)	5,176,515	(1,030,040)	19,641,792

</TABLE>

The accompanying notes are an integral part of the consolidated financial statements.

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STATE OF FRANKLIN BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	THREE MONTHS ENDED MARCH 31,	
<S>	2002 - UNAUDITED	2001 - UNAUDITED
<S>	<C>	<C>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income	\$ 649,528	411,886
Items Not Affecting Cash:		
Depreciation	120,664	92,567
(Increase) Decrease in Accrued Interest	(627,534)	213,244

Deferred Income Taxes (Benefit)	(4,635)	(14,707)
Provision for Loan and Lease Losses	147,500	78,277
(Increase) Decrease in Prepaid Expenses and Accounts Receivable	40,544	(40,815)
Increase in Interest Payable	6,482	29,079
Increase in Accounts Payable and Accrued Expenses	220,650	90,807
Increase (Decrease) in Deferred Loan Fees, Net	41,716	(3,066)
Discount Accretion	(127,990)	(98,484)
Earned ESOP Shares	60,054	21,371
FHLB Stock Dividends	(23,900)	(23,900)
Net (Increase) Decrease in Loans Held for Sale	1,091,891	(937,013)
<hr/>		
NET CASH PROVIDED BY OPERATING ACTIVITIES	1,594,970	(190,454)
<hr/>		
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of Held-to-Maturity Investments	(8,911,815)	-
Purchase of Available-for-Sale Investments	(3,989,834)	(16,156,869)
Proceeds from Sale of Available-for-Sale Investments	-	-
Proceeds from Maturities of Available-for-Sale Investments	350,865	3,925,000
Proceeds from Sale of Available-for-Sale Investments	-	6,000,000
(Increase) Decrease in Federal Funds Sold	17,990,000	(1,730,000)
(Increase) Decrease in Short-Term Interest Bearing Deposits	(243,830)	188,467
(Increase) in Loans Receivable, Net	(6,463,698)	(2,543,105)
Purchases of Premises and Equipment	(252,940)	(20,750)
Purchases of Federal Home Loan Bank Stock	-	(500,000)
<hr/>		
NET CASH (USED) BY INVESTING ACTIVITIES	(1,521,251)	(10,837,257)
<hr/>		
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net Increase (Decrease) in Deposits	(1,937,180)	6,392,977
Net Increase in Advances by Borrowers for Taxes and Insurance	74,223	66,644
Repayment of Debt	-	(14,522)
Repayment of FHLB Advances	-	(12,660,000)
Proceeds from FHLB Advances	253,466	16,998,593
<hr/>		
NET CASH PROVIDED BY FINANCING ACTIVITIES	(1,609,491)	10,783,692
<hr/>		
NET INCREASE IN CASH	(1,535,772)	(244,019)
CASH AND DUE FROM BANKS AT BEGINNING OF PERIOD	5,252,689	4,715,833
<hr/>		
CASH AND DUE FROM BANKS AT END OF PERIOD	\$ 3,716,917	4,471,814
<hr/>		
SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Increase (Decrease) in Unrealized Gain (Loss) on Securities Available-For-Sale, Net of Deferred Tax Liability	\$ 146,343	342,122
Acquisition of Real Estate Property through Foreclosure of Related Loans	\$ 870,910	-
<hr/>		
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash Paid During the Period for:		
Income Taxes	\$ 714,077	20,000
Interest	\$ 1,927,400	2,526,157
<hr/>		

</TABLE>

The accompanying notes are an integral part of the consolidated financial statements.

STATE OF FRANKLIN BANCSHARES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - UNAUDITED

NOTE 1 INCORPORATION AND OPERATIONS

State of Franklin Bancshares, Inc. (the "Company") was incorporated under the laws of the State of Tennessee for the purpose of becoming the holding company of State of Franklin Savings Bank (the "Savings Bank"). The stockholders of the Savings Bank exchanged their shares for the shares of the Company, whereby the Savings Bank became a wholly owned subsidiary of

the Company. State of Franklin Leasing Corporation (the "Leasing Corp") was incorporated under the laws of the State of Tennessee for the purpose of lease financing. In January 2002, State of Franklin Real Estate, Inc. (the "Real Estate Company") was incorporated for the purpose of selling real estate. The Real Estate Company and John Sevier Title Services, Inc. (the "Title Company") are wholly owned subsidiaries of the Savings Bank. The Leasing Corp is a wholly owned subsidiary of the Company.

NOTE 2 BASIS OF PREPARATION

The accompanying reviewed consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated. These financial statements were prepared in accordance with generally accepted accounting principles for interim financial information and in accordance with the instructions for Form 10-QSB. Accordingly, they do not include all disclosures necessary for a complete presentation of the consolidated statements of financial condition, income, cash flows, and changes in stockholders' equity in conformity with generally accepted accounting principles. However, all adjustments which are, in the opinion of management, necessary for the fair presentation of the interim financial statements have been included. All such adjustments are of a normal recurring nature. The statement of comprehensive income for the three months ended March 31, 2002 is not necessarily indicative of the results which may be expected for the entire year.

These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the Company for the year ended December 31, 2001.

NOTE 3 RECLASSIFICATIONS

In instances where required, amounts reported in prior period's financial statements included herein have been reclassified to put them on a comparable basis to the amounts reported in the March 31, 2002 consolidated financial statements.

NOTE 4 LAND BUILDINGS AND EQUIPMENT

Fixed assets at March 31, 2002, and December 31, 2001 are summarized as follows:

<TABLE>
<CAPTION>

	2002	2001
	-----	-----
<S>	<C>	<C>
Land	1,450,000	1,450,000
Buildings and Leasehold Improvements	3,078,176	3,040,756
Furniture, Fixtures and Equipment	2,307,496	2,091,976
	-----	-----
	6,835,672	6,582,732
Less: Accumulated Depreciation	1,384,216	1,263,552
	-----	-----
	5,451,456	5,319,180
	=====	=====

</TABLE>

NOTE 5 LOANS RECEIVABLE

Loans receivable at March 31, 2002 and December 31, 2001, consist of the following:

<TABLE>
<CAPTION>

	2002	2001
	-----	-----
<S>	<C>	<C>
First Mortgage Loans	57,110,664	54,554,665
Construction Loans	23,792,705	20,163,050
Consumer Loans	12,595,071	12,536,061
Participation Loans, Net	498,142	503,354
Commercial Loans	59,931,593	56,028,216
Credit Line Advances	692,322	710,137
Lease Finance	1,260,604	1,342,242
	-----	-----
Gross Loans and Leases Receivable	155,881,101	145,837,725
	-----	-----
Less:		
Undisbursed Portion of Loans in Process	(10,756,535)	(6,606,444)
Net Deferred Loan Origination Fees	(182,665)	(140,949)
Accumulated General Loan Loss Allowance	(1,367,186)	(1,473,855)
	-----	-----
	(12,283,396)	(8,221,248)
	-----	-----
Loans and Leases Receivable, Net	143,597,705	137,616,477
	=====	=====

</TABLE>

An analysis of the allowance for loan and lease losses at March 31, 2002 and December 31, 2001 is as follows:

<TABLE>
<CAPTION>

	2002	2001
	-----	-----
<S>	<C>	<C>
Balance - Beginning of Period	1,473,855	1,062,511
Provision for Loan and Lease Losses	147,500	589,902
Loans and Leases Charged-Off	(277,502)	(181,508)
Charged-Off Loan and Lease Recoveries	343	2,950
	-----	-----
Balance - End of Period	1,344,196	1,473,855
	=====	=====

</TABLE>

The gross amount of participation loans serviced by State of Franklin Savings Bank was \$995,858 at March 31, 2002 and \$1,006,596 at December 31, 2001.

The Bank had \$1.3 million in non-performing loans at March 31, 2002 compared to \$2.8 million at December 31, 2001.

NOTE 6 FEDERAL REGULATION

The capital ratios for State of Franklin Savings Bank are as follows:

<TABLE>
<CAPTION>

For Capital
Adequacy
Purposes

In Thousands (Reviewed)	Actual		And To Be Well Capitalized Under Prompt Corrective Action Provision	
	Amount	Ratio	Amount	Ratio
<S>	<C>	<C>	<C>	<C>
As of March 31, 2002:				
Total Risk-Based Capital (to Risk-Weighted Assets)	19,246	11.32%	>=17,006	10.0%
Tier 1 Capital (to Risk-Weighted Assets)	17,947	10.55%	>=10,203	6.0%
Tier 1 Capital (to Adjusted Total Assets)	17,947	7.17%	>=12,517	5.0%
As of December 31, 2001:				
Total Risk-Based Capital (to Risk-Weighted Assets)	18,680	11.25%	>=16,602	10.0%
Tier 1 Capital (to Risk-Weighted Assets)	17,244	10.39%	>= 9,961	6.0%
Tier 1 Capital (to Adjusted Total Assets)	17,244	7.44%	>=11,588	5.0%

</TABLE>

The capital ratios for State of Franklin Bancshares, Inc. are as follows:

<TABLE>
<CAPTION>

In Thousands (Reviewed)	Actual		For Capital Adequacy Purposes And To Be Well Capitalized Under Prompt Corrective Action Provision	
	Amount	Ratio	Amount	Ratio
<S>	<C>	<C>	<C>	<C>
As of March 31, 2002:				
Total Risk-Based Capital (to Risk-Weighted Assets)	29,007	16.97%	>=17,078	10.0%
Tier 1 Capital (to Risk-Weighted Assets)	26,186	15.33%	>=10,247	6.0%
Tier 1 Capital (to Adjusted Total Assets)	26,186	10.39%	>=12,598	5.0%
As of December 31, 2001:				
Total Risk-Based Capital (to Risk-Weighted Assets)	28,392	17.03%	>=16,671	10.0%
Tier 1 Capital (to Risk-Weighted Assets)	25,224	15.13%	>=10,003	6.0%
Tier 1 Capital (to Adjusted Total Assets)	25,224	10.80%	>=11,675	5.0%

</TABLE>

EMPLOYEE STOCK OWNERSHIP PLAN

The Company has an employee stock ownership plan (ESOP) for those employees who meet the eligibility requirements of the plan. The ESOP was established and funded for 1997. On February 28, 1998, 5,236 shares of the Savings Bank with a fair value of \$57,600 were issued for the 1997 contribution. The Savings Bank stock was exchanged for Company stock.

During the third quarter of 1998, the ESOP borrowed \$700,000 from the Company and used the funds to purchase 63,636 shares of common stock of the Company at \$11 per share. Note payments were \$8,218 per month for ten years with a fixed interest rate of 7.25%. The note balances outstanding at December 31, 2000 and 1999 were \$571,637 and \$626,615, respectively. A related loan was granted for the purpose of leveraging the ESOP in the amount of \$700,000 with similar terms and collateralized with stock. The note balances outstanding at December 31, 2000 and 1999 were \$571,637 and \$626,615, respectively.

On June 30, 2000, the ESOP borrowed an additional \$599,994 from the Company and used the funds to purchase 44,444 additional shares of common stock of the Company at \$13.50 per share. Note payments were \$7,280 per month for ten years with a fixed interest rate of 8.00%. The note balance outstanding at December 31, 2000 was \$579,985. In November 2001, the ESOP loans were consolidated into a seven year term loan from the Company in the amount of \$1,071,093 with a fixed interest rate of 6.00%. Note payments are \$15,218 per month for 83 months plus a final principal payment of \$24,092. The note balance outstanding at March 31, 2002 was \$1,015,140. Also, in November 2001, the Company granted a \$300,000 line of credit to the ESOP for the purchase of additional shares of stock in the Company as it becomes available. The interest rate for balances outstanding on the line of credit is 6% with a five year term. Interest is paid monthly with principal payments made as funds are available. At March 31, 2002, the outstanding balance advanced on the line of credit was \$14,900.

Shares owned by the ESOP at December 31, 2001 totaled 151,528. ESOP shares are maintained in a suspense account until released and allocated to participants' accounts. The release of shares from the suspense account is based on the principal paid in the year in proportion to the total of current year and remaining outstanding debt. Allocation of released shares to participants' accounts is done as of December 31. Shares allocated and remaining in suspense were as follows:

	March 31, 2002	December 31, 2001
	-----	-----
Number of Shares		
Released and Allocated	49,340	43,654
Committed to be Released	2,533	5,687
Suspense	86,292	88,814
Fair Value		
Released and Allocated	888,120	707,195
Committed to be Released	45,594	351,049
Suspense	1,553,256	1,438,787

Contributions to the ESOP are as follows:

	March 31, 2002	December 31, 2001
	-----	-----
Compensation Expense	78,000	264,000
Contributions	78,000	264,000

For the purpose of computing earnings per share, all ESOP shares committed to be released will be considered outstanding.

STOCK OPTION PLANS

<TABLE>
<CAPTION>

Weighted

		Awarded And Unexercised Options	Vested Options	Average Exercise Price Per Share
<S>		<C>	<C>	<C>
Options Granted - Outside Directors	January 1, 2002 During 2002	76,014 7,000	49,707 7,000	\$11.62 16.20
Options Granted - Management	January 1, 2002 During 2002	182,166 20,982	109,910 --	\$11.64 16.20
Options Outstanding - March 31, 2002		286,162 =====	166,617 =====	\$12.08

</TABLE>

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NOTE 8 DEPOSITS

Deposit balances are summarized as follows:

	March 31, 2002			December 31, 2001		
	Rate	Amount	Percent	Rate	Amount	Percent
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Passbook	2.63	52,620,594	26.55	2.60	41,603,020	20.79
Interest-Free Checking	--	9,302,202	4.69	--	18,216,284	9.10
NOW	1.98	9,818,913	4.95	2.00	8,512,548	4.26
Money Market Deposit	2.20	40,526,056	20.45	2.21	46,020,212	22.99
		112,267,765	56.64		114,352,064	57.14
Fixed Term Certificate Accounts						
Balances \$100,000 or greater	4.00	22,663,906	11.44	4.45	22,237,766	11.11
Balances less than \$100,000	3.81	63,268,223	31.92	4.32	63,547,244	31.75
		85,932,129	43.36		85,785,010	42.86
		198,199,894	100.00		200,137,074	100.00

</TABLE>

The contractual maturity of certificate accounts at March 31, 2001 and December 31, 2000, is as follows:

Period Ending March 31, 2002		Year Ending December 31, 2001	
2002	64,381,162	2002	77,330,432
2003	15,136,346	2003	5,968,854
2004	3,974,088	2004	1,323,611
2005	2,220,253	2005	1,162,113
2006 and After	220,280	2006 and After	--
	85,932,129		85,785,010

NOTE 9 FEDERAL HOME LOAN BANK ADVANCES

Advances from FHLB are summarized as follows for the periods ended March 31, 2002 and December 31, 2001:

Contractual Maturity	2002	2001
Convertible Fixed Rate (Within 10 Years)	30,000,000	30,000,000
Matched-Funding (30-Year Amortizing)	494,461	240,995
Weighted Average Rate	4.92%	4.95%

The convertible fixed rate advances have an original maturity of 10 years with an option held by FHLB to convert to a variable rate tied to 3-month LIBOR beginning 1 to 3 years from the original issue date. If converted to a variable rate the bank maintains the option to pay off the advance or continue at the variable rate over the original contractual maturity of the advance.

NOTE 10 INVESTMENT SECURITIES

The amortized cost and fair value of investment securities held-to-maturity and available-for-sale at March 31, 2002, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations without call or prepayment penalties.

11

NOTE 10 CONTINUED

March 31, 2002:

<TABLE>

<CAPTION>

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
<S>	<C>	<C>	<C>	<C>

Available-for-Sale:

United States Government Agency Securities Maturing:

After five years				
but within ten years	6,891,182	120,382	--	7,011,564
After ten years				
but within fifteen years	999,740	--	38,810	960,930
After fifteen years				
but within twenty years	3,434,010	128,796	138,669	3,424,137
After twenty years	1,104,343	--	74,653	1,029,690

U S Agency Collateralized Mortgage Obligations:

After five years				
but within ten years	1,946,387	1,288	12,868	1,934,807
After fifteen years				
but within twenty years	1,948,644	22,682	--	1,971,326

Municipal Securities Maturing:

After one year				
but within five years	675,000	22,532	--	697,532
After five years				
but within ten years	2,401,656	30,468	28,944	2,403,180
After ten years				
but within fifteen years	10,598,565	62,035	121,139	10,539,461
After fifteen years				
but within twenty years	4,965,622	--	153,139	4,812,483
After twenty years	1,512,760	549	24,053	1,489,256

Equity Securities (Preferred

Stock in U S Government Agencies):

Callable after 1 year				
but within five years	17,000,000	--	234,444	16,765,556
Callable after five years				
but within ten years	5,933,450	178,702	--	6,112,152

Other

Within one year	1,080,595	--	--	1,080,595
After five years				
but within ten years	3,000,000	--	79,602	2,920,398
After ten years				
but within fifteen years	2,100,000	--	75,095	2,024,905
After twenty years	2,558,494	75,311	16,092	2,617,713
	-----		-----	-----
Total Available-for-Sale	68,150,448	642,745	997,508	67,795,685
	=====	=====	=====	=====

Held-to-Maturity:

United States Government Agency Securities Maturing:

After five years				
but within ten years	4,838,347	--	14,400	4,823,947
After ten years				
but within fifteen years	5,490,878	--	138,362	5,352,516

U S Agency Collateralized Mortgage Obligations:

After one year				
but within five years	4,235,443	32,983	26,907	4,241,519
After five years				
but within ten years	4,012,066	--	139,478	3,872,588
	-----		-----	-----
Total Held-to-Maturity	18,576,734	32,983	319,147	18,290,570
	=====	=====	=====	=====

</TABLE>

NOTE 11 EARNINGS PER SHARE

Earnings per share for quarter ended March 31, 2002, compared with quarter ended March 31, 2001, is as follows:

<TABLE>
<CAPTION>

	March 31,	
	2002	2001
	-----	-----
<S>	<C>	<C>
Net Income	649,528	411,886
Average Basic Shares Outstanding	1,378,208	1,366,126
Basic Earnings Per Share	0.47	0.30
	====	====
Net Income	649,528	411,886
Average Basic Shares Outstanding	1,378,208	1,366,126
Dilutive Effect Due to Stock Options	91,327	58,155
	-----	-----
Average Shares Outstanding, as Adjusted	1,469,535	1,424,281
Diluted Earnings Per Share	0.44	0.29
	====	====

</TABLE>

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

GENERAL

The following discussion and analysis is intended to assist in understanding the financial condition and the results of operations of the Company. State of Franklin Savings Bank (the "Savings Bank") and State of Franklin Leasing Corporation (the "Leasing Corp") represents virtually all of the assets of State of Franklin Bancshares, Inc. (the "Company"). The Company places an emphasis on an integrated approach to its balance sheet management. Significant balance sheet components of investment securities, loans and sources of funds are managed in an integrated manner with the management of interest rate risk, liquidity, and capital. These components are examined below.

BALANCE SHEET REVIEW

At March 31, 2002, assets of the Company totaled \$257.5 million reflecting a slight decline of \$404,000 or .2% since December 31, 2001. The decline in assets was due primarily to a \$1.9 million decline in deposits combined with increases in Federal Home Loan Bank advances and stockholders' equity.

LOANS

Loans outstanding totaled \$146.4 million at March 31, 2002. This represented an increase of 3% from the December 31, 2001 outstanding loans of \$141.6 million.

Commercial loans increased \$3.9 million to \$59.9 million at March 31, 2002, an increase of 7% from \$56 million at December 31, 2001. Real estate construction lending totaled \$23.8 million compared with \$20.2 million at December 31, 2001, reflecting an increase of \$3.6 million or 18%. Consumer loans of \$12.6 million at March 31, 2002 increased \$59,000 from \$12.5 million at December 31, 2001. During the first three months of 2002, first mortgage residential loans increased to \$57.1 million or 5% from \$54.6 million at December 31, 2001. The loan portfolio mix at March 31, 2002 consists of 37% residential mortgages, 39% commercial, 14% real estate

construction, and 10% consumer loans.

INVESTMENT SECURITIES

Investment securities totaled \$86.4 million at March 31, 2001. The investment portfolio at quarter end consisted of \$22.8 million in debt securities issued by the U. S. Government or Federal Agencies, \$12.2 million in Federal Agency Collateralized Mortgage Obligations, \$22.9 million in preferred stock issued by Federal Agencies, \$19.9 million in securities issued by state, county, or municipalities, and \$8.6 million in corporate securities.

At March 31, 2002, securities categorized as available-for-sale totaled \$67.8 million while the held-to-maturity securities totaled \$18.6 million compared to \$63.8 million in available-for-sale and \$9.7 million in held-to-maturity at December 31, 2001. At March 31, 2002, the available-for-sale portfolio had a net unrealized loss of \$354,763 while our held-to-maturity securities had \$286,164 in unrealized losses due to changes in market rates. Due to the credit quality of these investments, no realized losses are expected.

NON-PERFORMING ASSETS

Loans past due 90 days or more were \$1.6 million at March 31, 2002 and \$881,000 at December 31, 2001. Nonaccrual loans were \$1.3 million at March 31, 2002 compared with \$2.8 million at December 31, 2001. The reserve for loan and lease losses was \$1,367,186 at March 31, 2002, or 0.94% of loans and leases outstanding, net of unearned income, compared to \$1,473,855 or 1.06% at December 31, 2001. Management believes the allowance for loan losses is adequate to provide for potential loan losses.

DEPOSITS

Total deposits at March 31, 2002 of \$198.2 million, reflected a decline of \$1.9 million or a 4% decrease from \$200.1 million at December 31, 2001. Non-interest bearing demand deposits totaled \$9,302,202 at March 31, 2002, a decrease of \$8.9 million from December 31, 2001. Interest bearing deposits increased \$7 million to \$188.9 million at March 31, 2002.

CAPITAL

Tier 1 capital for the Savings Bank at March 31, 2002 was \$17.9 million. At March 31, 2002, all capital ratios were in excess of the regulatory minimums, with the Savings Bank's Tier 1, total risk-based, and leverage ratios of 10.55%, 11.32% and 7.17%, respectively.

Tier 1 capital for the Company at March 31, 2002, was \$26.2 million with Tier 1, total risk-based, and leverage ratios of 15.33%, 16.97%, and 10.39%, respectively.

LIQUIDITY

The purpose of liquidity management is to ensure that there is sufficient cash flow to satisfy demands for credit, deposit withdrawals, and other corporate needs. Traditional sources of liquidity include asset maturities and growth in core deposits. Other sources of funds such as securities sold under agreements to repurchase, negotiable certificates of deposit and other liabilities are sources of liquidity that the Company has not significantly used. The Company had unused sources of liquidity in the form of unused federal funds lines of credit and an unused line of credit with

the Federal Home Loan Bank of Cincinnati totaling \$19 million at March 31, 2002.

EARNINGS REVIEW

The Company had net income of \$649,528 for the three months ending March 31, 2002, compared with \$411,886 for the same period last year, resulting in an increase of 58%. Net income per diluted share was \$0.44 compared to earnings per share of \$0.29 for the three months ending March 31, 2001. Return on average assets was 1.04% and the return on average equity was 14.07% for the three month period ended March 31, 2002, compared with .80% and 9.21%, respectively, for the same period in 2001.

Noninterest income increased \$92,394, or 60%, during the three months ended March 31, 2002, compared the same period last year as a result of the net effect several factors. Gain on loans sold increased \$63,345, other fees and service charges increased \$6,265, rental income increased \$7,148, and insurance commission income increased \$15,636.

Noninterest expense was \$1,344,183 for the three months ending March 31, 2002, an increase of 46% over the 2001 period, resulting mainly from compensation and related benefits, occupancy, furniture and equipment expense, advertising, data processing, and other expenses associated with growth of the Company.

NET INTEREST INCOME

Interest income increased while interest expense decreased from 2001 to 2002 resulting from a combination of increases in earning assets and interest bearing liabilities and a decline in overall interest rates. Net interest income of \$2.0 million for the three months ended March 31, 2002 reflects an increase of \$606,258 or 42% over the same period last year. For the three months ending March 31, 2002, average earning assets increased \$42.1 million or 21% while average interest bearing liabilities increased \$39.9 million, or 22%, compared with the same period in 2001. Average earning asset yield declined 125 basis points to 7.01% while the cost on interest bearing liabilities decreased 217 basis points to 3.50%. Consequently, the net interest margin based on average earning assets increased to 3.80% for the three months ending March 31, 2002 compared with 3.10% for the same period in 2001.

PROVISION FOR LOAN LOSSES

During the three months ended March 31, 2002, the provision for possible loan losses was \$147,500 compared with \$78,277 for the same period last year. Loan charge-offs for the three months ended March 31, 2002, were \$278,000 compared with \$873 during the same period in 2001. The allowance for possible loan losses represented .93% of total loans, net of mortgage loans held-for-sale, at March 31, 2001, compared to .82% at March 31, 2001. Management considers the allowance for loan losses to be adequate to cover losses inherent in the loan portfolio.

PROVISION FOR INCOME TAXES

For the three months ended March 31, 2002, the provision for federal and state income taxes was \$149,271, a decrease of \$29,136 from the March 31, 2001 provision of \$178,407. The decline was primarily due to the increase in tax free municipal income and the tax benefit from the increase in dividends on agency preferred stocks.

NONINTEREST INCOME

The Company's noninterest income was \$247,434 during the three months ended

March 31, 2002, an increase of \$92,394 or 60% from the comparable 2001 period. The increase resulted from increases in service charges on deposit accounts, gains on loans sold, insurance commissions, and rental income of \$6,265, \$63,345, \$15,636, and \$7,148, respectively.

NONINTEREST EXPENSE

Noninterest expense totaled \$1,344,183 for the three month period ending March 31, 2002, an increase of \$420,922 or 46%. The increase was result of increases in compensation and related benefits, occupancy expense, furniture and equipment expense, advertising, data processing expense, and other expenses of \$167,789, \$13,937, \$30,434, \$7,291, \$12,965, and \$188,506, respectively.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None

ITEM 2. CHANGES IN SECURITIES

None

ITEM 3. DEFAULT UPON SENIOR SECURITIES

None

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

None

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

b) The Company did not file any reports on Form 8-K during the quarter ended March 31, 2002

SIGNATURES

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

STATE OF FRANKLIN BANCSHARES, INC.

(Registrant)

May 10, 2002

(Date)

/s/ Randal R. Greene

Randal R. Greene, President

May 10, 2002

(Date)

/s/ Charles E. Allen, Jr.

Charles E. Allen, Jr.,
Chairman of the Board
and Chief Executive Officer
(Principal Executive, Financial
and Accounting Officer)

