GREENE COUNTY BANCSHARES INC
Form 10-K
March 27, 2003

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

FOR ANNUAL AND TRANSITION REPORTS

PURSUANT TO SECTIONS 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

(Mark One)

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

For the fiscal year ended December 31, 2002

OR

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

For the transition period from ___________ to ___________

Commission file number **0-14289**

GREENE COUNTY BANCSHARES, INC.

(Exact name of registrant as specified in its charter)

Tennessee	**62-1222567**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
100 North Main Street, Greeneville, Tennessee	**37743-4992**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: **(423) 639-5111**.

Securities registered pursuant to Section 12(b) of the Act: **None**

Securities registered pursuant to Section 12(g) of the Act:

Common Stock - $2.00 par value

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 o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act.) YES x NO o

Prior to the listing of the registrant s common stock on the Nasdaq National Market on October 1, 2002, under the symbol GCBS , the common stock was not regularly and actively traded in any established market, and there were no regularly quoted bid and ask prices for the registrant s common stock. Based upon the negotiated trading price of $16.50 per share of common stock on June 30, 2002, using the best information available at the time, the registrant believes that the aggregate market value of the approximately 5,912,855 shares of its issued and outstanding common stock held by non-affiliates on June 30, 2002 was approximately $97.6 million. For purposes of this calculation, the term affiliate refers to all directors, executive officers and 10% shareholders of the registrant. As of the close of business on March 24, 2003, 6,820,540 shares of the registrant s common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

The following lists the documents incorporated by reference and the Part of the Form 10-K into which the document is incorporated:

1. Portions of Proxy Statement for 2003 Annual Meeting of Shareholders. (Part III)

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PART I

Forward-Looking Statements

The information contained herein contains forward-looking statements that involve a number of risks and uncertainties. A number of factors, including those discussed herein, could cause results to differ materially from those anticipated by such forward-looking statements. In addition, such forward-looking statements are necessarily dependent upon assumptions, estimates and data that may be incorrect or imprecise. Accordingly, any forward-looking statements included herein do not purport to be predictions of future events or circumstances and may not be realized. Forward-looking statements can be identified by, among other things, the use of forward-looking terminology such as intends, believes, expects, may, will, should, seeks, pro forma or anticipates, or the r thereof, or other variations thereon of comparable terminology, or by discussions of strategy or intentions. All forward-looking statements herein are based on information available to us as of the date this Annual Report was first mailed to our shareholders, and we assume no obligation to update any such forward-looking statements.

ITEM 1. BUSINESS

Presentation of Amounts

All dollar amounts set forth below, other than per-share amounts and percentages, are in thousands unless otherwise noted.

The Company

Greene County Bancshares, Inc. (the Company) was formed in 1985 and serves as the bank holding company for Greene County Bank (the Bank), which is a Tennessee-chartered commercial bank that conducts the principal business of the Company. At December 31, 2002, the Company maintained a main office in Greeneville, Tennessee and 30 bank branches (of which six are in leased operating premises) and 11 separate locations operated by the Bank s subsidiaries.

The Company s assets consist primarily of its investment in the Bank and liquid investments. Its primary activities are conducted through the Bank. At December 31, 2002, the Company s consolidated total assets were $899,396, its consolidated net loans, including loans held for sale, were $744,317, its total deposits were $719,323 and its total shareholders equity was $74,595.

The Company s net income is dependent primarily on its net interest income, which is the difference between the interest income earned on its loans, investment assets and other interest-earning assets and the interest paid on deposits and other interest-bearing liabilities. To a lesser extent, the Company s net income also is affected by its non-interest income derived principally from service charges and fees as well as the level of non-interest expenses such as salaries and employee benefits.

The operations of the Company are significantly affected by prevailing economic conditions, competition and the monetary, fiscal and regulatory policies of governmental agencies. Lending activities are influenced by the general credit needs of small businesses in the Company s market area, competition among lenders, the level of interest rates and the availability of funds. Deposit flows and costs of funds are influenced by prevailing market rates of interest, primarily on competing investments, account maturities and the levels of personal income and savings in the Company s market area.

The principal executive offices of the Company are located at 100 North Main Street, Greeneville, Tennessee 37743-4992 and its telephone number is (423) 639-5111.

The Bank

The Bank is a Tennessee-chartered commercial bank established in 1890 and which has its principal executive offices in Greeneville, Tennessee. The principal business of the Bank consists of attracting deposits from the general public and investing those funds, together with funds generated from operations and from principal and interest payments on loans, primarily in commercial, commercial and residential real estate loans, and installment

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consumer loans. The Bank also provides collection and other banking services, directly and through its finance, acceptance and title subsidiary corporations. At December 31, 2002, the Bank had 28 full service banking offices located in East Tennessee, including Greene, Washington, Blount, Hamblen, McMinn, Loudon, Hawkins, Sullivan, Cocke, and Monroe Counties. The Bank also had one full service branch located in nearby Hot Springs, North Carolina. Further, the Bank operates a trust and money management function located in Wilson County, Tennessee and doing business as President s Trust, and operates a mortgage loan operation in Knox County, Tennessee. Also, subsequent to year-end, the Bank, in January 2003, opened a loan production office in Washington County, Virginia and doing business as First Bristol Loans. These functions and operations are defined as Bank branches but are not considered to be full service branches.

The Bank also conducts separate businesses through three wholly owned subsidiaries. Through Superior Financial Services, Inc. (Superior Financial), the Bank operates 10 consumer finance company offices located in Greene, Blount, Hamblen, McMinn, Washington, Sullivan, Sevier, Knox and Hamilton Counties, Tennessee. The Bank also operates a mortgage banking operation through its main office in Knox County, Tennessee and it also has representatives located throughout the Company s branch system. Through GCB Acceptance Corporation (GCB Acceptance), the Bank operates a sub-prime automobile lending company with a sole office in Johnson City, Tennessee. Through Fairway Title Co., the Bank operates a title company headquartered in Knoxville, Tennessee which has an office in Johnson City, Tennessee.

Deposits of the Bank are insured by the Bank Insurance Fund (BIF) of the Federal Deposit Insurance Corporation (FDIC) to a maximum of $100,000 for each insured depositor. The Bank is subject to supervision and regulation by the Tennessee Department of Financial Institutions (the Banking Department) and the FDIC. See Regulation, Supervision and Governmental Policy.

Growth and Business Strategy

The Company expects that, over the intermediate term, a majority of its growth will result from mergers and acquisitions including acquisitions of both entire financial institutions and selected branches of financial institutions. De novo branching will also be a method of growth, particularly in high-growth and other demographically-desirable markets.

The Company s strategic plan outlines a geographic expansion policy within a 300-mile radius of its major markets. This policy could result in the Company expanding westward and eastward up to and including Nashville, Tennessee and Roanoke, Virginia, respectively, east/southeast up to and including the Piedmont area of North Carolina and western North Carolina, southward to northern Georgia and northward into eastern and central Kentucky. In particular, the Company believes the markets in and around Knoxville and Nashville, Tennessee are highly desirable areas with respect to expansion and growth plans.

In addition to the Company s business model, which is summarized in the paragraphs above entitled The Company and The Bank , the Company is continuously investigating and analyzing other lines and areas of business. These include, but are not limited to, various types of insurance, real estate activities, etc. Conversely, the Company frequently evaluates and analyzes the profitability, risk factors and viability of its various business lines and segments and, depending upon the results of these evaluations and analyses, may conclude to exit certain segments and/or business lines. Further, in conjunction with these ongoing evaluations and analyses, the Company may decide to sell, merge or close certain branch facilities.

Lending Activities

General. The loan portfolio of the Company is composed of commercial, commercial and residential real estate and installment consumer loans. Such loans are primarily originated within the Company s market areas of East Tennessee and are generally secured by residential or commercial real estate or business or personal property located in the counties of Greene, Washington, Hamblen, Sullivan, Hawkins, Blount, Knox, McMinn, Loudon, Monroe and Cocke Counties, Tennessee.

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Loan Composition. The following table sets forth the composition of the Company s loans at December 31 for each of the periods indicated.

	2002	2001	2000	1999	1998
Commercial	$ 93,836	$ 96,122	$ 87,680	$ 68,793	$ 57,860
Commercial real estate	342,407	295,002	288,254	242,574	185,063
Residential real estate	233,128	210,489	218,007	181,960	143,500
Loans held for sale	6,646	7,945	1,725	1,210	5,043
Consumer	77,644	80,314	74,882	59,508	68,092
Other	14,938	13,779	12,493	16,774	27,349
Total	768,599	703,651	683,041	570,819	486,907
Less:					
Unearned Income	(11,696)	(13,159)	(14,248)	(13,590)	(9,993)
Allowance for loan losses	(12,586)	(11,221)	(11,728)	(10,332)	(10,253)
Net loans	$744,317	$679,271	$657,065	$546,897	$466,661

Loan Maturities. The following table reflects at December 31, 2002 the dollar amount of loans maturing based on their contractual terms to maturity. Demand loans, loans having no stated schedule of repayments and loans having no stated maturity are reported as due in one year or less.

	Due in One Year or Less	Due After One Year Through Five Years	Due After Five Years	Total
Commercial	$ 61,450	$ 28,092	$ 4,294	$ 93,836
Commercial real estate	123,904	185,899	32,604	342,407
Residential real estate	28,501	85,167	119,460	233,128
Loans held-for-sale	6,646			6,646
Consumer	15,940	60,912	792	77,644
Other	13,166	1,441	331	14,938
Total	$249,607	$ 361,511	$157,481	$768,599

The following table sets forth the dollar amount of the loans maturing subsequent to the year ending December 31, 2003 between those with predetermined interest rates and those with floating, or variable, interest rates.

	Fixed Rate	Variable Rate	Total
		(In thousands)	
Commercial	$ 20,037	$ 12,349	$ 32,386
Commercial real estate	140,577	77,926	218,503
Residential real estate	113,192	91,435	204,627
Loans held-for-sale			
Consumer	61,219	485	61,704
Other	1,321	451	1,772
Total	$336,346	$182,646	$518,992

Commercial Loans. Commercial loans are made for a variety of business purposes, including working capital, inventory and equipment and capital expansion. At December 31, 2002, commercial loans outstanding totaled $93,836, or 12.61%, of the Company s net loan portfolio. The terms for commercial loans are generally one to seven years. Commercial loan applications must be supported by current financial information on the borrower and, where appropriate, by adequate collateral. Commercial loans are generally underwritten by addressing cash flow (debt service coverage), primary and secondary sources of repayment, financial strength of any guarantor, liquidity, leverage, management experience, ownership structure, economic conditions and industry-specific trends and collateral. The loan to value ratio depends on the type of collateral. Generally speaking, accounts receivable are financed at 70% of accounts receivable less than 90 days past due. If other collateral is taken to support the loan, the loan to value of accounts receivable may approach 85%. Inventory financing will range between 50% and 60% depending on the borrower and nature of inventory. The Company requires a first lien position for such loans. These types of loans are generally considered to be a higher credit risk than other loans originated by the Company.

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Commercial Real Estate Loans. The Company originates commercial loans, generally to existing business customers, secured by real estate located in the Company s market area. At December 31, 2002, commercial real estate loans totaled $342,407, or 46.00%, of the Company s net loan portfolio. The terms of such loans are generally for 10 to 20 years and are priced based in part upon the prime rate, as reported in *The Wall Street Journal*. Commercial real estate loans are generally underwritten by addressing cash flow (debt service coverage), primary and secondary source of repayment, financial strength of any guarantor, strength of the tenant (if any), liquidity, leverage, management experience, ownership structure, economic conditions and industry specific trends and collateral. Generally, the Company will loan up to 80-85% of the value of improved property, 65% of the value of raw land and 75% of the value of land to be acquired and developed. A first lien on the property and assignment of lease is required if the collateral is rental property, with second lien positions considered on a case-by-case basis.

Residential Real Estate. The Company also originates one-to-four family, owner-occupied residential mortgage loans secured by property located in the Company s primary market area. The majority of the Company s residential mortgage loans consists of loans secured by owner-occupied, single-family residences. At December 31, 2002, the Company had $233,128, or 31.32%, of its net loan portfolio in residential real estate loans. Residential real estate loans generally have a loan-to-value ratio of 85%. These loans are underwritten by giving consideration to the ability to pay, stability of employment or source of income, credit history and loan-to-value ratio. Home equity loans make up approximately 13% of residential real estate loans. Home equity loans may have higher loan-to-value ratios when the borrower s repayment capacity and credit history conform to underwriting standards. Superior Financial extends sub-prime mortgages to borrowers who generally have a higher risk of default than mortgages extended by the Bank. Sub-prime mortgages totaled $11,950, or 5.13%, of the Company s residential real estate loans.

Mortgage loans originated by the Bank were not previously underwritten in conformity with secondary market guidelines and therefore were not readily salable. Beginning in April 1997, the Company began selling one-to-four family mortgage loans in the secondary market to Freddie Mac through the Bank s mortgage banking operation. Sales of such loans to Freddie Mac and other mortgage investors totaled $61,728 during 2002, and the related mortgage servicing rights were sold together with the loans.

Installment Consumer Loans. At December 31, 2002, the Company s installment consumer loan portfolio totaled $77,644, or 10.43%, of the Company s total net loan portfolio. The Company s consumer loan portfolio is composed of secured and unsecured loans originated by the Bank, Superior Financial and GCB Acceptance. The consumer loans of the Bank have a higher risk of default than other loans originated by the Bank. Further, consumer loans originated by Superior Financial and GCB Acceptance, which are finance companies rather than a bank, generally have a greater risk of default than such loans originated by commercial banks and, accordingly, carry a higher interest rate. Superior Financial and GCB Acceptance installment consumer loans totaled approximately $34,456, or 44.38%, of the Company s installment consumer loans. The performance of consumer loans will be affected by the local and regional economy as well as the rates of personal bankruptcies, job loss, divorce and other individual-specific characteristics.

Past Due, Special Mention, Classified and Non-Accrual Loans. The Company classifies its problem loans into three categories: past due loans, special mention loans and classified loans (both accruing and non-accruing interest).

When management determines that a loan is no longer performing, and that collection of interest appears doubtful, the loan is placed on non-accrual status. All loans that are 90 days past due are considered non-accrual unless they are adequately secured and there is reasonable assurance of full collection of principal and interest. Management closely monitors all loans that are contractually 90 days past due, treated as special mention or otherwise classified or on non-accrual status. Non-accrual loans that are 120 days past due without assurance of repayment are charged off against the allowance for loan losses.

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The following table sets forth information with respect to the Company s non-performing assets at the dates indicated. At these dates, the Company did not have any restructured loans within the meaning of Statement of Financial Accounting Standards No. 15.

	At December 31,				
	2002	2001	2000	1999	1998
	(In thousands)				
Loans accounted for on a non-accrual basis	$ 7,475	$5,857	$4,813	$2,952	$4,159
Accruing loans which are contractually past due 90 days or more as to interest or principal payments	307	871	475	996	872
Total non-performing loans	7,782	6,728	5,288	3,948	5,031
Real estate owned:					
Foreclosures	4,805	2,589	1,937	1,546	920
Other real estate held and repossessed assets	767	623	350	826	607
Total non-performing assets	$13,354	$9,940	$7,575	$6,320	$6,558

The Company s continuing efforts to resolve non-performing loans occasionally include foreclosures, which result in the Company s ownership of the real estate underlying the mortgage. If non-accrual loans at December 31, 2002 had been current according to their original terms and had been outstanding throughout 2002, or since origination if originated during the year, interest income on these loans would have been approximately $585. Interest actually recognized on these loans during 2002 was not significant.

Foreclosed real estate increased $2,216, or 85.59%, to $4,805 at December 31, 2002 from $2,589 at December 31, 2001. The real estate consists of 33 properties, of which seven are commercial properties valued at $2,923, and 26 are residential properties valued at $1,882. Management expects to liquidate these properties during 2003. Management has recorded these properties at net realizable value and the subsequent sale of such properties is not expected to result in any adverse effect on the Company, subject to business and marketing conditions at the time of sale. Other repossessed assets increased $144, or 23.11%, to $767 at December 31, 2002 from $623 at December 31, 2001. This increase is primarily due to repossession activity at GCB Acceptance.

Total impaired loans decreased by $1,686, or 15.00%, from $11,243 at December 31, 2001 to $9,557 at December 31, 2002. This decrease is reflective of reduced impaired loans at Superior Financial resulting primarily from heightened collection activity and improved underwriting discipline.

At December 31, 2002, the Company had approximately $1,339 in loans that are not currently classified as non-accrual or 90 days past due or otherwise restructured but which known information about possible credit problems of borrowers caused management to have concerns as to the ability of the borrowers to comply with present loan repayment terms. Such loans were considered classified by the Company and were composed primarily of various consumer loans and residential real estate loans. Generally, these are bankruptcy loans that are adequately secured and management expects substantial collection of these accounts through reaffirmation or liquidation of collateral.

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Allowance for Loan Losses. The allowance for loan losses is maintained at a level which management believes is adequate to absorb all probable losses on loans then present in the loan portfolio. The amount of the allowance is affected by: (1) loan charge-offs, which decrease the allowance; (2) recoveries on loans previously charged-off, which increase the allowance; and (3) the provision of possible loan losses charged to income, which increases the allowance. In determining the provision for possible loan losses, it is necessary for management to monitor fluctuations in the allowance resulting from actual charge-offs and recoveries, and to periodically review the size and composition of the loan portfolio in light of current and anticipated economic conditions in an effort to evaluate portfolio risks. If actual losses exceed the amount of the allowance for loan losses, earnings of the Company could be adversely affected. The amount of the provision is based on management s judgment of those risks. During the year ended December 31, 2002, the Company s provision for loan losses increased by $1,106 to $7,065 as the Company adjusted the allowance for loan losses to a level it deemed adequate as of December 31, 2002.

The following is a summary of activity in the allowance for loan losses for the periods indicated:

	Year Ended December 31,				
	2002	2001	2000	1999	1998
			(In thousands)		
Balance at beginning of year	$11,221	$11,728	$10,332	$10,253	$ 9,154
Charge-offs:					
Commercial	(1,216)	(411)	(429)	(298)	(440)
Commercial real estate	(956)	(997)	(537)	(302)	(87)
Subtotal	(2,172)	(1,408)	(966)	(600)	(527)
Residential real estate	(740)	(669)	(800)	(407)	
Consumer	(4,736)	(5,753)	(6,022)	(3,010)	(2,707)
Other					
Total charge-offs	(7,648)	(7,830)	(7,788)	(4,017)	(3,234)
Recoveries:					
Commercial	54	11	43	295	216
Commercial real estate	239	54	137		24
Subtotal	293	65	180	295	240
Residential real estate	141	102	69	93	
Consumer	1,514	1,197	926	575	673
Other					3
Total recoveries	1,948	1,364	1,175	963	916
Net charge-offs	(5,700)	(6,466)	(6,613)	(3,054)	(2,318)
Provision for loan losses	7,065	5,959	8,009	3,133	3,417
Balance at end of year	$12,586	$11,221	$11,728	$10,332	$10,253
Ratio of net charge-offs to average loans outstanding, net of unearned discount, during the period	.80%	0.94%	1.09%	0.60%	0.52%
Ratio of allowance for loan losses to non-performing loans	161.73%	166.78%	221.79%	261.70%	203.80%
Ratio of allowance for loan losses to total loans	1.65%	1.61%	1.72%	1.81%	2.11%

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Breakdown of allowance for loan losses by category. The following table presents an allocation among the listed categories of the Company s allowance for loan losses at the dates indicated and the percentage of loans in each category to the total amount of loans at the respective year-ends.

	At December 31,					
	2002		2001		2000	
	(Dollars in thousands)					
Balance at end of period applicable to:	Amount	Percent of loan in each category to total loans	Amount(1)	Percent of loan in each category to total loans	Amount(1)	Percent of loan in each category to total loans