SECOND BANCORP INC
Form 10-Q
November 14, 2001

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

(X) QUARTERLY REPORT UNDER SECTION 13 OR 15(d) THE SECURITIES EXCHANGE ACT OF 1934 For the quarterly period ended September 30, 2001

OR

( ) TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934. For the transition period ..... to .....

Commission file number: 0-15624

SECOND BANCORP INCORPORATED
(exact name of registrant as specified in its charter)

Ohio	34-1547453
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

108 Main Ave. S. W. Warren, Ohio	44482-1311
(Address of principal executive offices)	(Zip Code)

330.841.0123
Registrant's telephone number, including area code

Not applicable
Former name, former address and former fiscal year, if changed since last report.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter periods 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 the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date.

Common Stock, without par value - 9,994,998 shares outstanding as of October 31, 2001.

SECOND BANCORP INCORPORATED AND SUBSIDIARIES

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Exhibit 4.1. Indenture for Subordinated Debentures due 2031 of Second Bancorp Incorporated dated September 28, 2001, by and between Second Bancorp Incorporated and Wilmington Trust Company, as indenture trustee

Exhibit 4.2. Amended and Restated Trust Agreement of Second Bancorp Capital Trust I, dated September 28, 2001, by and among Second Bancorp Incorporated, as depositor, Wilmington Trust Company, as property trustee, Wilmington Trust Company, as Delaware trustee, and the administrative trustees named therein.

Exhibit 4.3. Preferred Securities Guarantee Agreement, dated September 28, 2001, by and between Second Bancorp Incorporated and Wilmington Trust Company

Exhibit 11. Statement Re: Computation of Earnings Per Share

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
Second Bancorp Incorporated and Subsidiaries
Consolidated Balance Sheets

	September 30	December 31	September
(Dollars in thousands)	2001	2000	2000
ASSETS			
Cash and due from banks	$32,441	$35,272	$3
Federal funds sold and temporary investments	51,233	0	
Trading account	0	328	
Securities:			
Available-for-sale (at market value)	407,004	382,098	40
Loans	1,060,741	1,070,089	1,05
Less reserve for loan losses	15,392	15,217	1
Net loans	1,045,349	1,054,872	1,04
Premises and equipment	16,650	18,039	1
Accrued interest receivable	10,272	11,181	1
Goodwill and intangible assets	8,328	6,038	
Other assets	37,742	38,462	3
Total assets	$1,609,019	$1,546,290	$1,56
LIABILITIES AND SHAREHOLDERS' EQUITY			
Deposits:			
Demand - non-interest bearing	$111,539	$110,045	$10
Demand - interest bearing	94,831	87,268	8
Savings	234,601	246,056	26
Time deposits	616,320	592,766	63
Total deposits	1,057,291	1,036,135	1,08
Federal funds purchased and securities sold under agreements to repurchase	110,071	129,895	11
Note payable	0	1,000	
Other borrowed funds	5,745	2,163	
Federal Home Loan Bank advances	267,301	251,733	23
Accrued expenses and other liabilities	11,185	8,167	
Corporation-obligated mandatorily redeemable capital securities of subsidiary trust	26,660	0	
Total liabilities	1,478,253	1,429,093	1,44
Shareholders' equity:			
Common stock, no par value; 30,000,000 shares authorized; 10,828,310, 10,787,310 and 10,776,870			

shares issued, respectively	37,424	36,935	3
Treasury stock; 801,512, 730,200 and 639,920 shares, respectively	(15,072)	(13,947)	(12
Other comprehensive income	6,850	281	(3
Retained earnings	101,564	93,928	9
Total shareholders' equity	130,766	117,197	11
Total liabilities and shareholders' equity	$1,609,019	$1,546,290	$1,56

See notes to consolidated financial statements.

Second Bancorp Incorporated and Subsidiaries
Consolidated Statements of Income

(Dollars in thousands, except per share data)	For the Three Months Ended September 30		For the Ended S
	2001	2000	2001
INTEREST INCOME			
Loans (including fees):			
Taxable	$21,015	$23,367	$64,86
Exempt from federal income taxes	268	285	83
Securities:			
Taxable	5,471	5,419	15,89
Exempt from federal income taxes	800	777	2,34
Federal funds sold and other	326	46	81
Total interest income	27,880	29,894	84,76
INTEREST EXPENSE			
Deposits	10,467	12,216	33,12
Federal funds purchased and securities sold under agreements to repurchase	937	1,440	3,17
Note payable	13	0	4
Other borrowed funds	23	46	7
Federal Home Loan Bank advances	3,946	4,586	11,62
Corporation-obligated mandatorily redeemable capital securities of subsidiary trust	21	0	2
Total interest expense	15,407	18,288	48,07
Net interest income	12,473	11,606	36,68
Provision for loan losses	988	4,843	3,09
Net interest income after provision for loan losses	11,485	6,763	33,59
NON-INTEREST INCOME			

Service charges on deposit accounts	1,344	1,163	3,87
Trust fees	761	833	2,26
Gain (loss) on sale of loans	1,394	(3,191)	3,28
Trading account (losses) gains	(52)	(28)	1
Security gains (losses)	123	(2,802)	64
Other operating income	921	1,167	3,59
Total non-interest income	4,491	(2,858)	13,68
NON-INTEREST EXPENSE			
Salaries and employee benefits	5,313	5,421	15,60
Net occupancy	1,001	1,062	3,17
Equipment	1,038	1,044	3,00
Professional services	320	1,650	1,06
Assessment on deposits and other taxes	415	423	1,22
Amortization of goodwill and other intangibles	81	216	24
Other operating expenses	1,914	3,324	5,62
Total non-interest expense	10,082	13,140	29,93
Income (loss) before federal income taxes	5,894	(9,235)	17,33
Income tax expense (benefit)	1,493	(3,690)	4,49
Net income (loss) before cumulative effect of accounting change	$4,401	($5,545)	$12,84
Cumulative effect of accounting change - FAS133	0	0	(101
Net income (loss)	$4,401	($5,545)	$12,74
NET INCOME (LOSS) PER COMMON SHARE:			
Basic - before cumulative effect of accounting change	$0.44	($0.55)	$1.2
Diluted - before cumulative effect of accounting change	$0.43	($0.55)	$1.2
Basic	$0.44	($0.55)	$1.2
Diluted	$0.43	($0.55)	$1.2
Weighted average common shares outstanding:			
Basic	10,033,365	10,161,386	10,021,47
Diluted	10,117,705	10,161,386	10,087,93

See notes to consolidated financial statements.

Second Bancorp Incorporated and Subsidiaries
Consolidated Statements of Comprehensive Income

(Dollars in thousands, except per share data)	For the Three Months Ended September 30		For the Nine Ended Septemb
	2001	2000	2001
Net income (loss)	$4,401	$(5,545)	$12,746

Other comprehensive income, net of tax:			
Change in other comprehensive income - deferred compensation plan	12	-	(59)
Change in unrealized market value adjustment on securities available-for-sale	5,028	4,782	6,628
Total other comprehensive income	5,040	4,782	6,569
Comprehensive income (loss)	$9,441	$(763)	$19,315

See notes to consolidated financial statements.

Second Bancorp Incorporated and Subsidiaries
Consolidated Statements of Shareholders' Equity

(Dollars in thousands)	Common Stock	Treasury Stock	Accumulated Other Comprehensive Income	Retaine Earning
Balance, January 1, 2000	$36,966	$ (7,140)	$(7,791)	$94,312
Net income				2,104
Change in unrealized market value adjustment on securities available-for-sale, net of tax of $2,123			3,942	
Cash dividends declared: common ($.48 per share)				(4,910
Purchase of treasury shares		(5,450)		
Common stock issued - dividend reinvestment plan	(14)			
Balance, September 30, 2000	$36,952	$(12,590)	$(3,849)	$ 91,506
Balance, January 1, 2001	$36,935	$(13,947)	$ 281	$ 93,928
Net income				12,746
Change in other comprehensive income - deferred compensation plan, net of tax of $(31)			(59)	
Change in unrealized market value adjustment on securities available-for-sale, net of tax of $3,573			6,628	
Cash dividends declared: common ($.51 per share)				(5,110
Purchase of treasury shares		(1,125)		

Common stock issued - stock options and dividend reinvestment plan	489			
Balance, September 30, 2001	$37,424	$(15,072)	$6,850	$101,564

See notes to consolidated financial statements.

Second Bancorp Incorporated and Subsidiaries
Consolidated Statements of Cash Flows

(Dollars in thousands) Operating Activities	For the Nine Months Ended September 30 2001	September 30 2000
Net income	$12,746	$2,104
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	3,091	6,226
Depreciation expense	2,556	2,639
Amortization of goodwill and other intangibles	242	447
Net (increase) in servicing rights	(2,532)	(709)
(Accretion) amortization of investment discount and premium	(316)	173
Deferred income taxes	(338)	138
Securities (gains) losses	(640)	2,497
Other (gains) losses, net	(3,279)	2,489
Net decrease (increase) in trading account securities	328	(447)
Decrease (increase) in interest receivable	909	(1,353)
(Decrease) increase in interest payable	(542)	422
Originations of loans held-for-sale	(295,166)	(58,167)
Proceeds from sale of loans held-for-sale	298,449	55,678
Net change in other assets & other liabilities	992	(3,078)
Net cash provided by operating activities	16,500	9,059
Investing Activities		
Proceeds from maturities of securities - available-for-sale	93,400	23,850
Proceeds from sales of securities - available-for-sale	76,420	105,167
Purchases of securities - available-for-sale	(183,575)	(158,218)
Net decrease in loans	6,432	9,777
Net increase in premises and equipment	(1,171)	(1,862)
Net cash used by investing activities	(8,494)	(21,286)
Financing Activities		
Net decrease in demand deposits, interest bearing		

demand and savings deposits	(2,398)	(18,519)
Net increase in time deposits	23,554	5,307
Net (decrease) increase in federal funds purchased and securities sold under agreements to repurchase	(19,824)	10,175
Decrease in note payable	(1,000)	(4,000)
Net increase (decrease) in borrowings	3,582	(2,117)
Net advances from Federal Home Loan Bank	15,568	38,596
Issuance of corporation-obligated mandatorily redeemable capital securities of subsidiary trust	26,660	0
Cash dividends	(5,110)	(4,910)
Purchase of treasury stock	(1,125)	(5,450)
Issuance of common stock	489	(14)
Net cash provided by financing activities	40,396	19,068
Increase in cash and cash equivalents	48,402	6,841
Cash and cash equivalents at beginning of year	35,272	35,238
Cash and cash equivalents at end of period	$83,674	$42,079

Supplementary Cash Flow Information:
Cash paid for 1) Federal income taxes - $3,850,000 and $2,810,000 for the nine months ended September 30, 2001 and 2000, respectively and 2) Interest - $48,618,000 and $50,261,000 for the nine months ended September 30, 2001 and 2000, respectively.

See notes to consolidated financial statements.

Second Bancorp Incorporated and Subsidiaries
Notes to Consolidated Financial Statements (unaudited)
September 30, 2001
(Dollars in thousands)

NOTE 1 - BASIS OF PRESENTATION
The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the nine-month period ended September 30, 2001 are not necessarily indicative of the results that may be expected for the year ended December 31, 2001. Certain reclassifications have been made to amounts previously reported in order to conform to current period presentations. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2000.

NOTE 2 - COMPREHENSIVE INCOME

During the first nine months of 2001 and 2000, total comprehensive income amounted to $9,874 and $6,809, respectively. The components of comprehensive income, net of tax, for the nine-month periods ended September 30, 2001 and 2000 are as follows:

	2001	2000
Net income	$12,746	$2,104
Change in other comprehensive income - deferred compensation plan	(59)	0
Unrealized gains on available-for-sale securities	6,628	3,942
Comprehensive income	$19,315	$6,046

Accumulated other comprehensive income, net of related tax, at September 30, 2001 totaled $6,850 and was comprised of accumulated changes in unrealized market value adjustments on securities available-for-sale, net of tax and deferred supplemental income, net of tax. Accumulated other comprehensive income and loss, net of related tax, at December 31, 2000 and September 30, 2000 totaled $281 and $(3,849), respectively, and was comprised entirely of accumulated changes in unrealized market value adjustments on securities available-for-sale, net of tax. Disclosure of reclassification amounts:

	NINE MONTHS ENDED	
	SEPT. 30, 2001	SEPT. 30, 2000
Unrealized holding gains (losses) arising during the period	$ 7,044	$2,319
Less: reclassification of (gains) losses included in net income, net of tax	(416)	1,623
Net unrealized gains on available-for-sale securities	$ 6,628	$3,942

NOTE 3 - RECENT ACCOUNTING PRONOUNCEMENTS

In June 1998, the Financial Accounting Standard Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activity" as amended in June 1999 by SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities - Deferral of the Effective Date of FASB Statement No. 133," and in June 2000, by SFAS 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities, " (collectively SFAS No. 133). SFAS No. 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments imbedded in other contracts, and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. If certain conditions are met, a derivative may be specifically designated as a hedge. The accounting for changes in the fair value of derivative (gains and losses) depends on the intended use of the derivative and resulting designation. On January 1, 2001, the Corporation adopted SFAS No. 133 resulting in a cumulative effect of accounting change transition adjustment of $(101), after tax. The impact on 2001 operating results is not considered to be material.

In June 2001, the FASB issued SFAS No. 141, "Business Combinations", and No.

142, "Goodwill and Other Intangible Assets", effective for fiscal years beginning after December 15, 2001. Under the new rules, goodwill and intangible assets deemed to have indefinite lives will no longer be amortized but will be subject to annual impairment tests in accordance with the Statements. Other intangible assets will continue to be amortized over their useful lives.

The Company will apply the new rules on accounting for goodwill and other intangible assets beginning in the first quarter of 2002. Application of the nonamortization provisions of the Statement to existing goodwill and indefinite lived intangible assets is expected to result in an increase in net income of $103 ($.01 per share) per year. Additionally, goodwill arising out of the recently completed acquisition of Commerce Exchange Corporation will not be amortized. The amount of the impact of the nonamortization of this goodwill has yet to be determined. During 2002, the Company will perform the first of the required impairment tests of goodwill and intangible assets deemed to have indefinite lives as of January 1, 2002 and has not yet determined what the effect of these tests will be on the earnings and financial position of the Company.

NOTE 4 - ACQUISITION OF COMMERCE EXCHANGE CORPORATION AND ISSUANCE OF TRUST PREFERRED SECURITIES AND SUBORDINATED DEBENTURES
On October 25, 2001 the Company completed the acquisition of Commerce Exchange Corporation located in Beachwood, Ohio. The all-cash transaction is structured as a purchase for accounting purposes and, excluding transaction costs, is expected to be modestly accretive to earnings per share in the first year. Commerce Exchange Corporation's subsidiary, Commerce Exchange Bank, was merged into Second National Bank. The two Commerce Exchange Bank offices in Beachwood and North Olmsted, Ohio are now operated as Second National retail banking centers.

On September 28, 2001, the Company sold, through Second Bancorp Capital Trust I (a newly formed subsidiary), $32 million of 9.00% corporation-obligated manditorily redeemable capital securities of subsidiary trust ("Trust Preferred Securities"). The Trust issued $28 million in Trust Preferred Securities on September 28, 2001 and the remaining $4 million Trust Preferred Securities were issued on October 12, 2001 pursuant to the exercise of an underwriters' over-allotment option. The proceeds of the offering of the Trust Preferred Securities were used by the Trust to purchase, from the Company, Subordinated Debentures due December 31, 2031. The Company used the proceeds from the offering of the Subordinated Debentures to fund the $26.9 acquisition cost for Commerce Exchange Corporation. The remaining net proceeds are being used to repay outstanding debt and to fund the Company's continuing repurchase of its common stock. The effect of the Trust Preferred Securities Offering will impact several key performance indicators of the Company's future financial results. Among those ratios impacted will be the net interest margin, which is expected to decline with the additional of the Trust Preferred Securities.

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

General

Second Bancorp Incorporated is a one-bank holding company headquartered in Warren, Ohio. Our bank, The Second National Bank of Warren, was originally established in 1880. Operating through 37 retail banking centers (including the newly acquired banking centers of Commerce Exchange Bank), we offer a wide range of commercial and consumer banking and trust services primarily to business and individual customers in various communities in a nine county area in northeastern and east-central Ohio. Among other things, our consumer banking business includes a large and growing mortgage banking function.

On September 28, 2001, Second Bancorp Incorporated issued through Second Bancorp Capital Trust I, a newly formed subsidiary, 2,800,000 shares of 9.00% Cumulative Trust Preferred Securities, $10 liquidation amount, in a public offering underwritten by Stifel, Nicolaus & Company, Incorporated and Sandler O'Neill & Partners, L.P. as co-representatives for a group of underwriters. The underwriters were also granted a 30-day option to purchase up to an additional 400,000 Trust Preferred Securities to cover over-allotments. This option was exercised by the underwriters and an additional 400,000 Trust Preferred Securities were issued on October 12, 2001.The gross proceeds of the offering of the Trust Preferred Securities was $32 million.

The Trust Preferred Securities represent undivided beneficial interests in the assets of Second Bancorp Capital Trust I which was established as a Delaware business trust for the purpose of issuing the Trust Preferred Securities. The Trust Preferred Securities mature on December 31, 2031 and are redeemable on or after December 31, 2006. Proceeds of the offering of the Trust Preferred Securities were invested by Second Bancorp Capital Trust I in $32,989,700 9.00% Subordinated Debentures of Second Bancorp Incorporated due December 31, 2031. Second Bancorp Incorporated used the proceeds received by it to fund the $26.9 million cash price for the acquisition of Commerce Exchange Corporation which was completed on October 25, 2001. Proceeds in excess of that cash price are being used by Second Bancorp Incorporated to pay off existing short-term indebtedness and for other general corporate purposes.

Forward-looking statements

The sections that follow contain certain forward-looking statements (as defined in the Private Securities Litigation Reform Act of 1995). These forward-looking statements may involve significant risks and uncertainties. Although the Company believes that the expectations reflected in such forward-looking statements are reasonable, actual results may differ materially from the expectations discussed in these forward-looking statements.

Financial Condition

At September 30, 2001, the Company had consolidated total assets of $1.61 billion, deposits of $1.06 billion and shareholders' equity of $131 million. Since September 30, 2000, total assets have increased by $47 million or 3%, primarily as a result of the issuance of the Trust Preferred Securities in anticipation of the Commerce acquisition. Gross loans have increased nominally during the past year by $1 million to $1.061 billion as of September 30, 2001. Consumer lending activities have resulted in a strong increase in outstanding consumer loan balances, while the sale of the residential mortgage loans has resulted in a reduction of total residential mortgage loans from a 33% concentration of total loans as of September 30, 2000 to 30% at the most recent quarter end. Consumer loans represented 27% of loans at the end of the third quarter of 2000 versus 30% for the third quarter of 2001. Cash, federal funds sold and other liquid assets increased by $42 million during the past 12 months primarily as a result of the issuance of the Trust Preferred Securities. Subsequently, $26.9 million of the cash was utilized in the fourth quarter of 2001 to fund the Commerce acquisition.

Deposits decreased by $27 million since September 30, 2000 primarily as a result of decreases in savings account and time deposit balances. Core transaction account funding, which includes DDA and NOW accounts, increased by $15 million since September 30, 2000, due to the positive momentum in new account growth associated with new deposit account offerings, internal sales incentives and increased advertising. Federal Home Loan Bank advances have increased by $28 million since a year ago, allowing the Company to raise additional longer-term funding. The Trust Preferred Securities totaled $26.7 million as of September 30, 2001 with an additional $3.8 million issued during the fourth quarter of 2001.

Since December 31, 2000, total assets have increased by an annualized rate of 5.4%, primarily through an increase in liquid assets. Deposits have increased by $21 million and now total $1.06 billion. The increase in deposits was attributable to an increase in core transaction account balances as well as short-term time deposits. Gross loans have decreased since the end of last year by $10 million, indicating the effectiveness of the residential real estate line of business. Although the Company has generated $347 million in new residential real estate loans, $295 million, or 83% of those loans produced, have been sold into the secondary market. As a result, residential real estate loan balances have decreased by $30 million from a year ago.

Results of Operations
Quarterly Comparison

The Company reported net operating income of $4,401,000 for the third quarter of 2001. Net income for the third quarter represented forty-three cents ($.43) per share on a diluted basis. Operating return on average assets (ROA) and return on average total shareholders' equity (ROE) were 1.11% and 13.87%, respectively, for the third quarter of 2001 compared to (1.34%)% and (19.01)% for last year's third quarter. The third quarter of 2000 was heavily influenced by a major restructuring of the balance sheet. The restructuring resulted in $9,022,000 in after-tax restructuring and other charges. Absent those charges, earnings for the period would have been $3,477,000 or thirty-four cents ($.34) per share. After tax charges to earnings (losses) during the third quarter of 2000 resulting from the balance sheet restructuring were $1,825,000 on securities sales; $2,836,000 on mortgage loan sales; $2,665,000 on additions to the loan loss reserve to reflect the shift in loan mix; $393,000 on Federal Home Loan Bank advance prepayments; and $1,303,000 on other non-recurring expenses. One of the effects of the third quarter 2000 restructuring was to minimally shrink the Company's balance sheet as $130 million in below market, fixed rate loan assets were sold and $100 million of the proceeds were used to reduce exposure on higher cost Federal Home Loan Bank advances. Some of the positive net effects of these actions will be to significantly improve balance sheet flexibility and liquidity, reduce the earnings drag caused by a large mortgage loan portfolio, and ease the overall cost of funds. Excluding the restructuring charges, operating return on average assets (ROA) and return on average total shareholders' equity (ROE) would have been .84% and 11.92%,

Commercial Lending. Commercial lending activities focus primarily on providing local independent commercial and professional firms with commercial business loans and loans secured by owner-occupied real estate. We primarily make secured and unsecured commercial loans for general business purposes, including working capital, accounts receivable financing, machinery and equipment acquisition, and commercial real estate financing. These loans have both fixed and floating interest rates and typically have maturities of three to seven years. To a lesser extent, we also make construction loans and finance commercial equipment leases. Commercial loans comprised approximately 40% of our total loan portfolio at September 30, 2001. As a result of the Commerce acquisition, the commercial loan balances (including commercial real estate loans) have increased to $523 million, or 46.6% of gross loans as of October 31, 2001.

Retail Lending. The Company offers a full range of retail loans to individuals, including the owners and principals of our commercial customers and a wide range of retail customers in our market area. We offer consumer loans for a variety of personal financial needs, including home equity, new and used automobiles, boat loans, credit cards and overdraft protection for checking account customers. At September 30, 2001, approximately 46% of our consumer loans consisted of indirect auto loans. Our indirect auto loans are originated through new car dealers in the local area. Indirect auto originations have decreased significantly since mid year. New loan originations averaged $6.5 million during the second quarter of 2001 and $2.25 million during the third quarter of 2001. The reduction was a result of tighter credit standards being employed. Consumer loans comprised approximately 30% of our total loan portfolio at September 30, 2001.

Trust. The trust department is a traditional provider of fiduciary services with a focus on administration of estates, trusts and qualified employee benefit plans. During 2000, personal trust accounts and employee benefit accounts produced approximately 75% and 25% of the total revenues of the department, respectively. The department began offering a daily valuation service for 401(k) plans during the third quarter of 2001, which is expected to position the Company well for future growth in employee benefit assets and revenues. Fee income is down 8.6% from the third quarter of 2000 due to the reduction in the amount of assets under management caused by the loss of over $150 million in accounts and the decline in overall equity values over the period. Our trust department had approximately $601 million in assets under management at September 30, 2001.

Mortgage Banking. Our mortgage department underwrites and originates a wide range of retail mortgage loan products and sells a significant volume of them primarily on a servicing retained basis. Generally, the loans sold into the secondary mortgage market make funds available for reuse in mortgage or other lending activities. The sales generate a net gain (including origination fee income and deferred origination costs), limit the interest rate risk caused by holding long-term, fixed-rate loans, and build a portfolio of serviced loans which generate a recurring stream of fee income. We sold approximately $120 million of loans during the third quarter of 2001, generating a net gain of $1,358,000. We service $652 million in mortgage loans for others at September 30, 2001.

Asset Quality. The reserve for loan losses represented 1.45% of loans as of September 30, 2001. The determination of the reserve for loan losses is based on management's evaluation of the potential losses in the loan portfolio at September 30, 2001 considering, among other relevant factors, repayment status, borrowers' ability to repay, collateral and current economic conditions. The methodology for the provision for loan losses includes analysis of various economic factors including loan losses and portfolio growth. The provision for loan losses decreased to $988,000 for the third quarter of 2001 from $4,893,000 during the same period in 2000. Absent the additional $4.1 million provision associated with the third quarter 2000 restructuring, the provision would have been $793,000. Total net charge-offs were $1,168,000 for the third quarter of 2001 versus $1,180,000 for the third quarter of 2000. Loan losses are expected to remain slightly above their historical level of .30% of loans for the remainder of the year. The reserve was 1.42% of total loans at September 30, 2000. Non-accrual loans have increased over the past year and total $4,273,000 as of September 30, 2001 versus $3,821,000 as of the same date last year. Similarly, loans past due over 90 days and still accruing totaled $4,693,000 as of September 30, 2001 versus $3,171,000 as of the same date last year, reflecting the general economic slowdown in both the national and local economies. Both the non-accrual and loans past due over 90 days and still accruing balances are down from the linked quarter ($4,666,000 and $5,415,000, respectively).

Net Interest Income. Net interest income for the third quarter of 2001 increased by $867,000 from the same period last year to $12,473,000. The increase was due to an improved net interest margin, partially offset by a decline in average earning assets. The net interest margin improved to 3.49% for the third quarter of 2001 versus 3.14% for the same period in 2000. The reduction in average interest earning assets during the past 12 months was strongly influenced by the sale of mortgage loans in the third quarter of 2000.

Non-interest Income. Non-interest income (excluding security gains and losses and trading activity) totaled $4,420,000. Excluding the restructuring charge for the loss on the sale of loans, the third quarter 2000 non-interest income would have been $3,683,000. The improvement came from a variety of sources including: 1) an increase in 15.6% in service charges on deposit accounts attributable to a revised deposit account structure, fee schedule, collection procedures and an increase in the number of accounts and 2) an increase in the gain on sale of loans from $520,000 (excluding restructuring) to $1,394,000 primarily due to lower mortgage rates and the resulting increase in refinancing activity. Trust department income is down 8.6% from the third quarter of 2000 due to the reduction in the amount of assets under management caused by the loss of over $150 million in accounts and the decline in overall equity values over the period. Miscellaneous income is down by 21% due to an increase of $475,000 in the valuation allowance for mortgage servicing rights. The rapid drop in long-term interest rates has increased prepayment speeds, causing a reduction in value of the servicing rights. Increasing prepayment speeds are anticipated to require additional adjustments in the valuation allowance for mortgage servicing rights in the fourth quarter of 2001.

Non-interest Expense. Expenses for the third quarter of 2001 were $3,058,000 lower than for the same period in 2000. Even excluding the impact of the third quarter restructuring, expenses were down $449,000,or 4.3%. Reductions were realized in all expense categories from a year ago. The Company expects to continue to focus on cost controls and reductions in the coming quarters.

Year-to-date Comparison:
The Company reported net income of $12,746,000 ($1.26 per diluted share) for the first nine months of 2001. Income before cumulative effect of accounting change ("operating net income") was $12,847,000 ($1.27 per diluted share), substantially greater than the net income reported for the same period in 2000. Excluding the third quarter 2000 restructuring charges, net income would have been $11,126,000, or $1.08 per diluted share. The following ratio discussion references operating net income for 2001 and 2000. Return on average assets (ROA) and return on average total shareholders' equity (ROE) were 1.09% and 13.97%, respectively, for the first nine months of 2001 compared to 0.93% and 12.87% for the same period last year. A strong increase in non-interest income and a 4.2% reduction in expenses helped increase net income and offset a neutral net interest margin and an increase of $965,000 in provision for loan losses from the first nine months of 2000.

Asset Quality. The provision for loan losses increased to $3,091,000 for the first nine months of 2001 from $2,126,000 during the same period in 2000 (excluding restructuring charges). The increase is due to an increase in consumer charge-offs, which elevated total charge-offs to $2,879,000 for the first three quarters of 2001 versus $2,355,000 during the first three quarters of 2000. Loan losses are expected to remain slightly above their historical level of .30% of loans for the remainder of the year.

Net Interest Income. Net interest income for the first nine months of 2001 was nearly unchanged at $36,387,000. The net interest margin held at 3.47% from a year ago on an operating basis and average earning assets declined by 1.5% from the first nine months of 2000.

Non-interest Income. Non-interest income (excluding security gains and losses, trading and restructuring activity) totaled $13,022,000, or 19.0% higher than the first nine months of 2000. The increase came from a variety of sources including: 1) an increase of 17.7% in service charges on deposit accounts attributable to a revised deposit account structure, fee schedule, collection procedures and an increase in the number of accounts and 2) an increase in the gain on sale of loans from $1,220,000 to $3,283,000 primarily due to lower mortgage rates and the resulting increase in refinancing activity. Trust department income is down 21.5% from the first three quarters of 2000 due to the reduction in the amount of assets under management caused by the loss of over $150 million in accounts and the decline in overall equity values over the period. Security gains for the first nine months of 2001 totaled $640,000 versus $317,000 for the same period in 2000. Miscellaneous income was virtually unchanged at $5,625,000 for the first three quarters of 2001, but included an increase in the valuation allowance for mortgage servicing rights of $505,000. The rapid drop in long-term interest rates has increased prepayment speeds, causing a reduction in value of the servicing rights. Increasing prepayment speeds are anticipated to require additional adjustments in the valuation allowance for mortgage servicing rights in the fourth quarter of 2001.

Non-interest Expense. Expenses for the first nine months of 2001 were 4.2% lower than for the same period in 2000. Reductions were realized in all expense categories except equipment and occupancy, which were 0.6% and 0.9% greater, respectively. The Company expects to continue to focus on cost controls and reductions in the coming quarters.

Capital resources. Shareholders' equity has increased by $13.6 million since December 31, 2000 due to the increase in accumulated other comprehensive income ("OCI"), which increased by nearly $6.6 million since year-end, and the increase in retained earnings, which increased by $7.6 million since year-end. The Company has slightly more than 180,000 shares remaining under the present repurchase authorization. Repurchases under this authorization are expected to be completed through open market transactions at prevailing market prices and are discretionary, based upon management's periodic assessment of market conditions and financial benefit to the Company. This continuing repurchase authorization will remain in effect until amended or withdrawn by subsequent board action. As of October 31, 2001, the Company had repurchased 833,312 of shares of common stock.

Liquidity. Management of the Company's liquidity position is necessary to ensure that funds are available to meet the cash flow needs of depositors and borrowers as well as the operating cash needs of the Company. Funds are available from a number of sources including maturing securities, payments made on loans, the acquisition of new deposits, the sale of packaged loans, borrowing from the FHLB and overnight lines of credit of over $37 million through correspondent banks. The parent company has three major sources of funding including dividends from the Bank, $20 million in unsecured lines of credit with correspondent banks, which are renewable annually, and access to the capital markets. There were no outstanding balances against the unsecured lines of credit as of September 30, 2001.

Item 3. Qualitative and Quantitative Disclosure About Market Risk

Forward-looking statements

The section that follows contains certain forward-looking statements (as defined in the Private Securities Litigation Reform Act of 1995). These forward-looking statements may involve significant risks and uncertainties. Although the Company believes that the expectations reflected in such forward-looking statements are reasonable, actual results may differ materially from the expectations discussed in these forward-looking statements.

Market Risk Management:
Market risk is the risk of economic loss from adverse changes in the fair value of financial instruments due to changes in (a) interest rates, (b) foreign exchange rates, or (c) other factors that relate to market volatility of the rate, index, or price underlying the financial instrument. The Company's market risk is composed primarily of interest rate risk. The Company's Asset/Liability Committee (ALCO) is responsible for reviewing the interest rate sensitivity position of the Company and establishing policies to monitor and limit the exposure to interest rate risk. Since nearly the Company's entire interest rate risk exposure relates to the financial instrument activity of the Bank, the Bank's Board of Directors review the policies and guidelines established by ALCO.

The primary objective of asset/liability management is to provide an optimum and stable net interest margin, after-tax return on assets and return on equity capital, as well as adequate liquidity and capital. Interest rate risk is monitored through the use of two complementary measures: dynamic gap analysis and earnings simulation models. While each of the measurement techniques has limitations, taken together they represent a reasonably comprehensive tool for measuring the magnitude of interest rate risk inherent in the Company.

The earnings simulation model forecasts earnings for a one-year horizon frame under a variety of interest rate scenarios; including interest rate shocks, stepped rates and yield curve shifts. Management evaluates the impact of the various rate simulations against earnings in a stable interest rate environment. The most recent model projects net income would increase by 3.1% if interest rates would immediately rise by 200 basis points. It projects a decrease in net income of 3.1% if interest rates would immediately fall by 200 basis points. Management believes this reflects an acceptable level of risk from interest rate movements. The earnings simulation model includes assumptions about how the various components of the balance sheet and rate structure are likely to react through time in different interest rate environments. These assumptions are derived from historical analysis and management's outlook. Management expects interest rates to have a neutral to downward bias for the remainder of 2001 and a neutral bias for the first half of 2002.

Interest rate sensitivity is managed through the use of security portfolio management techniques, the use of fixed rate long-term borrowings from the FHLB, the establishment of rate and term structures for time deposits and loans and the sale of long-term fixed rate mortgages through the secondary mortgage market. The Company also may use interest rate swaps, caps and floors to manage interest rate risk.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings -
The Company is subject to various pending and threatened lawsuits in the ordinary course of business in which claims for monetary damages are asserted. While any litigation involves an element of uncertainty, in the opinion of management, liabilities, if any, arising from such litigation or threat thereof will not have a material impact on the financial position or results of operations of the Company.

Item 2. Changes in Securities - None

Item 3. Defaults upon Senior Securities - Not Applicable

Item 4. Submission of Matters to a Vote of Security Holders - Not applicable

Item 5. Other Information - On September 28, 2001, Second Bancorp Incorporated issued through Second Bancorp Capital Trust I, a newly formed subsidiary, 2,800,000 shares of 9.00% Cumulative Trust Preferred Securities, $10 liquidation amount, in a public offering underwritten by Stifel, Nicolaus & Company, Incorporated and Sandler O'Neill & Partners, L.P. as co-representatives for a group of underwriters. The underwriters were also granted a 30-day option to purchase up to an additional 400,000 Trust Preferred Securities to cover over-allotments. This option was exercised by the underwriters and an additional 400,000 Trust Preferred Securities were issued on October 12, 2001.The gross proceeds of the offering of the Trust Preferred Securities was $32 million.

The Trust Preferred Securities represent undivided beneficial interests in the assets of Second Bancorp Capital Trust I which was established as a Delaware business trust for the purpose of issuing the Trust Preferred Securities. The Trust Preferred Securities mature on December 31, 2031 and are redeemable on or after December 31, 2006. Proceeds of the offering of the Trust Preferred Securities were invested by Second Bancorp Capital Trust I in $32,989,700 9.00% Subordinated Debentures of Second Bancorp Incorporated due December 31, 2031. Second Bancorp Incorporated used the proceeds received by it to fund the $26.9 million cash price for the acquisition of Commerce Exchange Corporation which was completed on October 25, 2001. Proceeds in excess of that cash price are being used by Second Bancorp Incorporated to pay off existing short-term indebtedness and for other general corporate purposes. The Trust Preferred Securities are traded on the Nasdaq National Market under ticker symbol "SECDP".

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

The following exhibits are included herein:

Exhibit 4.1. Indenture for Subordinated Debentures due 2031 of Second Bancorp Incorporated, dated September 28, 2001, by and between Second Bancorp Incorporated and Wilmington Trust Company, as indenture trustee

Exhibit 4.2. Amended and Restated Trust Agreement of Second Bancorp Capital Trust I, dated September 28, 2001, by and among Second Bancorp Incorporated, as depositor, Wilmington Trust Company, as property trustee, Wilmington Trust Company, as Delaware trustee, and the administrative trustees named therein.

Exhibit 4.3. Preferred Securities Guarantee Agreement, dated September 28, 2001, by and between Second Bancorp Incorporated and

Wilmington Trust Company

Exhibit 11. Statement re: computation of earnings per share

The Company filed a report on Form 8-K on July 26, 2001 to announce earnings for the second quarter of 2001. The Company filed a report on Form 8-K on July 26, 2001 to announce the execution of a definitive merger agreement with Commerce Exchange Corporation. The Company filed a report on Form 8-K on October 1, 2001 to announce the issuance of Trust Preferred Securities. The Company filed a report on Form 8-K on October 22, 2001 to announce earnings for the third quarter of 2001. The Company filed a report on Form 8-K on October 30, 2001 to announce the completion of the acquisition of Commerce Exchange Corporation. (See Note 4 of the Notes to Consolidated Financial Statements for more information regarding the acquisition).

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.

SECOND BANCORP INCORPORATED

Date: November 14, 2001 /s/ David L. Kellerman

David L. Kellerman, Treasurer

Signing on behalf of the registrant and as principal accounting officer and principal financial officer.