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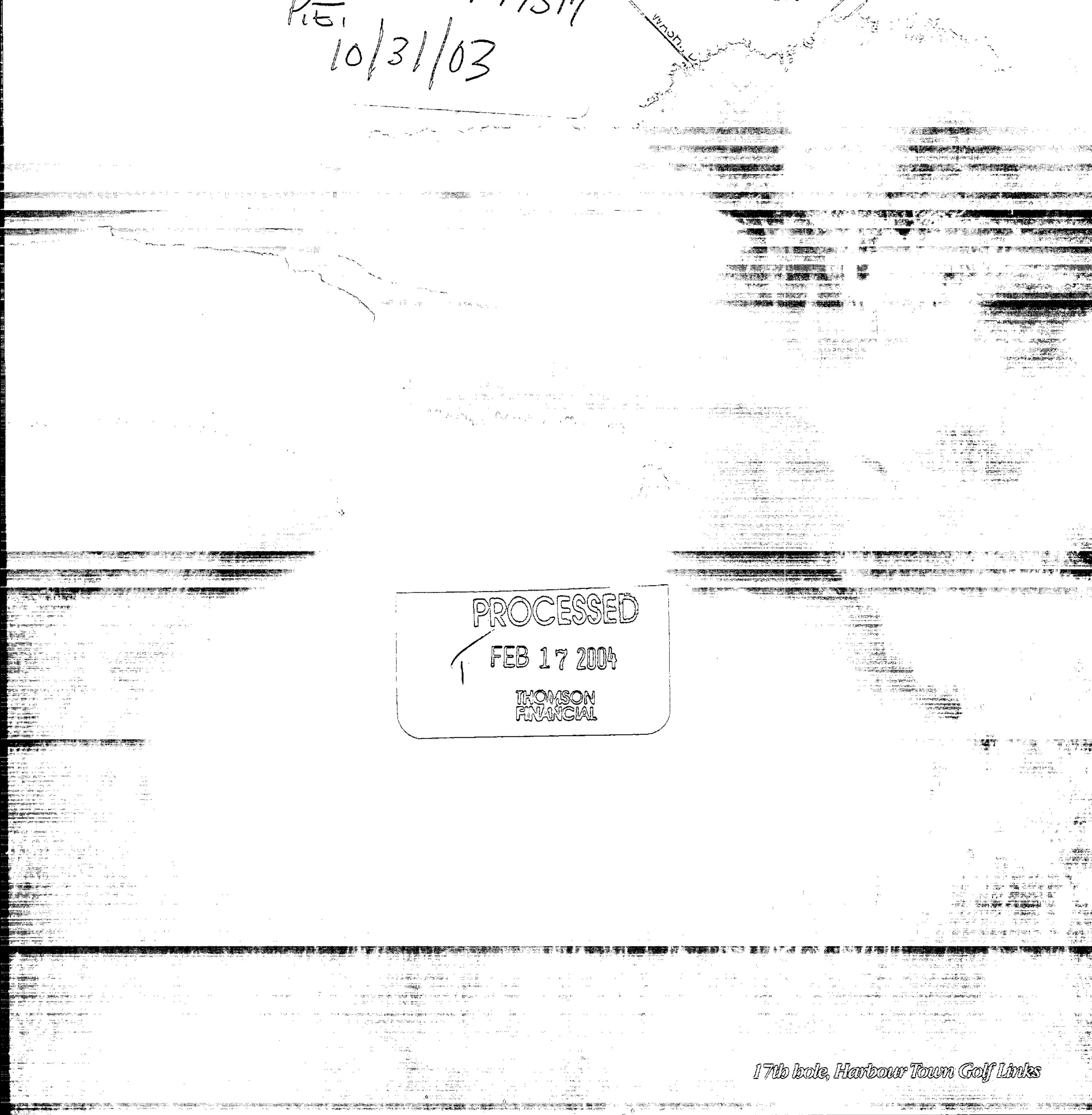
Sea Pines Associates, Inc.

2003 Annual Report



17th hole, Harbour Town Golf Links

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This document, other than historical financial information, may contain forward-looking statements that involve risks and uncertainties. These statements may differ materially from actual future events or results. For instance, factors which could cause results to differ from expectations include those described on page 44 of this document. Readers are also referred to the documents filed by Sea Pines Associates, Inc. with the Securities and Exchange Commission, specifically the most recent report on Form 10-K, which identifies important risk factors that may cause actual results to differ from those contained in the forward-looking statements.

Sea Pines ASSOCIATES

MESSAGE FROM THE CHAIRMAN

Overview

The Company recorded a net loss of nearly $6.5 million for its 2003 fiscal year. Two factors led to the loss. By far the most significant was the $6.3 million total cost of the Grey Point Associates lawsuit, including the final settlement and legal expenses. The other negative factor was subpar Resort activity for most of the year.

The year did have some bright spots. Most noteworthy were the results of the Sea Pines Real Estate Company, which eclipsed all previous records. And resort operations showed significant improvement during the final fiscal quarter, a hopeful sign of recovery from the depressed conditions that have plagued the entire resort business sector since 2001.

Although financial constraints have been severe, the Company has been able to move forward with several important asset improvements. Physical improvements were made at the Beach Club and food services at that location were expanded. Significant improvements at the Harbour Town Club House are currently under way.

The Company won further recognition in 2003 for the quality of its facilities and customer service. In particular: Harbour Town Golf Links moved up nine spots on Golf Magazine's "Top 100 Courses in the U.S." and continues to be rated the top course in South Carolina on that list. And The Inn at Harbour Town was named to the Conde Nast Traveler Gold List, the only hotel on Hilton Head Island and one of four in South Carolina to be so honored.

Looking forward, first quarter results for 2004 are encouraging. All facets of resort operations are showing significant revenue gains compared to the same period a year ago. Real estate activity also continues at a healthy pace, although it is too early to say whether 2004 will equal the record levels achieved in 2003.

A detailed discussion of 2003's financial results, including comparisons with prior years, is found in Management's Discussion and Analysis of Financial Condition and Results of Operation, which begins on page 4. A recent change in accounting standards affects the way these results are reported. The nature of that change is explained below. All financial information in this report, including information for prior years, is consistent with the new requirements.

Effects of a Change in Accounting Standards

A recently-adopted accounting standard changes the way certain "pass-through" transactions are reported on the Income Statement. These pass-through transactions include, for example, expenses for repairs authorized and paid for by the Company but immediately reimbursed by rental property owners. In the past, expense and reimbursement in these cases were treated as offsetting transactions within a single account, which resulted in no reportable revenue or expense.

The new standard requires that the cost of any transaction for which a Company has discretionary responsibility be reported as a Company expense, and that any reimbursement received from the third party be considered as Company revenue. The result is a new revenue line item, entitled Cost Reimbursements, and a new expense line entitled Costs Subject to Reimbursement.

You will note that the entries are equal and offsetting. Revenues and expenses for prior periods have been reclassified to conform to the current year presentation. The magnitude of Cost Reimbursements and Costs Subject to Reimbursements was $3,639,000 in fiscal year 2003, $3,550,000 in fiscal year 2002 and $3,507,000 in fiscal year 2001.

Grey Point Litigation and Judgment Loan

The outcome of the Grey Point Associates lawsuit has added significantly to the Company's already high debt load. The Company obtained a $5.9 million Judgment Loan from Wachovia to fund the settlement of that suit. The Judgment Loan balance has since been reduced to $4.8 million, using $1.1 million the Company received from the repayment of a note receivable from the sale of the Old Welcome Center in 1996.

The remaining $4.8 million balance of the Judgment Loan must be repaid by July 2005. Cash flow from operations can be expected to cover only a portion of that repayment within the required timeframe. The Board and management are carefully reviewing potential asset sale alternatives to fund the balance of the repayment.

The Judgment Loan agreement requires that preferred dividend payments and trust preferred interest payments be deferred until significant progress toward repayment has been accomplished. The Board considers the reinstatement of those dividend payments a major priority.

Recognition and Thanks

Difficult years are revealing. They tell us more about an organization's leadership, and about the loyalty and commitment of its people, than do the years when good results come more easily. The Company operated effectively during 2003, despite the year's special challenges, because of the 100% effort of its employees, its real estate agents and its management team. For their contributions, and for the loyalty and resilience of our shareholders, we are deeply grateful.

Norman P. Harberger

Norman P. Harberger
Chairman

MANAGEMENT'S DISCUSSION AND ANALYSIS

OF

FINANCIAL CONDITION AND RESULTS OF OPERATION

Results of Operations

The Company's operations are conducted primarily through two wholly owned subsidiaries. Sea Pines Company, Inc. operates all of the resort assets, including a 60-room inn, conference facilities, three resort golf courses, a tennis center, home and villa rental management operations, retail sales outlets, food service operations and other resort recreational facilities. Sea Pines Real Estate Company, Inc. is an independent real estate brokerage firm with 15 offices serving Hilton Head Island and its neighboring communities.

Critical Accounting Policies

In preparation of its financial statements, the Company applies accounting principles generally accepted in the United States. The application of generally accepted accounting principles may require management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying results. These critical accounting policies have been discussed with the Company's audit committee.

Revenue Recognition

Revenue from resort operations is recognized as goods are sold and services are provided and revenue from real estate brokerage is recognized upon closing of the sale. As a result, the Company's revenue recognition process does not involve significant judgments or estimates.

Investment in Real Estate Assets

The Company's management is required to make subjective assessments as to the useful lives of its depreciable assets. The Company considers the period of future benefit of the asset to determine the appropriate useful life. These assessments have a direct impact on net income. The estimated useful lives of the Company's assets by class are as follows:

Land improvements	15 years
Buildings	39 years
Machinery and equipment	5 – 7 years

In the event that management uses inappropriate useful lives or methods for depreciation, the Company's net income would be misstated.

Valuation of Real Estate Assets

Management continually monitors events and changes in circumstances that could indicate that the carrying amounts of the real estate assets, both operating properties and properties held for future development, may not be recoverable. When there are indicators that the carrying amount of a real estate asset may not be recoverable, management assesses the recoverability of the asset by determining whether the carrying value of the real estate asset will be recovered through the undiscounted future operating cash flows expected from the use of the asset and its eventual disposition. In the event that such expected undiscounted future cash flows do not exceed the carrying value, management adjusts the real estate asset to fair value and the Company recognizes an impairment loss. A projection of expected future cash flows requires management to make certain estimates. If management uses inappropriate assumptions in the future cash flow analysis, resulting in an incorrect assessment of the property's future cash flows and fair value, it could result in the overstatement of the carrying value of real estate assets and net income of the Company.

2003 Compared to 2002

Revenues

The Company reported revenues of $56,935,000 for fiscal 2003, a $2,243,000, or 4.1%, increase over fiscal year 2002. Resort revenues, excluding cost reimbursements revenues, declined by $1,306,000, or 3.7%, compared to 2002; while real estate brokerage revenues, excluding cost reimbursements revenues, improved by $3,460,000, or 21.3%. The decline in resort revenues showed the effects of a nationwide decrease in personal resort travel and corporate meetings during the Company's first three quarters of fiscal year 2003.

The primary factors contributing to the $2,243,000 increase in revenues were as follows:

- Real estate brokerage revenues increased by $3,460,000, or 21.3%, during fiscal 2003 as compared with fiscal 2002. This increase was primarily the result of a 24.3% increase in sales volume in fiscal 2002. This improvement is attributable to low mortgage interest rates and a favorable second home real estate market.

- Golf revenue in fiscal 2003 decreased by $514,000, or 4.2%, as compared to fiscal 2002. The number of resort golf rounds played at Harbour Town Golf Links during fiscal 2003 decreased by 1,123 rounds, or 4.4%, from fiscal 2002. This decrease in rounds played was partially offset by a $2.68, or 1.9%, increase in average resort rate paid per round in fiscal 2003 over fiscal 2002. The number of resort golf rounds played at the Ocean and Sea Marsh golf courses during fiscal 2003 decreased by 8,195 rounds, or 12.1%, from fiscal 2002. This decrease was partially offset by a $2.47, or 4.2%, increase in average resort rate paid per round in fiscal 2003 over fiscal 2002.

- Rental management revenue decreased by $977,000, or 8.4%, during fiscal 2003 as compared with fiscal 2002. Total guest occupied nights during fiscal 2003 were 48,081 as compared to 52,470 during fiscal 2002. The average daily rate was $212.08 in fiscal 2003, as compared to $212.81 during fiscal 2002.

- Food and beverage operations generated revenues of $4,468,000 in fiscal 2003. This represents a decrease of $24,000, or 0.5%, over fiscal 2002. This decrease was primarily due to a $348,000, or 17.3%, decline in revenue from catering operations and a $54,000, or 10.0%, decline in revenue from golf food and beverage operations. These decreases were partially offset by a $342,000, or 48.3%, increase in revenue from the Sea Pines Beach Club, a $53,000, or 14.2%, increase in revenue from the Harbour Town Bakery and a $42,000, or 8.5%, increase in revenue from the Heritage Grill.

- The Inn at Harbour Town generated revenues of $2,366,000 in fiscal 2003. This represents a decrease of $301,000, or 11.3%, from fiscal 2002. Total occupied room nights were 12,043 as compared to 13,516 during 2002. The average daily rate was $182.93 during fiscal 2003, a decrease of $5.04, or 2.7%, from the same period in fiscal 2002.

- Other recreation services revenue increased by $450,000, or 14.2%, during fiscal 2003 as compared with fiscal 2002. This increase is primarily the result of increased revenue from tennis operations related to the Smith/Stearns Tennis Academy and increased rental income from the Company's bike shop operations.

Cost of revenues

Cost of revenues were $39,596,000 in fiscal 2003, representing an increase of $3,333,000, or 9.2%, over fiscal 2002. A majority of this increase, $2,989,000, was attributable to increased commissions earned by real estate sales agents as a result of improved real estate sales activity.

Expenses

- Sales and marketing expenses increased by $249,000, or 8.2%, and totaled $3,271,000 in fiscal 2003. This increase is the result of increased real estate marketing and resort marketing promotions during fiscal 2003.

- General and administrative expenses increased by $98,000, or 1.5%, totaling $6,464,000 for the year. This increase is the result of a $219,000 increase in medical claims paid by the Company's self-funded medical plan, $101,000 increase in insurance expenses and a $52,000 increase in bank service fees. These increases were partially offset by a $164,000 increase in property tax expenses, the $304,000 property tax refund discussed in Note 14 and a $109,000 decrease in bad debt expense.

- Depreciation and amortization expense decreased by $11,000, or 0.4%, and totaled $2,578,000 in fiscal 2003.

Other income (expense)

- The Company reports changes in the value of its interest rate swap agreements in its operations. The Company recorded interest rate swap agreement income of $533,000 in fiscal 2003. During fiscal 2002, falling interest rates caused the fair value of the agreements to decline and the Company recorded interest rate swap agreement expense of $381,000. If the swap agreements remain in effect until their expiration date in 2005, the cumulative total of all related income and expense entries will equal zero.

- Interest income increased by $90,000 during fiscal 2003 as compared to fiscal 2002. This was primarily as a result of the Company receiving interest of $104,000 during the first quarter fiscal 2003 on a refund of excess property taxes paid during fiscal 1998 through fiscal 2001.

- Gain on the sale of assets totaled $63,000 for fiscal 2003. These gains were the result of the sale of two density units and certain other assets.

- Interest expense decreased by $121,000, or 5.1%, during fiscal 2003 as compared to fiscal 2002. This decrease is attributable to lower interest rates during fiscal 2003.

- Litigation expenses totaling $6,324,000 were recorded during fiscal 2003. On April 30, 2003, a jury verdict of approximately $7.8 million was rendered against a wholly owned subsidiary of the Company in <u>Grey Point Associates, et al. v. Sea Pines Company, Inc.</u> The lawsuit involved alleged breach of contract by Sea Pines related to the development of the TidePointe retirement community. On October 6, 2003, the Company agreed pursuant to the terms of a settlement agreement and release to pay $5.9 million to settle the lawsuit. The Company incurred $424,000 in legal fees and related expenses in connection with the lawsuit.

Income taxes

The Company has not recognized any income tax benefit for fiscal 2003 related to its taxable loss since the Company is uncertain whether there will be sufficient taxable income in future periods to allow for utilization of the loss. The Company has current tax expense of approximately $54,000 for fiscal 2003. This expense related to a reduction of the current income tax receivable upon finalization of the timing differences for the 2002 income tax returns. Because the Company's deferred assets are fully reserved, this reduction results in a net current tax charge for the 2003 fiscal year. The Company's valuation allowance on its deferred tax assets increased by $2,599,000 during the year ended October 31, 2003 to $3,285,000.

<u>2002 Compared to 2001</u>

Revenues

The Company reported revenues of $54,692,000 for fiscal 2002, an $841,000, or 1.6%, increase over fiscal 2001.

The primary factors contributing to the $841,000 increase in revenues were as follows:

- Golf revenue in fiscal 2002 increased by $377,000, or 3.2%, as compared to fiscal 2001. This increase was due to the Harbour Town Golf Links being open for all twelve months of fiscal 2002 as compared to only being open for ten months of fiscal 2001. The golf course was closed for eight months beginning with the third quarter of fiscal 2000 through part of the first quarter of fiscal 2001 to complete a major restoration project.

- Food and beverage operations generated revenues of $4,444,000 in fiscal 2002. This represents an increase of $355,000, or 8.7%, over fiscal 2001. This increase was due to increased revenue in the catering operations, Harbour Town Bakery and the Sea Pines Beach Club.

- The Inn at Harbour Town generated revenues of $2,667,000 in fiscal 2002. This represents an increase of $294,000, or 12.4%, over fiscal 2001. Total occupied room nights were 13,516 as compared to 12,599 during fiscal 2001. The average daily rate was $187.97 during fiscal 2002, an increase of $7.87, or 4.4%, from fiscal 2001.

- Revenues from the Company's rental management operation in fiscal 2002 decreased by $217,000, or 1.8%, compared with fiscal 2001. This decrease is primarily the result of current economic conditions and the decline in air travel. Guest occupied unit nights decreased 6.3% in fiscal 2002, totaling 52,470 for the year. The average daily rate of $212.81 in fiscal 2002 was a 5.1% increase over the average daily rate in fiscal 2001 of $202.43.

- Gross commission revenue in fiscal 2002 from the real estate brokerage operation decreased by $360,000, or 2.2%, as compared to fiscal 2001. This decrease was primarily the result of the economic downturn during the first six months of fiscal 2002, which adversely affected the second-home sales market.

Cost of revenues

Cost of revenues were $36,263,000 in fiscal year 2002, representing a 1.0% decrease from fiscal 2001. This decrease is primarily due to a decrease in commission expense from real estate brokerage operations.

Expenses

- Sales and marketing expenses were $3,022,000 in fiscal 2002, representing a 4.4% decrease from fiscal 2001. This decrease is primarily the result of reduced real estate marketing costs.

- General and administrative expenses decreased by $397,000, or 5.9%, totaling $6,366,000 for the year. This decrease was primarily the result of lower medical claims paid by the Company's self-funded medical plan and a reduction in property tax expense. These decreases were partially offset by increases in insurance costs.

- Depreciation and amortization expense increased by $85,000, or 3.4%, and totaled $2,589,000 in fiscal 2002. This increase was the result of a full year's depreciation on the Inn at Harbour Town and the Harbour Town Golf Links restoration project. Both of these projects were completed during fiscal 2001, and depreciation expense applied only to the period the facilities were in operation.

Other income (expense)

- The Company reports changes in the value of its interest rate swap agreements in its operations. The value of these agreements is greatest when interest rates are high enough to bring the rate protection into play. Falling interest rates during fiscal year 2002 made the rate protection less relevant, causing the fair value of the agreements to decline by $381,000. This charge is a non-cash expense in 2002. If interest rates rise in the future, there will be a gain reported. If the swap agreements remain in effect until their expiration date in 2005, the cumulative total of all related income and expense entries will equal zero.

- Interest expense decreased by $379,000, or 13.7%, during fiscal 2002 as compared with fiscal 2001. This decrease is attributable to lower interest rates during fiscal 2002 and lower outstanding debt balances.

Financial Condition, Liquidity and Capital Resources

The Company's financial results from its resort operations and real estate brokerage activities experience fluctuations by season. The period from November through February has historically been the Company's lower resort revenue and real estate sales season, and the period from March through October has historically been the Company's higher season.

Cash and cash equivalents increased by $980,000 during fiscal 2003 and totaled approximately $4,042,000 at October 31, 2003, of which $3,571,000 was restricted. Restricted cash includes cash held in escrow pending real estate closings, advance deposits for home and villa rentals, and rental receipts to be paid to home and villa owners. Working capital (current assets less current liabilities) decreased during fiscal 2003 by $567,000, resulting in a working capital deficit of $1,896,000 at October 31, 2003.

In July 2003, the Company completed a modification to its master credit agreement with its principal corporate lender. The modification included revisions to certain loan covenants and representations and waived certain loan covenants for the year ending October 31, 2003.

The modification also provided for a Judgment Loan Facility (the "Judgment Loan") in an amount up to $8,000,000. This loan facility may only be used to pay for expenses related to the litigation described in Note 5 of the financial statements. Interest on the facility is payable monthly at various London Interbank Offered Rates (LIBOR) plus 2.35%, and it is collateralized by substantially all assets of the Company. The terms of the Judgment Loan require the Company to cease the payment of dividends on the Series A cumulative preferred stock and interest on its junior subordinated debentures.

Under the Company's master credit agreement, the Company maintains four loan facilities: a term loan, a revolving line of credit, the Judgment Loan and a seasonal line of credit. Available funds under these four loan facilities total $43,497,000, of which $37,797,000 was outstanding at October 31, 2003.

The term loan had an outstanding principal amount of $14,797,000 as of October 31, 2003 and matures on November 1, 2008. The revolving line of credit had an outstanding balance of $17,100,000 as of October 31, 2003 and matures on November 1, 2007. The Judgment Loan had an outstanding balance of $5,900,000 on October 31, 2003 and matures on July 30, 2005. The available balance under the seasonal line of credit totals $4,500,000. It is used to meet cash requirements during the Company's off-season winter months. As of October 31, 2003, the seasonal line of credit had no outstanding balance. The seasonal line of credit expires on November 1, 2007.

The Company has two interest rate swap agreements which effectively fix the interest rate on a $24 million notional principal amount outstanding under the loan facilities described above. An amount of $18 million has been fixed at 5.24% per annum plus a credit margin ranging from 1.40% to 1.85%, and an amount of $6 million has been fixed at 6.58% plus a credit margin ranging from 1.40% to 1.85%.

A summary of our contractual obligations is presented below:

Payments Due by Period
Contractual Obligations
(in thousands)

	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
Long-term debt	$37,797	$1,230	$8,655	$20,300	$7,612
Trust preferred securities	2,480	--	--	--	2,480
Operating leases	3,334	992	1,289	544	509
Purchase obligations	925	300	625	--	--
Total contractual obligations	$44,536	$2,522	$10,569	$20,844	$10,601

Subsequent Events

In December 2003, the bank waived the loan covenant in the Company's master credit agreement related to the net worth ratio for the year ending October 31, 2004. The waiver was required because the Company did not expect to be in compliance with this covenant for the year ending October 31, 2004.

Quantitative and Qualitative Disclosures About Market Risk

On September 30, 1998, the Company entered into an interest rate swap agreement, which effectively fixed the interest rate on $18 million of principal amount outstanding under the four loan facilities the Company maintains under its master credit agreement with its principal corporate lender at 5.24% plus a credit margin ranging from 1.40% to 1.85%, based on the calculation of certain financial ratios, for a period ending November 10, 2005.

The Company entered into a second interest rate swap agreement on May 4, 2000, which effectively fixed the interest rate on an additional $6 million of principal amount at 6.58% plus a credit margin ranging from 1.40% to 1.85% for a period ending November 1, 2005.

The Company has reduced its interest rate risk exposure by entering into these two swap agreements. A change in the LIBOR rate would affect the rate at which the Company could borrow funds in excess of the $24 million fixed by the above swap agreements. Based on variable rate obligations outstanding at October 31, 2003, each 25 basis point increase or decrease in the level of interest rates would increase or decrease the Company's annual interest expense and related cash payments by approximately $34,000.

MANAGEMENT'S REPORT ON RESPONSIBILITY

FOR FINANCIAL REPORTING

The management of Sea Pines Associates, Inc. and its subsidiaries have the responsibility for preparing and assuring the integrity and objectivity of the accompanying financial statements and other financial information in this annual report. The financial statements were developed using generally accepted accounting principles and appropriate policies, consistently applied. They reflect, where applicable, management's best estimates and judgments and include disclosures and explanations which are relevant to an understanding of the financial affairs of the Company.

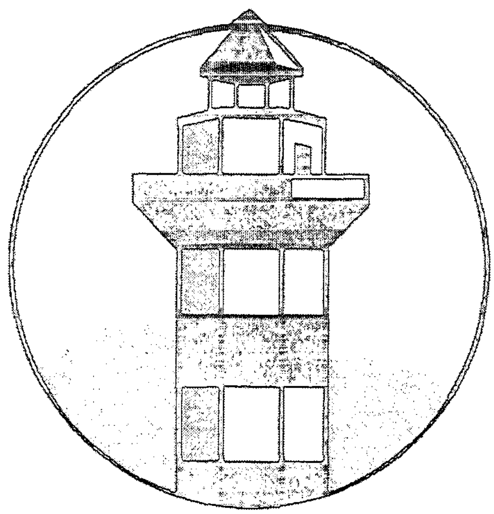
The Company's financial statements have been audited by Ernst & Young LLP, independent auditors. Management has made available to Ernst & Young LLP the Company's financial records and related data, and has made written and oral representations and disclosures in connection with the audit.

Management has established and maintains a system of internal control that it believes provides reasonable assurance as to the integrity and reliability of the financial statements, the protection of assets and the prevention and detection of fraudulent financial reporting. The system of internal control is believed to provide for appropriate division of responsibility and is documented by written policies and procedures that are utilized by employees involved in the financial reporting process. Management also recognizes its responsibility for fostering a strong ethical climate. This responsibility is characterized and reflected in the Company's code of ethics for senior financial executives, and code of corporate conduct, which is communicated to all of the Company's employees.

The Board of Directors oversees the Company's financial reporting through its Audit Committee, which regularly meets with management representatives and, jointly and separately, with the independent auditors to review accounting, auditing and financial reporting matters.

Michael E. Lawrence
Chief Executive Officer

Steven P. Birdwell
Chief Financial Officer



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Report of Independent Auditors

Board of Directors and Shareholders
Sea Pines Associates, Inc.

We have audited the accompanying consolidated balance sheets of Sea Pines Associates, Inc. (the "Company") as of October 31, 2003 and 2002, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended October 31, 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Sea Pines Associates, Inc. at October 31, 2003 and 2002, and the consolidated results of its operations and its cash flows for each of the three years in the period ended October 31, 2003, in conformity with accounting principles generally accepted in the United States.

Ernst & Young LLP

Atlanta, Georgia
December 8, 2003,
except for the subsequent events paragraph in Note 7,
as to which the date is
December 17, 2003

Sea Pines Associates, Inc.

Consolidated Balance Sheets
(In thousands)

	October 31	
	2003	**2002**
Assets		
Current assets:		
Cash and cash equivalents		
Unrestricted	$ 471	$ 574
Restricted	3,571	2,488
	4,042	3,062
Accounts receivable, less allowance for doubtful accounts of $35 and $115 at October 31, 2003 and 2002, respectively	1,420	1,290
Current portion of notes receivable	--	88
Income tax refund receivable	--	217
Inventories	792	859
Prepaid expenses	360	378
Total current assets	6,614	5,894
Notes receivable, less current portion	--	1,002
Deferred loan fees, net	279	139
Other assets, net	60	60
	339	1,201
Real estate assets:		
Operating properties, net	42,675	44,197
Properties held for future development	3,186	3,219
	45,861	47,416
Total assets	$52,814	$54,511

Sea Pines Associates, Inc.

Consolidated Balance Sheets
(In thousands, except share amounts)

	October 31	
	2003	2002
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable and accrued expenses	$3,114	$2,786
Accrued property taxes	429	512
Advance deposits	3,441	2,410
Current portion of deferred revenue and other long-term liabilities	296	373
Current portion of long-term debt	1,230	1,142
Total current liabilities	8,510	7,223
Long-term debt, less current portion	36,567	32,398
Interest rate swap agreement	1,744	2,277
Deferred revenue and other long-term liabilities	660	793
Trust preferred securities	2,480	2,480
Total liabilities	49,961	45,171
Commitments and contingencies		
Shareholders' equity:		
Series A cumulative preferred stock, no par value, 2,000,000 shares authorized; 220,900 shares issued and outstanding at October 31, 2003 and 2002, respectively (liquidation preference of $1,679 at October 31, 2003 and 2002, respectively)	1,294	1,294
Series B junior cumulative preferred stock, no par value; 20,000 shares authorized, none issued or outstanding	--	--
Common stock, 23,000,000 shares authorized, no par value; 3,587,400 shares and 3,573,400 shares issued and outstanding at October 31, 2003 and 2002, respectively	7,916	7,759
Unearned stock compensation	(255)	(235)
(Accumulated deficit) retained earnings	(6,102)	522
Total shareholders' equity	2,853	9,340
Total liabilities and shareholders' equity	$52,814	$54,511

See accompanying notes.

Sea Pines Associates, Inc.

Consolidated Statements of Operations
(In thousands, except per share amounts)

	Year ended October 31 2003	2002	2001
Revenues			
Resort	$33,586	$34,892	$33,734
Real estate	19,710	16,250	16,610
Cost reimbursements	3,639	3,550	3,507
	56,935	54,692	53,851
Cost and expenses:			
Cost of revenues	39,596	36,263	36,626
Costs subject to reimbursement	3,639	3,550	3,507
Sales and marketing expenses	3,271	3,022	3,161
General and administrative expenses	6,464	6,366	6,763
Depreciation and amortization	2,578	2,589	2,504
	55,548	51,790	52,561
Income from operations	1,387	2,902	1,290
Other income (expense):			
Gain on sale or disposal of assets, net	63	--	172
Interest income	202	111	101
Interest rate swap agreements	533	(381)	(1,896)
Interest expense, net of amounts capitalized	(2,271)	(2,392)	(2,771)
Litigation expenses	(6,324)	--	--
	(7,797)	(2,662)	(4,394)
(Loss) income before income taxes	(6,410)	240	(3,104)
(Provision for) benefit from income taxes	(54)	(43)	430
Net (loss) income	(6,464)	197	(2,674)
Preferred stock dividend requirements	(160)	(160)	(160)
Net (loss) income attributable to common stock	$(6,624)	$ 37	$(2,834)
Net (loss) income per share of common stock; basic and diluted	$ (1.85)	$ 0.01	$ (0.80)
Weighted average shares outstanding	3,580	3,568	3,554

See accompanying notes.

Sea Pines Associates, Inc.

Consolidated Statements of Shareholders' Equity
(In thousands)

	Series A Preferred Stock Shares	Series A Preferred Stock Amount	Common Stock Shares	Common Stock Amount	Unearned Stock Compensation	(Accumulated Deficit) Retained Earnings	Total
Balance at October 31, 2000	221	$1,294	3,546	$7,343	$ --	$3,319	$11,956
Net loss	--	--	--	--	--	(2,674)	(2,674)
Issuance of common stock to directors	--	--	14	63	(63)	--	--
Issuance of grants for deferred stock plan	--	--	--	153	(153)	--	--
Amortization of stock compensation	--	--	--	--	57	--	57
Preferred stock dividend	--	--	--	--	--	(160)	(160)
Balance at October 31, 2001	221	1,294	3,560	7,559	(159)	485	9,179
Net income	--	--	--	--	--	197	197
Issuance of common stock to directors	--	--	14	84	(84)	--	--
Issuance of grants for deferred stock plan	--	--	--	116	(116)	--	--
Amortization of stock compensation	--	--	--	--	124	--	124
Preferred stock dividend	--	--	--	--	--	(160)	(160)
Balance at October 31, 2002	221	1,294	3,574	7,759	(235)	522	9,340
Net loss	--	--	--	--	--	(6,464)	(6,464)
Issuance of common stock to directors	--	--	14	56	(56)	--	--
Issuance of grants for deferred stock plan	--	--	--	101	(101)	--	--
Amortization of stock compensation	--	--	--	--	137	--	137
Preferred stock dividend	--	--	--	--	--	(160)	(160)
Balance at October 31, 2003	221	$1,294	3,588	$7,916	($255)	($6,102)	$2,853

See accompanying notes.

Sea Pines Associates, Inc.

Consolidated Statements of Cash Flows
(In thousands)

	Year ended October 31		
	2003	2002	2001
Cash flows from operating activities			
Net (loss) income	$(6,464)	$197	$(2,674)
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:			
Depreciation	2,536	2,563	2,413
Amortization of deferred loan fees	42	26	91
Allowance for doubtful accounts	(80)	85	12
Gain on sale of assets	(63)	--	(172)
Amortization of stock compensation	137	124	57
Interest rate swap agreements	(533)	381	1,896
Deferred income taxes	--	200	135
Changes in assets and liabilities:			
Restricted cash	(1,083)	(1,306)	1,469
Accounts and notes receivable	1,040	(348)	190
Inventories	67	11	(177)
Prepaid expenses	18	(134)	(8)
Accounts payable and accrued expenses	245	(1)	(1,495)
Advance deposits	1,031	1,379	(1,531)
Deferred revenue	(210)	(122)	156
Income taxes receivable/payable	217	252	(623)
Net cash (used in) provided by operating activities	(3,100)	3,307	(261)
Cash flows from investing activities			
Proceeds from sale of assets	118	5	335
Capital expenditures and property acquisitions	(1,036)	(468)	(1,784)
Net cash used in investing activities	(918)	(463)	(1,449)
Cash flows from financing activities			
Payment of deferred loan fees	(182)	(11)	(77)
(Repayments) borrowings on revolving line of credit	(500)	600	2,300
Borrowings on judgment loan	5,900	--	--
(Repayments) borrowings on seasonal line of credit	--	(2,000)	2,000
Principal repayments of term note	(1,143)	(1,059)	(2,034)
Preferred stock dividends paid	(160)	(160)	(341)
Net cash provided by (used in) financing activities	3,915	(2,630)	1,848
Net (decrease) increase in unrestricted cash and cash equivalents	(103)	214	138
Unrestricted cash and cash equivalents at beginning of year	574	360	222
Unrestricted cash and cash equivalents at end of year	$471	$574	$360

See accompanying notes.

1. Description of Business and Summary of Significant Accounting Policies

Sea Pines Associates, Inc. ("SPA" or the "Company") was incorporated in South Carolina on May 4, 1987. The Company was principally organized to acquire, own and operate certain resort assets in Sea Pines Plantation on Hilton Head Island, South Carolina.

The wholly-owned subsidiaries of the Company are Sea Pines Company, Inc. ("SPC"), Sea Pines Real Estate Company ("SPREC"), Fifth Golf Course Club, Inc., and Sea Pines Associates Trust I. SPC is a full-service resort, which provides guests with the use of three golf courses, tennis facilities, inn and conference facilities, various other recreational facilities, home and villa rental management operations, and food-and-beverage services. SPREC provides real estate brokerage services for buyers and sellers of real estate in the Hilton Head Island, South Carolina area (see Note 16 for business segment information). Fifth Golf Course Club, Inc. owns certain acreage which could be used for outdoor recreational activities. Sea Pines Associates Trust I (the "Trust") holds certain company debentures. Interest on the debentures is used by the Trust to pay interest on the trust preferred securities issued by the Trust.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All intercompany accounts and transactions have been eliminated.

Statements of Cash Flows

For purposes of the statements of cash flows, the Company considers all short-term investments with maturities of 90 days or less at the time of purchase to be cash equivalents.

Revenue Recognition

Revenues and expenses from resort operations are recognized as goods are sold and services are provided. Reimbursements received from third parties for services that the Company procures and manages are reflected as revenues as such reimbursements are earned. Real estate brokerage revenues are recognized upon closing of the sale. Advance deposits are required for certain resort reservations and real estate transactions and are not recognized as revenue until earned. The Company's accounts receivable are unsecured.

1. Description of Business and Summary of Significant Accounting Policies (continued)

Cost of Revenues

Cost of revenues includes payments to home and villa owners, real estate sales commissions, cost of inventories sold, credit-card commissions and costs incurred to operate and maintain operating properties.

Concentration of Credit Risk

The Company maintains substantially all of its cash with one financial institution. Account balances greater than $100,000 are not federally insured and are subject to a loss if the financial institution fails. Management believes such risk is minimal based on the current financial condition of the financial institution.

Restricted Cash

Restricted cash includes cash held in escrow pending real estate closings, advance deposits for home and villa rentals, and rental receipts to be paid to home and villa owners.

Accounts Receivable

Receivables are recognized and carried at original amount earned less a provision for any uncollectible amounts, which approximates fair value. An allowance for doubtful accounts is made when collection of the full amount is no longer probable.

Inventories

Inventories are valued at the lower of cost (first-in, first-out method) or net realizable value.

Advertising Expense

The cost of advertising is expensed as incurred and is classified as selling and marketing expenses in the Consolidated Statements of Operations. Advertising expenses were approximately $1,858,000, $1,620,000, and $1,652,000 for the years ended October 31, 2003, 2002, and 2001, respectively.

1. Description of Business and Summary of Significant Accounting Policies (continued)

Real Estate Assets

Real estate assets are recorded at cost less any impairment losses, if applicable. The costs of new development, additions and improvements which substantially extend the useful lives of assets are capitalized. Capitalized costs include costs of construction, property taxes, interest and miscellaneous expenses incurred during the construction period. Capitalized construction period interest totaled approximately $61,000 in 2001. No interest expense was capitalized in 2003 and 2002. Repairs and maintenance costs are expensed as incurred. The Company provides depreciation for financial reporting purposes when the asset is placed in operation using the straight-line method over the estimated useful lives of the assets, which range from five to 39 years.

Other Assets

Deferred loan fees are amortized on a straight-line basis over the lives of the corresponding debt, which approximates the effective interest method.

Impairment of Long-Lived Assets

An impairment loss is recognized whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The Company considers historical performance and future estimated results in its evaluation of potential impairment and then compares the carrying amount of the asset to the estimated future cash flows expected to result from the use of the asset. If the carrying amount of the asset exceeds the estimated expected future cash flows, the Company measures the amount of the impairment by comparing the carrying amount of the asset to its fair value. The Company has not incurred any impairment losses for the years ended October 31, 2003, 2002 or 2001.

Financial Instruments

The carrying amounts of cash and cash equivalents, trade receivables, notes receivable, other current assets, accounts payable, line of credit with bank, long-term debt and accruals meeting the definition of financial instruments approximate their fair market values as of October 31, 2003 and 2002.

1. Description of Business and Summary of Significant Accounting Policies (continued)

Income Taxes

The Company accounts for income taxes using the liability method, which requires recognition of deferred tax liabilities and assets based on temporary differences between the financial statement and tax basis of assets and liabilities using current statutory tax rates. A valuation allowance is established against net deferred tax assets if, based upon the available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized.

Interest Rate Swap Agreements

The Company's results of operations can be significantly affected by changes in interest rates as the outstanding debt has variable interest rates based on a LIBOR index. To manage the risks associated with changes in interest rates, the Company entered into two interest rate swap agreements, which have maturities on November 1, 2005 and November 10, 2005, to fix the interest rate the Company is charged on a notional amount of $24 million of the outstanding debt. The Company accounts for interest expense under its swap agreements by recording differences between the interest rates on the underlying debt and the swap rates, applied to the notional amount of the swaps.

The Company records the fair market value of the interest rate swaps on its consolidated balance sheet. On an ongoing basis, the Company adjusts the balance sheet to reflect the current fair market value of the interest rate swap agreements. The interest rate swap agreements do not qualify for hedge accounting as defined by SFAS 133, and accordingly, the change in the fair market value of the derivative is immediately recognized in the consolidated statement of operations. The Company recorded income of $533,000, expense of $381,000 and expense of $1,896,000 in the consolidated statements of operations for the change in fair value of the interest rate swap agreement for the years ended October 31, 2003, 2002 and 2001, respectively.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

1. Description of Business and Summary of Significant Accounting Policies (continued)

Reclassifications

Certain amounts in the prior years financial statements have been reclassified to conform to the current year presentation.

2. Recent Accounting Pronouncements

In response to a FASB staff announcement in November 2001, and in accordance with the Emerging Issues Task Force ("EITF") Issue No. 01-14, "Income Statement Characterization of Reimbursements received for 'Out-Of-Pocket' Expenses Incurred," which was issued in January 2002, the Company began recording the reimbursements of costs incurred on behalf of other parties (e.g. villa owners, real estate agents) received as cost reimbursements revenues and the costs incurred on behalf of other parties as costs subject to reimbursements in the year ended October 31, 2003. These costs relate primarily to situations where the Company has discretionary responsibility to procure and manage the resources in performing its services under certain contracts. Comparative financial statements for the prior periods were reclassified to conform with the presentation in the 2003 financial statements. Since the reimbursements are made based upon the costs incurred with no added margin, the adoption of this guidance has no effect on the operating income, cash flows or financial position of the Company.

In November 2002, the FASB issued FASB Interpretation 45 ("FIN 45"), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." FIN 45 currently requires that a liability be recorded in the guarantor's balance sheet upon issuance of a guarantee. In addition, as of December 31, 2002, FIN 45 requires disclosures about the guarantees that an entity has issued, including a roll-forward of the entity's product warranty liabilities. The adoption of FIN 45 did not have any impact on the Company's financial position, results of operations or disclosures.

In December 2002, the FASB issued SFAS 148, "Accounting for Stock-Based Compensation, Transition and Disclosure." SFAS 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the disclosure provisions of SFAS 123, "Accounting for Stock Based Compensation," to currently require disclosure of the effects of an entity's accounting policy with respect to stock-based employee compensation on reported net income and earnings

2. Recent Accounting Pronouncements (continued)

per share in annual and interim financial statements. SFAS 148 does not amend SFAS 123 to require companies to account for their employee stock-based awards using the fair value method. Adoption of SFAS 148 did not have any impact on the Company's financial position, results of operations or disclosures.

In January 2003, the FASB issued FASB Interpretation 46 ("FIN 46"), "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51." In December 2003, the FASB issued a Revised Interpretation on FIN 46 ("Revised Interpretation"). FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of the Revised Interpretation must be applied for the Company's first interim period ending after March 15, 2004. There has been no impact on the Company's financial position, results of operations or disclosures for fiscal 2003 under FIN 46. The Company is currently evaluating the impact of the Revised Interpretation that will be adopted in the first quarter of the year ending October 31, 2004. Adoption will require that the Company deconsolidate the Trust and record a liability for amounts due to the Trust. The net impact of deconsolidation will not have a significant impact on the Company's financial position or results of operations.

In April 2003, the FASB issued SFAS 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." SFAS 149 requires that contracts with comparable characteristics be accounted for similarly. In particular, SFAS 149 clarifies under what circumstances a contract with an initial net investment meets the characteristic of a derivative, clarifies when a derivative contains a financing component, amends the definition of an underlying derivative to conform it to language used in FIN 45, and amends certain other existing pronouncements. SFAS 149 is effective for contracts entered into or modified after June 30, 2003, and for hedging relationships designated after June 30, 2003. In addition, provisions of SFAS 149 should be applied prospectively. The Company does not expect the application of SFAS 149 to have a significant impact on its financial position, results of operations or disclosures.

2. Recent Accounting Pronouncements (continued)

In May 2003, the FASB issued SFAS 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." SFAS 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). Many of those instruments were previously classified as equity. Certain components of SFAS 150 were deferred by the FASB in October 2003 for an indefinite period. The Company does not expect the application of SFAS 150 to have a significant impact on its financial position, results of operations or disclosures.

3. Statements of Cash Flows

Supplemental disclosure of cash flow information follows (in thousands of dollars):

	Year ended October 31		
	2003	2002	2001
Cash paid during the year for:			
Interest, net of amounts capitalized	$2,261	$2,409	$2,803

4. Inventories

Inventories consist of the following (in thousands of dollars):

	October 31	
	2003	2002
Merchandise	$592	$667
Supplies, parts and accessories	35	35
Food and beverages	121	115
Other	44	42
	$792	$859

5. Litigation

On April 30, 2003, a jury verdict of approximately $7.8 million was rendered against a wholly owned subsidiary of the Company in Grey Point Associates, et al. v. Sea Pines Company, Inc. The lawsuit involved alleged breach of contract by Sea Pines related to the development of the TidePointe retirement community.

On October 6, 2003, the Company agreed, pursuant to the terms of a settlement agreement and release, to pay $5.9 million to settle the lawsuit. For the year ended October 31, 2003, the Company incurred $6,324,000 in litigation expenses. The expenses included $5,900,000 in settlement costs and $424,000 in legal fees and related expenses.

6. Real Estate Assets

Operating properties consist of the following (in thousands of dollars):

	October 31	
	2003	**2002**
Land and improvements	**$26,806**	$26,487
Buildings	**23,510**	23,265
Machinery and equipment	**11,955**	11,642
	62,271	61,394
Less accumulated depreciation	**(19,596)**	(17,197)
	$42,675	$44,197

Properties held for future development of $3,186,000 and $3,219,000 at October 31, 2003 and 2002, respectively, consist primarily of land and certain future development rights.

7. Long-Term Debt

Long Term Debt and Line of Credit Agreements

Long-term debt consists of loans obtained under a master credit agreement with one bank and include the following (in thousands of dollars):

	October 31	
	2003	2002
Term note payable to bank, bearing interest at the London Interbank Offered Rates (LIBOR) (1.12% at October 31, 2003), plus 1.40% to 1.85% collateralized by substantially all assets of the Company. Principal is payable monthly from May through October each year in amounts ranging from $205,000 in 2004 to $276,667 in 2008, with a balloon payment due on maturity. Interest is payable monthly. The note matures November 1, 2008.	$14,797	$15,940
$18.3 million revolving line of credit with bank, bearing interest at LIBOR (1.12% at October 31, 2003), plus 1.40% to 1.85%, collateralized by substantially all assets of the Company. Interest is payable monthly. The line matures November 1, 2007.	17,100	17,600
Judgment loan note payable to bank, bearing interest at LIBOR (1.12% at October 31, 2003), plus 2.35% collateralized by substantially all assets of the Company. Interest is payable monthly. The loan facility matures on July 30, 2005.	5,900	--
	37,797	33,540
Less current portion of long-term debt	(1,230)	(1,142)
Total long-term debt	$36,567	$32,398

7. Long-Term Debt (continued)

Long Term Debt and Line of Credit Agreements (continued)

Scheduled maturities of long-term debt as of October 31, 2003 are as follows (in thousands of dollars):

Year ending October 31	
2004	$ 1,230
2005	7,225
2006	1,430
2007	1,540
2008	18,760
Thereafter	7,612
Total	$37,797

The master credit agreement relating to the debt described above contains provisions and covenants which impose certain restrictions on the use of the Company's assets, including limitations as to new indebtedness, the sale or disposal of certain assets, capital contributions and investments, and new lines of business.

The master credit agreement also contains representations and warranties which are required to be maintained and covenants with which the Company is required to comply. As a result of the litigation described in Note 5, the Company was, as of April 30, 2003, in breach of certain of such representations and warranties and in violation of certain of such covenants. In June 2003, the bank signed a waiver in which the bank waived retroactively to the filing of the complaint in the litigation all events of default arising under the credit agreement as a result of the litigation, including the rendering of the verdict and any judgment entered thereon.

In July 2003, the Company completed a modification to its master credit agreement. The modification included revisions to certain loan covenants and representations and waivers of certain loan covenants for the year ended October 31, 2003.

The July modification also provided for a Judgment Loan Facility (the "Judgment Loan") in an amount up to $8,000,000 to pay for expenses related to the litigation described in Note 5. The terms of the Judgment Loan required the Company to cease the payment of dividends on its Series A cumulative preferred stock and interest on its trust preferred securities. The facility matures on July 30, 2005. As of October 31, 2003, the Judgment Loan had an outstanding balance of $5,900,000.

7. Long-Term Debt (continued)

Long Term Debt and Line of Credit Agreements (continued)

On September 8, 2003, $8,000,000 was drawn on the loan facility. As a result of the settlement (see Note 5), $2,100,000 of the loan was repaid in October 2003.

In addition to the term loan, the revolving line of credit and the Judgment Loan, the master credit agreement includes a $4,500,000 seasonal line of credit (the "Seasonal Line"). Interest is payable monthly at LIBOR plus 1.50%. The Seasonal Line expires on November 1, 2007. Borrowings under the Seasonal Line are also collateralized by substantially all of the assets of the Company. As of October 31, 2003 and 2002, the Seasonal Line had no outstanding balance.

Interest Rate Swaps

The Company has two interest rate swap agreements. The first interest rate swap agreement effectively fixes the interest rate on an $18,000,000 notional principal amount at 5.24% plus a credit margin ranging from 1.40% to 1.85% until the maturity date of the agreement, November 10, 2005. The second interest rate swap agreement effectively fixes the interest rate on a $6,000,000 notional principal amount at 6.58% plus a credit margin ranging from 1.40% to 1.85% until the maturity date of the agreement, November 1, 2005 (see Note 1).

Trust Preferred Securities

The trust preferred securities bear interest at 9.5% per annum with payments due quarterly, nine months in arrears, commencing January 31, 2001. The trust preferred securities mature on January 31, 2030. The Company has the right to redeem the trust preferred securities as specified in the indenture agreement. The interest payments on the trust preferred securities are subordinate in right of payment to all senior debt of the Company. Interest payments on the trust preferred securities have been suspended as a result of restrictions imposed by the Judgment Loan, and, therefore, the Company has twelve months of interest accrued as of October 31, 2003.

Subsequent Events

In December 2003, the bank waived the loan covenant related to the net worth ratio for the year ending October 31, 2004. The waiver was required because the Company did not expect to be in compliance with this covenant for the year ending October 31, 2004.

8. Income Taxes

The Company has not recognized any income tax benefit for fiscal 2003 related to its taxable loss since the Company is uncertain whether there will be sufficient taxable income in future periods to allow for utilization of the loss. The Company has current tax expense of approximately $54,000 for fiscal 2003. The provision (benefit) for income taxes consists of the following (in thousands of dollars):

	Year ended October 31		
	2003	**2002**	**2001**
Current provision (benefit):			
Federal	$54	$(157)	$(548)
State	--	--	(17)
	54	(157)	(565)
Deferred provision (benefit):			
Federal	--	173	172
State	--	27	(37)
	--	200	135
	$54	$43	$(430)

The reconciliation between actual income tax expense (benefit) and the amount calculated by applying the federal statutory rates to income (loss) before income taxes follows (in thousands of dollars):

	Year ended October 31		
	2003	**2002**	**2001**
Tax (benefit) expense at statutory federal income tax rates	$(2,180)	$82	$(1,051)
State income tax (benefit) expense, net of federal income tax (charge) benefit	(342)	9	(58)
Increase (decrease) in valuation allowance	2,599	(44)	707
Other	(23)	(4)	(28)
	$54	$43	$(430)

8. Income Taxes (continued)

The tax effects of the types of temporary differences and carryovers, which give rise to deferred income tax assets (liabilities), are as follows (in thousands of dollars):

	October 31		
	2003	2002	2001
Deferred revenue:			
License and fee income	$334	$432	$480
Country club membership sales	20	29	7
Loss on interest rate swaps	650	849	707
Charitable contribution carryover	32	10	7
Net operating loss carryforwards	3,012	88	65
Severance payments	--	--	44
Accrued liabilities	227	208	138
Other	7	--	12
Gross deferred income tax assets	4,282	1,616	1,460
Less: Valuation allowance	(3,285)	(686)	(730)
Deferred income tax assets	997	930	730
Depreciation	(879)	(763)	(442)
Other	(118)	(167)	(88)
Gross deferred income tax liabilities	(997)	(930)	(530)
Net deferred income tax assets	$--	$--	$200

The valuation allowance is due to the Company's review of its estimate of realization of deferred tax assets, primarily related to the net operating loss carryforwards and the loss on the interest rate swaps. The Company's federal net operating loss carryforward of $7,514,000 expires in 2023.

9. Shareholders' Equity

Preferred Stock

Of the 5,000,000 authorized shares of preferred stock, 2,000,000 shares are designated as Series A cumulative preferred stock and 20,000 shares are designated as Series B junior cumulative preferred stock. The Board of Directors has the authority to approve the issuance amount, rights and powers of an additional 2,980,000 shares of non-Series A preferred stock except that such rights and powers shall not be superior to those of the Series A cumulative preferred shares.

9. Shareholders' Equity (continued)

Preferred Stock (continued)

The Series A cumulative preferred shares provide for a cumulative dividend of $0.722 per share per annum, payable in arrears as declared by the Board of Directors. These shares have a liquidation value of $7.60 per share plus accumulated but unpaid dividends. If four or more years of dividends are in arrears, the Series A cumulative preferred shareholders will be entitled to elect a majority of the Board of Directors of the Company. All or any part of such shares may be redeemed at the option of the Company at liquidation value. As of October 31, 2003, all preferred stock dividends applicable to the fiscal year ended October 31, 2002 and all prior years have been declared and paid.

The Series B junior cumulative preferred shares are subject to the prior and superior rights of the holders of the Series A and all other classes of preferred shares. These Series B shares provide for a cumulative dividend of the greater of $0.25 per share or an amount as adjusted for the anti-dilution number (initially 1,000). Each share of the Series B also entitles the holder to the number of votes equal to the anti-dilution number. Generally, the Series B and common shareholders will vote together as one class on all matters submitted to a vote. The Series B shares have a liquidation value of $100 per share, plus dividends thereon. The Series B shares are not redeemable. No shares of the Series B junior cumulative preferred stock have been issued (see Stock Purchase Rights Plan).

Common Stock

Of the 23,000,000 authorized shares of common stock, 2,000,000 shares are designated as special common stock and 1,000,000 are designated as nonvoting common stock. All other shares are voting. All of the 3,587,400 shares of common stock outstanding as of October 31, 2003 are voting common stock.

Each share of common stock (regardless of class) shall participate on an equal and pro rata basis in all dividends and other distributions, including liquidation, subject to the rights of the preferred shareholders.

Holders of shares of voting common stock are entitled to one vote per share. Holders of special common shares (if issued) will have such voting rights as specified by the Board of Directors, except that such rights will not be superior to the voting common stock.

9. Shareholders' Equity (continued)

Stock Purchase Rights Plan

On August 5, 2003, the Company entered into a Second Amended and Restated Rights Agreement, with Wachovia Bank, N.A. as rights agent, which amends and restates in its entirety the Rights Agreement dated as of August 23, 1993, which was scheduled to expire in accordance with its terms on August 23, 2003 (as amended and restated, the "Rights Agreement"). Among other things, the Second Amended and Restated Rights Agreement deleted the requirement in the original Rights Agreement that "continuing directors" approve any redemption of the rights following a proxy or consent solicitation in certain situations and extends the Rights Agreement for an additional ten-year term expiring August 5, 2013.

Each share of the Company's outstanding common stock carries with it the right ("Right") to purchase one one-thousandth of a share of the Company's Series B junior cumulative preferred stock at a price of $50 per one one-thousandth of a share, subject to adjustment. In general, the Rights may be redeemed by the Company at $0.01 per Right at anytime before they become exercisable. Until they become exercisable, the Rights are not separately transferable from the Company's common stock.

Generally, the Rights become exercisable when a person or group of affiliated or associated persons becomes an "Acquiring Person" or an "Adverse Person" or a tender offer that would result in such person or group becoming an Acquiring Person is announced or commenced. A person or group of affiliated or associated persons becomes an Acquiring Person when such person or group becomes the beneficial owner of 20% or more of the Company's outstanding common stock. However, a person or group that became the owner of 20% or more of the Company's outstanding common stock as a result of the Company's Exchange Offer that closed in 2000 does not trigger the exercisability of the Rights unless such person or group becomes the owner of an additional share of the Company's common stock. A person or group of affiliated or associated persons becomes an Adverse Person when such person or group exceeds an ownership limitation (which must be at least 10% of the Company's outstanding common stock) specified by the Board for such person or group.

In the event the Rights become exercisable, a Right will entitle the holder (except those beneficially owned by the Acquiring Person or Adverse Person) to receive shares of the Company's common stock having a value equal to at least twice the exercise price of the Right. In the event that the Company is acquired in a merger or other business combination or sale of 50% or more of its assets or earning power, a Right will entitle the holder (except those beneficially owned by an Acquiring Person or Adverse Person) to receive shares of the surviving

9. Shareholders' Equity (continued)

Stock Purchase Rights Plan (continued)

company's common stock having a market value equal to twice the exercise price of the Right.

10. Commitments

Rent expense aggregated approximately $1,023,000, $1,174,000 and $1,203,000 for the years ended October 31, 2003, 2002 and 2001, respectively. Operating leases relate primarily to office space and equipment. Minimum annual rental commitments remaining at October 31, 2003, under non-cancelable operating leases with original terms of at least one year are as follows (in thousands of dollars):

Year ending October 31	
2004	$ 992
2005	895
2006	394
2007	319
2008	225
Thereafter	509
Total	$3,334

In 1993, the Company made a commitment to donate approximately 404 acres of a wildlife preserve owned by the Company to a not-for-profit organization on Hilton Head Island, South Carolina. As of October 31, 2003 approximately 90 of the 404 acres have been donated and title transferred. The remaining 314 acres have been leased to the same not-for-profit organization for a nominal amount.

11. Contingencies

The Company is subject to claims and suits in the ordinary course of business. In management's opinion, such currently pending claims and suits against the Company will not, in the aggregate, have a material adverse effect on the Company.

12. Employee Savings Plan

The Company maintains a 401(k) defined contribution plan for all eligible employees with a minimum of one year of service and who meet certain age requirements, as defined. The Company matches 50% of the first 6% of the participants' compensation. The Company's contributions to the plan were approximately $140,000, $132,000 and $156,000 for the years ended October 31, 2003, 2002 and 2001, respectively.

13. Stock Compensation Plan and Deferred Issuance Stock Plan

Director Stock Compensation Plan

Effective October 30, 2000, the Company established a director stock compensation plan. The purpose of the plan is to enable the Company to use common stock rather than cash to compensate non-employee directors for service to the Company and thereby foster increased stock ownership by the directors. The Company reserved 50,000 shares of common stock for issuance pursuant to grants under the plan. In April 2003, 14,000 shares were issued, at a fair market value of $4.00 per share. The Company recorded $56,000 as deferred compensation at the time the stock was issued and that amount is being amortized over the directors' 12-month terms. In March 2002, 14,000 shares were issued, at a fair market value of $6.00 per share. The Company recorded $84,000 as deferred compensation at the time the stock was issued and that amount was amortized over the directors' 12-month terms. In March 2001, 14,000 shares were issued, at a fair market value of $4.50 per share. The Company recorded $63,000 as deferred compensation at the time the stock was issued and that amount was amortized over the directors' 12-month terms. For the years ended October 31, 2003, 2002 and 2001, the Company recorded $65,333, $76,125 and $43,875 respectively, of director stock compensation expense.

Deferred Issuance Stock Plan

Effective October 30, 2000, the Company established a deferred issuance stock plan. The purpose of the plan is to optimize the profitability and growth of the Company through long-term incentives, which link the personal interest of participants to those of the Company's stockholders. The Company reserved 180,000 shares of common stock for issuance to key

13. Stock Compensation Plan and Deferred Issuance Plan (continued)

Deferred Issuance Stock Plan (continued)

employees pursuant to grants under the plan. Generally common stock of the Company will be issued to the participant on the fifth anniversary of the date the award is granted. On February 7, 2003, the Company awarded 25,450 deferred shares, at a fair market value of $4.50 per share. On January 2, 2002, the Company awarded 24,300 deferred shares, at a fair market value of $5.00 per share. On June 1, 2001, the Company awarded 32,300 deferred shares, at a fair market value of $4.75 per share. For the years ended October 31, 2003, 2002 and 2001, the Company recorded $71,531, $47,974 and $12,785, respectively, of stock compensation expense amortization. In fiscal 2003, 2,900 deferred shares were forfeited by employees. In fiscal 2002, 1,200 deferred shares were forfeited by employees.

14. Property Tax Refund

The Company was involved in an administrative law proceeding involving the valuation of its three golf courses for property tax purposes. The Company previously accrued its property tax expense based on the valuation originally assessed for these properties. During the third quarter 2002, the court issued a final order and decision, ultimately lowering the property taxes owed for the fiscal years 1998 through 2002. Based on this ruling and the Company's estimate of its property tax liability, the Company lowered its property tax accrual in the third quarter 2002 by $322,000. This amount was included as a reduction to general and administrative expenses. In February 2003, the Company received a refund of property taxes paid of $304,000 plus accrued interest of $104,000. The property tax refund of $304,000 is reflected within general and administrative expenses, and the interest income of $104,000 is reflected in interest income, in the consolidated statement of operations for the year ended October 31, 2003.

15. Quarterly Results of Operations (Unaudited)

The following is a summary of the quarterly results of operations for the years ended October 31, 2003 and 2002 (in thousands of dollars):

	Year Ended October 31, 2003			
	First	Second	Third	Fourth
Revenues	$7,789	$14,484	$18,726	$15,936
Gross profit	$639	$4,637	$4,886	$3,538
Net (loss) income	$(1,883)	$(7,908)	$1,257	$2,070
Net (loss) income per share of common stock; basic and diluted	$(0.54)	$(2.22)	$0.34	$0.57

	Year Ended October 31, 2002			
	First	Second	Third	Fourth
Revenues	$7,154	$14,921	$19,267	$13,350
Gross profit	$1,011	$5,289	$5,444	$3,135
Net (loss) income	$(1,063)	$1,078	$695	$(513)
Net (loss) income per share of common stock; basic and diluted	$(0.31)	$0.29	$0.18	$(0.15)

15. Quarterly Results of Operations (Unaudited) (continued)

As discussed in Note 2, the Company adopted EITF Issue No. 01-14 for the year ended October 31, 2003. Comparative financial statements for the prior years have been reclassified to conform with the presentation in the 2003 financial statements. These reclassifications have no impact on net income (loss), earnings per share or cash flows of the Company. Additionally, the Company reclassified litigation expenses associated with the litigation discussed in Note 5 as other expense within continuing operations for all periods presented. Financial information in previously filed Forms 10-Q has been reclassified as follows (in thousands of dollars):

	Year ended October 31, 2003		
	First	Second	Third
Revenues as reported	$7,159	$13,614	$17,545
Adjustment for cost reimbursements	630	870	1,181
Revenues as reclassified	$7,789	$14,484	$18,726
Costs and expenses as reported	$9,398	$20,220	$16,173
Adjustment for costs subject to reimbursements	630	870	1,181
Reclassification of litigation expenses	--	(8,000)	(450)
Costs and expenses as reclassified	$10,028	$13,090	$16,904

	Year ended October 31, 2002			
	First	Second	Third	Fourth
Revenues as reported	$6,537	$14,085	$18,038	$12,482
Adjustment for cost reimbursements	617	836	1,229	868
Revenues as reclassified	$7,154	$14,921	$19,267	$13,350
Costs and expenses as reported	$8,476	$11,858	$15,429	$12,477
Adjustment for costs subject to reimbursements	617	836	1,229	$868
Costs and expenses as reclassified	$9,093	$12,694	$16,658	13,345

16. Business Segment Information

The Company has two reportable business segments. The Company's reportable segments are organized by the type of operations and for the years ended October 31, 2003, 2002 and 2001 were: (1) resort activities, including home and villa rental management operations, golf course operations, food and beverage operations, inn and conference facility operations, and various other recreational activities; and (2) real estate brokerage for buyers and sellers of real estate in the Hilton Head, South Carolina, area. The Company evaluates performance and allocates resources based on earnings before interest, depreciation and other non-cash items. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies (Note 1). All intercompany transactions between segments have been eliminated upon consolidation.

Segment information as of and for the years ended October 31, 2003, 2002 and 2001 are as follows (in thousands of dollars):

	Year ended October 31		
	2003	2002	2001
Revenues:			
Resort	$36,268	$37,615	$36,567
Real estate brokerage	20,667	17,077	17,284
	$56,935	$54,692	$53,851
Cost of revenues:			
Resort	$25,031	$24,687	$24,402
Real estate brokerage	14,565	11,576	12,224
	$39,596	$36,263	$36,626
Interest expense:			
Resort	$2,271	$2,392	$2,771
	$2,271	$2,392	$2,771
Depreciation and amortization expense:			
Resort	$2,513	$2,521	$2,435
Real estate brokerage	65	68	69
	$2,578	$2,589	$2,504
Segment income (loss) before income taxes:			
Resort	$(8,065)	$(1,080)	$(3,723)
Real estate brokerage	1,655	1,320	619
	$(6,410)	$240	$(3,104)
Identifiable assets:	$49,010	$51,859	$54,016
Resort	3,804	2,652	1,156
Real estate brokerage	$52,814	$54,511	$55,172

SELECTED FINANCIAL DATA

The following selected consolidated financial data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and with the consolidated financial statements and notes thereto, which are included elsewhere in this annual report.

	Years Ended October 31,				
	2003	2002	2001	2000	1999
	(In thousands, except per share amounts)				
Consolidated Statements of Operations Data:					
Revenues	$56,935	$54,692	$53,851	$52,765	$49,547
Costs and expenses	$55,548	$51,790	$52,561	$51,677	$45,696
Income from operations	$1,387	$2,902	$1,290	$1,088	$3,851
Interest expense	$(2,271)	$(2,392)	$(2,771)	$(1,426)	$(1,099)
Other (expense) income (1)	$(5,526)	$(270)	$(1,623)	$(149)	$523
Net (loss) income (1)	$(6,464)	$197	$(2,674)	$(389)	$2,063
Net (loss) income attributable to common stock	$(6,624)	$37	$(2,834)	$(730)	$1,176
Per share of common stock					
Net (loss) income	$(1.85)	$0.01	$(0.80)	$(0.23)	$0.64
Weighted average shares outstanding	3,580	3,568	3,554	3,174	1,843
Consolidated Balance Sheet Data:					
Current assets	$6,614	$5,894	$4,259	$5,017	$5,926
Real estate assets, net	$45,861	$47,416	$49,516	$50,310	$34,963
Total assets	$52,814	$54,511	$55,172	$56,994	$42,690
Current liabilities	$8,510	$7,223	$7,495	$8,802	$6,392
Long-term obligations, less current portion	$41,451	$37,948	$38,498	$36,236	$20,404
Shareholders' equity (1)	$2,853	$9,340	$9,179	$11,956	$15,894

(1) Litigation expenses totaling $6,324 were recorded during fiscal year 2003, as discussed in Note 5 to the Company's consolidated financial statements.

SHAREHOLDER INFORMATION

Outstanding Securities

Sea Pines Associates, Inc. and its subsidiaries currently have three classes of outstanding securities: common stock, Series A preferred stock and trust preferred securities. As of October 31, 2003, 23,000,000 shares of common stock were authorized, of which 3,587,400 shares were issued and outstanding; 2,000,000 shares of Series A preferred stock were authorized, of which 220,900 shares were issued and outstanding; and $10,000,000 of trust preferred securities were authorized, of which $2,480,000 were issued and outstanding. As of December 31, 2003, there were approximately 548 holders of record of shares of common stock.

Trading in the Company's Securities

There is no established public trading market for the Company's securities. Prior to February 2000, the Company's securities were traded either in private transactions between buyers and sellers, or in the over-the-counter market at Robinson-Humphrey in Atlanta, Georgia. Robinson-Humphrey discontinued that service in February 2000. The Company has been investigating other broker-based trading arrangements, but none of the possibilities that have come to light so far could be justified from a cost standpoint.

In May 2000, the Company established a securities bulletin board on its internet website. The bulletin board makes it easier for shareholders to locate shares to buy or to find buyers for shares they want to sell. Interested buyers and sellers post the number of shares they wish to buy or sell and the price they are prepared to pay or that they expect to receive. The bulletin board can be accessed on the Company's website at www.seapines.com.

Neither the Company nor any of its affiliates will: (a) receive any compensation for creating or maintaining the bulletin board or for its use, (b) be involved in any purchase or sale negotiations arising from the bulletin board, (c) give advice regarding the merits or shortcomings of any particular trade, (d) use the bulletin board, directly or indirectly, to offer to buy or sell securities except in compliance with all securities laws or (e) receive, transfer or hold any funds or securities as an incident of operating the bulletin board.

For more information concerning the bulletin board, please contact:

Steven P. Birdwell
Chief Financial Officer
Sea Pines Associates, Inc.
P. O. Box 7000
Hilton Head Island, SC 29938
(843) 842-1419

SHAREHOLDER INFORMATION (CONTINUED)

Dividends

The Articles of Incorporation of the Company provide for dividends on the series A preferred stock of $.722 per share per annum to be paid in arrears. The Company has paid all accrued dividends on the preferred stock through the fiscal year ended October 31, 2002.

The payment of dividends on the series A cumulative preferred stock and interest on its trust preferred securities were ceased as required by the terms of the Company's current loan agreement with its bank. The payment of these dividend and interest can be resumed with approval from the bank.

The Company has not paid any dividends on its common stock and has no present intention of paying such dividends in the foreseeable future. The Company's Articles of Incorporation prohibit the payment of dividend on the common stock until the accrued dividends on the preferred stock have been paid.

Transfer Agent

The Company utilizes Wachovia Bank as its transfer agent. For information concerning stock transfers, please contact:

Wachovia Bank
Customer Information Center
1525 West W. T. Harris Boulevard
Charlotte, NC 28262
(800) 829-8432

Annual Meeting

The Annual Meeting of shareholders will be held on March 10, 2004 at 3:00 p.m. at the Harbour Town Conference Center in Sea Pines Plantation, 11 Lighthouse Lane, Hilton Head Island, South Carolina.

SAFE HARBOR DISCUSSION

This Annual Report including the Chairman's letter to the shareholders may include forward-looking statements that involve risks and uncertainties. In addition to the risks identified in the Company's Annual Report on Form 10-K and herein, the Company identifies the following risks, which could adversely affect the Company's actual results and cause actual results to differ materially from those in the forward-looking statements.

Risks Related to Resort Operations. The risks associated with the Company's resort operations include the intense competition among local, regional and national resorts, the dependence upon Sea Pines and Hilton Head Island continuing to be considered as prime destination resort areas, the seasonality of the resort business, economic or other conditions which may adversely affect tourism, vacation resorts or the vacation or retirement home industries, generally, the impact of the 2001 terrorist attacks on the travel and resort industry and the Company, the possibility of additional terrorist attacks, adverse weather conditions including the consequences of a hurricane, the possibility of oil or hazardous waste spills offshore, the impact of increased fuel or other transportation costs on travel, adverse changes in applicable environmental regulation and the possible loss of the Company's national golf tournament. There can be no assurance that the Company will be able to compete successfully in the future with existing and future competitors, or that the Company and Hilton Head Island will be able to continue to attract the level of resort business the Company has experienced in the past.

Risks Related to Real Estate Brokerage Operations. Risks associated with the Company's real estate brokerage operations include general reductions in resort visitors, rising interest rates, other economic conditions which may adversely affect real estate sales in general or vacation or second-home sales in particular, competition from other real estate brokerage firms and the loss of key brokers or sales executives.

Risks Related to Litigation and Other Factors. Other factors which could affect the Company's operations include the risk of adverse outcomes on litigation, the availability of adequate capital to finance possible future capital improvements and repairs, and the loss of key members of management.

OFFICERS AND KEY EXECUTIVES

SEA PINES ASSOCIATES, INC.

Norman P. Harberger
Chairman

Joseph F. Vercellotti
Vice Chairman

Michael E. Lawrence
Chief Executive Officer

Steven P. Birdwell
Chief Financial Officer

Thomas C. Morton
Treasurer

Peter Parrott
Secretary

SEA PINES REAL ESTATE COMPANY, INC.

Michael E. Lawrence
President

Paul T. Franks
Broker-In-Charge

David T. Warren
Director of Real Estate Marketing

SEA PINES COMPANY, INC.

Michael E. Lawrence
President

Steven P. Birdwell
Chief Financial Officer

Cary C. Corbitt
Director of Sports and Retail Operations

John S. Munro
Director of Hospitality

Monika M. Nash
Director of Human Resources

BOARD OF DIRECTORS

John F. Bard
Retired, formerly Chief Financial Officer of The Wm. Wrigley Jr. Company

Paul B. Barringer, II
Chairman and CEO, Coastal Lumber Company

Ralph L. Dupps, Jr.
President, Dupps and Company (Real Estate Development)

P. R. Easterlin, Jr.
President, Florida Properties of Amelia, Inc. (Real Estate Development)

Norman Harberger
Chairman
President, Harberger & Associates, Inc. (Management Consulting)

Michael E. Lawrence
Chief Executive Officer
President, Sea Pines Company, Inc. and Sea Pines Real Estate Company, Inc.

John G. McGarty
Retired, formerly President of Charleston Valve and Fitting Company

Thomas C. Morton
Treasurer
Certified Public Accountant

BOARD OF DIRECTORS (CONTINUED)

John A. Norlander
Retired, formerly President and CEO of Carlson Hospitality Worldwide, Inc.

David E. Pardue
Chairman, Primus Capital, LLC (Real Estate Development)

Peter Parrott
President, University Housing Group (Real Estate Development)

Marc Puntereri
Managing Member, The Cypress Group, LLC (Real Estate Development/Operations)

Robert W. Siler, Jr.
Retired, formerly Chairman and CEO of Hammer, Siler, George Associates

Kathleen B. Speer
Retired, formerly Partner of Hewitt Associates, LLC

Arthur P. Sundry
Retired, formerly President and General Manager of Communication Sector, Motorola, Inc.

Joseph F. Vercellotti
Retired, formerly Executive of General Electric Company

Sea Pines Associates, Inc.
P.O. Box 7000 Hilton Head Island, SC 29938