SUMMIT BANCSHARES INC /TX/
Form 10-Q
May 07, 2004

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

Mark One

x **Quarterly report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934**

For the quarterly period ended March 31, 2004 or

o **Transition report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934**

For the Transition period from ____________ to ____________.

Commission File Number 0-11986

SUMMIT BANCSHARES, INC.

(Exact name of registrant as specified in its charter)

Texas	**75-1694807**
(State of Incorporation)	(I.R.S. Employer Identification No.)

3880 Hulen St., Fort Worth, Texas 76107
(Address of principal executive offices)

(817) 336-6817
(Registrant s telephone number, including area code)

No Change
(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 period that the registrant was authorized to file such reports), and (2) has been subject to such filing requirements for the past 90 days. **Yes x No o**

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

The number of shares of common stock, $1.25 par value, outstand–ing at March 31, 2004 was 6,153,599 shares.

SUMMIT BANCSHARES, INC.

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The March 31, 2004 and 2003 financial statements included herein are unaudited; however, such information reflects all adjustments (consisting solely of normal recurring adjustments), which are, in the opinion of management of the registrant, necessary to a fair statement of the results for the interim periods. The financial statements for the year ended December 31, 2003 included herein are headed unaudited. These financial statements were reported as audited in our Annual Report on Form 10-K for the year ended December 31, 2003 filed with the Securities and Exchange Commission but are required to be reflected herein as unaudited because of the absence of an independent auditor s report.

PART I - FINANCIAL INFORMATION

Item 1 - Financial Statements

SUMMIT BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	(Unaudited) March 31,		(Unaudited) December 31,
	2004	**2003**	**2003**

	(In Thousands)		
ASSETS			
CASH AND DUE FROM BANKS NOTE 1	$ 27,738	$ 31,961	$ 28,620
FEDERAL FUNDS SOLD & DUE FROM TIME	43,243	76	1,336
INVESTMENT SECURITIES NOTE 2			
Securities Available-for-Sale, at fair value	181,879	163,639	195,959
LOANS NOTES 3, 11 AND 17			
Loans, Net of Unearned Discount	593,271	489,352	553,769
Allowance for Loan Losses	(8,320)	(7,365)	(7,784)
LOANS, NET	584,951	481,987	545,985
PREMISES AND EQUIPMENT NOTE 4	12,755	11,652	12,920
ACCRUED INCOME RECEIVABLE	3,631	3,606	3,754
OTHER REAL ESTATE NOTE 5	-0-	-0-	-0-
OTHER ASSETS	6,164	4,972	6,904
TOTAL ASSETS	$ 860,361	$ 697,893	$ 795,478
LIABILITIES AND SHAREHOLDERS EQUITY			
DEPOSITS NOTE 6			
Noninterest-Bearing Demand	$ 186,198	$ 165,220	$ 192,877
Interest-Bearing	470,186	421,699	448,504
TOTAL DEPOSITS	656,384	586,919	641,381
SHORT TERM BORROWINGS NOTE 7	129,691	41,317	82,234
ACCRUED INTEREST PAYABLE	320	373	294
OTHER LIABILITIES	2,391	2,704	2,885
TOTAL LIABILITIES	788,786	631,313	726,794
COMMITMENTS AND CONTINGENCIES NOTES 12, 14, 16 AND 18			
SHAREHOLDERS EQUITY NOTES 13, 15 AND 19			
Common Stock - $1.25 Par Value; 20,000,000 shares authorized; 6,153,599, 6,179,317 and 6,152,329 shares issued and outstanding at March 31, 2004 and 2003 and at December 31, 2003, respectively	7,692	7,724	7,690
Capital Surplus	7,453	7,330	7,421
Retained Earnings	54,481	48,974	52,988
Accumulated Other Comprehensive Income Unrealized Gain on Available-for-Sale Investment Securities, Net of Tax	1,949	2,908	688
Treasury Stock at Cost (18,500 and 3,700 shares at March 31, 2003 and at December 31, 2003, respectively)	-0-	(356)	(103)
TOTAL SHAREHOLDERS EQUITY	71,575	66,580	68,684
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 860,361	$ 697,893	$ 795,478

The accompanying Notes should be read with these financial statements.

SUMMIT BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

	(Unaudited) For the Three Months Ended March 31, 2004	(Unaudited) For the Three Months Ended March 31, 2003	(Unaudited) Year Ended December 31, 2003
	(In Thousands, Except Per Share Data)		
INTEREST INCOME			
Interest and Fees on Loans	$ 8,409	$ 7,489	$ 31,134
Interest and Dividends on Investment Securities:			
Taxable	1,718	1,711	7,106
Exempt from Federal Income Taxes	58	47	206
Interest on Federal Funds Sold and Due From Time	13	4	81
TOTAL INTEREST INCOME	10,198	9,251	38,527
INTEREST EXPENSE			
Interest on Deposits	1,641	1,660	6,810
Interest on Short Term Borrowings	274	156	627
TOTAL INTEREST EXPENSE	1,915	1,816	7,437
NET INTEREST INCOME	8,283	7,435	31,090
LESS: PROVISION FOR LOAN LOSSES NOTE 3	605	300	880
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	7,678	7,135	30,210
NON-INTEREST INCOME			
Service Charges and Fees on Deposits	906	758	3,443
Gain on Sale of Investment Securities	-0-	-0-	230
Other Income	661	590	2,355
TOTAL NON-INTEREST INCOME	1,567	1,348	6,028
NON-INTEREST EXPENSE			
Salaries and Employee Benefits - NOTE 14	3,368	2,905	12,926
Occupancy Expense - Net	438	293	1,734
Furniture and Equipment Expense	495	429	1,877
Other Real Estate Owned Expense - Net	-0-	(15)	(4)
Other Expense NOTE 9	1,229	1,185	4,920

TOTAL NON-INTEREST EXPENSE	5,530	4,797	21,453
INCOME BEFORE INCOME TAXES	3,715	3,686	14,785
APPLICABLE INCOME TAXES NOTE 10	1,264	1,253	5,017
NET INCOME	$ 2,451	$ 2,433	$ 9,768
NET INCOME PER SHARE NOTE 15			
Basic	$ 0.40	$ 0.39	$ 1.59
Diluted	0.39	0.39	1.55

The accompanying Notes should be read with these financial statements.

SUMMIT BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY
FOR THE THREE MONTHS ENDED MARCH 31, 2004 AND 2003
AND FOR THE YEAR ENDED DECEMBER 31, 2003
(Unaudited)

	Common Stock				Accumulated Other Comprehensive Income - Net Unrealized Gain (Loss on) Investment Securities		
	Shares	Amount	Capital Surplus	Retained Earnings		Treasury Stock	Total Share-Holders Equity
	(Dollars in Thousands, Except Per Share Data)						
Balance at January 1, 2003	6,158,542	$ 7,698	$ 7,122	$ 47,660	$ 2,861	$ (403)	$ 64,938
Stock Options Exercised	40,775	51	208				259
Purchases of Stock Held in Treasury						(356)	(356)
Retirement of Stock Held in Treasury	(20,000)	(25)		(378)		403	-0-
Cash Dividend - $.12 Per Share				(741)			(741)
Net Income for the Three Months Ended March 31, 2003				2,433			2,433
Securities Available-for-Sale Adjustment					47		47
Total Comprehensive Income NOTE 22							2,480
Balance at March 31, 2003	6,179,317	7,724	7,330	48,974	2,908	(356)	66,580
Stock Options Exercised	12,450	15	91				106
Purchases of Stock Held in Treasury						(653)	(653)
Retirement of Stock Held in Treasury	(39,438)	(49)		(857)		906	-0-
Cash Dividend - $.40 Per Share				(2,464)			(2,464)
Net Income for the Nine Months Ended				7,335			7,335

December 31, 2003							
Securities Available-for-Sale Adjustment					(2,220)		(2,220)
Total Comprehensive Income NOTE 22							5,115
Balance at December 31, 2003	6,152,329	7,690	7,421	52,988	688	(103)	68,684
Stock Options Exercised	4,970	7	32				39
Purchases of Stock Held in Treasury							-0-
Retirement of Stock Held in Treasury	(3,700)	(5)		(98)		103	-0-
Cash Dividend - $.14 Per Share				(860)			(860)
Net Income for the Three Months Ended March 31, 2004				2,451			2,451
Securities Available-for-Sale Adjustment					1,261		1,261
Total Comprehensive Income NOTE 22							3,712
Balance at March 31, 2004	6,153,599	$ 7,692	$ 7,453	$ 54,481	$ 1,949	-0-	$ 71,575

The accompanying Notes should be read with these financial statements.

SUMMIT BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED MARCH 31, 2004 AND 2003
AND FOR THE YEAR ENDED DECEMBER 31, 2003

	(Unaudited) For the Three Months Ended March 31,		**(Unaudited) Year Ended December 31,**
	2004	**2003**	**2003**
	(In Thousands)		
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net Income	$ 2,451	$ 2,433	$ 9,768
Adjustments to Reconcile Net Income to Net			
Cash Provided by Operating Activities:			
Depreciation and Amortization	364	298	1,370
Net Premium Amortization of Investment Securities	317	360	1,486
Provision for Loan Losses	605	300	880
Deferred Income Taxes Expense (Benefit)	(268)	(212)	336
Net Gain on Sale of Investment Securites	-0-	-0-	(230)
Net (Gain) Loss From Sale of Other Real Estate & Repossessed Assets	(167)	-0-	10
Net Gain From Sale of Premises and Equipment	(1)	-0-	(46)
Net (Increase) Decrease in Accrued Income and Other Assets	(720)	1,619	(68)
Net Decrease in Accrued Expenses and Other Liabilities	(494)	(533)	(352)
Total Adjustments	(364)	1,832	3,386

NET CASH PROVIDED BY OPERATING ACTIVITIES	2,087	4,265	13,154
CASH FLOWS FROM INVESTING ACTIVITIES:			
Net (Increase) Decrease in Federal Funds Sold and Due From Time	(41,907)	186	(1,074)
Proceeds from Matured and Prepaid Investment Securities - Available-for-Sale	17,034	13,439	101,354
Proceeds from Sales of Investment Securities	-0-	-0-	125,620
Purchase of Investment Securities - Available-for-Sale	-0-	(3,855)	(253,971)
Loans Originated and Principal Repayments, Net	(39,639)	(20,287)	(85,163)
Recoveries of Loans Previously Charged-Off	68	439	737
Proceeds from Sale of Premises and Equipment	1	17	279
Proceeds from Sale of Other Real Estate & Repossessed Assets	-0-	1,142	1,257
Purchases of Premises and Equipment	(165)	(482)	(3,038)
NET CASH USED BY INVESTING ACTIVITIES	(64,608)	(9,401)	(113,999)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net Increase in Demand Deposits, Savings Accounts and Interest-Bearing Transaction Accounts	11,909	87	49,540
Net Increase in Certificates of Deposit	3,094	4,883	9,892
Net Increase in Short Term Borrowings	47,457	4,062	44,979
Payments of Cash Dividends	(860)	(741)	(3,205)
Proceeds from Stock Options Exercised	39	259	365
Purchase of Treasury Stock	-0-	(356)	(1,009)
NET CASH PROVIDED BY FINANCING ACTIVITIES	61,639	8,194	100,562
NET (DECREASE) INCREASE IN CASH AND DUE FROM BANKS	(882)	3,058	(283)
CASH AND DUE FROM BANKS AT BEGINNING OF PERIOD	28,620	28,903	28,903
CASH AND DUE FROM BANKS AT END OF PERIOD	$ 27,738	$ 31,961	$ 28,620
SUPPLEMENTAL SCHEDULE OF OPERATING AND INVESTING ACTIVITIES:			
Interest Paid	$ 1,889	$ 1,797	$ 7,497
Income Taxes Paid (Refunded)	75	(325)	4,296
Other Real Estate and Other Assets Acquired in Settlement of Loans	7	-0-	-0-

The accompanying Notes should be read with these financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SUMMIT BANCSHARES, INC. AND SUBSIDIARIES
FOR THE THREE MONTHS ENDED MARCH 31, 2004 AND 2003 (UNAUDITED)
AND FOR THE YEAR ENDED DECEMBER 31, 2003 (UNAUDITED)

NOTE 1 - Summary of Significant Accounting and Reporting Policies

The accounting and reporting policies of Summit Bancshares, Inc. are in accordance with accounting principles generally accepted in the United States of America and the prevailing practices within the banking industry. A summary of the more significant policies follows:

Basis of Presentation and Principles of Consolidation

The consolidated financial statements of Summit Bancshares, Inc. (hereinafter, collectively with its subsidiaries, the Corporation), include its accounts and its direct and indirect wholly-owned subsidiaries, Summit Delaware Financial Corporation, Summit Bank, National Association (the Bank) and SIA Insurance Agency, Inc. (SIA). All significant intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ materially from those estimates.

Cash and Due From Banks

The Bank is required to maintain certain noninterest-bearing cash balances at the Federal Reserve Bank based on its level of deposits. During the first three months of 2004, the average cash balance maintained at the Federal Reserve Bank was $2,141,000. Compensating balances held at correspondent banks, to minimize service charges, averaged approximately $19,324,000 during the same period.

Investment Securities

The Corporation has adopted Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (SFAS 115). At the date of purchase, the Corporation is required to classify debt and equity securities into one of three categories: held-to-maturity, trading or available-for-sale. At each reporting date, the appropriateness of the classification is reassessed. Investments in debt securities are classified as held-to-maturity and measured at amortized cost in the financial statements only if management has the positive intent and ability to hold those securities to maturity. Securities that are bought and held principally for the purpose of selling them in the near term are classified as trading and measured at fair value in the financial statements with unrealized gains and losses included in earnings. Investments not classified as either held-to-maturity or trading are classified as available-for-sale and measured at fair value in the financial statements with unrealized gains and losses reported, net of tax, in a separate component of shareholders equity until realized.

The Corporation has the ability and intent to hold to maturity its investment securities classified as held-to-maturity; accordingly, no adjustment has been made for the excess, if any, of amortized cost over market. In determining the investment category classifications at the time of purchase of securities, management considers its asset/liability strategy, changes in interest rates and prepayment risk, the need to increase capital and other factors. Under certain circumstances (including the deterioration of the issuer s creditworthiness, a change in tax law, or statutory or regulatory requirements), the Corporation may change the investment security classification. In the periods reported for 2004 and 2003, the Corporation held no securities that would have been classified as trading securities.

All investment securities are adjusted for amortization of premiums and accretion of discounts. Amortization of premiums and accretion of discounts are recorded to income over the contractual maturity or estimated life of the individual investment on the level yield method. Gain or loss on sale of investments is based upon the specific identification method and the gain or loss is recorded in non-interest income. Income earned on the Corporation s investments in state and political subdivisions is not taxable.

Loans and Allowance for Loan Losses

Loans are stated at the principal amount outstanding less unearned discount, deferred fees and the allowance for loan losses. Unearned discount on installment loans is recognized as income over the terms of the loans by a method approximating the interest method. Interest income on all other loans is recognized based upon the principal amounts outstanding, the simple interest method. Loan origination fee income, net of direct loan origination costs, is deferred and amortized over the life of the related loan. The accrual of interest on a loan is discontinued when, in the opinion of management, there is doubt about the ability of the borrower to pay interest or principal. Interest previously earned, but uncollected on such loans, is written off. After loans are placed on non-accrual all payments received are applied to principal and no interest income is recorded until the loan is returned to accrual status or the principal has been reduced to zero.

NOTE 1 - Summary of Significant Accounting and Reporting Policies (cont d.)

The Corporation has adopted Statement of Financial Accounting Standards No. 114, Accounting by Creditors for Impairment of a Loan, as amended by Statement of Financial Accounting Standards No. 118, Accounting by Creditors for Impairment of a Loan - Income Recognition and Disclosure. Under this standard, the allowance for loan losses related to loans that are identified for evaluation in accordance with Statement No. 114 (impaired loans) is based on discounted cash flows using the loan s initial effective rate or the fair value of the collateral for certain collateral dependent loans.

The allowance for loan losses is comprised of amounts charged against income in the form of a provision for loan losses for certain loans when it is probable that all amounts due pursuant to the contractual terms of the loan will not be collected. In these situations, a reserve is recorded when the carrying amount of the loan exceeds the discounted cash flows using the loan s initial effective interest rate or the fair value of the collateral for certain collateral dependent loans. Income on impaired loans is recognized based on the collectibility of the principal amount. Adjustments to the allowance for loan losses will be reported in the period such adjustments become known or are reasonably estimable.

The amount maintained in the allowance reflects management s continuing assessment of the potential losses inherent in its loan portfolio based on its evaluation of a number of factors, including the Bank s loss experience in relation to outstanding loans and the existing level of the allowance, prevailing and prospective economic conditions, and management s continuing review of the discounted cash flow values of impaired loans and its evaluation of the quality of the loan portfolio. Loans are charged against the allowance for loan losses when management believes that the collectibility of the principal is unlikely.

The evaluation of the adequacy of loan collateral is often based upon estimates and appraisals. Because of changing economic conditions, the valuations determined from such estimates and appraisals may also change. Accordingly, the Corporation may ultimately incur losses which vary materially from management s current estimates.

Premises and Equipment

Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation expense is computed on the straight-line method based upon the estimated useful lives of the assets ranging from three to forty years. Maintenance and repairs are charged to non-interest expense. Renewals and betterments are added to the asset accounts and depreciated over the periods benefited. Depreciable assets sold or retired are removed from the asset and related accumulated depreciation accounts and any gain or loss is reflected in the income and expense accounts.

Other Real Estate

Other real estate is foreclosed property held pending disposition and is valued at the lower of its fair value or the recorded investment in the related loan. At foreclosure, if the fair value, less estimated costs to sell, of the real estate acquired is less than the Corporation s recorded investment in the related loan, a write-down is recognized through a charge to the allowance for loan losses. Any subsequent reduction in value is recognized by a charge to income. Operating expenses of such properties, net of related income, and gains and losses on their disposition are included in non-interest expense.

Federal Income Taxes

The Corporation joins with its subsidiaries in filing a consolidated federal income tax return. The subsidiaries pay to the parent a charge equivalent to their current federal income tax based on the separate taxable income of the subsidiaries.

The Corporation and the subsidiaries maintain their records for financial reporting and income tax reporting purposes on the accrual basis of accounting. Deferred income taxes are provided in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes. Deferred income taxes are provided for accumulated temporary differences due to basic differences for assets and liabilities for financial reporting and income tax purposes.

Realization of net deferred tax assets is dependent on generating sufficient future taxable income. Although realization is not assured, management believes it is more likely than not that all of the net deferred tax assets will be realized. The amount of the net deferred tax asset considered realizable, however, could be reduced in the near term if estimates of future taxable income are reduced.

Cash and Cash Equivalents

For the purpose of presentation in the Statements of Cash Flows, cash and cash equivalents include cash on hand, clearings and exchanges, and balances due from correspondent banks.

Reclassification

Certain reclassifications have been made to the 2003 financial statements to conform to the 2004 presentation.

NOTE 1 - Summary of Significant Accounting Policies (cont d.)

Earnings Per Common and Common Equivalent Shares

Statement of Financial Accounting Standards No. 128 (SFAS 128), Earnings Per Share, requires presentation of basic and diluted earnings per share. Basic earnings per share has been computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding for the reporting period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. Net income per common share for all periods presented has been calculated in accordance with SFAS 128. Outstanding stock options issued by the Corporation represent the only dilutive effect reflected in diluted weighted average shares.

Stock-Based Compensation

The Corporation accounts for stock-based compensation in accordance with the intrinsic value based method recommended by Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees. Under the intrinsic value based method, compensation cost is the excess, if any, of the quoted market price of the stock at grant date over the amount an employee must pay to acquire the stock. The impact on the financial statements of using this method is disclosed in Note 13, Stock Option Plans to the financial statements.

SFAS No. 123, Accounting for Stock-Based Compensation, as amended by SFAS 148, requires pro forma disclosures of net income and earnings per share for companies not adopting its fair value accounting method for stock-based compensation. The pro forma disclosures presented in Note 13, Stock Option Plans use the fair value method of SFAS 123 to measure compensation expense for stock-based compensation plans.

Comprehensive Income

Comprehensive income includes all changes in shareholders equity during a period, except those resulting from investments by and distributions to owners and treasury stock transactions. Besides net income, the other component of the Corporation s comprehensive income is the after tax effect of changes in the fair value of securities available for sale. Comprehensive income for the periods ended March 31, 2004 and 2003 and for the year ended December 31, 2003 is reported in Note 22, Comprehensive Income.

Audited Financial Statements

The consolidated balance sheet as of December 31, 2003, and the consolidated statements of income, changes in shareholders equity and cash flows for the year ended December 31, 2003 are headed unaudited in these financial statements. These statements were reported as audited in our Annual Report of Form 10-K for the year ended December 31, 2003 filed with the Securities and Exchange Commission but are required to be reflected in these statements as unaudited because of the absence of an independent auditor s report.

NOTE 2 - Investment Securities

A summary of amortized cost and estimated fair values of investment securities as of March 31, 2004 is as follows (in thousands):

	March 31, 2004			
	Amortized Cost	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**

Investment Securities - Available-for-Sale				
U.S. Government Agencies and Corporations	$ 104,035	$ 2,679	$ (174)	$ 106,540
U.S. Government Agency Mortgage Backed Securities	59,206	490	(281)	59,415
Obligations of States and Political Subdivisions	6,739	247	(8)	6,978
Community Reinvestment Act Investment Fund	3,000	-0-	-0-	3,000
Federal Reserve and Federal Home Loan Bank Stock	5,946	-0-	-0-	5,946
Total Available-for-Sale Securities	178,926	3,416	(463)	181,879
Total Investment Securities	$ 178,926	$ 3,416	$ (463)	$ 181,879

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NOTE 2 - Investment Securities (cont d.)

All investment securities are carried on the consolidated balance sheet as of March 31, 2004 at fair value. The net unrealized gain of $2,953,000 is included in the Available-for-Sale Investment Securities balance. The unrealized gain, net of tax, is included in Shareholders Equity.

Included in the Other Securities category at March 31, 2004 is $5,626,000 of Federal Home Loan Bank Stock and $320,000 of Federal Reserve Stock which are classified as restricted investment securities, carried at cost, and evaluated for impairment. No impairment losses were recorded as of March 31, 2004. The Corporation is required to have stock holdings of Federal Home Loan Bank Stock equal to ..20% of the Corporation s total assets as of the previous year end plus 4.25% of its outstanding advancements from the Federal Home Loan Bank (FHLB). The Corporation is also required to have stock holdings of Federal Reserve Stock equal to 6% of its Capital Stock and Surplus.

A summary of amortized cost and estimated fair values of investment securities as of March 31, 2003 is as follows (in thousands):

	March 31, 2003			
	Amortized Cost	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
Investment Securities - Available-for-Sale				
U.S. Treasury Securities	$ 998	$ 9	$ -0-	$ 1,007
U.S. Government Agencies and Corporations	114,306	3,793	-0-	118,099
U.S. Government Agency Mortgage Backed Securities	33,788	426	(6)	34,208
Obligations of States and Political Subdivisions	5,014	185	-0-	5,199
Community Reinvestment Act Investment Fund	3,000	-0-	-0-	3,000
Federal Reserve and Federal Home Loan Bank Stock	2,126	-0-	-0-	2,126
Total Available-for-Sale Securities	159,232	4,413	(6)	163,639
Total Investment Securities	$ 159,232	$ 4,413	$ (6)	$ 163,639

All investment securities were carried on the consolidated balance sheet as of March 31, 2003 at fair value. The net unrealized gain of $4,407,000 was included in the Available-for-Sale Investment Securities balance. The unrealized gain, net of tax, was included in Shareholders Equity.

Included in the Other Securities category at March 31, 2003 was $1,806,000 of Federal Home Loan Bank Stock and $320,000 of Federal Reserve Stock which are classified as restricted investment securities, carried at cost, and evaluated for impairment. No impairment losses were recorded as of March 31, 2003. The Corporation was required at March 31, 2003 to have stock holdings of Federal Home Loan Bank Stock equal to 5% of its outstanding advancements from the FHLB. The Corporation is also required to have stock holdings of Federal Reserve Stock equal to 6% of its Capital Stock and Surplus.

NOTE 3 - Loans and Allowance for Loan Losses

The book values of loans by major type follow (in thousands):

	March 31, 2004	March 31, 2003	December 31, 2003
Commercial and Industrial	$ 232,015	$ 202,448	$ 219,805
Real Estate Mortgage - Commercial	169,376	135,353	159,082
Real Estate Mortgage - Residential	73,481	53,388	67,635
Real Estate - Construction	86,315	64,679	74,069
Loans to Individuals	32,084	33,484	33,178
	593,271	489,352	553,769
Allowance for Loan Losses	(8,320)	(7,365)	(7,784)
Loans - Net	$ 584,951	$ 481,987	$ 545,985

Loans are net of unearned income of $742,000 and $562,000 at March 31, 2004 and 2003, respectively, and $690,000 at December 31, 2003.

NOTE 3 - Loans and Allowance for Loan Losses (cont d.)

Transactions in the allowance for loan losses are summarized as follows (in thousands):

	Three Months Ended March 31, 2004	Three Months Ended March 31, 2003	Year Ended December 31, 2003
Balance, Beginning of Period	$ 7,784	$ 6,706	$ 6,706
Provisions, Charged to Income	605	300	880
Loans Charged-Off	(137)	(80)	(539)
Recoveries of Loans Previously Charged-Off	68	439	737
Net Loans (Charged-Off) Recovered	(69)	359	198
Balance, End of Period	$ 8,320	$ 7,365	$ 7,784

The provisions for loan losses charged to operating expenses during the three months ended March 31, 2004 and March 31, 2003 of $605,000 and $300,000, respectively, were considered adequate to maintain the allowance in accordance with the policy discussed in Note 1. For the year ended December 31, 2003, a provision of $880,000 was recorded.

At March 31, 2004, the recorded investment in loans that are considered to be impaired under Statement of Financial Accounting Standards No. 114 was $1,671,000 (of which $1,671,000 were on non-accrual status). The related allowance for loan losses for these loans was $390,000. The average recorded investment in impaired loans during the three months ended March 31, 2004 was approximately $1,606,000. For this period, the Corporation recognized no interest income on these impaired loans.

NOTE 4 - Premises and Equipment

The investment in premises and equipment stated at cost and net of accumulated amortization and depreciation is as follows (in thousands):

	March 31, 2004	March 31, 2003	December 31, 2003
Land	$ 2,212	$ 2,317	$ 2,212
Buildings and Improvements	10,215	10,154	10,209
Furniture & Equipment	10,671	9,347	10,515
Total Cost	23,098	21,818	22,936
Less: Accumulated Amortization and Depreciation	10,343	10,166	10,016
Net Book Value	$ 12,755	$ 11,652	$ 12,920

NOTE 5 - Other Real Estate

The carrying value of other real estate is as follows (in thousands):

	March 31, 2004	March 31, 2003	December 31, 2003
Other Real Estate	$ -0-	$ -0-	$ -0-

There were no direct write-downs of other real estate charged to income for the three months ended March 31, 2004 or March 31, 2003. There were also no direct write-downs of other real estate charged to income for the year ended December 31, 2003.

Included in Other Assets at March 31, 2004 and March 31, 2003 were $7,000 and $125,000, respectively, of Other Foreclosed Assets. The 2004 and 2003 assets were comprised of motor vehicles. There were no direct write-downs of these assets as of March 31, 2004 or for any period during 2003.

NOTE 6 - Deposits

The book values of deposits by major type follow (in thousands):

	March 31,		December 31, 2003

	2004	2003	
Noninterest-Bearing Demand Deposits	$ 186,198	$ 165,220	$ 192,877
Interest-Bearing Deposits:			
Interest-Bearing Transaction Accounts and Money Market Funds	205,434	185,055	195,184
Savings	135,968	115,962	127,630
Certificates of Deposit under $100,000 and IRA s	62,172	62,959	62,275
Certificates of Deposit $100,000 or more	66,296	57,407	63,099
Other	316	316	316
Total	470,186	421,699	448,504
Total Deposits	$ 656,384	$ 586,919	$ 641,381

At March 31, 2004 and December 31, 2003, the Corporation had $991,000 of brokered deposits. At March 31, 2003, the Corporation had no brokered deposits. There were no major deposit concentrations. Demand deposit overdrafts that have been reclassified as loan balances were $619,000 and $386,000 at March 31, 2004 and 2003, respectively, and $873,000 at December 31, 2003.

NOTE 7 - Short Term Borrowings

Securities sold under repurchase agreements generally represent borrowings with maturities ranging from one to thirty days. Information relating to these and other borrowings are summarized as follows (in thousands):

	Three Months Ended March 31,		Year Ended December 31,
	2004	2003	2003
Securities Sold Under Repurchase Agreements:			
Average Balance	$ 31,129	$ 21,138	$ 26,850
Period-End Balance	29,691	17,017	32,234
Maximum Month-End Balance During Period	31,083	22,597	32,234
Interest Rate:			
Average	0.50%	0.54%	0.31%
Period-End	0.54	0.61	0.44
Federal Home Loan Bank Advances:			
Average Balance	$ 65,824	$ 21,967	$ 30,532
Period-End Balance	100,000	24,300	50,000
Maximum Month-End Balance During Period	100,000	24,300	50,000
Interest Rate:			
Average	1.35%	2.02%	1.65%
Period-End	1.26	2.05	1.52
Federal Funds Purchased:			
Average Balance	$ 4,396	$ 4,908	$ 2,774
Period-End Balance	-0-	-0-	-0-
Maximum Month-End Balance During Period	16,425	1,075	7,200
Interest Rate:			
Average	1.28%	1.53%	1.41%
Period-End	-0-	-0-	-0-

The Corporation has available a line of credit with the FHLB of Dallas which allows it to borrow on a collateralized basis at a fixed term. The borrowings are collateralized by a blanket floating lien on all first mortgage loans, the FHLB capital stock owned by the Corporation and any funds on deposit with FHLB. At March 31, 2004, the Corporation had $100.0 million of borrowings outstanding under the line of credit at a rate of 1.26%, $85.0 million of which matures in 2004 and the remaining $15.0 million matures in 2005. $30.0 million was borrowed for thirty days on the last day of the quarter for the purpose of maximizing the borrowing potential for the Corporation over the next year based on limits established by the FHLB. For the three months ended March 31, 2004, the Corporation had average borrowings under the line of credit of $65.8 million. For the three months ended March 31, 2003, the Corporation had $22.0 million of borrowings outstanding under the line of credit at a rate of 1.65% which matured during 2003. In addition, at March, 31, 2003, the Corporation had $2,300,000 borrowed under a match funding agreement with the FHLB at a rate of 4.41% which matured in June 2003. At December 31, 2003, $50.0 million of borrowings were outstanding at a rate of 1.52%, $45.0 million of which matures during 2004 and $5.0 million of which matures in April 2005. For the year ended December 31, 2003, the Corporation had average borrowings of $30.5 million.

NOTE 8 Notes Payable

On September 15, 2003, the Corporation obtained lines of credit from a bank under which the Corporation may borrow $11,000,000 at prime rate. The lines of credit are secured by stock of the Bank and mature on September 15, 2004, whereupon, if balances are outstanding, the lines convert to term notes having five year terms. The Corporation will not pay a fee for any unused portion of the lines. As of March 31, 2004, no funds had been borrowed under these lines nor were any borrowings outstanding.

NOTE 9 - Other Non-Interest Expense

The significant components of other non-interest expense are as follows (in thousands):

	Three Months Ended March 31,		Year Ended December 31,
	2004	**2003**	**2003**
Business Development	$ 193	$ 173	$ 762
Legal and Professional Fees	179	169	688
Item Processing	147	170	672
Printing and Supplies	95	106	435
Regulatory Fees and Assessments	67	62	250
Other	548	505	2,113
Total	$ 1,229	$ 1,185	$ 4,920

NOTE 10 - Income Taxes

Federal income taxes included in the consolidated balance sheets were as follows (in thousands):

	March 31,		December 31,
	2004	**2003**	**2003**
Current Tax Asset (Liability)	$ (1,495)	$ (1,418)	$ (39)
Net Deferred Tax Asset	1,294	1,056	1,677
Total Included in Other (Liabilities) Assets	$ (201)	$ (362)	$ 1,638

The net deferred tax asset at March 31, 2004 of $1,294,000 included $(1,004,000), a deferred tax liability related to unrealized gains on Available-for-Sale Securities.

The components of income tax expense were as follows (in thousands):

	Three Months Ended March 31,	Year Ended December 31, 2003

	2004	2003	
Federal Income Tax Expense			
Current	$ 1,532	$ 1,465	$ 4,681
Deferred (Benefit)	(268)	(212)	336
Total Federal Income Tax Expense	$ 1,264	$ 1,253	$ 5,017
Effective Tax Rates	34.00%	34.00%	34.00%

NOTE 10 - Income Taxes (cont d.)

The reasons for the difference between income tax expense and the amount computed by applying the statutory federal income tax rate to operating earnings are as follows (in thousands):

	Three Months Ended March 31,		Year Ended December 31,
	2004	2003	2003
Federal Income Taxes at Statutory Rate of 34.5%	$ 1,282	$ 1,271	$ 5,071
Effect of Tax Exempt Interest Income	(23)	(23)	(94)
Non-deductible Expenses	23	17	70
Other	(18)	(12)	(30)
Income Taxes Per Income Statement	$ 1,264	$ 1,253	$ 5,017

Deferred income tax expense (benefit) results from differences between amounts of assets and liabilities as measured for income tax return and financial reporting purposes. The significant components of federal deferred tax assets and liabilities are in the following table (in thousands):

	Three Months Ended March 31,		Year Ended December 31,
	2004	2003	2003
Federal Deferred Tax Assets:			
Allowance for Loan Losses	$ 2,851	$ 2,526	$ 2,667
Valuation Reserves - Other Real Estate	-0-	-0-	2
Interest on Non-accrual Loans	121	290	121
Deferred Compensation	592	551	541
Gross Federal Deferred Tax Assets	3,564	3,367	3,331
Federal Deferred Tax Liabilities:			
Depreciation and Amortization	1,120	575	1,087
Accretion	62	191	135
Unrealized Gains on Available-for-Sale Securities	1,004	1,498	354
Other	84	47	78

Gross Federal Deferred Tax Liabilities	2,270	2,311	1,654
Net Deferred Tax Asset	$ 1,294	$ 1,056	$ 1,677

NOTE 11 - Related Party Transactions

The Bank has made transactions in the ordinary course of business with certain of its and the Corporation s officers, directors and their affiliates. All loans included in such transactions are made on substantially the same terms, including interest rate and collateral, as those prevailing at the time for comparable transactions with other persons and all loans are current as to principal and interest payments. Total loans outstanding to such parties amounted to approximately $9,389,000 at December 31, 2003.

NOTE 12 - Commitments and Contingent Liabilities

In the normal course of business, there are various outstanding commitments and contingent liabilities, such as guarantees and commitments to extend credit, which are not reflected in the financial statements. No losses are anticipated as a result of these transactions. Commitments are most frequently extended for real estate, commercial and industrial loans.

At March 31, 2004, outstanding documentary and standby letters of credit totaled $4,463,000 and commitments to extend credit totaled $149,455,000.

In addition, the Corporation leases certain office facilities under operating leases. Rent expense for all operating leases totaled $246,000 and $148,000 for the three months ended March 31, 2004 and 2003, respectively, and $981,000 for the year ended December 31, 2003. There have been no material changes in the future minimum lease payments payable by the Corporation since December 31, 2003. See the 2003 Report on Form 10-K for information regarding these commitments.

NOTE 13 - Stock Option Plans

The Corporation has two Incentive Stock Option Plans, the 1993 Plan and the 1997 Plan, (each, a Plan, and, collectively, the Plans). Each Plan has reserved 600,000 shares (adjusted for two-for-one stock splits in 1995 and 1997) of common stock for grants thereunder. The Plans provide for the granting to executive management and other key employees of the Corporation and its subsidiary incentive stock options, as defined under the current tax law. The options under the Plans will be exercisable for ten years from the date of grant and generally vest ratably over a five year period. Options will be and have been granted at prices which will not be less than 100-110% of the fair market value of the underlying common stock at the date of grant.

The following is a summary of transactions during the periods presented:

	Shares Under Option	
	Three Months Ended March 31, 2004	**Year Ended December 31, 2003**
Outstanding, Beginning of Period	379,659	418,934
Additional Options Granted During the Period	20,000	25,000
Forfeited During the Period	(5,000)	(11,050)
Exercised During the Period	(4,970)	(53,225)
Outstanding, End of Period	389,689	379,659