HCB BANCSHARES INC
Form 10-K
September 26, 2003

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

FOR ANNUAL AND TRANSITION REPORTS PURSUANT TO SECTIONS 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

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

For the fiscal year ended June 30, 2003

Commission File Number: 0-22423

HCB BANCSHARES, INC.
(Exact Name of Registrant as Specified in Its Charter)

Oklahoma	62-1670792
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
237 Jackson Street, Camden, Arkansas	71701-3941
(Address of Principal Executive Offices)	(Zip Code)

Registrant's telephone number, including area code: (870) 836-6841

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

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

Common Stock, par value $.01 per share

(Title of Class)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES X NO ___.

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

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

The aggregate market value of the voting stock held by non-affiliates of the registrant at August 31, 2003 was approximately $18,991,000 based on the closing sale price of the registrant's Common Stock as listed on the Nasdaq SmallCap MarketSM as of December 31, 2002 ($16.00 per share). Solely for purposes of this calculation, directors, executive officers and greater than 5% stockholders are treated as affiliates.

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 1,450,230 shares of common stock as of August 31, 2003.

DOCUMENTS INCORPORATED BY REFERENCE

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

1. Portions of Annual Report to Stockholders for the Fiscal Year Ended June 30, 2003. (Parts II and IV)

2. Portions of Proxy Statement for the 2003 Annual Meeting of Stockholders. (Part III)

PART I

ITEM 1. BUSINESS

GENERAL

HCB BANCSHARES, INC. HCB Bancshares, Inc. ("Bancshares") was incorporated under the laws of the State of Oklahoma in December 1996 at the direction of the Board of Directors of HEARTLAND Community Bank (the "Bank") for the purpose of serving as a savings institution holding company of the Bank, upon the acquisition of all of the capital stock issued by the Bank upon its conversion from mutual to stock form, which was completed on April 30, 1997 (the "Conversion"). The consolidated financial statements include the accounts of Bancshares and the Bank and are collectively referred to as the "Company". All significant intercompany balances and transactions have been eliminated in consolidation.

Prior to the Conversion, Bancshares did not engage in any material operations. Since the Conversion, Bancshares has had no significant assets other than the outstanding capital stock of the Bank, a portion of the net proceeds of the Conversion and notes receivable, one of which is from the Employee Stock Ownership Plan ("ESOP"). Bancshares principal business is the business of the Bank. At June 30, 2003, the Company had consolidated total assets of $251.0 million, deposits of $152.0 million and stockholders' equity of $28.5 million, or 11.3% of total assets.

The holding company structure permits Bancshares to expand the financial services currently offered through the Bank. As a holding company, Bancshares has greater flexibility than the Bank to diversify its business activities through existing or newly formed subsidiaries or through acquisition or merger with other financial institutions. Bancshares is classified as a unitary savings institution holding company and is subject to regulation by the Office of Thrift Supervision ("OTS"). As long as Bancshares remains a unitary savings institution holding company, under current law it can diversify its activities in such a manner as to include any activities allowed by law or regulation to a unitary savings institution holding company. See "Regulation -- Regulation of Bancshares -- Activities Restrictions."

The Company's executive offices are located at 237 Jackson Street, Camden, Arkansas 71701-3941, and its telephone number is (870) 836-6841.

HEARTLAND COMMUNITY BANK. HEARTLAND Community Bank was organized as a federally chartered mutual savings and loan association named "First Federal Savings and Loan Association of Camden" ("First Federal") in 1933, and in 1934 it became a member of the FHLB system and obtained federal deposit insurance. In May 1996, First Federal acquired the former Heritage Bank, FSB, which retained its separate federal savings bank charter and deposit insurance as a wholly owned subsidiary of First Federal (in order to facilitate possible future branch expansion, in the event the Bank ever becomes subject to Arkansas branching restrictions, which at that time were based on the home office location of each separately chartered banking institution), but whose business operations were fully integrated with those of First Federal. In September 1996, First Federal and Heritage changed their names to HEARTLAND Community Bank and HEARTLAND Community Bank, F.S.B., respectively. Then on February 23, 1998, the Bank sold all of the shares of stock of Heritage Banc Holding, Inc., parent of its subsidiary savings bank, HEARTLAND Community Bank, FSB ("FSB"), pursuant to an agreement between the Bank and the Bank of the Ozarks, Inc. ("BOO"). Upon completion of the transaction and pursuant to the terms of the agreement, the Bank acquired the loans and certain other assets and non-deposit liabilities of the Little Rock, Arkansas branch of FSB and all assets and liabilities of the Monticello, Arkansas branch and the Bryant, Arkansas loan production office of FSB and BOO acquired the savings deposits and premises and equipment of the Little Rock, Arkansas branch of FSB, as well as FSB's holding company charter and stock. This transaction was substantively a branch sale. Also at such time, Bancshares became a unitary rather than a multiple savings institution holding company.

On March 7, 2002, the Company announced that its bank subsidiary, HEARTLAND Community Bank had entered into a definitive Branch Purchase and Assumption Agreement with Simmons First Bank of South Arkansas ("SFB"), a subsidiary of Simmons First National Corporation. Pursuant to such agreement, the Bank sold its Monticello, Arkansas branch office to SFB on July 19, 2002, which included approximately $8.3 million in loans,

$1.5 million in fixed assets, $0.2 million in other assets, and $13.2 million in deposits. The Bank recognized a premium on the deposits of approximately $0.9 million and the difference was paid in cash to the buyer.

After the sale of the Monticello branch, the Bank has operated through five full-service banking offices located in Camden (2), Fordyce, Sheridan, and Bryant, Arkansas. Historically, the principal business strategy of the Bank, like most other savings institutions in Arkansas and elsewhere, has been to accept savings deposits from residents of the communities served by the Bank's branch offices and to invest those funds in single-family mortgage loans to those and other local residents. In this manner, the Bank and countless other independent community-oriented savings institutions operated safely and soundly for generations. Moreover, during this period the Bank's market area experienced only limited economic growth.

The Board of Directors of the Company continually seeks to maximize value for all its stockholders. In conjunction with that goal, the Board of Directors has recently engaged in strategic planning meetings to consider available strategies for maximizing stockholder value including a sale of the Company. The Board will continue to explore available alternatives and has retained the services of the consulting firm of Gerrish & McCreary PC to assist in these matters. The Company's current business strategy, as developed and adopted by all of its directors, officers and employees, incorporates the following key elements: (i) continuing to provide the quality service that only a locally based institution and its dedicated staff can deliver, (ii) strengthening its core deposit base, decreasing interest costs, and increasing fee income by the effective cross selling of deposit facilities and products; and, (iii) maintaining loan yields and fee income while improving asset quality. In recent months, due to an increase in nonperforming loans, the Company has increased and intensified its collection efforts and shortened the time frames when these collection efforts are put into action.

As a federally chartered savings institution, the Bank is subject to extensive regulation by the OTS. The Bank's lending activities and other investments must comply with various federal regulatory requirements, and the OTS periodically examines the Bank for compliance with various regulatory requirements. The Federal Deposit Insurance Corporation ("FDIC") also has the authority to conduct special examinations. The Bank must file reports with the OTS describing its activities and financial condition and is also subject to certain reserve requirements promulgated by the Board of Governors of the Federal Reserve System ("Federal Reserve Board").

FORWARD-LOOKING STATEMENTS

When used in this Annual Report, the words or phrases "will likely result," "are expected to," "will continue," "is anticipated," "estimate," "project" or similar expressions are intended to identify "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements are subject to certain risks and uncertainties including changes in economic conditions in the Company's market area, changes in policies by regulatory agencies, fluctuations in interest rates, demand for loans in the Company's market area, and competition that could cause actual results to differ materially from historical earnings and those presently anticipated or projected. The Company wishes to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made. The Company wishes to advise readers that the factors listed above could affect the Company's financial performance and could cause the Company's actual results for future periods to differ materially from any opinions or statements expressed with respect to future periods in any current statements.

The Company does not undertake, and specifically disclaims any obligation, to publicly release the result of any revisions which may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

MARKET AREA

Management considers the Bank's primary market area to comprise the following Counties in Arkansas: Calhoun, Cleveland, Dallas, Grant, Ouachita and Saline. To a lesser extent, the Bank accepts savings deposits and offers loans throughout the remainder of central and southern Arkansas.

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The year 2000 census data indicated that the population experienced growth in Cleveland (10.2%), Grant (18.0%) and Saline (30.1%) Counties, while population declined somewhat in Calhoun (-1.4%), Dallas (-4.2%) and Ouachita (-5.8%) Counties over the past ten years. Median household income has been well above the Arkansas average in Saline, Grant and Cleveland Counties, slightly below the Arkansas average in Ouachita and Calhoun Counties, and well below the Arkansas average in Dallas County, though the Arkansas average is below the national average. With respect to unemployment rates, the Arkansas average has tended to rise slightly above the national average, and while unemployment rates have been well below the Arkansas average in Saline County, unemployment rates have been moderately above the Arkansas average in Grant and Cleveland Counties, and well above the Arkansas average in Calhoun, Dallas, and Ouachita Counties.

The economies in the Bank's primary market area include a variety of industries, including manufacturing, government, services and retail trade. Important employers include Georgia Pacific in the timber industry and Lockheed Martin, Raytheon Missile Systems, and Atlantic Research in the defense industry, Southern Arkansas University-Technical College, and Ouachita Valley Medical Center. In addition, industries in the Bryant area include Bryant School District as the largest employer, with Alcoa as the largest industrial business, and United Auto Group as the second largest employer.

COMPETITION

The Bank experiences substantial competition both in attracting and retaining savings deposits and in the originating of mortgage and other loans. Direct competition for savings deposits comes from other savings institutions, credit unions, and both regional and local commercial banks. Significant competition for the Bank's other deposit products and services comes from money market mutual funds and brokerage firms. The primary factors in competing for loans are loan products, interest rates and the quality of personal service. Competition for origination of real estate loans normally comes from other savings institutions, commercial banks, credit unions and mortgage companies.

The Bank's primary competition comes from institutions located in the Bank's primary market area. Competing financial institutions offer a wide variety of deposit and loan products. In recent years, as the banking business nationwide and in the Bank's primary market area in particular has become more competitive, the Bank has come under increasing pressure. Management's principal competitive strategy has been to emphasize quality customer service.

LENDING ACTIVITIES

The Bank's principal lending activity consists of the origination of loans collateralized by mortgages on existing and on construction of single-family residences in the Bank's primary market area, and commercial real estate and multifamily properties in the State of Arkansas. The Bank also makes a variety of consumer and commercial business loans. Management expects to continue these types of lending.

With certain limited exceptions, the maximum amount that a savings institution may lend to any borrower (including certain related entities of the borrower) at one time may not exceed 15% of the unimpaired capital and surplus of the institution, plus an additional 10% of unimpaired capital and surplus for loans fully collateralized by readily marketable collateral. Savings institutions are additionally authorized to make loans to one borrower, for any purpose, in an amount not to exceed $500,000 or, by order of the Director of the OTS, in an amount not to exceed the lesser of $30,000,000 or 30% of unimpaired capital and surplus to develop residential housing, provided: (i) the purchase price of each single-family dwelling in the development does not exceed $500,000; (ii) the institution is in compliance with its regulatory capital requirements; (iii) the loans comply with applicable loan-to-value requirements, and; (iv) the aggregate amount of loans made under this authority does not exceed 150% of unimpaired capital and surplus. At June 30, 2003, the maximum aggregate amount that the Bank could have lent to any one borrower under the 15% limit was approximately $3.7 million. At such date, the largest aggregate amount of loans that the Bank had outstanding to any one borrower was $2.8 million. Bancshares may participate in loans to one borrower thereby permitting loans to one borrower to be made by the Bank and Bancshares lending together that exceed the Bank's regulatory loan limit. At June 30, 2003, the Bank and Bancshares' loans to the borrower referred to above totaled approximately $3.1million with Bancshares carrying $0.3 million of the loans.

LOAN PORTFOLIO COMPOSITION. The following table sets forth information regarding the composition of the Bank's loan portfolio by type of loan at the dates indicated. At June 30, 2003, the Bank had no concentrations of loans exceeding 10% of gross loans other than as disclosed below.

	June 30,						
	2003		2002		2001		
	Amount	%	Amount	%	Amount	%	Amount
Type of Loan							
Real estate loans:							
One-to-four family residential	$ 42,450,596	38.52%	$ 48,507,922	36.38%	$ 57,001,679	38.97%	$ 61,198,
Multi-family loans	5,629,548	5.11	6,355,028	4.77	6,810,198	4.66	9,220,
Non-residential	29,668,812	26.92	41,334,937	31.00	49,736,511	34.01	48,756,
Land and other mortgage loans	8,088,129	7.34	8,602,412	6.45	10,080,790	6.89	5,644,
Consumer loans:							
Loans secured by savings deposits	2,034,110	1.84	2,469,033	1.85	2,488,948	1.70	2,320,
Home improvement	40,444	0.04	35,310	0.03	23,611	0.02	40,
Auto	4,102,692	3.72	6,836,399	5.13	6,779,218	4.64	6,589,
Other consumer	4,989,442	4.53	4,771,908	3.58	2,050,039	1.40	2,260,
Commercial	13,207,629	11.98	14,406,499	10.81	11,289,519	7.71	8,769,
Total	$110,211,402	100.00%	$133,319,448	100.00%	$146,260,513	100.00%	$144,800,
Less:							
Loans in process	$ 7,910,521		$ 7,663,698		$ 13,294,723		$ 8,100,
Deferred loan costs (fees), net	(84,341)		(149,663)		(131,745)		(158,
Allowance for loan losses	1,605,677		1,628,515		1,446,114		1,231,
Total	$100,779,545		$124,176,898		$131,651,421		$135,626,

LOAN MATURITY SCHEDULES. The following table sets forth information regarding dollar amounts of loans maturing in the Bank's portfolio based on their contractual terms to maturity, at June 30, 2003. Demand loans, loans having no stated schedule of repayments and no stated maturity and overdrafts are reported as due in one year or less. The table does not include any estimate of prepayments, which significantly shorten the average life of all mortgage loans and may cause the Bank's repayment experience to differ from that shown below.

	Due Within One Year	Due After One Through Five Years	Due After Five Years	Total
		(In thousands)		
Real estate loans:				
One-to-four family mortgage loans...	$ 12,979	$ 9,460	$ 20,012	$ 42,451
Other mortgage loans................	6,840	15,894	20,652	43,386
Commercial loans......................	4,307	4,496	4,405	13,208
Consumer loans:				
Loans secured by savings deposits......	1,561	473	--	2,034
Other................................	1,344	5,106	2,682	9,132
Total............................	$ 27,031	$ 35,429	$ 47,751	$ 110,211

The following table sets forth as of June 30, 2003, dollar amounts of loans due one year or more after June 30, 2003 that had predetermined interest rates and that had adjustable interest rates at that date.

	Predetermined Rates	Floating or Adjustable Rates	
		(In thousands)	
Real estate loans:			
One-to-four family mortgage loans.........	$ 27,159	$ 2,313	$
Other mortgage loans.....................	25,822	10,724	
Commercial loans............................	8,409	492	
Consumer loans:			
Loans secured by savings deposits...........	473	--	
Other consumer loans........................	7,788	--	
Total.................................	$ 69,651	$ 13,529	$

Scheduled contractual principal repayments of loans do not reflect the actual life of such assets. The average life of loans is substantially less than their contractual terms because of prepayments. In addition, due-on-sale clauses on loans generally give the Bank the right to declare a loan immediately due and payable in the event, among other things, that the borrower sells the real property subject to the mortgage and the loan is not repaid. The average life of mortgage loans tends to increase when current mortgage loan market rates are substantially higher than rates on existing mortgage loans and, conversely, decrease when current mortgage loan market rates are substantially lower than rates on existing mortgage loans.

LOAN ORIGINATIONS, PURCHASES AND SALES. The following table sets forth information regarding the Bank's loan originations, purchases and sales during the periods indicated.

	Year Ended June 30,		
	2003	2002	2001
Loans originated:			
Real estate loans:			
One-to-four family residential	$62,179,051	$42,880,138	$28,443,919
Other mortgage loans	18,675,658	10,737,552	22,007,354
Commercial loans	9,180,715	14,547,306	4,465,227
Consumer loans	9,034,787	11,231,892	9,659,572
Total loans originated	$99,070,211	$79,396,888	$64,576,072
Loans purchased:			
Real estate loans	$ --	$ --	$ 40,000
Loans sold	$33,795,154	$27,117,741	$12,732,692

The Bank has maintained its scope of loan products offered; however with the prevailing low interest rate environment and significant competition, loan origination efforts have been focused more on quality as opposed to quantity. The table above illustrates that while the Bank originated a greater dollar amount of one-to-four family residential loans for the year ended June 30, 2003, than either of the two previous fiscal years, a significantly greater amount of these loans were originated for sale resulting in a net decrease in one-to-four family loans. In addition, the Bank originated a greater dollar amount of other mortgage loans for the year ended June 30, 2003 than for the year ended June 30, 2002, however, due to increased competition and low interest rates, prepayments on these types of loans were very high, resulting in an overall decrease in other mortgage loans for the year.

The Bank has purchased loans from established and reputable loan originators from time to time to supplement the Bank's internally generated originations. The Bank originates long term, fixed-rate, single-family mortgage loans and sells them to investors in the secondary market. Management expects the Bank to increase its origination of selected types of loans that do not meet the Bank's loan portfolio needs, such as long-term fixed-rate residential mortgage loans for sale to investors.

ONE-TO-FOUR FAMILY RESIDENTIAL LENDING. Historically, the Bank's principal lending activity has been the origination of fifteen-year fixed-rate first mortgage loans in the Bank's primary market area. The purchase price or appraised value of most of such residences generally has been between $50,000 and $200,000, with the Bank's loan amounts averaging approximately $90,000. At June 30, 2003, $42.5 million, or 38.5%, of the Bank's total loans were collateralized by one-to-four family residences, substantially all of which were existing, owner-occupied, single-family residences in the Bank's primary market area.

While the Bank offers a variety of one-to-four family residential mortgage loans with fixed or adjustable interest rates and terms of up to 30 years, substantially all of the fixed-rate loans retained in the Bank's portfolio have terms of 15 years or less. Despite the relatively low credit risks associated with the Bank's 30-year one-to-four family portfolio loans, due to the interest rate risks associated with such longer term loans, management has approved shifting the Bank's one-to-four family residential lending emphasis in the future away from the origination of such loans for the Bank's portfolio and toward the origination of such loans for sale. Currently, it is the Bank's policy to originate all 30-year term one-to-four family residential loans in accordance with the investor's underwriting guidelines and to sell all such originations promptly to investors, servicing released. Such loan originations and sales have become significant. One-to-four-family residential loans originated during the year totaled $62.2 million with $33.8 million or 54.4% of originations sold or to be sold in the secondary market. The Bank will continue to make some non-conforming loans to be held in the Bank's portfolio. Management expects to continue these policies in the future.

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With respect to one-to-four family residential loans originated for retention in the Bank's portfolio, the Bank's lending policies generally limit the maximum loan-to-value ratio to 90% for owner-occupied properties and 80% for non-owner-occupied properties. Loans originated expressly for sale are originated in accordance with the lending policies and underwriting guidelines of the investor.

From time to time, the Bank makes loans to individuals for construction of one-to-four family owner-occupied residences located in the Bank's primary market area, with such loans usually converting to permanent financing upon completion of construction. At June 30, 2003, the Bank's loan portfolio included $4.3 million of loans collateralized by one-to-four family properties under construction, some of which were construction/permanent loans structured to become permanent loans upon the completion of construction and some of which were interim construction loans structured to be repaid in full upon completion of construction and receipt of permanent financing. The Bank also offers loans to qualified builders for the construction of one-to-four family residences located in the Bank's primary market area. Because such homes are intended for resale, such loans are generally not covered by permanent financing commitments by the Bank. All construction loans are collateralized by a first lien on the property under construction. Loan proceeds are disbursed in increments as construction progresses and as inspections warrant. Construction/permanent loans are underwritten in accordance with the same requirements as the Bank's permanent mortgages, except the loans generally provide for disbursement in stages during a construction period of up to nine months, during which period the borrower may be required to make monthly interest payments. Borrowers must satisfy all credit requirements that would apply to the Bank's permanent mortgage loan financing prior to receiving construction financing for the subject property. Construction financing generally is considered to involve a higher degree of risk of loss than financing on existing properties. The Bank has sought to minimize this risk by limiting construction lending to qualified borrowers in the Bank's primary market area, and by requiring the involvement of qualified builders.

COMMERCIAL AND MULTI-FAMILY REAL ESTATE LENDING. The Bank offers commercial and multi-family real estate loans in order to benefit from the higher interest rates than could be obtained from investment securities. The Bank has offered commercial and multi-family loans for years and will continue to place emphasis on the direct origination of commercial and multi-family real estate loans, particularly in central Arkansas.

All commercial and multi-family loans above loan officers' approved lending authorities are reviewed and approved by the Bank's lending committees at the headquarters in Camden prior to any funding or the issuance of any binding commitment by the Bank.

The Bank's commercial real estate loans may be collateralized by offices, warehouses, shopping centers, land, nursing homes, single-family subdivision developments and other income-producing and commercial properties. Multi-family real estate loans are collateralized by greater than one-to-four family residential properties. At June 30, 2003, the Bank had 181 commercial real estate, construction commercial real estate, land, and multi-family loans, with an average loan balance of approximately $224,000. At that date, 24 of these loans totaling approximately $6.2 million were collateralized by properties outside Arkansas, and none of these out-of-market loans were classified by management as substandard, doubtful or loss or designated by management as special mention. Management expects the Bank to continue making these out-of-market loans from time to time as opportunities arise.

The Bank's commercial and multi-family real estate loans generally are limited to loans not exceeding $2,500,000 on properties located either in Arkansas or other areas selected by management and approved by the Board of Directors, with terms of up to 20 years and loan-to-value ratios of up to 80%. Interest rates may be fixed for up to 20 years. Under certain circumstances, these longer-term loans may be match funded with similar term FHLB advances to reduce interest rate risk.

Commercial and multi-family real estate lending entails significant additional risks compared with one-to-four family residential lending. For example, commercial and multi-family real estate loans typically involve large loan balances to single borrowers or groups of related borrowers, the payment experience on such loans typically is dependent on the successful operation of the real estate project, and these risks can be significantly impacted by supply and demand conditions in the market for multi-family residential units and commercial office, retail and warehouse space. These risks may be higher with respect to loans collateralized by properties outside the Bank's primary market area or outside the Bank's most historically active lending areas.

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The aggregate amount of loans which federally chartered savings institutions may make on the security of liens on commercial real estate generally may not exceed 400% of the institution's capital.

CONSUMER LENDING. The Bank's consumer loans primarily consist of loans collateralized by savings deposits at the Bank, and automobiles. These loans totaled $2.0 million and $4.1 million, respectively, at June 30, 2003. Management plans to continue the expansion of the Bank's consumer lending activities in the future as part of management's plan to provide a wider range of financial services while increasing the Bank's portfolio yields and improving its asset/liability management.

The Bank makes certificate of deposit loans for up to 100% of the balance of the account. The interest rate on these loans typically is fixed at least three percentage points above the rate paid on a deposit at the Bank or four percentage points above the rate paid on a deposit at another institution, with the maturity and payment frequency matched to the terms of the deposit. The account must be pledged as collateral to secure the loan.

The Bank makes home improvement loans collateralized by the borrower's residence. These loans, combined with any higher priority mortgage loan, which usually is from the Bank, generally are limited to 90% of the appraised value of the residence. Home improvement loans generally have fixed interest rates and terms of up to ten years.

The Bank's new and used automobile loans generally are underwritten in amounts up to 80% of the purchase price, dealer cost or the loan value as published by the National Automobile Dealers Association. The terms of such loans generally do not exceed 60 months, with loans for older used cars underwritten for shorter terms. The Bank requires that the vehicles be insured and that the Bank be listed as loss payee on the insurance policy.

Consumer loans generally involve more risk than first mortgage loans. Repossessed collateral for a defaulted loan may not provide an adequate source of repayment of the outstanding loan balance as a result of damage, loss or depreciation and the remaining deficiency often does not warrant further substantial collection efforts against the borrower. In addition, loan collections are dependent on the borrower's continuing financial stability, and thus are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Further, the application of various federal and state laws, including federal and state bankruptcy and insolvency laws, may limit the amount which can be recovered. These loans may also give rise to claims and defenses by a borrower against the Bank, and a borrower may be able to assert against the Bank claims and defenses which it has against the seller of the underlying collateral. In underwriting consumer loans, the Bank considers the borrower's credit history, an analysis of the borrower's income, expenses and ability to repay the loan and the value of the collateral.

COMMERCIAL BUSINESS LENDING. The Bank currently offers working capital loans and business equipment loans. At June 30, 2003, the Bank's commercial business loans totaled $13.2 million and primarily consisted of inventory and equipment loans.

Commercial business loans generally involve more risk than single-family residential loans. In underwriting commercial business loans, the Bank considers the obligor's credit history, an analysis of the obligor's income, expenses and ability to repay the obligation and the value of the collateral.

LOAN SOLICITATION AND PROCESSING. The Bank's loan originations are derived from a number of sources, including referrals by realtors, builders, depositors, borrowers and mortgage brokers as well as walk-in customers. The Bank's solicitation programs consist of calls by the Bank's officers, branch presidents and other responsible employees to local realtors, builders, commercial businesses, and advertisements in local newspapers and billboards and radio broadcasts. The Bank's loan officers, including corporate lending staff, as well as branch presidents originate loans. Loan applications are accepted at each of the Bank's offices and, depending on the loan type and amount, may be processed and underwritten at the originating office or forwarded to the main office.

Upon receipt of a loan application from a prospective borrower, the Bank's staff preliminarily reviews the information provided and makes an initial determination regarding the qualification of the borrower. If not disapproved, the application then is placed in processing, and a credit report and verifications are ordered to verify specific information

relating to the loan applicant's employment, income and credit standing. It is the Bank's policy to obtain an appraisal of the real estate intended to secure a proposed mortgage loan from independent fee appraisers. It is the Bank's policy to obtain personal guarantees from the principals on all loans. The Bank generally does not obtain a formal environmental report on the real estate at the time a loan is made, except when a particular risk of environmental contamination is suspected.

It is the Bank's policy to record a lien on the real estate securing the loan and to obtain a title insurance policy that insures the property is free of prior encumbrances. Borrowers must also obtain hazard insurance policies prior to closing and, when the property is in a designated flood plain, paid flood insurance policies.

The Board of Directors has the overall responsibility and authority for general supervision of the Bank's loan policies. The Board has established written lending policies for the Bank. The Bank's officers and loan committees approve loans up to specified limits above which the approval of the Board is required. Loan applicants are promptly notified of the decision of the Bank. It has been management's experience that substantially all approved loans are funded.

INTEREST RATES AND LOAN FEES. Interest rates charged by the Bank on mortgage loans are primarily determined by competitive loan rates offered in its primary market area and the Bank's minimum yield requirements. Mortgage loan rates reflect factors such as prevailing market interest rate levels, the supply of money available to the savings industry and the demand for such loans. These factors are in turn affected by general economic conditions, the monetary policies of the federal government, including the Federal Reserve Board, the general supply of money in the economy, tax policies and governmental budget matters.

The Bank receives fees in connection with loan commitments and originations, loan modifications, late payments and changes of property ownership and for miscellaneous services related to its loans. Loan origination fees are calculated as a percentage of the loan principal. The excess, if any, of loan origination fees over direct loan origination costs is deferred and accreted into income over the contractual life of the loan using the level yield method. If costs exceed fees, the excess is deferred and amortized to expense over the loan's contractual life using the level yield method. If a loan is prepaid, refinanced, or sold, all remaining deferred fees/costs with respect to such loan are taken into income or recognized in expense at such time.

COLLECTION POLICIES. When a borrower fails to make a payment on a loan, the Bank generally takes prompt steps to have the delinquency cured and the loan restored to current status. Once the payment grace period has expired (in most instances 15 days after the due date), a late notice is mailed to the borrower, and a late charge is imposed, if applicable. If payment is not promptly received, a second notice is sent 15 days after the expiration of the grace period. If the loan becomes 30 days delinquent, the borrower is contacted, and efforts are made to formulate an affirmative plan to cure the delinquency. If a loan becomes 60 days delinquent, the loan is reviewed by the Bank's management, and if payment is not made, management may pursue foreclosure, repossession, or other appropriate action. If a loan remains delinquent 90 days or more, the Bank generally initiates foreclosure proceedings.

ASSET CLASSIFICATION; ALLOWANCES FOR LOSSES AND NONPERFORMING ASSETS. Federal regulations require savings institutions to classify their assets on the basis of quality on a regular basis. An asset is classified as substandard if it is determined to be inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. An asset is classified as doubtful if full collection is highly questionable or improbable. An asset is classified as loss if it is considered uncollectible, even if a partial recovery could be expected in the future. The regulations also provide for a special mention designation, described as assets which do not currently expose an institution to a sufficient degree of risk to warrant classification but do possess credit deficiencies or potential weaknesses deserving management's close attention. Assets classified as substandard or doubtful require an institution to establish general allowances for loan losses. If an asset or portion thereof is classified loss, an institution must either establish a specific allowance for loss in the amount of the portion of the asset classified loss, or charge off such amount. Federal examiners may disagree with an institution's classifications. If an institution does not agree with an examiner's classification of an asset, it may appeal this determination to the OTS Regional Director.

Management regularly reviews the Bank's assets to determine whether assets require classification or re-classification, and the Board of Directors reviews and approves all classifications. As of June 30, 2003, the Bank had $175,829 of assets classified doubtful, $9,671,698 of assets classified substandard, and $3,103,591 of assets designated as special mention. The Bank's total adversely classified assets represented approximately 3.9% of the Bank's total assets and 39.8% of the Bank's tangible regulatory capital plus allowance for loan loss at June 30, 2003. At June 30, 2003, management did not expect the Bank to incur any loss in excess of attributable existing allowances on any of the Bank's adversely classified or designated assets.

Management also reviews the loss factors to determine whether they are current and relevant. Differences between estimated and actual losses have been insignificant for several years. However, if the losses experienced change significantly, a determination is made as to which factors utilized should be adjusted prospectively.

Homogeneous loans are those that are considered to have common characteristics that provide for evaluation on an aggregate or pool basis. The Company considers the characteristics of (1) one-to-four family residential first mortgage loans; (2) automobile loans; and (3) consumer and home improvement loans to permit consideration of the appropriateness of the allowance for losses of each group of loans on a pool basis. The primary methodology used to determine the appropriateness of the allowance for losses includes segregating certain specific, poorly performing loans based on their performance characteristics from the pools of loans as to type and then applying a loss factor to the remaining pool balance based on several factors including classification of the loans as to grade, past loss experience, inherent risks, economic conditions in the primary market areas and other factors which usually are beyond the control of the Company.

Non-homogeneous loans are those loans that can be included in a particular loan type, such as commercial loans and multi-family and commercial first mortgage loans, but which differ in other characteristics to the extent that valuation on a pool basis is not valid. After segregating specific, poorly performing loans and applying the methodology as noted in the preceding paragraph for such specific loans, the remaining loans are evaluated based on payment experience, known difficulties in the borrower's business or geographic area, loss experience, inherent risks and other factors usually beyond the control of the Company. These loans are then graded and a factor, based on experience, is applied to estimate the probable loss.

In extending credit, the Bank recognizes that losses will occur and that the risk of loss will vary with, among other things, the type of credit being extended, the creditworthiness of the obligor over the term of the obligation, general economic conditions and, in the case of a collateralized obligation, the quality of the security. It is management's policy to maintain adequate allowances for losses based on management's assessment of the Bank's loan portfolio. The Bank increases its allowance for losses by charging provisions for losses against the Bank's income. Federal examiners may disagree with an institution's allowance for losses and may require adjustment.

The Bank's methodology for establishing the allowance for losses takes into consideration probable losses that have been identified in connection with specific assets as well as losses that have not been identified but can be expected to occur. Management conducts regular reviews of the Bank's assets and evaluates the need to establish allowances on the basis of this review. Allowances are established by the Board of Directors on a regular basis based on an assessment of risk in the Bank's assets taking into consideration the composition and quality of the portfolio, delinquency trends, current charge-off and loss experience, the state of the real estate market, regulatory reviews conducted in the regulatory examination process and current economic conditions.

At the date of foreclosure or other repossession, the Bank records the property at fair value less estimated costs to sell. Fair value is defined as the amount in cash or cash-equivalent value of other consideration that a property would yield in a current sale between a willing buyer and a willing seller. Fair value is measured by market transactions. If a market does not exist, fair value of the property is estimated based on selling prices of similar properties in active markets or, if there are no active markets for similar properties, by discounting a forecast of expected cash flows at a rate commensurate with the risk involved. Fair value generally is determined through an appraisal at the time of foreclosure. At June 30, 2003, the Bank held no properties acquired in settlement of loans for which estimated market values were unavailable. Any amount of cost in excess of fair value at foreclosure is charged-off against the allowance for loan losses. Subsequent to acquisition, the property is periodically evaluated by management and an allowance is established

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if the estimated fair value of the property, less estimated costs to sell, declines. If, upon ultimate disposition of the property, net sales proceeds differ from the net carrying value of the property, a gain or loss on sale of real estate is recorded.

The banking regulatory agencies, including the OTS, have adopted a policy statement regarding maintenance of an adequate allowance for loan and lease losses and an effective loan review system. This policy includes an arithmetic formula for checking the reasonableness of an institution's allowance for loan loss estimate compared to the average loss experience of the industry as a whole.

Management actively monitors the Bank's asset quality and charges off loans and properties acquired in settlement of loans against the allowances for losses on such loans and such properties when appropriate and provides specific loss allowances when necessary. Although management believes it uses the best information available to make determinations with respect to the allowances for losses, future adjustments may be necessary if economic conditions differ substantially from the economic conditions in the assumptions used in making the determinations as to the appropriateness of the allowance.

During the year ended June 30, 2003, in light of the Bank's loan portfolio review and changes in the mix of loan types, the Bank made $533,000 in provisions for loan losses bringing the total reserve for losses after net charged-off loans to $1.6 million, or 1.46% of total loans which compares to 1.22% as of June 30, 2002. The provision was made in consideration of reviews of individual loans and the fact that nonperforming loans as of June 30, 2003 as a percent of total loans increased to 3.18% from 1.44% as of June 30, 2002. In addition, total classified assets as a percent of the Bank's tangible capital plus allowance for loan loss was 39.8% as of June 30, 2003, which compares to 31.0% as of June 30, 2002. As of June 30, 2003, the Bank had $9.8 million in assets classified substandard or doubtful as compared to $7.1 million as of June 30, 2002.

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The following table sets forth an analysis of the Bank's allowance for loan losses for the periods indicated:

	Year Ended June 30,				
	2003	2002	2001	2000	1
Balance at beginning of period	$1,628,515	$ 1,446,114	$1,231,709	$1,329,201	$1,
Loans charged-off:					
Real estate mortgage:					
One-to-four family residential ..	226,415	2,407	19,982	4,960	
Other mortgage loans	120,881	--	--	--	
Commercial	66,412	77,500	25,811	50,047	
Consumer	239,260	154,475	55,968	44,791	
Total charge-offs	652,968	234,382	101,761	99,798	
Recoveries:					
Real estate mortgage:					
One-to-four family residential ..	42,060	6,407	1,617	--	
Other mortgage loans	--	--	--	--	
Commercial	17,243	57,357	--	--	
Consumer	37,827	23,019	18,549	2,306	
Total recoveries	97,130	86,783	20,166	2,306	
Net loans charged-off	555,838	147,599	81,595	97,492	
Provision for loan losses	533,000	330,000	296,000	--	
Balance at end of period	$1,605,677	$ 1,628,515	$1,446,114	$1,231,709	$1,
Ratio of net charge-offs to average loans outstanding during the period	0.51%	0.11%	0.06 %	0.08%	

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The following table allocates the allowance for loan losses by asset category at the dates indicated. The allocation of the allowance to each category is not necessarily indicative of future losses and does not restrict the use of the allowance to absorb losses in any category.

	At June 30, 2003 Amount	2003 Percent of Loans in Category to Total Loans	2002 Amount	2002 Percent of Loans in Category to Total Loans	2001 Amount
Allocated to:					
Real estate loans:					
One-to-four family residential	$ 361,958	38.5%	$ 321,538	36.4%	$ 480,460
Multi-family, non-residential, and land	880,988	39.4	998,653	42.2	570,261
Consumer loans	192,878	10.1	137,273	10.6	89,360
Commercial loans	169,853	12.0	171,051	10.8	255,662
Unallocated	--	--	--	--	50,371
Total	$1,605,677	100.0%	$1,628,515	100.0%	$1,446,114

	At June 30, 2000 Amount	2000 Percent of Loans in Category to Total Loans	1999 Amount	1999 Percent of Loans in Category to Total Loans
Allocated to:				
Real estate loans:				
One-to-four family residential	$ 440,709	42.3%	$ 422,000	43.7%
Multi-family, non-residential, and	551,000	43.9	603,000	44.6
land	91,000	7.7	101,000	7.3
Consumer loans	149,000	6.1	82,000	4.4
Commercial loans	--	--	121,201	--
Unallocated				
Total	$1,231,709	100.0%	$1,329,201	100.0%

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While management believes the Bank has established its existing loss allowances in accordance with generally accepted accounting principles, there can be no guarantee or assurance that such allowances are, or in the future will be, adequate to absorb all loan losses or that regulators, in reviewing the Bank's assets, will not require the Bank to increase its loss allowance, thereby negatively affecting the Bank's reported financial condition and results of operations.

The following table sets forth information with respect to the Bank's nonperforming assets at the dates indicated. For information regarding the Bank's interest accrual practices, see the Notes to Consolidated Financial Statements set forth in Item 8 herein.

	At June 30				
	2003	2002	2001	2000	1
Loans accounted for on a nonaccrual basis: /1/					
Real estate:					
One-to-four family residential	$1,241,085	$1,176,095	$ 838,271	$ 655,988	$
Other mortgage loans	1,740,878	3,838	--	--	
Consumer loans	287,925	188,824	137,987	102,003	
Commercial loans	232,562	152,699	--	--	
Total	$3,502,450	$1,521,456	$ 976,258	$ 757,991	$
Accruing loans which are contractually past due 90 days or more:					
Real estate:					
One-to-four family residential	$ --	$ 109,209	$ 38,816	$ 140,000	$
Other mortgage loans	--	251,333	--	--	
Commercial loans	--	--	161,926	--	
Consumer loans	--	35,953	13,400	21,524	$
Total	$ --	$ 396,495	$ 214,142	$ 161,524	$
Total nonperforming loans	$3,502,450	$1,917,951	$1,190,400	$ 919,515	$
Percentage of total loans..............	3.18%	1.44%	0.81%	0.64%	
Other nonperforming assets /2/.........	$ 246,160	$ 623,114	$ 175,783	$ 52,919	$
Loans modified in troubled debt restructurings	$5,355,927	$4,678,247	$ --	$ --	$

/1/ Designated nonaccrual loan payments received are applied first to contractual principal and interest income is recognized only when contractually current.

/2/ Other nonperforming assets includes foreclosed real estate.

During the years ended June 30, 2003 and 2002, gross interest income of approximately $200,000 and $128,000, respectively, would have been recorded on loans accounted for on a nonaccrual basis if the loans had been current throughout the respective periods. Interest on such loans included in income during such respective periods amounted to approximately $97,000 and $65,000, respectively.

Nonperforming loans increased from $1,917,951 on June 30, 2002 to $3,502,450 on June 30, 2003. Total nonperforming one-to-four family residential loans decreased slightly while total nonperforming consumer and commercial loans increased. The largest increase in nonperforming loans was in other mortgage loans, which increased from $255,171 on June 30, 2002, to six loans for $1,740,878 on June 30, 2003. This increase is primarily attributed one borrower, which represents two loans totaling $1.3 million. While these loans were placed in nonaccrual due to delinquency, management does not expect any loss on the loans due to them being very well collateralized.

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At June 30, 2003, management had identified approximately $4.0 million of loans which amount is not reflected in the preceding table but as to where known information about possible credit problems of borrowers caused management to have serious doubts as to the ability of such borrowers to comply with the present loan repayment terms and which may result in future disclosure of such loans in the table above. All of these loans were included in the Bank's adversely classified asset amounts as of June 30, 2003. Of this aggregate amount, approximately $1,621,000 was attributable to 36 one-to-four family residential loans, $326,000 was attributable to 5 commercial loans, $1,628,000 was attributable to 13 other mortgage loans, and $439,000 was attributable to 43 consumer loans. At June 30, 2003, management did not expect the Bank to incur any loss in excess of attributable existing allowances on any of the Bank's assets.

INVESTMENT ACTIVITIES

GENERAL. The Bank is permitted under federal law to make certain investments, including investments in securities issued by various federal agencies and state and municipal governments, savings deposits at the FHLB of Dallas, certificates of deposit in federally insured institutions, certain bankers' acceptances and federal funds. It may also invest, subject to certain limitations, in commercial paper rated in one of the two highest investment-rating categories of a nationally recognized credit rating agency, and certain other types of corporate debt securities and mutual funds. Federal regulations require the Bank to maintain an investment in FHLB stock and to maintain a sufficient level of liquidity. The Bank has chosen to fulfill a portion of this requirement by investing in securities which provide liquidity.

The Bank makes investments in order to maintain a sufficient level of liquid assets as required by regulatory authorities and manage cash flow, diversify its assets, obtain yield and, under prior federal income tax law, satisfy certain requirements for favorable tax treatment. The investment activities of the Bank consist primarily of investments in mortgage-backed securities and other investment securities, consisting primarily of securities issued or guaranteed by the U.S. government or agencies thereof and state and municipal securities. Typical investments include federally sponsored agency mortgage pass-through and federally sponsored agency and mortgage-related securities. Investment and aggregate investment limitations and credit quality parameters of each class of investment are prescribed in the Bank's investment policy. The Bank performs analyses on securities prior to purchase and on an ongoing basis to determine the impact on earnings and market value under various interest rate and prepayment conditions. Securities purchases are approved by the Bank's Investment Committee, and the Board of Directors reviews all securities transactions on a monthly basis.

Securities designated as "held to maturity" are those assets which the Bank has the ability and intent to hold to maturity. The "held to maturity" investment portfolio is carried at amortized cost. Securities designated as "available for sale" are those assets which the Bank might not hold to maturity and thus are carried at market value with unrealized gains or losses, net of tax effect, recognized in stockholders' equity.

Mortgage-backed securities typically represent an interest in a pool of fixed-rate or adjustable-rate mortgage loans, the principal and interest payments on which are passed from the mortgage borrowers to investors such as the Bank. Mortgage-backed security sponsors may be private companies or quasi-governmental agencies such as FHLMC, FNMA and GNMA, which guarantee the payment of principal and interest to investors. Mortgage-backed securities can represent a proportionate participation interest in a pool of loans or, alternatively, an obligation to repay a specified amount collateralized by a pool of loans (commonly referred to as a "collateralized mortgage obligation," or "CMO"). Mortgage-backed securities generally increase the quality of the Bank's assets by virtue of the credit enhancements that back them. They are more liquid than individual mortgage loans and may be used to collateralize borrowings or other obligations of the Bank. The Bank's mortgage-backed securities portfolio primarily consists of seasoned securities either issued by one of the quasi-governmental agencies or rated in one of the top two categories by a recognized rating organization.

All of the Bank's privately issued securities were rated "AA" or higher by a nationally recognized credit rating agency at the time of purchase. Management regularly monitors the ratings of the Bank's privately issued holdings by reference to nationally published rating media and by communication with the issuer when necessary. At June 30, 2003, no privately issued securities were rated below AA except as follows:

A Citicorp Mortgage, Inc. REMIC Pass-Through Class A Certificate was rated "CAA1" by Moody. The grade reflects deterioration in the performance of the mortgage pools underlying the security. At June 30, 2003, the Bank estimated the value of the security at approximately $29,000 less than its face value. The Bank's carrying value for this security at that date was approximately $83,000 after recognition of impairment loss.

A DLJ Mortgage Acceptance Corp. Pass-Through Class A-3 Certificate was rated "CAA2" by Moody. The grade reflects deterioration in the performance of the mortgage pools underlying the security. As of June 30, 2003, the deterioration affected the credit support and not the principal or interest of the security itself. At June 30, 2003, the Bank estimated the value of the security at approximately $54,000 less than its face value. The Bank's carrying value for this security at that date was approximately $94,000 after recognition of impairment loss.

The Bank's privately issued mortgage securities consist of collateralized mortgage obligations (CMOs) and mortgage pass-through securities. At June 30, 2003, all of the privately issued mortgage securities had adjustable interest rates with a weighted average yield of 5.19% and a weighted contractual average term to maturity of 19.1 years. The carrying value of the privately issued mortgage securities was approximately $561,000 or 0.60% of the mortgage-backed securities and CMOs at that date. None of the privately issued mortgage securities are insured or guaranteed by FHLMC or FNMA.

The actual maturity of a mortgage-backed security varies, depending on when the mortgagors prepay or repay the underlying mortgages. Prepayments of the underlying mortgages may shorten the life of the investment, thereby adversely affecting its yield to maturity and the related market value of the mortgage-backed security. The yield is based upon the interest income and the amortization of the premium or accretion of the discount related to the mortgage-backed security. Premiums and discounts on mortgage-backed securities are amortized or accreted over the estimated term of the securities using a level yield method. The prepayment assumptions used to determine the amortization period for premiums and discounts can significantly affect the yield of the mortgage-backed security, and these assumptions are reviewed periodically to reflect the actual prepayment. The actual prepayments of the underlying mortgages depend on many factors, including the type of mortgage, the coupon rate, the age of the mortgages, the geographical location of the underlying real estate collateralizing the mortgages and general levels of market interest rates. The difference between the interest rates on the underlying mortgages and the prevailing mortgage interest rates is an important determinant in the rate of prepayments. During periods of falling mortgage interest rates, prepayments generally increase, and, conversely, during periods of rising mortgage interest rates, prepayments generally decrease. If the coupon rate of the underlying mortgage significantly exceeds the prevailing market interest rates offered for mortgage loans, refinancing generally increases and accelerates the prepayment of the underlying mortgages. Prepayment experience is more difficult to estimate for adjustable-rate mortgage-backed securities.

The following table sets forth information regarding carrying values of the Company's investment securities at the dates indicated. All securities are held as available for sale. At June 30,

	2003	2002	2001
Securities available for sale:			
U.S. government and agencies	$ --	$ 1,530,945	$ 1,900,448
Municipal securities	26,463,922	25,689,191	30,197,186
Other securities	1,980,000	1,995,000	--
Collateralized mortgage obligations...	25,247,609	11,310,152	12,159,483
Other mortgage-backed securities	76,160,245	77,603,036	75,784,260
Equity securities	108,570	70,240	40,800
	$129,960,346	$118,198,564	$120,082,177

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The following table sets forth information regarding scheduled maturities of the Company's investment portfolio at June 30, 2003. Yields on municipal securities are not tax-effected.

	One Year or Less		One to Five Years		Five to Ten Years	
	Carrying Value	Average Yield	Carrying Value	Average Yield	Carrying Value	Average Yield
Municipal securities	$ --	--%	$ --	--%	$ --	--%
Other securities	--	--	--	--	--	--
Collateralized mortgage obligations	--	--	--	--	4,453,119	5.58

Other mortgage-backed securities	1,646	7.23	2,473,352	6.18	12,915,530	3.84
Total	$1,646	7.23%	$2,473,352	6.18%	$17,368,649	4.29%
Equity securities						

	More than Ten Years		Total Investment Portfolio		
	Carrying Value	Average Yield	Carrying Value	Market Value	Average Yield
Municipal securities	$ 26,463,922	5.00	26,463,922	26,463,922	5.00
Other securities	1,980,000	2.30	1,980,000	1,980,000	2.30
Collateralized mortgage obligations	20,794,490	3.95	25,247,609	25,247,609	4.24
Other mortgage-backed securities	60,769,717	5.03	76,160,245	76,160,245	4.86
Total	$110,008,129	4.77%	$129,851,776	$129,851,776	4.69%
Equity securities			108,570	108,570	
			$129,960,346	$129,960,346	

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DEPOSIT ACTIVITY AND OTHER SOURCES OF FUNDS

GENERAL. Deposits are the primary source of the Bank's funds for lending, investment activities and general operational purposes. While the Bank, like most independent savings institutions, historically has relied on certificates of deposit for a substantial portion of its deposit base, management has recently shifted the Bank's deposit gathering emphasis away from certificates of deposit and toward transaction accounts with more favorable interest costs, interest rate risk characteristics and opportunities for the Bank to perform valued customer services that generate additional fee income, and it is expected that management will continue this trend in the future. In addition to deposits, the Bank derives funds from loan principal and interest repayments, maturities of investment securities and interest payments thereon. Although loan repayments are a relatively stable source of funds, deposit inflows and outflows are significantly influenced by general interest rates and money market conditions. Borrowings may be used to compensate for reductions in the availability of funds, or for general operational purposes. The Bank has access to advances from the FHLB of Dallas.

DEPOSITS. The Bank attracts deposits principally from within its primary market area by offering competitive rates on its deposit instruments, including NOW accounts, money market accounts, statement savings accounts, Individual Retirement Accounts and certificates of deposit which range in maturity from 90 days to three years. Deposit terms vary according to the minimum balance required, the length of time the funds must remain on deposit and the interest rate. The Bank on a periodic basis establishes maturities, terms, service fees and withdrawal penalties for its deposit accounts. In determining the characteristics of its deposit accounts, the Bank considers the rates offered by competing institutions, lending and liquidity requirements, growth goals and federal regulations. The Bank does not typically accept brokered deposits or pay negotiated rates for jumbo certificates of deposits.

The Bank attempts to compete for deposits with other institutions in its market area by offering competitively priced deposit instruments that are tailored to the needs of its customers. Additionally, the Bank seeks to meet customers' needs by providing convenient customer service to the community, efficient staff and convenient hours of service. Substantially all of the Bank's depositors are Arkansas residents who reside in the Bank's primary market area.

The following table sets forth information regarding interest-bearing average deposit balances and rates during the periods presented.

	Year Ended June 30,					
	2003		2002		2001	
	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Ave Ra
NOW accounts	$ 30,223,526	1.49%	$ 30,164,006	1.87%	$ 25,799,621	4
Money market savings deposits...	5,034,371	1.01	6,191,033	1.90	6,967,070	3
Savings deposits - statement....	7,485,563	1.04	7,211,717	1.54	6,774,023	2
Certificates of deposit	100,545,473	3.18	112,568,794	4.36	106,806,416	5
Total	$143,288,933	2.63%	$156,135,550	3.65%	$146,347,130	5

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The following table sets forth information regarding changes in dollar amounts of deposits in various types of accounts offered by the Bank between the dates indicated.

	Balance at June 30, 2003	% of Deposits	Increase (Decrease)	Balance at June 30, 2002	% De
Noninterest bearing deposits	$ 9,447,561	6.22%	$ 557,694	$ 8,889,867	
NOW accounts	33,360,141	21.95	3,157,598	30,202,543	
Money market savings deposits ...	4,751,127	3.13	(1,160,588)	5,911,715	
Savings deposits - statement	7,927,966	5.22	(83,007)	8,010,973	

Certificates of deposit	96,469,709	63.48	(15,520,376)	111,990,085
	$ 151,956,504	100.00%	$ (13,048,679)	$ 165,005,183

	Balance at June 30, 2001	% of Deposits
Noninterest bearing deposits	$ 7,379,892	4.58%
NOW accounts	30,675,428	19.02
Money market savings deposits ...	5,733,865	3.56
Savings deposits - statement	6,903,036	4.28
Certificates of deposit	110,592,958	68.56
	$ 161,285,179	100.00%

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The following table sets forth information regarding certificates of deposits classified by rates at the dates indicated.

	At June 30,		
	2003	2002	2001
0.75 - 2.99%	$ 50,099,367	$ 32,873,143	$ --
3.00 - 4.99%	40,723,104	61,567,322	33,036,565
5.00 - 7.99%	5,647,238	17,549,620	77,556,393
	$ 96,469,709	$111,990,085	$110,592,958

The following table sets forth information regarding amounts and maturities of certificates of deposits at June 30, 2003.

	Balance Maturing 12-Months Ending June 30,			
Rate	2004	2005	2006	Total
0.75 - 2.99%	$46,592,917	$ 3,348,991	$ 157,459	$50,099,367
3.00 - 4.99%	24,626,508	13,182,753	2,913,843	40,723,104
5.00 - 7.99%	5,153,457	493,781	--	5,647,238
	$76,372,882	$17,025,525	$ 3,071,302	$96,469,709

The following table sets forth information regarding amounts of certificates of deposit of $100,000 or more by time remaining until maturity at June 30, 2003.

Maturity Period	Certificates of Deposit

Three months or less	$ 3,877,002
Over three through six months...	4,893,717
Over six through 12 months	5,266,896
Over 12 months	3,145,294
Total	$17,182,909

The following table sets forth information regarding deposit activities of the Bank for the periods indicated.

	Year Ended June 30,		
	2003	2002	2001
Net (decrease) increase before interest credited	$(16,134,036)	$ (831,186)	$ 10,433,478
Interest credited	3,085,357	4,551,190	5,978,630
Net (decrease) increase in deposits	$(13,048,679)	$ 3,720,004	$ 16,412,108

BORROWINGS. Deposits historically have been the primary source of funds for the Bank's lending, investments and general operating activities. The Bank is authorized, however, to use advances from the FHLB of Dallas to supplement its supply of lendable funds and to meet deposit withdrawal requirements. The FHLB of Dallas functions as a central reserve bank providing credit for savings institutions and certain other member financial institutions. As a member of the FHLB System, the Bank is required to own stock in the FHLB of Dallas and is authorized to apply for advances. Advances are pursuant to several different programs, each with its own interest rate and range of maturities. Advances from the FHLB of Dallas are collateralized by the Bank's stock in the FHLB of Dallas, qualifying first mortgage loans and mortgage-backed investment securities.

The following table sets forth certain information regarding borrowings by the Bank for the periods indicated. Averages are based on monthly balances. See the Notes to Consolidated Financial Statements set forth in item 8 herein.

	Year Ended June 30,		
	2003	2002	2001
Amounts outstanding at end of period:			
FHLB advances	$ 69,068,534	$ 82,263,936	$ 91,915,694
Weighted average rate	5.96%	5.93%	5.88%
Maximum amount of borrowings outstanding at any month end:			
FHLB advances	$ 80,164,637	$ 91,831,310	$114,694,903

Approximate average borrowings during the year outstanding with respect to:			
FHLB advances	$ 74,823,968	$ 86,442,890	$105,619,861
Weighted average rate	5.95%	5.92%	6.03%

SUBSIDIARY ACTIVITIES

As a federally chartered savings bank, the Bank is permitted to invest an amount equal to 2% of its assets in non-savings institution service corporation subsidiaries, with an additional investment of 1% of assets where such investment serves primarily community, inner-city and community development purposes. Under such limitations, as of June 30, 2003, on a consolidated basis the Bank was authorized to invest up to approximately $7.5 million in the stock of or loans to such subsidiaries, including the additional 1% investment for community, inner-city and community development purposes. The Bank has one subsidiary service corporation, HCB Properties, Inc., which was formed in August 1996 to hold certain properties acquired by the Bank for possible future expansion, because the properties are larger than the Bank's anticipated expansion needs, and it is expected that portions of the properties eventually will be sold. At June 30, 2003, the Bank's aggregate investment in, and loans to, the subsidiary service corporation totaled $261,740.

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REGULATION OF THE BANK

GENERAL. As a federally chartered savings institution the Bank is subject to extensive regulation by the OTS and the FDIC and to OTS regulations governing such matters as capital standards, mergers, establishment of branch offices, subsidiary investments and activities and general investment authority. The OTS periodically examines the Bank for compliance with various regulatory requirements. The FDIC also has the authority to conduct special examinations of the Bank because its savings deposits are insured by the SAIF. The Bank must file reports with the OTS describing its activities and financial condition and also is subject to certain reserve requirements promulgated by the Federal Reserve Board. This supervision and regulation is intended primarily for the protection of depositors.

FEDERAL HOME LOAN BANK SYSTEM. The Bank is a member of the FHLB System, which consists of 12 district FHLB's subject to supervision and regulation by the Federal Housing Finance Board ("FHFB"). The FHLB's provide a central credit facility primarily for member institutions. As a member of the FHLB of Dallas, the Bank is required to acquire and hold shares of capital stock in the FHLB of Dallas in an amount at least equal to 1% of the aggregate unpaid principal of its home mortgage loans, home purchase contracts and similar obligations at the beginning of each year, or 1/20 of its advances (borrowings) from the FHLB of Dallas, whichever is greater.

The Gramm-Leach-Bliley Act of 1999 required each FHLB to replace its existing capital stock with a new class or classes of capital stock, establish new minimum investment requirements for its members, and comply with new minimum leverage and risk-based capital requirements. The Bank is a member of the Dallas FHLB, which currently plans to implement its new capital plan on September 2, 2003.

The new minimum investment requirement states that each member must maintain an investment in new Class B Stock equal to the sum of a membership investment requirement (0.20% of the member's total assets as of the previous

December 31), and an activity-based investment requirement (4.25% of currently outstanding advances and certain new Mortgage Partnership Finance Program loans). As of June 30, 2003, the Bank is estimated to have a capital stock requirement of $3.4 million, well below its capital stock balance of $4.7 million as of the same date.

The FHLB of Dallas serves as a reserve or central bank for its member institutions within its assigned district. It is funded primarily from proceeds derived from the sale of consolidated obligations of the FHLB System. It makes advances to members in accordance with policies and procedures established by the FHLB and the Board of Directors of the FHLB of Dallas. Long-term advances may only be made for the purpose of providing funds for residential housing finance and small businesses, small farms and small agri-businesses. At June 30, 2003, the Bank had $69.1 million in advances outstanding with the FHLB of Dallas. See " -- Deposit Activity and Other Sources of Funds -- Borrowings."

QUALIFIED THRIFT LENDER TEST. The Bank is subject to OTS regulations that use the concept of a Qualified Thrift Lender to determine eligibility for Federal Home Loan Bank advances and for certain other purposes. To qualify as a Qualified Thrift Lender, a savings institution must either qualify as a "domestic building and loan association" under the Internal Revenue Code or maintain at least 65% of its "portfolio" assets in Qualified Thrift Investments. Portfolio assets are defined to include total assets less intangibles, value of property used by a savings institution in its business and liquidity investments in an amount not exceeding 20% of assets. Qualified Thrift Investments consist of (i) loans, equity positions or securities related to domestic, residential real estate or manufactured housing, and educational, small business and credit card loans, (ii) 50% of the dollar amount of residential mortgage loans subject to sale under certain conditions, and (iii) stock issued by a Federal Home Loan Bank. Subject to a 20% of portfolio assets limit, savings institutions are able to treat as Qualified Thrift Investments 200% of their investments in loans to finance "starter homes" and loans for construction, development or improvement of housing and community service facilities or for financing small businesses in "credit-needy" areas. To be qualified as a Qualified Thrift Lender, a savings institution must maintain its status as a Qualified Thrift Lender for nine out of every 12 months. Failure to qualify as a Qualified Thrift Lender results in a number of sanctions, including the imposition of certain operating restrictions imposed on national banks. Upon failure to qualify as a Qualified Thrift Lender for two years, a savings institution must convert to a commercial bank.

A savings institution that does not meet the Qualified Thrift Lender test must either convert to a bank charter or comply with the following restrictions on its operations: (i) the institution may not engage in any new activity or make any new investment, directly or indirectly, unless such activity or investment is permissible for a national bank; (ii) the branching powers of the institution shall be restricted to those of a national bank; and (iii) payment of dividends by the institution shall be subject to the rules regarding payment of dividends by a national bank. Upon the expiration of three years from the date the institution ceases to be a Qualified Thrift Lender, it must cease any activity, and not retain any investment not permissible for a national bank and savings association.

REGULATORY CAPITAL REQUIREMENTS. Under OTS capital standards, savings institutions must maintain "tangible" capital equal to at least 1.5% of tangible assets, "core" capital equal to at least 4.0% (or 3.0% if the institution is rated CAMELS 1 under the OTS examination rating system) of adjusted total assets and "total" capital (a combination of core and "supplementary" capital) equal to at least 8.0% of "risk-weighted" assets. In addition, the OTS regulations impose certain restrictions on institutions that have a total risk-based capital ratio that is less than 8.0%, a ratio of Tier 1 capital to risk-weighted assets of less than 4.0% or a ratio of Tier 1 capital to adjusted total assets of less than 4.0% (or 3.0% if the institution is rated CAMELS 1 under the OTS examination rating system). For purposes of these regulations, Tier 1 capital has the same definition as core capital. See " -- Prompt Corrective Regulatory Action." Core capital is defined as common stockholders' equity (including retained earnings), noncumulative perpetual preferred stock and related surplus, minority interests in the equity accounts of fully consolidated subsidiaries, certain nonwithdrawable accounts and pledged savings deposits and "qualifying supervisory goodwill." Core capital is generally reduced by the amount of an institution's intangible assets for which no market exists. Limited exceptions to the deduction of intangible assets are provided for purchased mortgage servicing rights and qualifying supervisory goodwill. Tangible capital is given the same definition as core capital, but does not include an exception for qualifying supervisory goodwill and is reduced by the amount of all the savings institution's intangible assets with only a limited exception for purchased mortgage servicing rights.

Both core and tangible capital are further reduced by an amount equal to a savings institution's debt and equity investments in subsidiaries engaged in activities not permissible to national banks (other than subsidiaries engaged in activities undertaken as agent for customers or in mortgage banking activities and depository institutions or their holding companies). As of June 30, 2003, the Bank had $261,740 investments in, or extensions of credit to, non-includable subsidiaries.

Adjusted total assets are a savings institution's total assets as determined under accounting principles generally accepted in the United States of America, increased by certain goodwill amounts and by a pro rated portion of the assets of unconsolidated includable subsidiaries in which the institution holds a minority interest. Adjusted total assets are reduced by the amount of assets that have been deducted from capital, the savings institution's investments in unconsolidated includable subsidiaries, and, for purposes of the core capital requirement, qualifying supervisory goodwill.

In determining compliance with the risk-based capital requirement, a savings institution is allowed to use both core capital and supplementary capital provided the amount of supplementary capital used does not exceed the institution's core capital. Supplementary capital is defined to include certain preferred stock issues, nonwithdrawable accounts and pledged savings deposits that do not qualify as core capital, certain approved subordinated debt, certain other capital instruments, a portion of the institution's general loan loss allowances and up to 45% of unrealized gains on equity securities. Total core and supplementary capital are reduced by the amount of capital instruments held by other depository institutions pursuant to reciprocal arrangements and equity investments other than those deducted from core and tangible capital. At June 30, 2003, the Bank has $261,740 in equity investments for which OTS regulations require a deduction from total capital.

The risk-based capital requirement is measured against risk-weighted assets, which equal the sum of each asset and the credit-equivalent amount of each off-balance sheet item after being multiplied by an assigned risk weight. Under the OTS risk-weighting system, one-to-four family first mortgages not more than 90 days past due with loan-to-value ratios under 80% and average annual occupancy rates of at least 80% and certain qualifying loans for the construction of one-to-four family residences pre-sold to home purchasers are assigned a risk weight of 50%. Consumer and residential construction loans are assigned a risk weight of 100%. Mortgage-backed securities issued or fully guaranteed as to principal and interest, by the FNMA or FHLMC are assigned a 20% risk weight. Cash and U.S. Government securities backed by the full faith and credit of the U.S. Government (such as mortgage-backed securities issued by GNMA) are given a 0% risk weight.

The table below presents the capital position of the Bank relative to its various regulatory capital requirements at June 30, 2003.

(Dollars in thousands)	Amount	Percent of Assets(1)
Tangible capital..............................	$ 23,056	9.39%
Tangible capital requirement..................	3,683	1.50
Excess....................................	$ 19,373	7.89%
Core capital..................................	$ 23,056	9.39%
Core capital requirement......................	9,821	4.00
Excess....................................	$ 13,235	5.39%
Total capital.................................	$ 24,459	21.83%
Risk-based capital requirement................	8,962	8.00
Excess....................................	$ 15,497	13.83%

(1) Based on adjusted total assets for purposes of the tangible capital and core capital requirements and risk-weighted assets for purpose of the risk-based capital requirement.

In addition to requiring generally applicable capital standards for savings institutions, the Director of the OTS is authorized to establish the minimum level of capital for a savings institution at such amount or at such ratio of capital-to-assets as the Director determines to be necessary or appropriate for such institution in light of the particular circumstances of the institution. Such circumstances would include a high degree of exposure of interest rate risk, prepayment risk, credit risk and concentration of credit risk and certain risks arising from non-traditional activities. The Director may treat the failure of any savings institution to maintain capital at or above such level as an unsafe or unsound practice and may issue a directive requiring any savings institution which fails to maintain capital at or above the minimum level required by the Director to submit and adhere to a plan for increasing capital. Such an order may be enforced in the same manner as an order issued by the FDIC.

DEPOSIT INSURANCE. The Bank is required to pay assessments based on a percentage of its insured savings deposits to the FDIC for insurance of its savings deposits by the SAIF. Under the Federal Deposit Insurance Act, the FDIC is required to set semi-annual assessments for SAIF-insured institutions at a level necessary to maintain the designated reserve ratio of the SAIF at 1.25% of estimated insured savings deposits or at a higher percentage of estimated insured savings deposits that the FDIC determines to be justified for that year by circumstances indicating a significant risk of substantial future losses to the SAIF. Under the FDIC's risk-based deposit insurance assessment system, the assessment rate for an insured depository institution depends on the assessment risk classification assigned to the institution by the FDIC, which is determined by the institution's capital level and supervisory evaluations. Based on the data reported to regulators for the date closest to the last day of the seventh month preceding the semi-annual assessment period, institutions are assigned to one of three capital groups -- well capitalized, adequately capitalized or undercapitalized -- using the same percentage criteria as in the prompt corrective action regulations. See "-- Prompt Corrective Regulatory Action." Within each capital group, institutions are assigned to one of three subgroups on the basis of supervisory evaluations by the institution's primary supervisory authority and such other information as the FDIC determines to be relevant to the institution's financial condition and the risk posed to the deposit insurance fund. Subgroup A consists of financially sound institutions with only a few minor weaknesses. Subgroup B consists of institutions that demonstrate weaknesses which, if not corrected, could result in significant deterioration of the institution and increased risk of loss to the deposit insurance fund. Subgroup C consists of institutions that pose a substantial probability of loss to the deposit insurance fund unless effective corrective action is taken.

The SAIF deposit insurance assessment rates set by the FDIC range from zero for "well capitalized" institutions with the highest supervisory ratings to 0.27% of insured savings deposits for institutions in the highest risk-based premium category. In addition, FDIC-insured institutions are required to pay assessments to the FDIC to help fund interest payments on certain bonds issued by the Financing Corporation ("FICO"), an agency of the federal government established to finance takeovers of insolvent thrifts. Until December 31, 1999, SAIF-insured institutions were required to pay FICO assessments at five times the rate at which Bank Insurance Fund ("BIF") members were assessed. Since December 31, 1999, both BIF and SAIF members have been assessed at the same rate for FICO payments.

The FDIC has adopted a regulation which provides that any insured depository institution with a ratio of Tier 1 capital to total assets of less than 2% will be deemed to be operating in an unsafe or unsound condition, which would constitute grounds for the initiation of termination of deposit insurance proceedings. The FDIC, however, would not initiate termination of insurance proceedings if the depository institution has entered into and is in compliance with a written agreement with its primary regulator, and the FDIC is a party to the agreement, to increase its Tier 1 capital to such level as the FDIC deems appropriate. Tier 1 capital is defined as the sum of common stockholders' equity, noncumulative perpetual preferred stock (including any related surplus) and minority interests in consolidated subsidiaries, minus all intangible assets other than mortgage servicing rights and qualifying supervisory goodwill eligible for inclusion in core capital under OTS regulations and minus identified losses and investments in certain securities subsidiaries. Insured depository institutions with Tier 1 capital equal to or greater than 2% of total assets may also be deemed to be operating in an unsafe or unsound condition notwithstanding such capital level. The regulation further provides that in considering applications that must be submitted to it by savings institutions, the FDIC will take into account whether the institution is meeting with the Tier 1 capital requirement for state non-member banks of 4% of total assets for all but the most highly rated state non-member banks.

FEDERAL RESERVE SYSTEM. Pursuant to regulations of the Federal Reserve Board, all FDIC-insured depository institutions must maintain average daily reserves equal to 3% on transaction accounts of up to $41.3 million plus 10% on the remainder. This percentage is subject to adjustment by the Federal Reserve

Board. Because required reserves must be maintained in the form of vault cash or in a noninterest-bearing account at a Federal Reserve Bank, the effect of the reserve requirement is to reduce the amount of the institution's interest-earning assets.

DIVIDEND RESTRICTIONS. Under OTS regulations, the Bank is not permitted to pay dividends on its capital stock if its regulatory capital would thereby be reduced below the amount then required for the liquidation account established for the benefit of certain depositors of the Bank at the time of the Conversion. In addition, the Bank is required by OTS regulations to give the OTS 30 days' prior notice of any proposed declaration of dividends.

OTS regulations require that savings institutions submit notice to the OTS prior to making a capital distribution if (a) they would not be well-capitalized after the distribution, (b) the distribution would result in the retirement of any of the institution's common or preferred stock or debt counted as its regulatory capital, or (c) the institution is a subsidiary of a holding company. A savings institution must make application to the OTS to pay a capital distribution if (x) the institution would not be adequately capitalized following the distribution, (y) the institution's total distributions for the calendar year exceeds the institution's net income for the calendar year to date plus its net income (less distributions) for the preceding two years, or (z) the distribution would otherwise violate applicable law or regulation or an agreement with or condition imposed by the OTS. If neither the savings institution nor the proposed capital distribution meet any of the foregoing criteria, then no notice or application is required to be filed with the OTS before making a capital distribution. The OTS may disapprove or deny a capital distribution if in the view of the OTS, the capital distribution would constitute an unsafe or unsound practice.

Under the OTS prompt corrective action regulations, the Bank would be prohibited from making any capital distributions if, after making the distribution, it would have: (i) a total risk-based capital ratio of less than 8.0%; (ii) a Tier 1 risk-based capital ratio of less than 4.0%; or (iii) a Tier 1 (core) capital ratio of less than 4.0%. See " -- Prompt Corrective Regulatory Action." The OTS, after consultation with the FDIC, however, may permit an otherwise prohibited stock repurchase if made in connection with the issuance of additional shares in an equivalent

amount and the repurchase will reduce the institution's financial obligations or otherwise improve the institution's financial condition.

In addition to the foregoing, earnings of the Bank appropriated to bad debt reserves and deducted for federal income tax purposes are not available for payment of cash dividends or other distributions to Bancshares without payment of taxes at the then current tax rate on the amount of earnings removed from the reserves for such distributions. See "Federal Income Taxation." Bancshares intends to make full use of this favorable tax treatment afforded to the Bank, and does not contemplate use of any post-Conversion earnings of the Bank in a manner which would limit the Bank's bad debt deduction or create federal tax liabilities.

TRANSACTIONS WITH RELATED PARTIES. Transactions between savings institutions and any affiliate are governed by Sections 23A and 23B of the Federal Reserve Act. An affiliate of a savings institution is any company or entity which controls, is controlled by or is under common control with the institution. In a holding company context, the parent holding company of an institution (such as Bancshares) and any companies which are controlled by such parent holding company are affiliates of the savings institution. Generally, Sections 23A and 23B (i) limit the extent to which the savings institution or its subsidiaries may engage in "covered transactions" with any one affiliate to an amount equal to 10% of such institution's capital stock and surplus, and contain an aggregate limit on all such transactions with all affiliates to an amount equal to 20% of such capital stock and surplus, and (ii) require that all such transactions be on terms substantially the same, or at least as favorable, to the institution or subsidiary as those provided to a non-affiliate. The term "covered transaction" includes the making of loans, purchase of assets, issuance of a guarantee and similar other types of transactions. In addition to the restrictions imposed by Sections 23A and 23B, no savings institution may (i) loan or otherwise extend credit to an affiliate, except for any affiliate which engages only in activities which are permissible for bank holding companies, or (ii) purchase or invest in any stocks, bonds, debentures, notes or similar obligations of any affiliate, except for affiliates which are subsidiaries of the savings institution. Section 106 of the Bank Holding Company Act which applies to the Bank, prohibits the Bank from extending credit to or offering any other services, or fixing or varying the consideration for such extension of credit or service, on the condition that the customer obtain some additional service from the institution or certain of its affiliates or not obtain services of a competitor of the institution, subject to certain exceptions.

LOANS TO DIRECTORS, EXECUTIVE OFFICERS AND PRINCIPAL STOCKHOLDERS. Depository institutions like the Bank are also subject to the restrictions contained in Section 22(h) and Section 22(g) of the Federal Reserve Act on loans to executive officers, directors and principal stockholders. Under Section 22(h), loans to a director, executive officer and to a greater than 10% stockholder of a depository institution and certain affiliated interests of such persons, may not exceed, together with all other outstanding loans to such person and affiliated interests, the institution's loans-to-one-borrower limit (generally equal to 15% of the institution's unimpaired capital and surplus plus an additional 10% of such capital and surplus for loans fully collateralized by certain readily marketable capital). Section 22(h) also prohibits the making of loans above amounts prescribed by the appropriate federal banking agency, to directors, executive officers and greater than 10% stockholders of an institution, and their respective affiliates, unless such loan is approved in advance by a majority of the board of directors of the institution with any "interested" director not participating in the voting. The Federal Reserve Board has prescribed the loan amount (which includes all other outstanding loans to such person) as to which such prior board of director approval is required as being the greater of $25,000 or 5% of capital and surplus (up to $500,000). Further, Section 22(h) requires that loans to directors, executive officers and principal stockholders be made on terms substantially the same as offered in comparable transactions to other persons. Section 22(h) also generally prohibits a depository institution from paying the overdrafts of any of its executive officers or directors.

Section 22(g) of the Federal Reserve Act requires that loans to executive officers of depository institutions not be made on terms more favorable than those afforded to other borrowers, requires approval for such extensions of credit by the board of directors of a the institution, and imposes reporting requirements for and additional restrictions on the type, amount and terms of credits to such officers. In addition, Section 106 of the Bank Holding Company Act prohibits extensions of credit to executive officers, directors, and greater than 10% stockholders of a depository institution by any other institution which has a correspondent banking relationship with the institution, unless such extension of credit is on substantially the same terms as those prevailing at the time for comparable transactions with other persons and does not involve more than the normal risk of repayment or present other unfavorable features.

PROMPT CORRECTIVE REGULATORY ACTION. Under the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"), the federal banking regulators are required to take prompt corrective action if an institution fails to satisfy certain minimum capital requirements. All institutions, regardless of their capital levels, are restricted from making any capital distribution or paying any management fees that would cause the institution to become undercapitalized. An institution that fails to meet the minimum level for any relevant capital measure (an "undercapitalized institution") generally is: (i) subject to increased monitoring by the appropriate federal banking regulator; (ii) required to submit an acceptable capital restoration plan within 45 days; (iii) subject to asset growth limits; and (iv) required to obtain prior regulatory approval for acquisitions, branching and new lines of businesses. The capital restoration plan must include a guarantee by the institution's holding company that the institution will comply with the plan until it has been adequately capitalized on average for four consecutive quarters, under which the holding company would be liable up to the lesser of 5% of the institution's total assets or the amount necessary to bring the institution into capital compliance as of the date it failed to comply with its capital restoration plan. A "significantly undercapitalized" institution, as well as any undercapitalized institution that does not submit an acceptable capital restoration plan, may be subject to regulatory demands for recapitalization, broader application of restrictions on transactions with affiliates, limitations on interest rates paid on savings deposits, asset growth and other activities, possible replacement of directors and officers, and restrictions on capital distributions by any bank holding company controlling the institution. Any company controlling the institution may also be required to divest the institution or the institution could be required to divest subsidiaries. The senior executive officers of a significantly undercapitalized institution may not receive bonuses or increases in compensation without prior approval and the institution is prohibited from making payments of principal or interest on its subordinated debt. In their discretion, the federal banking regulators may also impose the foregoing sanctions on an undercapitalized institution if the regulators determine that such actions are necessary to carry out the purposes of the prompt corrective action provisions. If an institution's ratio of tangible capital to total assets falls below the "critical capital level," the institution will be subject to conservatorship or receivership within specified time periods.

Under the regulations jointly adopted by the federal banking regulators, a savings institution's capital adequacy for purposes of the FDICIA prompt corrective action rules is determined on the basis of the institution's total risk-based capital ratio (the ratio of its total capital to risk-weighted assets), Tier 1 risk-based capital ratio (the ratio of its core capital to risk-weighted assets) and leverage ratio (the ratio of its Tier 1 or core capital to adjusted total assets).

The following table shows the capital ratio requirements for each prompt corrective action category:

	Well Capitalized	Adequately Capitalized	Undercapitalized	S Und
Total risk-based capital ratio	10.0% or more	8.0% or more	Less than 8.0%	Le
Tier 1 risk-based capital ratio	6.0% or more	4.0% or more	Less than 4.0%	Le

Leverage ratio	5.0% or more	4.0% or more*	Less than 4.0%*	Le

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* 3.0% if the institution has a composite 1 CAMELS rating.

A "critically undercapitalized" savings institution is defined as an institution that has a ratio of "tangible equity" to total assets of less than 2.0%. Tangible equity is defined as core capital plus cumulative perpetual preferred stock (and related surplus) less all intangibles other than qualifying supervisory goodwill and certain purchased mortgage servicing rights. The OTS may reclassify a well capitalized savings institution as adequately capitalized and may require an adequately capitalized or undercapitalized institution to comply with the supervisory actions applicable to institutions in the next lower capital category (but may not reclassify a significantly undercapitalized institution as critically-undercapitalized) if the OTS determines, after notice and an opportunity for

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a hearing, that the savings institution is in an unsafe or unsound condition or that the institution has received and not corrected a less-than-satisfactory rating for any CAMELS rating category. For information regarding the position of the Bank with respect to the FDICIA prompt corrective action rules, see Note 16 of Notes to Consolidated Financial Statements included under Item 8 hereof.

SAFETY AND SOUNDNESS GUIDELINES. Under FDICIA, as amended by the Riegle Community Development and Regulatory Improvement Act of 1994 (the "CDRI Act"), each federal banking agency is required to establish safety and soundness standards for institutions under its authority. On July 10, 1995, the federal banking agencies, including the OTS and Federal Reserve Board, released Interagency Guidelines Establishing Standards for Safety and Soundness and published a final rule establishing deadlines for submission and review of safety and soundness compliance plans. The final rule and the guidelines went into effect on August 9, 1995. The guidelines require depository institutions to maintain internal controls and information systems and internal audit systems that are appropriate for the size, nature and scope of the institution's business. The guidelines also establish certain basic standards for loan documentation, credit underwriting, interest rate risk exposure, and asset growth. The guidelines further provide that depository institutions should maintain safeguards to prevent the payment of compensation, fees and benefits that are excessive or that could lead to material financial loss, and should take into account factors such as comparable compensation practices at comparable institutions. If the appropriate federal banking agency determines that a depository institution is not in compliance with the safety and soundness guidelines, it may require the institution to submit an acceptable plan to achieve compliance with the guidelines. A depository institution must submit an acceptable compliance plan to its primary federal regulator within 30 days of receipt of a request for such a plan. Failure to submit or implement a compliance plan may subject the institution to regulatory sanctions. Management believes that the Bank already meets substantially all the standards adopted in the interagency guidelines, and therefore does not believe that implementation of these regulatory standards will materially affect the Bank's operations.

Additionally, the federal banking agencies, including the OTS and Federal Reserve Board, have issued guidelines relating to asset quality and earnings. Under the guidelines, an FDIC insured depository institution should maintain systems, commensurate with its size and the nature and scope of its operations, to identify problem assets and prevent deterioration in those assets as well as to evaluate and monitor earnings and ensure that earnings are sufficient to maintain adequate capital and reserves. Management believes that the asset quality and earnings standards will not have a material effect on the Bank's operations.

FINANCIAL MODERNIZATION LEGISLATION. On November 12, 1999, legislation was enacted which could have a far-reaching impact on the financial services industry. The Gramm-Leach-Bliley ("G-L-B") Act authorizes affiliations between banking, securities and insurance firms and authorizes bank holding companies and national banks to engage in a variety of new financial activities. Among the new activities that will be permitted to bank holding companies are securities and insurance brokerage, securities underwriting, insurance underwriting and merchant banking. The Federal Reserve Board, in consultation with the Secretary of the Treasury, may approve additional financial activities. The G-L-B Act, however, prohibits future acquisitions of existing unitary savings and loan holding companies, like the Company, by firms which are engaged in commercial activities and limits the permissible activities of unitary holding companies formed after May 4, 1999.

The G-L-B Act imposes new requirements on financial institutions with respect to customer privacy. The G-L-B Act generally prohibits disclosure of customer information to non-affiliated third parties unless the customer has been given the opportunity to object and has not objected to such disclosure. Financial institutions are further required to disclose their privacy policies to customers annually. Financial institutions, however, will be required to comply with state law if it is more protective of customer privacy than the G-L-B Act. The G-L-B Act directs the federal banking agencies, the National Credit Union Administration, the Secretary of the Treasury, the Securities and Exchange Commission and the Federal Trade Commission, after consultation with the National Association of Insurance Commissioners, to promulgate implementing regulations within six months of enactment. The privacy provisions became effective in July 2001.

The G-L-B Act contains significant revisions to the FHLB System. The G-L-B Act imposes new capital requirements on the FHLBs and authorizes them to issue two classes of stock with differing dividend rates and

redemption requirements. The G-L-B Act deletes the current requirement that the FHLBs annually contribute $300 million to pay interest on certain government obligations in favor of a 20% of net earnings formula. The G-L-B Act expands the permissible uses of FHLB advances by community financial institutions (under $500 million in assets) to include funding loans to small businesses, small farms and small agri-businesses. The G-L-B Act makes membership in the FHLB voluntary for federal savings associations.

The G-L-B Act contains a variety of other provisions including a prohibition against ATM surcharges unless the customer has first been provided notice of the imposition and amount of the fee. The G-L-B Act reduces the frequency of Community Reinvestment Act examinations for smaller institutions and imposes certain reporting requirements on depository institutions that make payments to non-governmental entities in connection with the Community Reinvestment Act. The G-L-B Act eliminates the SAIF special reserve and authorizes a federal savings association that converts to a national or state bank charter to continue to use the term "federal" in its name and to retain any interstate branches.

The Company is unable to predict the impact of the G-L-B Act on its operations at this time. Although the G-L-B Act reduces the range of companies with which may acquire control of the Company, it may facilitate affiliations with companies in the financial services industry.

PATRIOT ACT. The Patriot Act is intended to strengthen U.S. law enforcement's and the intelligence communities' abilities to work cohesively to combat terrorism on a variety of fronts. The potential impact of the Patriot Act on financial institutions of all kinds is significant and wide ranging. The Patriot Act contains sweeping anti-money laundering and financial transparency laws and imposes various regulations including standards for verifying client identification at account opening, and rules to promote cooperation among financial institutions, regulators and law enforcement entities in identifying parties that may be involved in terrorism or money laundering.

REGULATION OF BANCSHARES

GENERAL. Bancshares is a savings and loan holding company as defined by the Home Owners' Loan Act. As such, it is registered with the OTS and is subject to OTS regulation, examination, supervision and reporting requirements. As a subsidiary of a savings institution holding company, the Bank is subject to certain restrictions in its dealings with Bancshares and affiliates thereof. Bancshares also is required to file certain reports with, and otherwise comply with the rules and regulations of, the Securities and Exchange Commission ("SEC") under the federal securities laws.

ACTIVITIES RESTRICTIONS. The Board of Directors of Bancshares presently intends to continue operating as a unitary savings and loan holding company. There are generally no restrictions on the activities of a unitary savings and loan holding company. However, if the Director of the OTS determines that there is reasonable cause to believe that the continuation by a savings and loan holding company of an activity constitutes a serious risk to the financial safety, soundness or stability of its subsidiary savings institution, the Director of the OTS may impose such restrictions as deemed necessary to address such risk including limiting: (i) payment of dividends by the savings institution; (ii) transactions between the savings institution and its affiliates; and (iii) any activities of the savings institution that might create a serious risk that the liabilities of the holding company and its affiliates may be imposed on the savings institution. Notwithstanding the above rules as to permissible business activities of unitary savings institution holding companies, if the savings institution subsidiary of such a holding company fails to meet the QTL test, then such unitary holding company shall also presently become subject to the activities restrictions applicable to multiple holding companies and, unless the savings institution requalifies as a QTL within one year thereafter, register as, and become subject to, the restrictions applicable to a bank holding company. See "--Regulation of the Bank -- Qualified Thrift Lender Test."

If Bancshares were to acquire control of another savings institution, other than through merger or other business combination with the Bank, Bancshares would thereupon become a multiple savings and loan holding company. Except where such acquisition is pursuant to the authority to approve emergency thrift acquisitions and where each subsidiary savings institution meets the QTL test, the activities of Bancshares and any of its subsidiaries (other than the Bank or other subsidiary savings institutions) would thereafter be subject to further restrictions.

Among other things, no multiple savings and loan holding company or subsidiary thereof which is not an institution shall commence or continue for a limited period of time after becoming a multiple savings institution holding company or subsidiary thereof, any business activity, upon prior notice to, and no objection by, the OTS, other than: (i) furnishing or performing management services for a subsidiary savings institution; (ii) conducting an insurance agency or escrow business; (iii) holding, managing, or liquidating assets owned by or acquired from a subsidiary savings institution; (iv) holding or managing properties used or occupied by a subsidiary savings institution; (v) acting as trustee under deeds of trust; (vi) those activities authorized by regulation as of March 5, 1987, to be engaged in by multiple holding companies; or (vii) unless the Director of the OTS by regulation prohibits or limits such activities for savings and loan holding companies, those activities authorized by the Federal Reserve Board as permissible for bank holding companies. A multiple savings and loan holding company must obtain the approval of the OTS prior to engaging in the activities described in (vii) above.

RESTRICTIONS ON ACQUISITIONS. Savings and loan holding companies may not acquire, without prior approval of the Director of the OTS, (i) control of any other savings institution or savings and loan holding company or substantially all the assets thereof, or (ii) more than 5% of the voting shares of an institution or holding company thereof which is not a subsidiary. Under certain circumstances, a registered savings and loan holding company is permitted to acquire, with the approval of the Director of the OTS, up to 15% of the voting shares of an under-capitalized savings institution pursuant to a "qualified stock issuance" without that savings institution being deemed controlled by the holding company. In order for the shares acquired to constitute a "qualified stock issuance," the shares must consist of previously unissued stock or treasury shares, the shares must be acquired for cash, the savings and loan holding company's other subsidiaries must have tangible capital of at least 6 1/2% of total assets, there must not be more than one common director or officer between the savings and loan holding company and the issuing savings institution, and transactions between the savings institution and the savings and loan holding company and any of its affiliates must conform to Sections 23A and 23B of the Federal Reserve Act. Except with the prior approval of the Director of the OTS, no director or officer of an institution holding company or person owning or controlling by proxy or otherwise more than 25% of such company's stock, may also acquire control of any savings institution, other than a subsidiary savings institution, or of any other savings and loan holding company.

The Director of the OTS may only approve acquisitions resulting in the formation of a multiple savings and loan holding company which controls savings institutions in more than one state if: (i) the multiple savings and loan holding company involved controls an institution which operated a home or branch office in the state of the institution to be acquired as of March 5, 1987; (ii) the acquiror is authorized to acquire control of the savings institution pursuant to the emergency acquisition provisions of the FDIC Act; or (iii) the statutes of the state in which the institution to be acquired is located specifically permit institutions to be acquired by state-chartered institutions or savings and loan holding companies located in the state where the acquiring entity is located (or by a holding company that controls such state-chartered savings institutions).

OTS regulations permit federal savings institutions to branch in any state or states of the United States and its territories. Except in supervisory cases or when interstate branching is otherwise permitted by state law or other statutory provision, a federal institution may not establish an out-of-state branch unless (i) the federal institution qualifies as a QTL or as a "domestic building and loan association" under 7701(a)(19) of the Internal Revenue Code and the total assets attributable to all branches of the institution in the state would qualify such branches taken as a whole for treatment as a QTL or as a domestic building and loan association and (ii) such branch would not result in (a) formation of a prohibited multi-state multiple savings and loan holding company or (b) a violation of certain statutory restrictions on branching by savings institution subsidiaries of banking holding companies. Federal savings institutions generally may not establish new branches unless the institution meets or exceeds minimum regulatory capital requirements. The OTS will also consider the institution's record of compliance with the Community Reinvestment Act of 1977 in connection with any branch application.

FEDERAL SECURITIES LAW. Bancshares' Common Stock is registered with the SEC under the Securities Exchange Act of 1934, as amended ("Securities Exchange Act"). Bancshares is subject to the information, proxy solicitation, insider trading restrictions and other requirements of the Securities Exchange Act.

SARBANES-OXLEY ACT OF 2002. On July 30, 2002, the Sarbanes-Oxley Act of 2002 ("SOX") was signed into law which mandated a variety of reforms intended to address corporate and accounting fraud. SOX contains provisions which amend the Securities Exchange Act of 1934, as amended (the "Act") and provisions which directed the Securities and Exchange Commission (the "SEC") to promulgate rules. The Act provides for the establishment of a new Public Company Accounting Oversight Board ("PCAOB"), which will enforce auditing, quality control and independence standards for firms that audit public reporting companies and will be funded by fees from all public reporting companies. The Act imposes higher standards for auditor independence and restricts provision of consulting services by auditing firms to companies they audit. Any non-audit services being provided to an audit client will require preapproval by the Company's audit committee members. In addition, certain audit partners must be rotated periodically. The Act requires chief executive officers and chief financial officers, or their equivalent, to certify to the accuracy of periodic reports filed with the SEC, subject to civil and criminal penalties if they knowingly or willfully violate this certification requirement. In addition, under the Act, counsel will be required to report evidence of a material violation of the securities laws or a breach of fiduciary duty by a company to its chief executive officer or its chief legal officer, and, if such officer does not appropriately respond, to report such evidence to the audit committee or other similar committee of the board of directors or the board itself.

Longer prison terms will also be applied to corporate executives who violate federal securities laws, the period during which certain types of suits can be brought against a company or its officers has been extended, and bonuses issued to top executives prior to restatement of a company's financial statements are now subject to disgorgement if such restatement was due to corporate misconduct. Executives are also prohibited from trading during retirement plan "blackout" periods, and loans to company executives are restricted. In addition, a provision directs that civil penalties levied by the SEC as a result of any judicial or administrative action under the Act be deposited in a fund for the benefit of harmed investors. Directors and executive officers must also report most changes in their ownership of a company's securities within two business days of the change, and as of the end of June, 2003, all ownership reports must be electronically filed.

The Act also increases the oversight and authority of audit committees of publicly traded companies. Audit committee members must be independent and are barred from accepting consulting, advisory or other compensatory fees from the issuer. In addition, all SEC-reporting companies must disclose whether at least one member of the committee is an "audit committee financial expert" (as such term is defined by the SEC rules) and if not, why not. Audit committees of publicly traded companies will have authority to retain their own counsel and other advisors funded by the company. Audit committees must establish procedures for the receipt, retention and treatment of complaints regarding accounting and auditing matters and procedures for confidential, anonymous submission of employee concerns regarding questionable accounting or auditing matters. It is the responsibility of the audit committee to hire, oversee and resolve disagreements with the Company's independent auditor.

Beginning six months after the SEC determines that the PCAOB is able to carry out its functions, it will be unlawful for any person that is not a registered public accounting firm ("RPAF") to audit a public reporting company. Under the Act, a RPAF is prohibited from performing statutorily mandated audit services for a company if such company's chief executive officer, chief financial officer, comptroller, chief accounting officer or any person serving in equivalent positions has been employed by such firm and participated in the audit of such company during the one-year period preceding the audit initiation date. The Act also prohibits any officer or director of a company or any other person acting under their direction from taking any action to fraudulently influence, coerce, manipulate or mislead any independent public or certified accountant engaged in the audit of the Company's financial statements for the purpose of rendering the financial statement's materially misleading. The Act also requires the SEC to prescribe rules requiring inclusion of an internal control report and assessment by management in the annual report to shareholders. The Act requires the RPAF that issues the audit report to attest to and report on management's assessment of the Company's internal controls. In addition, the Act requires that each financial report required to be prepared in accordance with (or reconciled to) generally accepted accounting principles and filed with the SEC reflect all material correcting adjustments that are identified by a RPAF in accordance with generally accepted accounting principles and the rules and regulations of the SEC.

Although the Company anticipates it will incur additional expense in complying with the provisions of the Act and the related rules, management does not expect that such compliance will have a material impact on the Company's financial condition or results of operations.

FEDERAL INCOME TAXATION

Savings institutions such as the Bank are subject to the provisions of the Internal Revenue Code of 1986, as amended (the "Internal Revenue Code") in the same general manner as other corporations. Through tax years beginning before December 31, 1995, institutions such as the Bank which met certain definitional tests and other conditions prescribed by the Internal Revenue Code benefited from certain favorable provisions regarding their deductions from taxable income for annual additions to their bad debt reserve. For purposes of the bad debt reserve deduction, loans are separated into "qualifying real property loans," which generally are loans collateralized by interests in certain real property, and "nonqualifying loans," which are all other loans. The bad debt reserve deduction with respect to nonqualifying loans must be based on actual loss experience. The amount of the bad debt reserve deduction with respect to qualifying real property loans was based upon actual loss experience (the "experience method") or a percentage of taxable income determined without regard to such deduction (the "percentage of taxable income method"). Under the experience method, the bad debt deduction for an addition to the reserve for qualifying real property loans was an amount determined under a formula based generally on the bad debts actually sustained by a savings institution over a period of years. Under the percentage of taxable income method, the bad debt reserve deduction for qualifying real property loans was computed as 8% of a savings institution's taxable income, with certain adjustments. The Bank generally elected to use the method which has resulted in the greatest deductions for federal income tax purposes in any given year.

Legislation that is effective for tax years beginning after December 31, 1995, requires institutions to recapture into taxable income over a six taxable year period the portion of the tax loan reserve that exceeds the pre-1988 tax loan loss reserve. The Bank will no longer be allowed to use the reserve method for tax loan loss provisions, but would be allowed to use the experience method of accounting for bad debts. There will be no future effect on net income from the recapture because the taxes on these bad debt reserves have already been accrued as a deferred tax liability. The regulatory authorities have not examined the Bank's federal income tax returns in the past five years.

For taxable years beginning after June 30, 1986, the Internal Revenue Code imposes an alternative minimum tax at a rate of 20%. The alternative minimum tax generally applies to a base of regular taxable income plus certain tax preferences ("alternative minimum taxable income" or "AMTI") and is payable to the extent such AMTI exceeds an exemption amount. The other items of tax preference that constitute AMTI include (a) tax-exempt interest on newly-issued (generally, issued on or after August 8, 1986) private activity bonds other than certain qualified bonds and (b) for taxable years including 1987 through 1989, 50% of the excess of (i) the taxpayer's pre-tax adjusted net book income over (ii) AMTI (determined without regard to this latter preference and prior to reduction by net operating losses). For taxable years beginning after 1989, this latter preference has been replaced by 75% of the excess (if any) of (i) adjusted current earnings as defined in the Internal Revenue Code, over (ii) AMTI (determined without regard to this preference and prior to reduction by net operating losses). For any taxable year beginning after 1986, net operating losses can offset no more than 90% of AMTI. Certain payments of alternative minimum taxes may be used as credits against regular tax liabilities in future years.

STATE INCOME TAXATION

The Bank is subject to Arkansas corporation income tax which is approximately 6.5% of taxable earnings. Bancshares is incorporated under Oklahoma law and qualified to do business in Arkansas as a foreign corporation, and accordingly it incurs certain franchise and other taxes, which management believes are not material.

EMPLOYEES

As of June 30, 2003, the Bank had 79 full-time equivalent employees, none of whom was represented by a collective bargaining agreement. Management considers the Bank's relationships with its employees to be good.

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ITEM 2. PROPERTIES

The following table sets forth information regarding the Bank's offices at June 30, 2003.

	YEAR OPENED	OWNED OR LEASED	BOOK VALUE	APPROXIMATE SQUARE FOOTAGE
Main Office:				
237 Jackson Street, SW Camden, Arkansas	1933	Owned	$ 211,361	12,000

Branch Offices:				
4937 Highway 5 North Bryant, Arkansas	2000	Owned	$ 1,669,404	6,500
1125 Fairview Road, SW Suite 208 Camden, Arkansas	1981	Owned	$ 123,426	1,200
610 West 4th Street Fordyce, Arkansas	1969	Owned	$ 730,419	3,500
108 South Main Sheridan, Arkansas	1996	Owned	$ 1,000,375	5,500
103 Greenfield Drive Monticello, Arkansas	2002	Leased	$ --	900

In addition to the offices described above, at June 30, 2003, the Bank held four other properties located in various communities within the Bank's primary market area. These properties were acquired for possible future construction of additional offices and related facilities. At June 30, 2003, the aggregate net book value of these properties totaled $653,000 of which none was classified as held for resale.

The book value of the Bank's aggregate investment in properties, premises and equipment totaled approximately $5.1 million at June 30, 2003. See Note 7 of the Notes to Consolidated Financial Statements in the Annual Report to Stockholders for June 30, 2003.

ITEM 3. LEGAL PROCEEDINGS

From time to time, the Bank is a party to various legal proceedings incident to its business. At June 30, 2003, except as set forth below, there were no legal proceedings to which the Company was a party, or to which any of its property was subject, which were expected by management to result in a material loss to the Company or Bank. In addition, there were no pending regulatory proceedings to which the Company or the Bank or any of its properties was a party, which were expected to result in a material loss.

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

There were no matters submitted to a vote of the security holders during the fourth quarter of the fiscal year ended June 30, 2003.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The information contained under the section "Market for Common Stock and Related Stockholder Matters" in the Annual Report is incorporated herein by reference.

ITEM 6. SELECTED FINANCIAL DATA

The information contained in the table captioned "Selected Consolidated Financial and Other Data" in the Annual Report is incorporated herein by reference.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The information contained in the section captioned "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Annual Report is incorporated herein by reference.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

The information contained in the section captioned "Market Risk" in the Annual Report is incorporated herein by reference.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The financial statements contained in the Annual Report, which are listed under Item 14 herein, are incorporated herein by reference.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

The information required by this item was previously disclosed in the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission (the "Commission") on November 9, 2001 (the "Form 8-K") and the Company's Amendment No. 1 to the Form 8-K filed with the Commission on November 13, 2001.

ITEM 9A. CONTROLS AND PROCEDURES

As of the end of the period covered by this report, management of the Company carried out an evaluation, under the supervision and with the participation of the Company's principal executive officer and principal financial officer, of the effectiveness of the Company's disclosure controls and procedures. Based on this evaluation, the Company's principal executive officer and principal financial officer concluded that the Company's disclosure controls and procedures are effective in ensuring that information required to be disclosed by the Company in reports that it files or submits under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms.

In addition, there have been no changes in the Company's internal control over financial reporting (to the extent that elements of internal control over financial reporting are subsumed within disclosure controls and procedures) identified in connection with the evaluation described in the above paragraph that occurred during the Company's last fiscal quarter, that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

For information concerning the Board of Directors and executive officers of the Company, the information contained under the section captioned "Proposal I - Election of Directors" in the Company's definitive proxy statement for the Company's 2003 Annual Meeting of Stockholders (the "Proxy Statement") which will be filed within 120 days of the Company's fiscal year end and is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

The information contained under the sections captioned "Director Compensation" and "Executive Compensation" in the Proxy Statement is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

(a) SECURITIES AUTHORIZED FOR ISSUANCE UNDER EQUITY COMPENSATION PLANS

Information required by this item is incorporated herein by reference to the sections captioned "Proposal I - Election of Directors -- Executive Compensation -- Securities Authorized for Issuance Under Equity Compensation Plans" in the Proxy Statement.

(b) SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS

Information required by this item is incorporated herein by reference to the section captioned "Voting Securities and Beneficial Ownership" in the Proxy Statement.

(c) CHANGES IN CONTROL

Management of the Company knows of no arrangements, including any pledge by any person of securities of the Company, the operation of which may at a subsequent date result in a change in control of the registrant.

(d) EQUITY COMPENSATION PLANS

The following table sets forth certain information with respect to the Company's equity compensation plans:

PLAN CATEGORY	(a) NUMBER OF SECURITIES TO BE ISSUED UPON EXERCISE OF OUTSTANDING OPTIONS, WARRANTS AND RIGHTS	(b) WEIGHTED-AVERAGE EXERCISE PRICE OF OUTSTANDING OPTIONS, WARRANTS AND RIGHTS	(NUMBER OF SECUR AVAILABLE FOR UNDER EQUITY PLANS (EXCL REFLECTED
Equity compensation			

plans approved by security holders	168,387	$10.47
Equity compensation plans not approved by security holders	--	--
Total	168,387	$10.47

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by this item is incorporated herein by reference to the section captioned "Transactions with Management" in the Proxy Statement.

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(a) LIST OF DOCUMENTS FILED AS PART OF THIS REPORT

(1) Financial Statements. The following consolidated financial statements are incorporated by reference from Item 8 hereof:

Independent Auditors' Reports

Consolidated Statements of Financial Condition as of June 30, 2003 and 2002

Consolidated Statements of Income and Comprehensive Income for the years ended June 30, 2003, 2002 and 2001

Consolidated Statements of Stockholders' Equity for the years ended June 30, 2003, 2002 and 2001

Consolidated Statements of Cash Flows for the years ended June 30, 2003, 2002 and 2001

Notes to Consolidated Financial Statements for the years ended June 30, 2003, 2002 and 2001

(2) Financial Statement Schedules. All schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission are omitted because of the absence of conditions under which they are required or because the required information is included in the Consolidated Financial Statements and related Notes thereto.

(3) Exhibits. The following is a list of exhibits filed as part of this Annual Report on Form 10-K and is also the Exhibit Index.

NO.	DESCRIPTION
3.1	Articles of Incorporation of HCB Bancshares, Inc. *

3.2	Bylaws of HCB Bancshares, Inc. ****
4	Form of Common Stock Certificate of HCB Bancshares, Inc. *
10.1	Form of HCB Bancshares, Inc. 1997 Stock Option and Incentive Plan *=
10.2	Form of HCB Bancshares, Inc. Management Recognition Plan and Trust Agreement *=
10.3(a)	Employment Agreements by and between Heartland Community Bank and Vida H. Lampkin and Cameron D. McKeel *=
10.3(b)	Employment Agreements by and between HCB Bancshares, Inc. and Vida H. Lampkin and Cameron D. McKeel **=
10.4	Intentionally omitted.

10.5	Heartland Community Bank Directors' Retirement Plan, as amended*=
10.6(a)	Change-in-Control Protective Agreement between Heartland Community Bank and Scott A. Swain *****=
10.6(b)	Change-in-Control Protective Agreement between HCB Bancshares, Inc. and Scott A. Swain *****=
10.7(a)	Employment Agreement by and between Heartland Community Bank and Charles Black ******=
10.7(b)	Employment Agreement by and between HCB Bancshares, Inc. and Charles Black ******=
10.8	Standstill Agreement dated August 29, 2001, by and among HCB Bancshares, Inc. and Stilwell Value Partners IV, L.P., Stilwell Associates, L.P., Stilwell Value LLC and Joseph Stilwell***
10.9	Change-in-Control Protective Agreement between Heartland Community Bank, HCB Bancshares, Inc. and Paula J. Bergstrom=
10.10	Change-in-Control Protective Agreement between Heartland Community Bank, HCB Bancshares, Inc. and Henry A. Pryor=
13	Annual Report to Stockholders for the fiscal year ended June 30, 2003
21	Subsidiaries
23.1	Consent of BKD, LLP
23.2	Consent of Deloitte & Touche LLP
31.1	Rule 13a-14(a) Certification of Chief Executive Officer
31.2	Rule 13a-14(a) Certification of Chief Financial Officer

32	18 USC Section 1350 Certification

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*	Incorporated by reference to the Company's Registration Statement on Form SB-2 (File No. 333-19093).
**	Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended June 30, 2000 (File No. 0-22423)
***	Incorporated by reference to the Company's Current Report on Form 8-K filed on September 5, 2001 (File No. 0-22423).
****	Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2001 (File No. 0-22423)
*****	Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2001 (File No. 0-22423)
******	Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended June 30, 2002 (File No. 0-22423)
=	Management contract or compensatory plan or arrangement.

(b) REPORTS ON FORM 8-K. The Company filed the following Current Reports on Form 8-K during the fourth quarter of the fiscal year ended June 30, 2003:

DATE OF REPORT	ITEM(S) REPORTED	FINANCIAL STATEMENTS FILED
April 22, 2003	7,12	N/A
May 22, 2003	5,7	N/A

(c) EXHIBITS. The exhibits required by Item 601 of Regulation S-K are either filed as part of this Annual Report on Form 10-K or incorporated by reference herein.

(d) FINANCIAL STATEMENTS AND SCHEDULES EXCLUDED FROM ANNUAL REPORT. There are no other financial statements and financial statement schedules which were excluded from the Annual Report to Stockholders pursuant to Rule 14a-3(b) which are required to be included herein.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

HCB BANCSHARES, INC.

Date: September 25, 2003

By: /s/ Charles T. Black

Charles T. Black
President and Chief Executive Officer
(Duly Authorized Representative)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant in the capacities and on the dates indicated.

By: /s/ Charles T. Black   September 25, 2003

Charles T. Black
Director, President and Chief Executive Officer
(Principal Executive Officer)

By: /s/ Scott A. Swain   September 25, 2003

Scott A. Swain
Senior Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)

By: /s/ Vida H. Lampkin   September 25, 2003

Vida H. Lampkin
Chairman of the Board

By: /s/ John G. Rich   September 25, 2003

John G. Rich
Director

By: /s/ Bruce D. Murry   September 25, 2003

Bruce D. Murry
Director

By: /s/ Carl E. Parker, Jr.   September 25, 2003

Carl E. Parker, Jr.
Director

By: /s/ F. Michael Akin   September 25, 2003

F. Michael Akin
Director

By:

Clifford Steelman
Director