GUARANTY BANCSHARES INC /TX/
Form 10-K
March 17, 2004

FINANCIAL INFORMATION
2003 Annual Report on Form 10-K

Part I

Part II

Part III

Part IV

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2003
OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to
Commission File Number 0-23113

GUARANTY BANCSHARES, INC.

(Exact name of registrant as specified in its charter)

Texas (State or other jurisdiction of incorporation or organization)	**75-1656431** (I.R.S.Employer Identification Number)
100 West Arkansas **Mount Pleasant, Texas** (Address of principal executive offices)	**75455** (Zip Code)

Registrant s telephone number, including area code:
(903) 572-9881

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

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

Common Stock, par value
$1.00 per share

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

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

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. o

As of February 17, 2004, the number of outstanding shares of Common Stock was 2,921,928. As of June 30, 2003, the last business day of the registrant s most recently completed second fiscal quarter, the aggregate market value of the shares of Common Stock held by non-affiliates, based on the closing price of the Common Stock on the Nasdaq National Market System on such date, was approximately $24.6

million.

Documents Incorporated by Reference:

Portions of the Company s Proxy Statement relating to the 2004 Annual Meeting of Shareholders, which will be filed within 120 days after December 31, 2003, are incorporated by reference into Part III, Items 10-14 of this Form 10-K.

PART I

SPECIAL CAUTIONARY NOTICE REGARDING FORWARD-LOOKING INFORMATION

Statements and financial discussion and analysis contained in this Annual Report on Form 10-K that are not historical facts are forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements describe the Company s future plans, strategies and expectations, are based on assumptions and involve a number of risks and uncertainties, many of which are beyond the Company s control. The important factors that could cause actual results to differ materially from the forward-looking statements include, without limitation:

changes in interest rates and market prices, which could reduce the Company s net interest margins, asset valuations and expense expectations;

changes in the levels of loan prepayments and the resulting effects on the value of the Company s loan portfolio;

changes in local economic and business conditions which adversely affect the Company s customers and their ability to transact profitable business with the Company, including the ability of its borrowers to repay their loans according to their terms or a change in the value of the related collateral;

increased competition for deposits and loans adversely affecting rates and terms;

the timing, impact and other uncertainties of the Company s potential future acquisitions, including the Company s ability to identify suitable future acquisition candidates, the success or failure in the integration of their operations, and the Company s ability to enter new markets successfully and capitalize on growth opportunities;

increased credit risk in the Company s assets and increased operating risk caused by a material change in commercial, consumer and/or real estate loans as a percentage of the total loan portfolio;

the failure of assumptions underlying the establishment of and provisions made to the allowance for loan losses;

changes in the availability of funds resulting in increased costs or reduced liquidity;

changes in the Company s ability to pay dividends on its Common Stock;

increased asset levels and changes in the composition of assets and the resulting impact on the Company s capital levels and regulatory capital ratios;

the Company s ability to acquire, operate and maintain cost effective and efficient systems without incurring unexpectedly difficult or expensive but necessary technological changes;

the loss of senior management or operating personnel and the potential inability to hire qualified personnel at reasonable compensation levels;

the effects of the Internal Revenue Service s examination regarding the Company s leveraged leasing transactions;

changes in economic and business conditions which would adversely affect the value of the Aircraft Finance Trust (AFT), and cause the Company to not fully realize its current investment in AFT; and,

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changes in status of government regulations or their interpretations applicable to bank holding companies and the Company s present and future banking and other subsidiaries, including changes in tax requirements and tax rates.

All written or oral forward-looking statements attributable to the Company are expressly qualified in their entirety by these cautionary statements.

Item 1. ***Business***

General

Guaranty Bancshares, Inc. (the Company) was incorporated as a business corporation under the laws of the State of Texas in 1980 to serve as a holding company for Guaranty Bond Bank, formally known as Guaranty Bank, (the Bank), which was chartered in 1913, and for Talco State Bank, which was chartered in 1912 and merged into the Bank in 1997. The Company s headquarters are located at 100 West Arkansas, Mount Pleasant, Texas 75455, and its telephone number is (903) 572-9881.

The Company has grown through a combination of internal growth, the acquisition of community banks and the opening of new community banking offices. In 1992, the Company established its Deport, Texas location by acquiring certain assets and liabilities of the First National Bank of Deport (the Deport Bank). The Deport Bank also had a branch in Paris, Texas, which the Company acquired. To enhance its expansion into the Paris community, in 1994 the Company constructed a new facility to serve as its Paris location. In 2001, the Paris facility was expanded from approximately 5,400 square feet to approximately 9,700 square feet, again to service the expanded customer base. In 1993, the Company purchased a commercial bank in Bogata, Texas and in 1996 opened a second retail-service banking facility in Mount Pleasant. In 1997, the Company merged Talco State Bank into the Bank and opened a full-service location in Texarkana. Texarkana is the center of a trade area encompassing approximately 130,000 people. Management of the Company continues to believe that this trade area provides opportunity for strong growth in loans and deposits. Texas Highway 59 (scheduled to become Interstate 69), which serves as the primary NAFTA Highway linking the interior United States and Mexico, is a main artery to Texarkana. The increased traffic along this NAFTA Highway is expected to enhance economic activity in this area and create more opportunities for growth. In 1998, the Company completed a new facility in Texarkana to enhance its expansion in the Texarkana market. In 1999, the Company opened a full-service location in Pittsburg, Texas, a community of approximately 4,500 people located 12 miles from Mount Pleasant. Also in 1999, the Company acquired the First American Financial Corporation, (First American), with locations in Sulphur Springs and Commerce, Texas. The Company also acquired First American s wholly owned mortgage company. In 2000, the operations of the mortgage subsidiary, which were being continued by the Company under the name Guaranty Mortgage Company, were merged into the Bank. Also in August 2000, the Company was granted approval by the Texas Department of Banking to open a loan production office in Fort Stockton, Texas, located in the western portion of Texas, which became a full-service bank in December of 2000. As of December 31, 2003, product offerings at the Fort Stockton location are limited to loans and time deposits.

The Company has developed a community-banking network, with most of its offices located in separate communities. Lending and investment activities are funded from a strong core deposit base consisting of approximately 40,000 deposit accounts as of December 31, 2003. Each of the Company s offices has the authority and flexibility to make pricing decisions within overall ranges developed by the Company as a form of quality control. Management of the Company believes that its responsiveness to local customers and ability to adjust deposit rates and price loans at each location gives it a distinct competitive advantage. Employees are committed to personal service and developing long-term customer relationships, and adequate staffing is provided at each location to ensure that customers needs are well addressed. The Company provides economic incentives to its officers to develop additional business for the Company and to cross-sell additional products and services to existing customers.

The Company continues to look for additional expansion opportunities, either through acquisitions of existing financial institutions or by establishing de novo offices. The Company intends to consider various strategic acquisitions of banks, banking assets or financial service entities related to banking in those areas that management

believes would complement and help grow the Company s existing business. The Company is particularly optimistic about the growth potential in the Texarkana, Sulphur Springs, Paris, and Mount Pleasant market areas.

The national, regional and local economies have experienced a slight deterioration, but have shown signs of improvement, though at a slow pace. While this deterioration has had a negative affect on the Bank s earnings and growth, management believes the Bank is well positioned to weather this event and get back into its growth pattern in 2004.

The Bank owns interests in five entities which complement the Company s business, the first three of which are wholly-owned: (i) Guaranty Leasing Company (Guaranty Leasing), which finances equipment leases and has engaged in certain leveraged lease transactions; (ii) Guaranty Company, which owns real estate for future Bank expansion; (iii) GB Com, Inc., a nominee company; (iv) BSC Securities, L.C. (BSC), which provides brokerage services; and, (v) Independent Bank Services, L.C. (IBS), which performs compliance, loan review, internal audit and EDP audit functions. These entities are accounted for in the Bank s financial statements using the equity method of accounting and are included in other assets on the balance sheet.

Business

The Company s guiding strategy is to increase shareholder value by providing customers with individualized, responsive, quality service and to augment its existing market share. The Company s main objective is to increase loans and deposits through additional expansion opportunities in Texas, while stressing efficiency and maximizing profitability. In furtherance of this objective, the Company has employed the following operating strategies:

Focus On Community Banking. The Company has developed a reputation of being a premier provider of financial services to small and medium-sized businesses, professionals and individuals in Northeast Texas. Management believes the Company s reputation for providing personal, professional and dependable service is well established in communities located in this area. Each of the Company s full-service branch locations is administered by a local President with knowledge of the community and lending expertise in the specific industries found in the community, whether it is agriculture, manufacturing and commerce or professional services. Decisions regarding loans are made at each location in a timely manner.

Controlled Core Growth. Prior to 2003, the Company had increased its market share in each of the communities in which it maintains a full-service banking center. In 2003, the Company experienced a decrease in time deposits due to accounts seeking alternative reinvestments caused by the historic low interest rate environment. Other types of accounts such as checking, money market and savings, experienced growth in volume and dollars. In its principal location of Mount Pleasant, the Company s market share of financial institution deposits, based on the FDIC Deposit Market Share data as of June 30, 2003, was approximately 42.5%, the largest single financial institution in that market. This same report showed gains in market share with total market share for the Commerce location at 4.95%, Pittsburg at 10.82%, Sulphur Springs at 15.43%, Paris at 11.91%, and Bogata at 12.31%. The Company is well known in its geographic area as a result of its longevity and reputation for service. The Company intends to continue to grow by seeking strategic acquisitions and branching opportunities as well as servicing its existing customer base.

Leadership Technology. The Company has embraced technological change as a way to remain competitive, manage operational costs associated with growth and offer superior products to its customers. Recent technological implements include mailroom automation, Voice-Over-IP telephony, and Internet Banking enhancements. This adds to our existing electronic bill and note payment, note and document imaging, electronic report management, remote proof capture, electronic statement delivery, and an automated voice response system. Currently, the Company is evaluating several additional enhancements that will improve its ability to deliver information internally to improve productivity and externally to provide convenience and timeliness to its growing customer base. Such enhancements include consolidation of various accounting systems the Bank uses, implementation of a new Check 21 compatible teller system and electronic check/image presentment. The Company has made significant investments in technology, and has become a technological leader in its market.

Offer Competitive Products. The Company recognizes its competition is not solely banks, but brokerage houses, insurance companies, credit unions and various other competitors, and that in order to thrive it must be

competitive in the products that it offers. The Company offers a full range of commercial loan products, including term loans, lines of credit, fixed asset loans, real estate loans and working capital loans. The Company also offers consumers a full range of personal loan products including automobile loans, home improvement loans, consumer loans and mortgage loans. The Company also has a wide variety of deposit products, including a Premier Money Market Account that pays a rate competitive with most brokerage investment accounts. This product, coupled with certificates of deposit, NOW accounts, savings accounts, Internet banking, free checking, debit cards and overdraft protection, gives the customer a full complement of deposit products at competitive rates.

Expand Revenue Sources. In order to provide service to its customers and to augment revenues, the Company offers brokerage services through BSC, a full-service brokerage company. BSC offers a complete array of investment options including stocks, bonds, mutual funds, financial and retirement planning, tax advantaged investments and asset allocations. BSC offers securities through Southwest Securities, a Texas-based independent clearing firm and is licensed and regulated through the National Association of Securities Dealers, the Securities and Exchange Commission and various state and federal banking authorities. The Company s Trust Department offers complete trust services, including estate administration and custody, trust and asset management services. Management believes that an aging affluent population will foster an increase in the need for professional estate administration services. The maturing of the baby boomer generation is creating a market for asset management services. The Trust Department is in a unique position since there is little competition for trust services in the Company s markets. Because of the Company s strong presence in its markets, management believes that banking relationships can be leveraged into growth for the Trust Department. In 2003, Trust Department assets under management increased $20.3 million, or 71%. Growth in trust assets and corresponding management fees will result from expanding estate administration, traditional trust services, asset management services and custodial services in the Company s markets.

Improve Operating Efficiencies. In order to control overhead expenses, the Company seeks to provide a full range of services as effectively as possible. Through BSC, the Company is able to provide its customers with full brokerage services without having to carry the entire cost itself due to a shared cost agreement with other banks. Similarly, the Company enjoys the compliance and loan review functions provided by IBS on a shared cost basis with a group of other banks participating in this arrangement. The Company has spent the last ten years and considerable revenue expanding its market and improving the delivery of its financial products, which has resulted in a higher than desired efficiency ratio. Beginning with the acquisition of the Deport Bank in 1992, the Company has added ten locations. As a result, it has taken longer for the Company to achieve the desired economies of scale, but with its growth rate, those economies are beginning to be realized and the efficiency ratio is expected to show improving trends in the future. The Company has the support staff and related fixed asset investments to accommodate additional growth and enjoy additional economies of scale.

Training. An effective training program is critical to the Company s success. The rapid growth experienced by the Company, changes in technology, changes in bank regulations, and staff development all contribute to the need for a strong training program. To this end, the Human Resource Manager has developed a formalized training program that focuses on technology, compliance, and operations. In addition, more programs are scheduled to come online in 2004 that target the heart of the Company s business sales and service.

Competition

The banking business is highly competitive, and the profitability of the Company depends principally on the Company s ability to compete in the market areas in which its banking operations are located. The Company competes with other commercial banks, savings banks, savings and loan associations, credit unions, finance companies, mutual funds, insurance companies, brokerage and investment banking firms, asset-based non-bank lenders and certain other non-financial entities, including retail stores which may maintain their own credit programs and certain governmental organizations which may offer more favorable financing than the Company. The Company has been able to compete effectively with other financial institutions by emphasizing customer service, technology and local office decision-making, by establishing long-term customer relationships and building customer loyalty, and by providing products and services designed to address the specific needs of its customers. Competition from both financial and non-financial institutions is expected to continue.

Under the Gramm-Leach-Bliley Act, effective March 11, 2000, securities firms and insurance companies that elect to become financial holding companies may acquire banks and other financial institutions. **See -**

Supervision and Regulation The Company . The financial services industry is also likely to become even more competitive as further technological advances enable more companies to provide financial services. These technological advances may diminish the importance of depository institutions and other financial intermediaries in the transfer of funds between parties.

Leveraged Lease Transactions

In a series of transactions in 1992, 1994 and 1995, Guaranty Leasing acquired limited partnership interests in three different partnerships (collectively, the Partnerships or individually, a Partnership) engaged in the equipment leasing business. The investments were structured by TransCapital Corporation (TransCapital) through various subsidiaries and controlled partnerships.

Generally, in each of the transactions the Partnership became the lessee of equipment from an equipment owner (pursuant to a sale and leaseback transaction) and the sublessor of the equipment to the equipment user. Each Partnership receives note payments from the equipment owner under a purchase money note given to purchase the equipment from that Partnership. The Partnership makes lease payments to the equipment owner pursuant to the master lease of the equipment. In most instances, payments under the purchase money note equals lease payments under the master lease. Rental payments from the equipment used under these equipment subleases were sold in advance subject to existing liens for purchase of the equipment.

The Partnership incurs a tax loss while the master lease/sublease structure is in place, primarily because deductions for rentals paid under the master lease exceed taxable interest income under the purchase money note. Consequently, Guaranty Leasing has reported tax losses as a result of its investments in the Partnerships, which were deductible by the Company. In November 1998, Guaranty Leasing was informed by the Internal Revenue Service (the Service) that it has taken the position that certain losses taken by one of the three Partnerships during 1994, 1995 and 1996 of $302,000, $410,000 and $447,000, respectively, would be disallowed. In October 2001, Guaranty Leasing was informed by the Service that it has taken the position that certain losses taken by that Partnership during 1997 of $487,000 would also be disallowed. In September 2002, the Company received from the Service a Notice of Final Partnership Administrative Adjustment disallowing these deductions. Based upon the advice of counsel, the Company believes that it has correctly reported these transactions for tax purposes and that it has obtained appropriate legal, accounting and appraisal opinions and authority to support its positions. The Company recorded and expensed the tax affect of the disallowed deductions in 2002. On February 3, 2003, the Company filed a petition to begin the process to litigate the matter in the United States District Court for the Eastern District of Texas the (Texas Court). On August 5, 2003, the Texas Court issued a Docket Control Order establishing a court timeline and a final Pretrial Conference for April 5, 2004. On October 17, 2003, the Government filed a Motion to Transfer Venue from the Texas Court to the United States District Court for the Eastern District for Virginia, (the Virginia Court). On November 25, 2003, the Government filed a Motion to Stay Proceedings. On December 18, 2003, the Texas Court issued an Order to Stay Proceedings pending the Court s ruling on the Government s Motion to Transfer Venue. Any final determination with respect to the Partnership will be binding on the Company. In addition to the ongoing litigation regarding the Partnership, the Service is currently in the process of examining the tax deductions taken for the other two Partnerships. No determination has been made regarding the disallowance of similar deductions for these other two Partnerships. Should the Service ultimately disallow the related tax deductions taken during the remaining years of the above partnership as well as the other two Partnerships, the Company will be required to recognize an additional maximum tax liability of approximately $3.9 million plus possible penalty and interest. The Company is actively contesting the position of the Service in connection with this matter, and will take appropriate steps necessary to protect its legal position.

During the year ended December 31, 2000, Guaranty Leasing acquired for approximately $2.8 million, a 2.5% ownership interest in an Aircraft Finance Trust (AFT), a special purpose business trust formed to acquire, finance, refinance, own, lease, sublease, sell and maintain aircraft. AFT was created by General Electric Capital Corporation, and is a financing transaction through which airlines lease aircraft. AFT is a business trust formed in 1999 under the laws of the state of Delaware, and it leases aircraft to airlines around the world. The senior notes issued to AFT are rated AA by Standard and Poors and the notes are secured by the cash flow from the aircraft leases. The notes mature in 2024.

During the fourth quarter of 2001, on belief that the Company s investment in AFT was impaired by declines in air travel and reduced demand for commercial aircraft, an impairment charge of $1.5 million was recorded and the carrying amount of the investment was reduced to $1.6 million. During the third quarter of 2001, AFT recorded an impairment charge of $18.2 million related to two airplanes. In addition, management received indications the appraised value of AFT s fleet of airplanes had declined approximately 9% from their value during 2003. Based on these factors, the limited marketability of the investment, the uncertainty surrounding the air transport industry and general economic conditions, management believed that the value of its investment in AFT was permanently impaired and in 2003 recorded an impairment charge of $113,000.

Employees

As of December 31, 2003, the Company had 211 full-time employees and 30 part-time employees, 86 of whom were officers of the Bank. All employees are non-union employees. The Company provides medical and hospitalization insurance to its full-time employees. The Company considers its relations with employees to be excellent.

Supervision and Regulation

The supervision and regulation of bank holding companies and their subsidiaries is intended primarily for the protection of depositors, the deposit insurance funds of the Federal Deposit Insurance Corporation (FDIC) and the banking system as a whole, and not for the protection of the bank holding company shareholders or creditors. The banking agencies have broad enforcement power over bank holding companies and banks including the power to impose substantial fines and other penalties for violations of laws and regulations.

The following description summarizes some of the laws to which the Company and the Bank are subject. References herein to applicable statutes and regulations are brief summaries thereof, do not purport to be complete, and are qualified in their entirety by reference to such statutes and regulations.

The Company. The Company is a bank holding company registered under the Bank Holding Company Act of 1956, as amended (the BHC Act), and it is subject to supervision, regulation and examination by the Board of Governors of the Federal Reserve System (Federal Reserve). The BHC Act and other federal laws subject bank holding companies to particular restrictions on the types of activities in which they may engage, and to a range of supervisory requirements and activities, including regulatory enforcement actions for violations of laws and regulations.

Regulatory Restrictions on Dividends; Source of Strength. It is the policy of the Federal Reserve that bank holding companies should pay cash dividends on common stock only out of income available over the past year and only if prospective earnings retention is consistent with the organization s expected future needs and financial condition. The policy provides that bank holding companies should not maintain a level of cash dividends that undermines the bank holding company s ability to serve as a source of strength to its banking subsidiaries.

Under Federal Reserve policy, a bank holding company is expected to act as a source of financial strength to each of its banking subsidiaries and commit resources to their support. Such support may be required at times when, absent this Federal Reserve policy, a holding company may not be inclined to provide it. As discussed below, a bank holding company in certain circumstances could be required to guarantee the capital plan of an undercapitalized banking subsidiary.

In the event of a bank holding company s bankruptcy under Chapter 11 of the U.S. Bankruptcy Code, the trustee will be deemed to have assumed and is required to cure immediately any deficit under any commitment by the debtor holding company to any of the federal banking agencies to maintain the capital of an insured depository institution, and any claim for breach of such obligation will generally have priority over most other unsecured claims.

Financial Modernization. On October 26, 2001, President Bush signed the USA Patriot Act of 2001. Enacted in response to the terrorist attacks in New York, Pennsylvania and Washington, D.C. on September 11, 2001, the Patriot Act is intended to strengthen U.S. law enforcement s and the intelligence communities ability to

work cohesively to combat terrorism on a variety of fronts. The potential impact of the Act on financial institutions of all kinds is significant and wide ranging. The Act contains sweeping anti-money laundering and financial transparency laws and requires various regulations, including:

- due diligence requirements for financial institutions that administer, maintain or manage private bank accounts or correspondent accounts for non-U.S. persons;
- standards for verifying customer identification at account opening;
- rules to promote cooperation among financial institutions, regulators, and law enforcement entities in identifying parties that may be involved in terrorism or money laundering;
- reports by non-financial trades and businesses filed with the Treasury Department s Financial Crimes Enforcement Network for transactions exceeding $10,000; and,
- filing of suspicious activities reports regarding securities by brokers and dealers if they believe a customer may be violating U.S. laws and regulations.

Under the Financial Services Modernization Act, federal banking regulators adopted rules that limit the ability of banks and other financial institutions to disclose non-public information about consumers to nonaffiliated third parties. Pursuant to the rules, financial institutions must provide:

- initial notices to customers about their privacy policies, describing the conditions under which they may disclose non-public personal information to nonaffiliated third parties and affiliates;
- annual notices of their privacy policies to current customers; and,
- a reasonable method for customers to opt out of disclosures to nonaffiliated third parties.

These privacy provisions will affect how customer information is transmitted through diversified financial companies and conveyed to outside vendors. Management believes the privacy positions have not had a material adverse effect on the Company s financial condition or results of operations.

Safe and Sound Banking Practices. Bank holding companies are not permitted to engage in unsafe and unsound banking practices. The Federal Reserve s Regulation Y, for example, generally requires a holding company to give the Federal Reserve prior notice of any redemption or repurchase of its own equity securities, if the consideration to be paid, together with the consideration paid for any repurchases or redemptions in the preceding year, is equal to 10% or more of the company s consolidated net worth. The Federal Reserve may oppose the transaction if it believes that the transaction would constitute an unsafe or unsound practice or would violate any law or regulation. Depending upon the circumstances, the Federal Reserve could take the position that paying a dividend would constitute an unsafe or unsound banking practice.

The Federal Reserve has broad authority to prohibit activities of bank holding companies and their non-banking subsidiaries which represent unsafe and unsound banking practices or which constitute violations of laws or regulations, and can assess civil money penalties for certain activities conducted on a knowing and reckless basis, if those activities caused a substantial loss to a depository institution. The penalties can be as high as $1.0 million for each day the activity continues.

Anti-Tying Restrictions. Bank holding companies and their affiliates are prohibited from tying the provision of certain services, such as extensions of credit, to other services offered by a holding company or its affiliates.

Capital Adequacy Requirements. The Federal Reserve has adopted a system using risk-based capital guidelines to evaluate the capital adequacy of bank holding companies. Under the guidelines, specific categories of assets are assigned different risk weights, based generally on the perceived credit risk of the asset. These risk weights are multiplied by corresponding asset balances to determine a risk-weighted asset base. The guidelines

require a minimum total risk-based capital ratio of 8.0% (of which at least 4.0% is required to consist of Tier 1 capital elements). Total capital is the sum of Tier 1 and Tier 2 capital. As of December 31, 2003, the Company s ratio of Tier 1 capital to total risk-weighted assets was 12.10% and its ratio of total capital to total risk-weighted assets was 13.18%. **See Management s Discussion and Analysis of Financial Condition and Results of Operations .**

In addition to the risk-based capital guidelines, the Federal Reserve uses a leverage ratio as an additional tool to evaluate the capital adequacy of bank holding companies. The leverage ratio is a company s Tier 1 capital divided by its average total consolidated assets. Certain highly rated bank holding companies may maintain a minimum leverage ratio of 3.0%, but other bank holding companies may be required to maintain a leverage ratio of up to 200 basis points above the regulatory minimum. As of December 31, 2003, the Company s leverage ratio was 8.32%.

The federal banking agencies risk-based and leverage ratios are minimum supervisory ratios generally applicable to banking organizations that meet certain specified criteria, assuming that they have the highest regulatory rating. Banking organizations not meeting these criteria are expected to operate with capital positions well above the minimum ratios. The federal bank regulatory agencies may set capital requirements for a particular banking organization that are higher than the minimum ratios when circumstances warrant. Federal Reserve guidelines also provide that banking organizations experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels, without significant reliance on intangible assets.

Imposition of Liability for Undercapitalized Subsidiaries. Bank regulators are required to take prompt corrective action to resolve problems associated with insured depository institutions whose capital declines below certain levels. In the event an institution becomes undercapitalized, it must submit a capital restoration plan. The capital restoration plan will not be accepted by the regulators unless each company having control of the undercapitalized institution guarantees the subsidiary s compliance with the capital restoration plan up to a certain specified amount. Any such guarantee from a depository institution s holding company is entitled to a priority of payment in bankruptcy.

The aggregate liability of the holding company of an undercapitalized bank is limited to the lesser of 5% of the institution s assets at the time it became undercapitalized or the amount necessary to cause the institution to be adequately capitalized. The bank regulators have greater power in situations where an institution becomes significantly or critically undercapitalized or fails to submit a capital restoration plan. For example, a bank holding company controlling such an institution can be required to obtain prior Federal Reserve approval of proposed dividends, or might be required to consent to a consolidation or to divest the troubled institution or other affiliates.

Acquisitions by Bank Holding Companies. The BHC Act requires every bank holding company to obtain the prior approval of the Federal Reserve before it may acquire all or substantially all of the assets of any bank, or ownership or control of any voting shares of any bank, if after such acquisition it would own or control, directly or indirectly, more than 5% of the voting shares of such bank. In approving bank acquisitions by bank holding companies, the Federal Reserve is required to consider the financial and managerial resources and future prospects of the bank holding company and the banks concerned, the convenience and needs of the communities to be served, and various competitive factors.

Control Acquisitions. The Change in Bank Control Act prohibits a person or group of persons from acquiring control of a bank holding company unless the Federal Reserve has been notified and has not objected to the transaction. Under a rebuttable presumption established by the Federal Reserve, the acquisition of 10% or more of a class of voting stock of a bank holding company with a class of securities registered under Section 12 of the Exchange Act, such as the Company, would, under the circumstances set forth in the presumption, constitute acquisition of control of the Company.

In addition, any company is required to obtain the approval of the Federal Reserve under the BHC Act before acquiring 25% (5% in the case of an acquirer that is a bank holding company) or more of the outstanding Common Stock of the Company, or otherwise obtaining control or a controlling influence over the Company.

The Bank. The Bank is a Texas-chartered banking association, the deposits of which are insured by the Bank Insurance Fund (BIF) of the FDIC. The Bank is not a member of the Federal Reserve System; therefore, the Bank is subject to supervision and regulation by the FDIC and the Texas Department of Banking (TDB). Such supervision and regulation subjects the Bank to special restrictions, requirements, potential enforcement actions and periodic examination by the FDIC and the TDB. Because the Federal Reserve regulates the bank holding company parent of the Bank, the Federal Reserve also has supervisory authority, which directly affects the Bank.

Equivalence to National Bank Powers. The Texas Constitution, as amended in 1986, provides that a Texas-chartered bank has the same rights and privileges that are or may be granted to national banks domiciled in Texas. To the extent that the Texas laws and regulations may have allowed state-chartered banks to engage in a broader range of activities than national banks, the FDICIA has operated to limit this authority. FDICIA provides that no state bank or subsidiary thereof may engage as principal in any activity not permitted for national banks, unless the institution complies with applicable capital requirements and the FDIC determines that the activity poses no significant risk to the insurance fund. In general, statutory restrictions on the activities of banks are aimed at protecting the safety and soundness of depository institutions.

Financial Modernization. Under the Gramm-Leach-Bliley Act, a national bank may establish a financial subsidiary and engage, subject to limitations on investment, in activities that are financial in nature, other than insurance underwriting as principal, insurance company portfolio investment, real estate development, real estate investment and annuity issuance. To do so, a bank must be well capitalized, well managed and have a CRA rating of satisfactory or better. Subsidiary banks of a bank holding company or national banks with financial subsidiaries must remain well capitalized and well managed in order to continue to engage in activities that are financial in nature without regulatory actions or restrictions, which could include divestiture of the financial subsidiary or subsidiaries. In addition, a bank holding company or a bank may not acquire a company that is engaged in activities that are financial in nature unless each of the subsidiary banks of the bank holding company or the bank has a CRA rating of satisfactory or better.

Although the powers of state-chartered banks with respect to engaging in financial activities are not specifically addressed in the Gramm-Leach-Bliley Act, state banks, such as the Bank, will have the same if not greater powers as national banks through the parity provision contained in the Texas Constitution.

Branching. Texas law provides that a Texas-chartered bank can establish a branch anywhere in Texas provided that the branch is approved in advance by the TDB. The branch must also be approved by the FDIC, which considers a number of factors, including financial history, capital adequacy, earnings prospects, character of management, needs of the community and consistency with corporate powers.

Restrictions on Transactions With Affiliates and Insiders. Transactions between the Bank and its nonbanking affiliates, including the Company, are subject to Section 23A of the Federal Reserve Act. In general, Section 23A imposes limits on the amount of such transactions, and also requires certain levels of collateral for loans to affiliated parties. It also limits the amount of advances to third parties, which are collateralized by the securities or obligations of the Company or its subsidiaries.

Affiliate transactions are also subject to Section 23B of the Federal Reserve Act which generally requires that certain transactions between the Bank and its affiliates be on terms substantially the same, or at least as favorable to the Bank, as those prevailing at the time for comparable transactions with or involving other nonaffiliated persons. The Federal Reserve has also issued Regulation W which codifies prior regulations under Section 23A and 23B of the Federal Reserve Act and interpretive guidance with respect to affiliate transactions.

The restrictions on loans to directors, executive officers, principal shareholders and their related interests (collectively referred to herein as insiders) contained in the Federal Reserve Act and Regulation O apply to all insured institutions and their subsidiaries and holding companies. These restrictions include limits on loans to one borrower and conditions that must be met before such a loan can be made. There is also an aggregate limitation on all loans to insiders and their related interests. These loans cannot exceed the institution s total unimpaired capital and surplus, and the FDIC may determine that a lesser amount is appropriate. Insiders are subject to enforcement actions for knowingly accepting loans in violation of applicable restrictions.

Restrictions on Distribution of Subsidiary Bank Dividends and Assets. Dividends paid by the Bank have provided a substantial part of the Company s operating funds and it is anticipated that dividends paid by the Bank to the Company will continue to be the Company s principal source of operating funds. Capital adequacy requirements serve to limit the amount of dividends that may be paid by the Bank. Under federal law, the Bank cannot pay a dividend if, after paying the dividend, the Bank will be undercapitalized. The FDIC may declare a dividend payment to be unsafe and unsound even though the Bank would continue to meet its capital requirements after the dividend.

Because the Company is a legal entity separate and distinct from its subsidiaries, its right to participate in the distribution of assets of any subsidiary upon the subsidiary s liquidation or reorganization will be subject to the prior claims of the subsidiary s creditors. In the event of a liquidation or other resolution of an insured depository institution, the claims of depositors and other general or subordinated creditors are entitled to a priority of payment over the claims of holders of any obligation of the institution to its shareholders, including any depository institution holding company (such as the Company) or any shareholder or creditor thereof.

Examinations. The FDIC periodically examines and evaluates insured banks. Based upon such an evaluation, the FDIC may revalue the assets of the institution and require that it establish specific reserves to compensate for the difference between the FDIC-determined value and the book value of such assets. The TDB also conducts examinations of state banks but may accept the results of a federal examination in lieu of conducting an independent examination.

Audit Reports. Insured institutions with total assets of $500 million or more must submit annual audit reports prepared by independent auditors to federal and state regulators. In some instances, the audit report of the institution s holding company can be used to satisfy this requirement. Auditors must receive examination reports, supervisory agreements and reports of enforcement actions. In addition, financial statements prepared in accordance with accounting principles generally accepted in the United States of America, management s certifications concerning responsibility for the financial statements, internal controls and compliance with legal requirements designated by the FDIC, and an attestation by the auditor regarding the statements of management relating to the internal controls must be submitted. For institutions with total assets of more than $3 billion, independent auditors may be required to review quarterly financial statements. FDICIA requires that independent audit committees be formed, consisting of outside directors only. The committees of such institutions must include members with experience in banking or financial management, must have access to outside counsel, and must not include representatives of large customers.

Capital Adequacy Requirements. The FDIC has adopted regulations establishing minimum requirements for the capital adequacy of insured institutions. The FDIC may establish higher minimum requirements if, for example, a bank has previously received special attention or has a high susceptibility to interest rate risk.

The FDIC s risk-based capital guidelines generally require state banks to have a minimum ratio of Tier 1 capital to total risk-weighted assets of 4.0% and a ratio of total capital to total risk-weighted assets of 8.0%. The capital categories have the same definitions for the Bank as for the Company. As of December 31, 2003, the Bank s ratio of Tier 1 capital to total risk-weighted assets was 11.72% and its ratio of total capital to total risk-weighted assets was 12.81%. **See Management s Discussion and Analysis of Financial Condition and Results of Operations .**

The FDIC s leverage guidelines require state banks to maintain Tier 1 capital of no less than 5.0% of average total assets, except in the case of certain highly rated banks for which the requirement is 3.0% of average total assets. The TDB has issued a policy, which generally requires state chartered banks to maintain a leverage ratio (defined in accordance with federal capital guidelines) of 6.0%. As of December 31, 2003, the Bank s ratio of Tier 1 capital to average total assets (leverage ratio) was 8.05%. **See Management s Discussion and Analysis of Financial Condition and Results of Operations .**

Corrective Measures for Capital Deficiencies. The federal banking regulators are required to take prompt corrective action with respect to capital-deficient institutions. Agency regulations define, for each capital category, the levels at which institutions are well capitalized, adequately capitalized, undercapitalized, significantly under capitalized and critically under capitalized. A well capitalized bank has a total risk-based capital ratio of 10.0% or higher; a Tier 1 risk-based capital ratio of 6.0% or higher; a leverage ratio of 5.0% or higher; and is not

subject to any written agreement, order or directive requiring it to maintain a specific capital level for any capital measure. An adequately capitalized bank has a total risk based capital ratio of 8.0% or higher; a Tier 1 risk-based capital ratio of 4.0% or higher; a leverage ratio of 4.0% or higher (3.0% or higher if the bank was rated a composite 1 in its most recent examination report and is not experiencing significant growth); and does not meet the criteria for a well capitalized bank. A bank is under capitalized if it fails to meet any one of the ratios required to be adequately capitalized.

In addition to requiring undercapitalized institutions to submit a capital restoration plan, agency regulations contain broad restrictions on certain activities of undercapitalized institutions including asset growth, acquisitions, branch establishment, and expansion into new lines of business. With certain exceptions, an insured depository institution is prohibited from making capital distributions, including dividends, and is prohibited from paying management fees to control persons if the institution would be undercapitalized after any such distribution or payment.

As an institution s capital decreases, the FDIC s enforcement powers become more severe. A significantly undercapitalized institution is subject to mandated capital raising activities, restrictions on interest rates paid and transactions with affiliates, removal of management, and other restrictions. The FDIC has only very limited discretion in dealing with a critically undercapitalized institution and is virtually required to appoint a receiver or conservator.

Banks with risk-based capital and leverage ratios below the required minimums may also be subject to certain administrative actions, including the termination of deposit insurance upon notice and hearing, or a temporary suspension of insurance without a hearing in the event the institution has no tangible capital.

Management believes that the Company meets all capital adequacy requirements to which it is subject at December 31, 2003. The Bank s capital ratios exceeded the minimum requirements for well capitalized institutions under the regulatory framework for prompt corrective action at December 31, 2003. As a result, the Company does not believe that FDICIA s prompt corrective action regulations will have any material effect on the activities or operations of the Bank. It should be noted, however, that a bank s capital category is determined solely for the purpose of applying the FDIC s prompt corrective action regulations and that the capital category may not constitute an accurate representation of the Bank s overall financial condition or prospects.

Deposit Insurance Assessments. The Bank must pay assessments to the FDIC for federal deposit insurance protection. The FDIC has adopted a risk-based assessment system as required by FDICIA. Under this system, FDIC-insured depository institutions pay insurance premiums at rates based on their risk classification. Institutions assigned to higher-risk classifications (that is, institutions that pose a greater risk of loss to their respective deposit insurance funds) pay assessments at higher rates than institutions that pose a lower risk. An institution s risk classification is assigned based on its capital levels and the level of supervisory concern the institution poses to the regulators. In addition, the FDIC can impose special assessments in certain instances. The current range of BIF assessments is between 0% and 0.27% of deposits.

The FDIC established a process for raising or lowering all rates for insured institutions semi-annually if conditions warrant a change. Under this new system, the FDIC has the flexibility to adjust the assessment rate schedule twice a year without seeking prior public comment, but only within a range of five cents per $100 above or below the premium schedule adopted. Changes in the rate schedule outside the five-cent range above or below the current schedule can be made by the FDIC only after a full rulemaking with opportunity for public comment.

On September 30, 1996, President Clinton signed into law an act that contained a comprehensive approach to recapitalize the Savings Association Insurance Fund (SAIF) and assure the payment of the Financing Corporation s (FICO) bond obligations. Under this new act, banks insured under the BIF are required to pay a portion of the interest due on bonds that were issued by FICO to help shore up the ailing Federal Savings and Loan Insurance Corporation in 1987. The FDIC also applies an assessment against BIF-assessable deposits to be paid to the Financing Corporation (FICO) to assist in paying interest of FICO bonds, which financed the resolution of the thrift industry crisis. The FICO assessment on BIF-insured deposits was approximately 1.52 basis points for the fourth quarter 2003. The FICO assessment rate is adjusted quarterly.

Enforcement Powers. The FDIC and the other federal banking agencies have broad enforcement powers, including the power to terminate deposit insurance, impose substantial fines and other civil and criminal penalties and appoint a conservator or receiver. Failure to comply with applicable laws, regulations and supervisory agreements could subject the Company or its banking subsidiaries, as well as officers, directors and other institution-affiliated parties of these organizations, to administrative sanctions and potentially substantial civil money penalties. The appropriate federal banking agency may appoint the FDIC as conservator or receiver for a banking institution (or the FDIC may appoint itself, under certain circumstances) if any one or more of a number of circumstances exist, including, without limitation, the fact that the banking institution is undercapitalized and has no reasonable prospect of becoming adequately capitalized; fails to become adequately capitalized when required to do so; fails to submit a timely and acceptable capital restoration plan; or materially fails to implement an accepted capital restoration plan. The TDB also has broad enforcement powers over the Bank, including the power to impose orders, remove officers and directors, impose fines and appoint supervisors and conservators.

Brokered Deposit Restrictions. Adequately capitalized institutions cannot accept, renew or roll over brokered deposits except with a waiver from the FDIC, and are subject to restrictions on the interest rates that can be paid on such deposits. Undercapitalized institutions may not accept, renew or roll over brokered deposits.

Cross-Guarantee Provisions. The Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) contains a cross-guarantee provision which generally makes commonly controlled insured depository institutions liable to the FDIC for any losses incurred in connection with the failure of a commonly controlled depository institution.

Community Reinvestment Act. The CRA and the regulations issued thereunder are intended to encourage banks to help meet the credit needs of their service area, including low and moderate income neighborhoods, consistent with the safe and sound operations of the banks. These regulations also provide for regulatory assessment of a bank s record in meeting the needs of its service area when considering applications to establish branches, merger applications and applications to acquire the assets and assume the liabilities of another bank. FIRREA requires federal banking agencies to make public a rating of a bank s performance under the CRA. In the case of a bank holding company, the CRA performance record of the banks involved in the transaction are reviewed in connection with the filing of an application to acquire ownership or control of shares or assets of a bank or to merge with any other bank holding company. An unsatisfactory record can substantially delay or block the transaction.

Consumer Laws and Regulations. In addition to the laws and regulations discussed herein, the Bank is also subject to certain consumer laws and regulations that are designed to protect consumers in transactions with banks. While the list set forth herein is not exhaustive, these laws and regulations include the Truth in Lending Act, the Truth in Savings Act, the Electronic Funds Transfer Act, the Expedited Funds Availability Act, the Equal Credit Opportunity Act, and the Fair Housing Act, among others. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must deal with customers when taking deposits or making loans to such customers. The Bank must comply with the applicable provisions of these consumer protection laws and regulations as part of their ongoing customer relations.

*Instability of Regulatory Structure***.** Various legislation, such as the Gramm-Leach-Bliley Act, which expanded the powers of banking institutions and bank holding companies, and proposals to overhaul the bank regulatory system and limit the investments that a depository institution may make with insured funds, is from time to time introduced in Congress. Such legislation may change banking statutes and the operating environment of the Company and the Bank in substantial and unpredictable ways. The Company cannot determine the ultimate effect that the Gramm-Leach-Bliley Act will have or the effect that potential legislation, if enacted, or implementing regulations with respect thereto, would have, upon the financial condition or results of operations of the Company or its subsidiaries.

*Expanding Enforcement Authority***.** One of the major additional burdens imposed on the banking industry by FDICIA is the increased ability of banking regulators to monitor the activities of banks and their holding companies. In addition, the Federal Reserve and FDIC possess extensive authority to police unsafe or unsound practices and violations of applicable laws and regulations by depository institutions and their holding companies. For example, the FDIC may terminate the deposit insurance of any institution, which it determines has engaged in an unsafe or unsound practice. The agencies can also assess civil money penalties, issue cease and desist or removal orders, seek injunctions, and publicly disclose such actions. FDICIA, FIRREA and other laws have expanded the

agencies authority in recent years, and the agencies have not yet fully tested the limits of their powers.

*Effect on Economic Environment***.** The policies of regulatory authorities, including the monetary policy of the Federal Reserve, have a significant effect on the operating results of bank holding companies and their subsidiaries. Among the means available to the Federal Reserve to affect the money supply are open market operations in U.S. Government securities, changes in the discount rate on member bank borrowings, and changes in reserve requirements against member bank deposits. These means are used in varying combinations to influence overall growth and distribution of bank loans, investments and deposits, and their use may affect interest rates charged on loans or paid for deposits.

Federal Reserve monetary policies have materially affected the operating results of commercial banks in the past and are expected to continue to do so in the future. The nature of future monetary policies and the effect of such policies on the business and earnings of the Company and the Bank cannot be predicted.

Item 2. ***Properties***

The Company conducts business at eleven banking locations, with two located in Mount Pleasant, eight located in the Northeast Texas communities of Bogata, Commerce, Deport, Paris, Pittsburg, Sulphur Springs, Talco, Texarkana and one located in the West Texas community of Fort Stockton. The Company s headquarters are located at 100 West Arkansas in Mount Pleasant in a two-story office building. The Company owns all of its locations and considers the properties to be suitable and adequate for the Company s present needs. The following table sets forth specific information on each of the Company s locations:

Location	Address	Deposits at December 31, 2003
		(Dollars in thousands)
Bogata	110 Halesboro Street, Bogata, Texas 75417	$ 14,925
Commerce	1108 Park Street, Commerce, Texas 75429	30,217
Deport	111 Main Street, Deport, Texas 75435	18,475
Fort Stockton	#1 Spring Drive, Fort Stockton, Texas 79735	673(1)
Mount Pleasant-Downtown	100 West Arkansas, Mount Pleasant, Texas 75455	154,143
Mount Pleasant-South	2317 South Jefferson, Mount Pleasant, Texas 75455	4,734
Paris	3250 Lamar Avenue, Paris, Texas 75460	64,604

Pittsburg	116 South Greer Blvd., Pittsburg, Texas 75686	20,776
Sulphur Springs	919 Gilmer Street, Sulphur Springs, Texas 75482	63,305
Talco	104 Broad Street, Talco, Texas 75487	13,919
Texarkana	2202 St. Michael Drive, Texarkana, Texas 75503	22,076

(1) Location offers loans and time deposits only.

Item 3. ***Legal Proceedings***

The Company faces ordinary routine litigation arising in the normal course of business. In the opinion of management, liabilities (if any) arising from such claims will not have a material adverse effect upon the business, results of operations or financial condition of the Company.

In March 2000, the Company filed an action in the District Court of Titus County, Texas against Guaranty Federal Bank, F.S.B., (Guaranty Federal) a thrift institution, after the Company discovered that Guaranty Federal was using the name, Guaranty Bank , in its business dealings. The case sought a declaratory judgment that the Company has the sole right to the name Guaranty Bank . In November 2001, a settlement was reached. In exchange for $3.0 million, the Company dropped the lawsuit against Guaranty Federal and the Company agreed to change its name by December 31, 2002. At December 31, 2001, the financial statements of the Company reflect the effect of this settlement. In October 2002, the Bank officially changed its name to Guaranty Bond Bank.

In November 1998, Guaranty Leasing was informed by the Internal Revenue Service (the Service) that it has taken the position that certain losses taken by one of the three Partnerships during 1994, 1995 and 1996 of $302,000, $410,000 and $447,000, respectively, would be disallowed. In October 2001, the Service informed Guaranty Leasing that it has taken the position that certain losses taken by that Partnership during 1997 of $487,000 would also be disallowed. In September 2002, the Company received from the Service a Notice of Final Partnership Administrative Adjustment disallowing these deductions. Based upon the advice of counsel, the Company believes that it has correctly reported these transactions for tax purposes and that it has obtained appropriate legal, accounting and appraisal opinions and authority to support its positions. The Company has recorded and expensed the tax affect of the disallowed deductions. On February 3, 2003, the Company filed a petition to begin the process to litigate the matter in the United States District Court for the Eastern District of Texas the (Texas Court). On August 5, 2003, the Texas Court issued a Docket Control Order establishing a court timeline and a final Pretrial Conference for April 5, 2004. On October 17, 2003, the Government filed a Motion to Transfer Venue from the Texas Court to the United States District Court for the Eastern District for Virginia, (the Virginia Court). On November 25, 2003, the Government filed a Motion to Stay Proceedings. On December 18, 2003, the Texas Court issued an Order to Stay Proceedings pending the Court s ruling on the Government s Motion to Transfer Venue. Any final determination with respect to the Partnership will be binding on the Company. In addition to the ongoing litigation regarding the Partnership, the Service is currently in the process of examining the tax deductions taken for the other two Partnerships. No determination has been made regarding the disallowance of similar deductions for these other two Partnerships. Should the Service ultimately disallow the related tax deductions taken during the remaining years of the above partnership as well as the other two partnerships, the Company will be required to recognize an additional maximum tax liability of approximately $3.9 million plus possible penalty and interest. The Company is actively contesting the position of the Service in connection with this matter, and will take appropriate steps necessary to protect its legal position.

Item 4. ***Submission of Matters to a Vote of Security Holders***

No matters were submitted to a vote of security holders during the fourth quarter of 2003.

PART II

Item 5. ***Market for Registrant s Common Equity and Related Shareholder Matters***

The Common Stock began trading on May 21, 1998 and is listed on the Nasdaq National Market System (Nasdaq NMS) under the symbol GNTY . Prior to that date, the Company s Common Stock was privately held and not listed on any public exchange or actively traded. The Company had a total of 2,921,928 shares outstanding at December 31, 2003. As of December 31, 2003, there were 371 registered shareholders of record. The number of beneficial shareholders is unknown to the Company at this time.

The following table presents the high and low Common Stock prices reported on the Nasdaq NMS by quarter during the two years ended December 31, 2003:

	2003	**2002**

	High	Low	High	Low
Fourth quarter	$ 22.00	$ 17.78	$ 16.25	$ 14.00
Third quarter	18.15	16.40	15.00	13.07
Second quarter	16.59	14.90	15.15	13.00
First quarter	16.40	15.64	13.25	12.26

Holders of Common Stock are entitled to receive dividends when, as and if declared by the Company s Board of Directors out of funds legally available therefore. While the Company has declared dividends on its Common Stock since 1980, and paid semi-annual dividends aggregating $0.37 per share per annum in 2003, there is no assurance that the Company will continue to pay dividends in the future.

The principal source of cash revenues to the Company is dividends paid by the Bank with respect to the Bank s capital stock. There are certain restrictions on the payment of such dividends imposed by federal and state banking laws, regulations and authorities. **See Management s Discussion and Analysis of Financial Condition and Results of Operations and Supervision and Regulation The Bank .**

The Company s cash dividends paid per share by quarter were as follows:

	2003	2002	2001
Fourth quarter	$ 0.20	$ 0.17	$ 0.15
Third quarter	-	-	-
Second quarter	0.17	0.15	0.13
First quarter	-	-	-

Securities Authorized for Issuance Under Equity Compensation Plans

The Company currently has stock options outstanding. The options were granted under the Company s 1998 Stock Incentive Plan which was approved by the Company s shareholders. The following table provides information as of December 31, 2003 regarding the Company s equity compensation plans under which the Company s equity securities are authorized for issuance:

	EQUITY COMPENSATION PLAN INFORMATION		
	(a)	(b)	(c)
Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	144,500	$ 11.42	853,500
Equity compensation plans not approved by security holders	-	-	-
Total	144,500	$ 11.42	853,500

Item 6. ***Selected Financial Data***

Selected Consolidated Financial Data Of The Company

The following selected consolidated financial data should be read in conjunction with the Consolidated Financial Statements of the Company and the notes thereto, appearing elsewhere in this Annual Report on Form 10-K, and the information contained in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations.

The following table presents selected historical consolidated financial data as of and for the five years ended December 31, 2003 and are derived from the Company s Consolidated Financial Statements, which have been audited by independent certified public accountants.

	As of and for the Years Ended December 31				
	2003	2002	2001	2000	1999
	(Dollars in thousands, except per share data)				
Income Statement Data:					
Interest income	$ 27,564	$ 28,955	$ 29,861	$ 29,017	$ 21,568
Interest expense	10,242	12,272	16,363	16,742	10,506
Net interest income	17,322	16,683	13,498	12,275	11,062
Provision for loan losses	1,075	1,260	1,385	595	310
Net interest income after provision for loan losses	16,247	15,423	12,113	11,680	10,752
Noninterest income	4,937	5,056	6,201	3,723	3,374
Noninterest expense	15,837	14,692	13,519	12,140	10,259
Earnings before taxes	5,347	5,787	4,795	3,263	3,867
Provision for income tax expense	1,503	1,410	1,505	755	745
Net earnings	$ 3,844	$ 4,377	$ 3,290	$ 2,508	$ 3,122
Common Share Data:					
Net earnings (basic) (1)	$ 1.32	$ 1.46	$ 1.09	$ 0.80	$ 1.03
Net earnings (diluted) (1)	1.30	1.45	1.09	0.80	1.03
Book value	12.47	11.81	10.59	9.67	8.77
Tangible book value	11.67	11.01	9.82	8.85	7.81
Cash dividends	0.37	0.32	0.28	0.25	0.25
Dividend payout ratio	28.12%	21.73%	25.56%	30.70%	24.58%
Weighted average common shares outstanding-basic (in thousands)	2,923	2,991	3,016	3,126	3,045
Weighted average common shares outstanding-diluted (in thousands)	2,953	3,013	3,027	3,133	3,045
Period end shares outstanding (in thousands)	2,922	2,932	3,004	3,044	3,232
Balance Sheet Data:					
Total assets	$ 517,078	$ 517,968	$ 460,509	$ 411,031	$ 370,438
Securities	99,614	106,992	81,715	81,620	79,761
Loans held for sale	1,244	5,727	1,634	172	-
Loans	364,270	359,888	329,621	287,163	255,209
Allowance for loan losses	3,906	3,692	3,346	2,578	2,491
Total deposits	407,847	424,950	383,279	358,265	328,637
Total common shareholders equity	36,448	34,644	31,827	29,425	28,496

(Table continues on next page.)

	As of and for the Years Ended December 31				
	2003	2002	2001	2000	1999
	(Dollars in thousands, except per share data)				
Average Balance Sheet Data:					
Total assets	$ 524,675	$ 490,620	$ 432,200	$ 394,496	$ 309,247
Securities	109,325	91,710	74,826	84,933	58,308
Loans	359,829	342,823	302,656	267,996	213,737
Allowance for loan losses	3,767	3,485	2,735	2,519	1,876
Total deposits	423,283	403,125	374,566	345,342	276,525
Total common shareholders equity	35,496	33,934	30,629	28,266	25,989
Performance Ratios:					
Return on average assets	0.73%	0.89%	0.76%	0.64%	1.01%
Return on average common equity	10.83	12.90	10.74	8.87	12.01
Net interest margin	3.63	3.73	3.46	3.44	3.93
Efficiency ratio [(2)]	71.75	68.79	70.10	75.72	71.12
Asset Quality Ratios[(3)]:					
Nonperforming assets to total loans and other real estate	0.90%	1.18%	1.87%	1.73%	0.43%
Net loan charge-offs to average loans	0.24	0.27	0.20	0.19	0.08
Allowance for loan losses to total loans	1.07	1.01	1.01	0.90	0.98
Allowance for loan losses to nonperforming loans [(4)]	152.52	114.87	59.23	54.83	244.94
Capital Ratios [(3)]:					
Leverage ratio	8.32%	8.62%	8.44%	8.60%	8.21%
Average shareholders equity to average total assets	6.77	6.92	7.09	7.17	8.40
Tier 1 risk-based capital ratio	12.10	12.06	11.52	11.79	9.86
Total risk-based capital ratio	13.18	13.12	12.58	12.69	10.83

(1) Net earnings per share are based upon the weighted average number of common shares outstanding during the period.

(2) Calculated by dividing total noninterest expenses by net interest income plus noninterest income, excluding securities losses or gains.

(3) At period end, except net loan charge-offs to average loans, and average shareholders equity to average total assets which is for periods ended at such date.

(4) Nonperforming loans consist of nonaccrual loans, loans contractually past due 90 days or more and restructured loans.

Item 7. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

Application of Critical Accounting Policies And Accounting Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. While the Company bases its estimates on historical experience, current information and other factors deemed to be relevant, actual results could differ from those estimates.

The Company considers accounting estimates to be critical to its reported financial results if (i) the accounting estimate requires management to make assumptions about matters that are highly uncertain and (ii) different estimates that management reasonably could have used for the accounting estimate in the current period, or changes in the accounting estimate that are reasonably likely to occur from period to period, would have a material impact on the Company s financial statements. Accounting policies related to allowance for loan losses and loss contingencies are considered to be critical as these policies involve considerable subjective judgment and estimation by management.

Critical accounting policies, and the Company s procedures related to these policies, are described in detail below. Also see Note 1 Summary of Significant Accounting Policies in the accompanying Notes to Consolidated Financial Statements.

Allowance for Loan Losses. The allowance for loan losses is a reserve established through a provision for loan losses charged to expense and represents management s best estimate of probable losses that have been incurred within the existing portfolio of loans. The allowance, in management s judgment, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. In estimating the allowance for loan losses, management considers historical charge-off experience, loan delinquencies, the credit worthiness of individual customers, economic conditions affecting specific customer industries and general economic conditions, among other factors. Should any of these factors change, the Company s estimate of probable loan losses could also change, which could affect the level of the future provisions for loan losses. See additional discussion under the sections captioned, Allowance for Loan Losses and Provision for Loan Losses, included elsewhere in this Management s Discussion and Analysis of Financial Condition and Results of Operations. Also see Note 3 Loans and Allowance for Loan Losses in the accompanying Notes to Consolidated Financial Statements.

Loss Contingencies. There are times when non-recurring events occur that require management to consider whether an accrual for a loss contingency is appropriate. Accruals for such loss contingencies typically relate to legal proceedings and other claims and are recorded when management believes the likelihood of an adverse outcome is probable and the amount of the loss is reasonably estimable. Contingent liabilities are often resolved over long time periods. Estimating probable losses requires analysis of multiple forecasts that often depend on judgments about potential actions by third parties. While there can be no assurance, the Company currently believes the outcome of current outstanding legal proceedings will not have a material adverse effect on the Company s business, financial condition or results of operations. The outcomes are inherently uncertain, and it is possible that some of these matters may be resolved materially adversely to the Company. The adverse resolution of any one or more of these matters could have a material adverse effect on the Company s financial condition or results of operations.

Overview

The Company s results of operations are dependent primarily on net interest income, which is the difference between the income earned on its loan, securities and investment portfolios and its cost of funds, consisting of the interest paid on deposits and borrowings. Results of operations are increased by the Company s noninterest income and decreased by the provision for loan losses and noninterest expenses. General economic and competitive conditions, particularly changes in interest rates, prepayment rates of mortgage-backed securities and loans, repricings of loan relationships, government policies and actions of regulatory authorities, also significantly affect the Company s results of operations. Future changes in applicable law, regulations or government policies may also have a material impact on the Company.

Net earnings were $3.8 million, $4.4 million and $3.3 million for the years ended December 31, 2003, 2002, and 2001 respectively, and diluted net earnings per share were $1.30, $1.45, and $1.09 for these same periods. The decrease in earnings from 2002 to 2003 resulted primarily from an increase in noninterest expense and a decrease in noninterest income, partially offset by an increase in net interest income, caused by a growth in interest-earnings assets and a lower cost of funds. Average interest-earning assets increased to $476.9 million from $447.4 million, or 6.6% in 2003, while the cost of funds decreased from 3.16% in 2002 to 2.46% in 2003. The resulting net interest margin decreased from 3.73% in 2002 to 3.63% in 2003, a decrease of 10 basis points or 2.7%. Noninterest income decreased $119,000, or 2.4% primarily from fewer gains on the sale of securities. Noninterest expense increased $1.1 million, or 7.8% during 2003 compared to 2002 resulting primarily from an increase in personnel cost. The increase in earnings from 2001 to 2002 resulted primarily from an increase in net interest income, caused by a growth in interest-earning assets and a lower cost of funds, and increase in noninterest income offset by an increase in the provision for loan losses and an increase in noninterest expense. The Company posted returns on average assets of 0.73%, 0.89% and 0.76% and returns on average common equity of 10.83%, 12.90% and 10.74% in 2003, 2002, and 2001, respectively.

Total assets at December 31, 2003 and 2002 were $517.1 million and $518.0 million, respectively. Total deposits at December 31, 2003 and 2002 were $407.8 million and $425.0 million, respectively, a decrease of $17.1 million, or 4.0% in 2003. The decrease was primarily attributable to a decrease in certificates of deposits of $25.4 million partially offset by increases in demand accounts of $3.7 million and NOW accounts of $5.0 million. At December 31, 2003 and 2002, securities totaled $99.6 million and $107.0 million, respectively. The decrease in securities in 2003 was primarily due to an increase in normal pay-downs in the secondary market caused by the increase in refinancing activity due to the low interest rate environment. Common shareholders equity was $36.4 million and $34.6 million at December 31, 2003 and 2002, respectively. The increase in common shareholder s equity for the year ended December 31, 2003 reflects earnings retention, partially offset by a decrease in the unrealized gain on securities available for sale, the purchase of treasury stock and payment of dividends.

Results of Operations

Net Interest Income

Net interest income represents the amount by which interest income on interest-earning assets, which include securities, loans, and federal funds sold, exceeds interest expense incurred on interest-bearing liabilities, which include deposits and other borrowed funds. Net interest income is the principal source of the Company s earnings. Interest rate fluctuations, as well as changes in the amount and type of earning assets and liabilities, combine to affect net interest income.

2003 versus 2002 Net interest income increased from $16.7 million in 2002 to $17.3 million in 2003, an increase of $639,000, or 3.8% primarily due to a decrease in interest expense of $2.0 million, or 16.5%, partially offset by a decrease in interest income of $1.4 million, or 4.8%. This resulted in net interest margins of 3.63% and 3.73% and net interest spreads of 3.32% and 3.31% for the years ended December 31, 2003 and 2002, respectively.

The increase in net interest income for 2003 was primarily due to the decrease in cost of interest-bearing liabilities from 3.16% in 2002 to 2.46% in 2003. While the Company had an increase in average loans of $17.0 million, or 4.96% and average securities of $17.6 million, or 19.21%, the impact of these increases were partially offset by lower yields on interest-earning assets which decreased from 6.47% in 2002 to 5.78% in 2003. The lower yields and lower cost of funds resulted from a decrease in prime rate during 2002 from 4.75% to 4.50% and a further

reduction in 2003 from 4.50% to 4.00%.

2002 versus 2001 Net interest income increased from $13.5 million in 2001 to $16.7 million in 2002, an increase of $3.2 million, or 23.7%. This resulted in net interest margins of 3.73% and 3.46% and net interest spreads of 3.31% and 2.85% for the years ended December 31, 2002 and 2001, respectively.

The increase in net interest income for 2002 was primarily due to the decrease in cost of interest-bearing liabilities from 4.80% in 2001 to 3.16% in 2002. While the Company had an increase in average loans of $40.2 million, or 13.3% and average securities of $16.9 million, or 22.6%, the impact of these increases were partially offset by lower yields on interest-earning assets which decreased from 7.65% in 2001 to 6.47% in 2002. The lower yields and lower costs of funds resulted from a decrease in prime rate during 2001 from 9.50% to 4.75% and a further reduction in 2002 from 4.75% to 4.50%.

The following table presents for the periods indicated the total dollar amount of interest income from average interest-earning assets and the resultant yields, as well as the interest expense on average interest-bearing liabilities, expressed both in dollars and rates. No tax equivalent adjustments were made and all average balances are derived from average daily balances. Nonaccruing loans have been included in the tables as loans carrying a zero yield.

	Years Ended December 31,								
	2003			2002			2001		
	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate
	(Dollars in thousands)								
Assets									
Interest-earning assets:									
Loans	$ 359,829	$ 23,473	6.52%	$ 342,823	$ 24,119	7.04%	$ 302,656	$ 24,591	8.13%
Securities	109,325	3,977	3.64	91,710	4,629	5.05	74,826	4,693	6.27
Federal funds sold and interest-bearing deposits	7,722	114	1.48	12,821	207	1.61	12,804	577	4.51
Total interest-earning assets	476,876	27,564	5.78%	447,354	28,955	6.47%	390,286	29,861	7.65%

Less allowance for loan losses	(3,767)			(3,485)			(2,735)		
Total interest-earning assets, net of allowance	473,109			443,869			387,551		
Non-earning assets:									
Cash and due from banks	19,440			14,640			12,508		
Premises and equipment	13,383			13,442			13,569		
Interest receivable and other assets	17,462			17,437			17,975		
Other real estate owned	1,281			1,232			597		
Total assets	$ 524,675			$ 490,620			$ 432,200		
Liabilities and shareholders equity									
Interest-bearing liabilities:									
NOW, savings, and money market accounts	$ 121,439	$ 941	0.77%	$ 108,664	$ 1,507	1.39%	$ 104,600	$ 2,704	2.59%
Time deposits	232,976	6,299	2.70	231,196	8,330	3.60	213,839	12,132	5.67
Total interest-bearing deposits	354,415	7,240	2.04	339,860	9,837	2.89	318,439	14,836	4.66
FHLB advances and federal funds purchased	51,377	2,001	3.89	40,827	1,639	4.02	15,636	755	4.83
Long-term debt	10,000	1,001	10.01	7,750	796	10.27	7,000	772	11.03
Total interest-bearing liabilities	415,792	10,242	2.46%	388,437	12,272	3.16%	341,075	16,363	4.80%
Noninterest-bearing liabilities:									
Demand deposits	68,868			63,265			56,127		
Accrued interest, taxes and other liabilities	4,519			4,984			4,369		
Total liabilities	489,179			456,686			401,571		
Shareholders equity	35,496			33,934			30,629		
Total liabilities and shareholders equity	$ 524,675			$ 490,620			$ 432,200		
Net interest income		$ 17,322			$ 16,683			$ 13,498	
Net interest spread			3.32%			3.31%			2.85%
Net interest margin			3.63%			3.73%			3.46%

The following table presents the dollar amount of changes in interest income and interest expense for the major components of interest-earning assets and interest-bearing liabilities and distinguishes between the changes in interest income and interest expense related to changes in average outstanding balances and the volatility of interest rates. For purposes of this table, changes attributable to both rate and volume, which can be segregated, have been allocated proportionately to changes due to rate and changes due to volume.

	Years Ended December 31,					
	2003 vs. 2002			2002 vs. 2001		
	Increase (Decrease) Due To			Increase (Decrease) Due To		
	Volume	Rate	Total	Volume	Rate	Total
	(Dollars in thousands)					
Interest-earning assets:						
Loans	$ 1,197	$ (1,843)	$ (646)	$ 3,266	$ (3,738)	$ (472)
Securities	890	(1,542)	(652)	1,056	(1,120)	(64)
Federal funds sold and interest-bearing deposits	(82)	(11)	(93)	1	(371)	(370)
Total increase (decrease) in interest income	2,005	(3,396)	(1,391)	4,323	(5,229)	(906)
Interest-bearing liabilities:						
NOW, savings and money market accounts	178	(744)	(566)	106	(1,303)	(1,197)
Time deposits	64	(2,095)	(2,031)	984	(4,786)	(3,802)
FHLB advances and federal funds purchased	424	(62)	362	1,216	(332)	884
Long-term debt	231	(26)	205	83	(59)	24
Total increase (decrease) in interest expense	897	(2,927)	(2,030)	2,389	(6,480)	(4,091)
Increase(decrease) in net interest income	$ 1,108	$ (469)	$ 639	$ 1,934	$ 1,251	$ 3,185

Provision for Loan Losses

The Company s provision for loan losses is established through charges to operating income in the form of the provision in order to bring the total allowance for loan losses to a level deemed appropriate by management of the Company based on such factors as historical loan loss experience, the volume and type of lending conducted by the Company, the amount of nonperforming assets, regulatory policies, generally accepted accounting principles, general economic conditions, and other factors related to the collectability of loans in the Company s portfolio as discussed under Allowance for Loan Losses . In the past two years, the Company has made significant enhancements to the allowance for loan loss methodology to better quantify the risk associated with these internal and external factors.

The Company s provision for loan losses for 2003 was $1.1 million compared with $1.3 million for 2002. The decrease in the provision was due primarily to a decrease in total nonperforming loans of $653,000, or 20.3%. Average loans outstanding increased from $342.8 million for 2002 to $359.8 million for 2003, an increase of $17.0 million, or 5.0%. Total classified loans decreased from $9.9 million at December 31, 2002 to $9.0 million at December 31, 2003, a decrease of $900,000, or 9.1%. Management believes the Company has maintained good asset quality as net charge-offs remain at manageable levels totaling $861,000, or 0.24% of average loans in 2003 compared with $914,000, or 0.27% of average loans in 2002. The Company s provision for loan losses decreased from $1.4 million in 2001 to $1.3 million in 2002 primarily due to a decrease in nonperforming assets.

Noninterest Income

Noninterest income is an important source of revenue for financial institutions. The Company s primary sources of noninterest income are service charges on deposit accounts and other banking service related fees. Noninterest income for the year ended December 31, 2003 was $4.9 million, a decrease of $119,000 or 2.4%, from $5.1 million for the year ended December 31, 2002 and a decrease in 2002 of $1.1 million or

18.5%, from $6.2

million for the year ended December 31, 2001. The 2003 decrease is primarily due to a decrease in securities gains of $192,000, an impairment charge of $113,000 and a loss associated with the AFT lease transaction, partially offset by an increase in gain on sale of loans due to more consumer refinancing into the secondary market. The 2002 decrease is primarily due to a nonrecurring gain of $3.0 million in 2001 in connection with the settlement of the Guaranty Federal lawsuit. This gain represents the amount received in January 2002 in connection with the November 2001 settlement and concurrent transfer of the Company s rights to certain intangible assets. This income was partially offset by a nonrecurring impairment charge during 2001 of $1.5 million associated with the AFT lease transaction.

During 2000, Guaranty Leasing, acquired a 2.5% ownership interest in AFT for approximately $2.8 million. The AFT ownership interest is classified as an Other Asset on the Company s balance sheet. As of December 31, 2003 and 2002, the book value of the AFT ownership was $1.4 million and $1.6 million, respectively. During the fourth quarter of 2001, on belief that the Company s investment in AFT was impaired by declines in air travel and reduced demand for commercial aircraft, an impairment charge of $1.5 million was recorded and the carrying amount of the investment was reduced to $1.6 million. During the third quarter of 2001, AFT recorded an impairment charge of $18.2 million related to two airplanes. In addition, management received indications the appraised value of AFT s fleet of airplanes had declined approximately 9% from their value the past year. Based on these factors, the limited marketability of the investment, the uncertainty surrounding the air transport industry and general economic conditions, management believed that the value of its investment in AFT was permanently impaired. During the second quarter of 2003, on belief that the Company s investment in AFT had been further impaired, an impairment charge of $113,000 was recorded.

Excluding the gain on settlement of litigation and the impairment charge of the AFT, recurring noninterest income for 2001 totaled $4.7 million. Excluding these items in 2001, and the additional impairment charge of the AFT in 2003, noninterest income for 2003 reflects an increase of $54,000, or 1.1%, over 2002 and an increase of $409,000 or 8.7% over 2001. The year ended December 31, 2003 reflected a decrease in service charge income of $88,000 or 3.0% over the same period in 2002 and an increase of $191,000 or 7.1% over the same period in 2001. Securities gains decreased $192,000, from $380,000 in 2002 to $188,000 in 2003. As to normal and recurring noninterest income, the Company experienced a slight increase of 1.1% to $5.1 million for the twelve months ended December 31, 2003 and a 7.6% increase to $5.1 million for the same period in 2002.

The following table presents for the periods indicated the major categories of noninterest income:

	Years Ended December 31,		
	2003	**2002**	**2001**
	(Dollars in thousands)		
Service charges	$ 2,869	$ 2,957	$ 2,678
Securities gains, net	188	380	416
Fee income	925	863	668
Fiduciary income	178	163	136
Earnings from key-man life insurance	251	236	204
Gain on sale of loans	586	272	98
Gain on sale of assets	-	97	36
Gain on sale of ORE	32	12	176
Income (loss) from investment in AFT	(60)	-	140
Impairment of investment in AFT	(113)	-	(1,500)
Gain on settlement of litigation	-	-	3,000
Other noninterest income	81	76	149
Total noninterest income	$ 4,937	$ 5,056	$ 6,201

Noninterest Expense

For the years ended December 31, 2003, 2002 and 2001, noninterest expense totaled $15.8 million, $14.7 million and $13.5 million, respectively. The $1.1 million, or 7.8%, increase in 2003 was primarily the result of an increase in employee compensation and benefits. This increase was due to an increase in full time equivalent employees from 212 at December 31, 2002 to 226 at December 31, 2003, normal salary adjustments, increased employee benefits, and payroll taxes. Legal and professional fees increased $235,000 or 25.2% in 2003 primarily due to litigation involving the lawsuit with the Internal Revenue Service.

The increase in total noninterest expense for 2002 compared with 2001 of $1.2 million, or 8.7%, was primarily the result of increases in employee compensation and benefits. Employee compensation and benefits increased from $7.6 million in 2001 to $8.7 million in 2002, an increase of $1.1 million, or 14.7%. This increase was due to an increase in full time equivalent employees from 199 at December 31, 2001 to 212 at December 31, 2002, an increase in normal salary adjustments, increased bonus incentives, profit sharing contributions and payroll taxes.

The Company s efficiency ratios, calculated by dividing total noninterest expense (excluding securities gains and losses) by net interest income plus noninterest income, was 71.75% in 2003, 68.79% in 2002, and 70.10% in 2001.

The following table presents for the periods indicated the major categories of noninterest expense:

	Years Ended December 31,		
	2003	2002	2001
	(Dollars in thousands)		
Employee compensation and benefits	$ 9,371	$ 8,711	$ 7,592
Non-staff expenses:			
Occupancy expenses	2,019	1,992	1,901
Legal and professional fees	1,168	933	864
Director and committee fees	560	534	412
Advertising	284	310	278
ATM and debit card expense	363	317	279
Office and computer supplies	301	265	429
Postage	211	187	180
Phone expense	252	194	188
Other	1,308	1,249	1,396
Total non-staff expenses	6,466	5,981	5,927
Total noninterest expense	$ 15,837	$ 14,692	$ 13,519

Income Taxes

Federal income tax is reported as income tax expense and is influenced by the amount of taxable income, the amount of tax-exempt income, the amount of non-deductible interest expense and the amount of other non-deductible expense. The Company did not utilize tax benefits on leveraged lease transactions in 2003. The Company utilized tax benefits on leveraged lease transactions in the amounts of $960,000 and $763,000 for 2002 and 2001, respectively. The effective tax rates for 2003, 2002 and 2001 were 28.11%, 24.37% and 31.39%, respectively. Income taxes for financial purposes in the consolidated statements of earnings differ from the amount computed by applying the statutory income tax rate of 34% to earnings before income taxes. The difference in the statutory rate is primarily due to the tax benefits on the leveraged lease transactions and non-taxable income.

Additionally, the State of Texas imposes a Texas franchise tax. Taxable income for the income tax component of the Texas franchise tax is the federal pre-tax income, plus certain officers salaries, less interest income from federal securities. Total franchise tax expense was $38,000 in 2003, $41,000 in 2002 and $50,000 in 2001. Such expense was included as a part of other noninterest expense.

Impact of Inflation

The effects of inflation on the local economy and on the Company s operating results have been relatively modest for the past several years. Since substantially all of the Company s assets and liabilities are monetary in nature, such as cash, securities, loans and deposits, their values are less sensitive to the effects of inflation than to changing interest rates, which do not necessarily change in accordance with inflation rates. The Company tries to control the impact of interest rate fluctuations by managing the relationship between its interest rate sensitive assets and liabilities. See **Quantitative and Qualitative Disclosures About Market Risk** below.

Financial Condition

Loan Portfolio (including loans held for sale)

The Company provides a broad range of commercial, real estate and consumer loan products to small and medium-sized businesses and individuals in its market areas. The Company aggressively pursues qualified lending customers in both the commercial and consumer sectors, providing customers with direct access to lending personnel and prompt, professional service. The 89.6% gross loan to deposit ratio as of December 31, 2003, reflects the Company s commitment as an active lender in the local communities it serves. Although the Company, as did the industry, experienced a large amount of activity in refinancing of its loans into the secondary market, the Company was able to book new loans to offset this run-off and ultimately showed no change in loan balances for the year 2003. Total loans were $365.5 million and $365.6 million at December 31, 2003 and 2002, respectively, reflecting no change. In 2002, total loans increased by $34.3 million, or 10.4% to $365.6 million from $331.3 million at December 31, 2001. The 2002 growth in loans, and the ability to maintain that level in 2003, is reflective of a stable local economy, an aggressive advertising campaign, the Company s pro-lending reputation and the solicitation of new companies and individuals entering the Company s market areas.

The following table summarizes the loan portfolio (including loans held for sale) of the Company by type of loan as of the dates indicated:

	December 31,									
	2003		2002		2001		2000		1999	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)									
Commercial and industrial	$ 55,285	15.13%	$ 58,661	16.05%	$ 66,641	20.12%	$ 66,616	23.18%	$ 61,153	23.96%
Agriculture	10,173	2.78	9,989	2.73	8,589	2.59	8,318	2.89	9,102	3.57
Real estate:										
Construction and land development	22,020	6.02	14,017	3.83	9,492	2.87	7,316	2.55	7,926	3.11
1-4 family residential	136,717	37.40	139,156	38.06	124,480	37.58	102,442	35.65	83,777	32.83
Loans held for sale	1,244	0.34	5,727	1.57	1,634	0.49	172	0.06	-	-
Farmland	20,267	5.54	14,765	4.04	9,794	2.96	7,716	2.69	7,976	3.13
Commercial	79,953	21.88	81,649	22.33	68,165	20.58	61,224	21.31	52,303	20.49
Multi-family residential	9,291	2.55	9,289	2.54	9,333	2.81	4,946	1.72	6,239	2.44
Consumer, net of unearned discounts	30,564	8.36	32,362	8.85	33,126	10.00	28,585	9.95	26,733	10.47
Total loans	$ 365,514	100.00%	$ 365,615	100.00%	$ 331,254	100.00%	$ 287,335	100.00%	$ 255,209	100.00%

The primary lending focus of the Company is on loans to small and medium-sized businesses and one-to- four family residential mortgage loans. The Company s commercial lending products include business loans,

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commercial real estate loans, equipment loans, working capital loans, term loans, revolving lines of credit and letters of credit. Most commercial loans are collateralized and on payment programs. The purpose of a particular loan generally determines its structure. In almost all cases, the Company requires personal guarantees on commercial loans to help assure repayment.

Commercial

The Company s commercial loans are primarily made within its market area and are underwritten on the basis of the borrower s ability to service such debt from income. As a general practice, the Company takes as collateral a lien on any available real estate, equipment, or other assets owned by the borrower and obtains a personal guaranty of the borrower. In general, commercial loans involve more credit risk than residential mortgage loans and commercial mortgage loans and, therefore, usually yield a higher return. The increased risk for commercial loans is due to the type of collateral securing these loans. The increased risk also derives from the expectation that commercial loans generally will be serviced principally from the business operations, and those operations may not be successful. As a result of these additional complexities, variables and risks, commercial loans require more thorough underwriting and servicing than other types of loans.

In addition to commercial loans secured by real estate, the Company makes commercial mortgage loans to finance the purchase of real property, which generally consists of real estate with completed structures. Commercial mortgage lending typically involves higher loan principal amounts and the repayment of loans is dependent, in large part, on sufficient income from the properties securing the loans to cover operating expenses and debt service. As a general practice, the Company requires its commercial mortgage loans to be secured by well-managed income producing property with adequate margins and to be guaranteed by responsible parties. The Company s commercial mortgage loans are generally secured by first liens on real estate. Loans with fixed interest rates typically amortize over a 10 to 15 year period with balloon payments due at the end of one to five years. In underwriting commercial mortgage loans, consideration is given to the property s operating history, future operating projections, current and projected occupancy, location and physical condition. The underwriting analysis also includes credit checks, appraisals and a review of the financial condition of the borrower and guarantor.

Construction

The Company makes loans to finance the construction of residential and, to a limited extent, nonresidential properties. Construction loans generally are secured by first liens on real estate. The Company conducts periodic inspections, either directly or through an agent, prior to approval of periodic draws on these loans. Construction loans involve additional risks attributable to the fact that loan funds are advanced upon the security of a project under construction, and the project is of uncertain value prior to its completion. Because of uncertainties inherent in estimating construction costs, the market value of the completed project and the effects of governmental regulation on real property, it can be difficult to accurately evaluate the total funds required to complete a project and the related loan to value ratio. As a result of these uncertainties, construction lending often involves the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project rather than the ability of a borrower or guarantor to repay the loan. If the Company is forced to foreclose on a project prior to completion, there is no assurance that it will be able to recover the entire unpaid portion of the loan. In addition, the Company may be required to fund additional amounts to complete a project and may have to hold the property for an indeterminate period of time.

1-4 Family Residential

The Company offers a variety of mortgage loan products. The Company s loans collateralized by one-to-four family residential real estate generally are originated in amounts of no more than 90% of the lower of cost or appraised value. The Company generally requires mortgage title insurance and hazard insurance in the amount of the loan. Of the mortgages originated, the Company generally retains mortgage loans with short terms or variable rates and sells longer-term fixed-rate loans that do not meet the Company s credit underwriting standards. Prior to the acquisition of First American in September 1999, the Company sold such loans to Texas Independent Bank Mortgage Company; however, since the First American acquisition, the Company sells these loans directly into the secondary market.

As of December 31, 2003, the Company s one-to-four family residential real estate loan portfolio (including loans held for sale) was $138.0 million. Of this amount, $46.3 million is repriceable in one year or less and an additional $83.5 million is repriceable from one year to five years. These high percentages in short-term real estate loans are an effort by the Company to reduce interest rate risk.

Consumer

The Company provides a wide variety of consumer loans including motor vehicle, watercraft, education loans, personal loans (collateralized and uncollateralized) and deposit account collateralized loans. The terms of these loans typically range from 12 to 60 months and vary based upon the nature of collateral and size of loan. As of December 31, 2003, the Company had no indirect consumer loans, indicating a preference to maintain personal banking relationships and strict underwriting standards. Consumer loans entail greater risk than do residential mortgage loans, particularly in the case of consumer loans that are unsecured or secured by rapidly depreciating assets such as automobiles. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment for the outstanding loan balance. The remaining deficiency often does not warrant further substantial collection efforts against the borrower beyond obtaining a deficiency judgment. In addition, consumer 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. Furthermore, the application of various federal and state laws may limit the amount that can be recovered on such loans. During the last several years, management has placed tighter controls on consumer credit due to record high personal bankruptcy filings nationwide.

Agriculture

The Company provides agricultural loans for short-term crop production, including cotton, milo and corn, farm equipment, cattle and agricultural real estate financing. The Company evaluates agricultural borrowers primarily based on their historical profitability, level of experience in their particular agricultural industry, overall financial capacity and the availability of secondary collateral to withstand economic and natural variations common to the industry. Because agricultural loans present a higher level of risk associated with events caused by nature, and the volatility of the world market prices on commodities, the Company routinely makes on-site visits, inspections, and utilizes government guaranteed programs in order to monitor, identify and manage such risks.

The Company rarely makes loans at its legal lending limit. Lending officers are assigned various levels of loan approval authority based upon their respective levels of experience and expertise. All loans above $700,000 are evaluated and acted upon by the Executive Committee, which meets weekly. All new and renewed loans greater than $100,000 are reported monthly to the Board of Directors. All new and renewed loans of $400,000 or less are reported weekly to the Executive Committee. The Company s strategy for approving or disapproving loans is to follow conservative loan policies and underwriting practices which include: (i) granting loans on a sound and collectible basis; (ii) investing funds properly for the benefit of shareholders and the protection of depositors; (iii) serving the legitimate needs of the community and the Company s general market area while obtaining a balance between maximum yield and minimum risk; (iv) ensuring that primary and secondary sources of repayment are adequate in relation to the amount of the loan; (v) developing and maintaining adequate diversification of the loan portfolio as a whole and of the loans within each category; and (vi) ensuring that each loan is properly documented and, if appropriate, insurance coverage is adequate. The Company s loan review and compliance personnel interact daily with commercial and consumer lenders to identify potential underwriting or technical exception variances. In addition, the Company has placed increased emphasis on the early identification of problem loans to aggressively seek resolution of the situations and thereby keep loan losses at a minimum.

The contractual maturity ranges of the commercial and industrial, agriculture, commercial real estate, and construction and land development loan portfolios and the amount of such loans with predetermined and floating interest rates in each maturity range as of December 31, 2003, are summarized in the following table:

	December 31, 2003			
	One Year or Less	After One Through Five Years	After Five Years	Total
	(Dollars in thousands)			
Commercial and industrial	$ 34,109	$ 19,027	$ 2,149	$ 55,285
Agriculture	7,118	2,812	243	10,173
Real estate-construction and land development	17,502	3,617	901	22,020
Commercial real estate	19,003	38,819	22,131	79,953
Total	$ 77,732	$ 64,275	$ 25,424	$ 167,431
Loans with a predetermined interest rate	$ 55,667	$ 48,612	$ 5,607	$ 109,886
Loans with a floating interest rate	22,065	15,663	19,817	57,545
Total	$ 77,732	$ 64,275	$ 25,424	$ 167,431

Nonperforming Assets

The Company has several procedures in place to assist it in maintaining the overall quality of its loan portfolio. The Company has established underwriting guidelines to be followed by its officers and also monitors its delinquency levels for any negative or adverse trends. There can be no assurance, however, that the Company s loan portfolio will not become subject to increasing pressures from deteriorating borrower credit due to general economic conditions.

Nonperforming assets at December 31, 2003, decreased $1.0 million, or 23.6%, to $3.3 million compared with $4.3 million at December 31, 2002. This decrease reflects a reduction in nonaccrual loans primarily attributed to four lines totaling $986,000 of which three were liquidated and one paid off during 2003. Other real estate also decreased from $1.1 million as of December 31, 2002 to $743,000 as of December 31, 2003. This decrease was the result of the sale of three properties. Continued aggressive collection efforts Company wide resulted in a minimal increase to accruing loans 90 days or more past due. This resulted in ratios of nonperforming assets to total loans plus other real estate of 0.90% and 1.18% for the years ended December 31, 2003 and 2002, respectively.

The Company generally places a loan on nonaccrual status and ceases to accrue interest when loan payment performance is deemed unsatisfactory. Loans where the interest payments jeopardize the collection of principal are placed on nonaccrual status, unless the loan is both well secured and in the process of collection. Cash payments received while a loan is classified as nonaccrual are recorded as a reduction of principal as long as doubt exists as to collection. If interest on nonaccrual loans had been accrued, such income would have been approximately $214,000 and $310,000 for 2003 and 2002, respectively. The Company is sometimes required to revise a loan s interest rate or repayment terms in a troubled debt restructuring; however, the Company had no restructured loans or additional nonperforming interest-earning assets at December 31, 2003, 2002, 2001, 2000 or 1999. In addition to regulatory examinations, the Company maintains an internal loan review staff and retains IBS on a semi-annual basis to evaluate the loan portfolio.

The Company maintains current appraisals on loans secured by real estate, particularly those categorized as nonperforming loans and potential problem loans. In instances where updated appraisals reflect reduced collateral values, an evaluation of the borrower s overall financial condition is made to determine the need, if any, for possible write-downs or appropriate additions to the allowance for loan losses. The Company records other real estate at the lower of its fair market value, minus estimated costs to sell the property, or the recorded investment in the loan on the date of transfer.

The following table presents information regarding nonperforming assets at the dates indicated:

	December 31,				
	2003	**2002**	**2001**	**2000**	**1999**
	(Dollars in thousands)				
Nonaccrual loans	$ 2,072	$ 2,810	$ 3,737	$ 1,214	$ 443
Accruing loans past due 90 days or more	489	404	1,912	3,488	574
Other real estate	743	1,111	562	274	79
Total nonperforming assets	$ 3,304	$ 4,325	$ 6,211	$ 4,976	$ 1,096
Nonperforming assets to total loans and other real estate	0.90%	1.18%	1.87%	1.73%	0.43%

The Company considers a loan to be impaired based on current information and events, if it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. The measurement of impaired loans is based on the present value of expected future cash flows discounted at the loan s effective interest rate or the loan s observable market price or based on the fair value of the collateral if the loan is collateral-dependent.

Allowance for Loan Losses

The allowance for loan losses is a reserve established through charges to earnings in the form of a provision for loan losses. Management has established an allowance for loan losses, which it believes, is adequate to absorb estimated losses in the Company s loan portfolio. Based on an evaluation of the loan portfolio, management presents a quarterly review of the adequacy of the allowance for loan losses to the Company s Board of Directors. In making its evaluation, management considers the diversification by industry of the Company s commercial loan portfolio, the effect of changes in the local real estate market on collateral values, the results of recent regulatory examinations, the effects on the loan portfolio of current economic indicators and their probable impact on borrowers, the amount of charge-offs for the period, the amount of nonperforming loans and related collateral security, the results of management s internal loan review and the evaluation of its loan portfolio through a semi-annual external loan review conducted by IBS. Charge-offs occur when loans are deemed to be uncollectible.

The Company follows an internal loan review program to evaluate the credit risk in the loan portfolio. Through the loan review process, the Company maintains an internally classified loan list, which, along with the delinquency list of loans, helps management assess the overall quality of the loan portfolio and the adequacy of the allowance for loan losses. Loans internally classified as special mention are those that contain a weakness that, if left unattended, could develop into a problem affecting the ultimate collectibility of the loan. Loans internally classified as substandard are those loans with clear and defined weaknesses such as highly leveraged positions, unfavorable financial ratios, uncertain repayment sources or poor financial condition, which may jeopardize recoverability of the loan. Loans internally classified as doubtful are those loans that have characteristics similar to substandard loans, but also have an increased risk that a loss may occur or at least a portion of the loan may require a charge-off if liquidated at present. Although loans classified as substandard do not duplicate loans classified as doubtful, both substandard and doubtful loans may include some loans that are past due at least 90 days, are on nonaccrual status or have been restructured. Loans internally classified as loss are those loans that are in the process of being charged off. At December 31, 2003, the Company had $9.0 million of internally classified loans compared with $9.9 million at December 31, 2002, a decrease of $900,000, or 9.1%. This decrease is primarily due to the improvement, workout, or foreclosure of seventeen loan relationships totaling $3.0 million, partially offset by the classification of fourteen new relationships, totaling $2.1 million. Specific reserves have been established for these new lines based on their estimated exposure.

In order to determine the adequacy of the allowance for loan losses, the Company establishes both specific and general reserves. The Company establishes specific allocations for the majority of problem loans based on the estimated exposure in each individual loan. The exposure is generally identified by determining the present value of

estimated future cash flows or the fair value of collateral if repayment is expected solely from the collateral. The Company establishes general reserves for non-problem loans primarily based on its historical loan loss experience, the volume and type of lending conducted by the Company, the amount of nonperforming assets, regulatory policies, generally accepted accounting principles, general economic conditions, and other factors related to the collectability of loans in the Company s loan portfolios.

Loans are charged-off against the allowance for loan losses when appropriate. Although management believes it uses the best information available to make determinations with respect to the allowance for loan losses, future adjustments may be necessary if economic conditions differ from the assumptions used in making the initial determinations.

The following table presents, for the periods indicated, an analysis of the allowance for loan losses and other related data:

	Years Ended December 31,				
	2003	**2002**	**2001**	**2000**	**1999**
	(Dollars in thousands)				
Average loans outstanding	$ 359,829	$ 342,823	$ 302,656	$ 267,996	$ 213,737
Gross loans outstanding at end of period	$ 365,514	$ 365,615	$ 331,254	$ 287,335	$ 255,209
Allowance for loan losses at beginning of period	$ 3,692	$ 3,346	$ 2,578	$ 2,491	$ 1,512
Provision for loan losses	1,075	1,260	1,385	595	310
Balance acquired with First American acquisition	-	-	-	-	846
Charge-offs:					
Commercial and industrial	(592)	(279)	(462)	(360)	(64)
Real estate	(38)	(375)	(162)	(146)	(2)
Consumer	(293)	(418)	(211)	(172)	(267)
Recoveries:					
Commercial and industrial	9	28	30	80	65
Real estate	12	57	124	11	42
Consumer	41	73	64	79	49
Net loan charge-offs	(861)	(914)	(617)	(508)	(177)
Allowance for loan losses at end of period	$ 3,906	$ 3,692	$ 3,346	$ 2,578	$ 2,491
Ratio of allowance to end of period loans	1.07%	1.01%	1.01%	0.90%	0.98%
	0.24%	0.27%	0.20%	0.19%	0.08%

Ratio of net loan charge-offs to average loans					
Ratio of allowance to end of period nonperforming loans	152.52%	114.87%	59.23%	54.83%	244.94%

The following tables describe the allocation of the allowance for loan losses among various categories of loans and certain other information for the dates indicated. The allocation is made for analytical purposes and is not necessarily indicative of the categories in which future losses may occur. The total allowance is available to absorb losses from any segment of loans.

	December 31,			
	2003		2002	
	Amount	Percent of Loans to Total Loans	Amount	Percent of Loans to Total Loans
	(Dollars in thousands)			
Balance of allowance for loan losses applicable to:				
Commercial, industrial and agriculture	$ 1,737	17.91%	$ 1,892	18.78%
Real estate:				
Construction and land development	-	6.02	-	3.83
1-4 family residential (1)	131	37.74	138	39.63
Commercial mortgage	192	21.88	173	22.33
Farmland	-	5.54	-	4.04
Multi-family	-	2.55	-	2.54
Consumer	301	8.36	320	8.85
Unallocated	1,545	-	1,169	-
Total allowance for loan losses	$ 3,906	100.00%	$ 3,692	100.00%

(1) The percentage of loans to total loans includes loans held for sale.

	2001		2000		1999	
	Amount	Percent of Loans to Total	Amount	Percent of Loans to Total Loans	Amount	Percent of Loans to Total Loans
	(Dollars in thousands)					
Balance of allowance for loan losses applicable to:						
Commercial, industrial and agriculture	$ 1,792	22.71%	$ 1,430	26.07%	$ 1,543	27.53%
Real estate:						
Construction and land development	-	2.87	-	2.55	-	3.11
1-4 family residential (1)	117	38.07	139	35.71	110	32.83
Commercial mortgage	138	20.58	193	21.31	176	20.49
Farmland	-	2.96	-	2.69	-	3.13
Multi-family	-	2.81	-	1.72	-	2.44
Consumer	333	10.00	289	9.95	262	10.47
Unallocated	966	-	527	-	400	-
Total allowance for loan losses	$ 3,346	100.00%	$ 2,578	100.00%	$ 2,491	100.00%

(1) The percentage of loans to total loans includes loans held for sale.

Securities Available- for-Sale

The Company uses its securities portfolio to ensure liquidity for cash requirements, to manage interest rate risk, to provide a source of income, to ensure collateral is available for municipal pledging requirements and to manage asset quality. At December 31, 2003, investment securities totaled $99.6 million, a decrease of $7.4 million from $107.0 million at December 31, 2002. The decrease was primarily attributable to $100.5 million in securities sold and in principal repayments, partially offset by $95.9 million in securities purchased. This decrease is a result of the decrease in deposits and a need for liquidity. The December 31, 2003 net unrealized gain was $704,000 compared to the December 31, 2002 net unrealized gain of $2.0 million. At December 31, 2003, securities represented 19.3% of total assets compared to 20.7% of total assets at December 31, 2002. The yield on the securities portfolio for 2003 was 3.64% compared to a yield of 5.05% for 2002 and 6.27% for 2001.

During 2003, the securities portfolio mix changed within various categories. U.S. Government securities decreased from $14.1 million at December 31, 2002 to $7.2 million at December 31, 2003. During 2003, Company discontinued investing in collateralized mortgage obligations (CMO s) and either sold or experienced prepayments of the $25.3 million of CMO s in its portfolio as of December 31, 2002. The Company had an increase of $24.1 million in mortgage-backed securities from $63.1 million at December 31, 2002 to $87.2 million at December 31, 2003. The Company s investments in equity securities increased from $3.2 million at December 31, 2002 to $3.9 million at December 31, 2003, an increase of $737,000 or 23.3%. Investments in obligations of state and political subdivisions were at $1.3 million for December 31, 2003 and 2002.

The following table summarizes the fair value of securities available for sale held by the Company as of the dates shown:

	December 31,		
	2003	**2002**	**2001**
	(Dollars in thousands)		
U.S. government agency securities	$ 7,194	$ 14,127	$ 4,494
Mortgage-backed securities	87,248	63,148	33,952
Collaterized mortgage obligations	-	25,280	34,390
Equity securities	3,902	3,165	2,112
Obligations of state and political subdivisions	1,270	1,272	6,767
Total securities	$ 99,614	$ 106,992	$ 81,715

The following table summarizes the contractual maturity of securities available for sale based on fair value and their weighted average yields as of December 31, 2003:

December 31, 2003									
Within One Year		**After One Year but Within Five Years**		**After Five Years but Within Ten Years**		**After Ten Years**		**Total**	
Amount	**Yield**	**Amount**	**Yield**	**Amount**	**Yield**	**Amount**	**Yield**	**Amount**	**Yield**
(Dollars in thousands)									

U.S. Government securities	$ 2,047	6.70%	$ 5,147	3.48%	$ -	-%	$ -	-%	$ 7,194	4.40%
Mortgage-backed securities	53	5.39	887	6.09	39,784	3.93	46,524	4.31	87,248	4.15
Equity securities	-	-	-	-	-	-	3,902	1.96	3,902	1.96
State and municipal securities	90	4.25	439	4.42	717	5.02	24	6.75	1,270	4.78
Totals	$ 2,190	6.57%	$ 6,473	3.90%	$ 40,501	3.95%	$ 50,450	4.12%	$ 99,614	4.09%

The Company classifies debt and equity securities at the date of purchase into one of two categories: held-to-maturity or available-for-sale. At each reporting date, the appropriateness of the classification is reassessed. Investments in debt securities are classified as held-to-maturity and measured at amortized cost in the financial statements only if management has the positive intent and ability to hold those securities to maturity. Investments not classified as held-to-maturity are classified as available-for-sale and measured at fair value in the financial statements with unrealized gains and losses reported, net of tax, in a separate component of shareholders equity until realized. The Company had no securities classified as held to maturity at December 31, 2003, 2002 or 2001.

Mortgage-backed securities and CMO s are securities, which have been developed by pooling a number of real estate mortgages and are principally issued by or guaranteed by federal agencies such as the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation. These securities are deemed to have high credit ratings and regular monthly cash flows of principal and interest, which are guaranteed by the issuing agencies. All the Company s mortgage-backed securities at December 31, 2003 were agency-issued collateral obligations.

At December 31, 2003, 53.3% of the mortgage-backed securities held by the Company had final maturities of more than 10 years. However, unlike U.S. Treasury and U.S. Government agency securities, which have a lump sum payment at maturity, mortgage-backed securities provide cash flows from regular principal and interest payments and principal prepayments throughout the lives of the securities. Therefore, the average life, or the average amount of time until the Company receives the total amount invested, of the mortgage-backed security will be shorter than the contractual maturity. The Company estimates the remaining average life of the fixed-rate mortgage-backed security portfolio to be less than three years. These securities, when purchased at a premium, will generally suffer decreasing net yields as interest rates drop because homeowners tend to refinance their mortgages. Thus, the premium paid must be amortized over a shorter period. Therefore, securities when purchased at a discount will obtain higher net yields in a decreasing interest rate environment. As interest rates rise, the opposite will generally be true. During a period of increasing interest rates, fixed rate mortgage-backed securities do not tend to experience heavy prepayments of principal and consequently, the average lives of these securities will not be unduly shortened.

Premises and Equipment

Premises and equipment totaled $13.2 million at December 31, 2003 and $13.6 million at December 31, 2002. The net change reflects a decrease of $382,000, or 2.8% in fixed assets. The decrease is primarily due to depreciation recorded for the year partially offset by the purchase of furniture and computer hardware for the Company.

Other Assets

The Company owns single premium insurance policies insuring the lives of certain key senior officers. The net cash surrender value of these polices totaled $6.2 million at December 31, 2003 and $5.9 million at December 31, 2002.

Deposits

The Company offers a variety of deposit accounts having a wide range of interest rates and terms. The Company s deposit accounts consist of demand, savings, money market and time accounts. The Company relies primarily on competitive pricing policies and customer service to attract and retain these deposits. The Company does not have or accept any brokered deposits.

Total deposits decreased to $407.8 million at December 31, 2003, from $425.0 million at December 31, 2002, a decrease of $17.1 million, or 4.0%. Noninterest-bearing deposits increased from $68.5 million at December 31, 2002, to $72.2 million at December 31, 2003, an increase of $3.7 million, or 5.4%. Certificates of deposit decreased from $241.3 million at December 31, 2002, to $215.9 million at December 31, 2003, a decrease of $25.4 million, or 10.5%. Other interest-bearing deposits increased from $115.1 million at December 31, 2002, to $119.7 million at December 31, 2003, an increase of 4.6 million, or 4.0%. The decrease in deposits is primarily due to the outflow of certificates of deposits into other investment options. All of the Company s markets showed decreases except for the Deport location, which increased certificates of deposits by $2.0 million. The Company s ratio of average noninterest-bearing demand deposits to average total deposits for years ended December 31, 2003, 2002, and 2001, were 16.3%, 15.7%, and 15.0%, respectively.

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The daily average balances and weighted-average rates paid on deposits for each of the years ended December 31, 2003, 2002 and 2001 are presented below:

	Years Ended December 31,					
	2003		2002		2001	
	(Dollars in thousands)					
	Amount	Rate	Amount	Rate	Amount	Rate
Regular savings	$ 14,781	0.69%	$ 11,774	1.44%	$ 10,084	1.97%
NOW accounts	43,781	0.71	35,740	1.04	33,992	2.09
Money market checking	62,877	0.84	61,150	1.58	60,524	2.96
Time deposits less than $100,000	130,770	2.64	132,800	3.53	125,236	5.62
Time deposits $100,000 and over	102,206	2.79	98,396	3.70	88,603	5.75
Total interest-bearing deposits	$ 354,415	2.04%	$ 339,860	2.89%	$ 318,439	4.66%
Noninterest-bearing deposits	68,868	-	63,265	-	56,127	-
Total deposits	$ 423,283	1.71%	$ 403,125	2.44%	$ 374,566	3.96%

The following table sets forth the amount of the Company s certificates of deposits at December 31, 2003 by time remaining until maturity:

	December 31, 2003
	(Dollars in thousands)
3 months or less	$ 51,849
Over 3 months through 6 months	38,422
Over 6 months through 1 year	80,193
Over 1 year	45,446
Total	$ 215,910

Other Borrowings

Federal Home Loan Bank (FHLB) advances may be utilized from time to time as either a short-term funding source or a longer-term funding source. FHLB advances can be particularly attractive as a longer-term funding source to balance interest rate sensitivity and reduce interest rate risk. The Company is eligible for two borrowing programs through the FHLB. The first, called Short Term Fixed, requires delivery of eligible securities for collateral. Maturities under this program range from 1-35 days. The Company does not currently have any borrowings under this program. As of December 31, 2003, the Company does not have any of its investment securities in safekeeping at the FHLB.

The second borrowing program, the Blanket Borrowing Program, is under a borrowing agreement which does not require the delivery of specific collateral. Borrowings are limited by the level of qualified pledgable real estate loans held and FHLB stock owned. At December 31, 2003, the Company had approximately $50.4 million borrowed of a potential $106.7 million available under this program, leaving approximately $56.3 million in available borrowings.

On March 23, 2000, the Company, in a private placement, issued $7.0 million (7,000 shares with a liquidation amount of $1,000 per security) of 10.875% Fixed Rate Capital Trust Pass-through Securities (TruPS) through a newly formed, wholly-owned subsidiary, Guaranty (TX) Capital Trust I (the Trust I). The Trust I invested the total proceeds from the sale of the TruPS in 10.875% Junior Subordinated Deferrable

Interest Debentures (the Debentures I) issued by the Company. The net proceeds from the sale of the Debentures I were used to repurchase shares of the Company s stock, provide a $1.5 million additional capital contribution to Guaranty Bond Bank and provide for additional working capital to support growth.

With certain exceptions, the amount of the principal and any accrued and unpaid interest on the Debentures I are subordinated in right of payment to the prior payment in full of all senior indebtedness of the Company. The terms of the Debentures I are such that they qualify as Tier I capital under the Federal Reserve Board s regulatory capital guidelines applicable to bank holding companies. Interest on the Debentures I is payable semi-annually on March 8 and September 8 of each year. The interest is deferrable on a cumulative basis for up to five consecutive years following a suspension of dividend payments on all other capital stock. No principal payments are due until maturity on March 8, 2030.

On any March 8 or September 8 on or after March 8, 2010 and prior to maturity, the Debentures I are redeemable for cash at the option of the Company, on at least 30 but not more than 60 days notice, in whole or in part, at the redemption prices set forth in the table below, plus accrued interest to the date of redemption:

If Redeemed During 12 Months Beginning March 8,	Percentage of Principal Amount	If Redeemed During 12 Months Beginning March 8,	Percentage of Principal Amount
2010	105.44%	2016	102.18%
2011	104.89%	2017	101.63%
2012	104.35%	2018	101.09%
2013	103.81%	2019	100.54%
2014	103.26%	2020 and after	100.00%
2015	102.72%		

Upon the occurrence of certain special events, the Company will have the right to call the securities at par at any time with the permission of the Federal Reserve.

On October 30, 2002, the Company, in a private placement, issued an additional $3.0 million (3,000 shares with a liquidation amount of $1,000 per security) of Capital Trust Pass-through Securities (TruPS II) through a newly formed, wholly-owned subsidiary, Guaranty (TX) Capital Trust II (the Trust II). The Trust II invested the total proceeds from the sale of the TruPS II in Junior Subordinated Deferrable Interest Debentures (the Debentures II) issued by the Company. The Debentures II bear a fixed rate of interest of 7.94% for 10 years; thereafter, until the maturity, the interest rate will float at 3.35% above the 3 month LIBOR. The net proceeds from the sale of the Debentures II are being used to repurchase shares of the Company s stock and provide for additional working capital to support growth.

With certain exceptions, the amount of the principal and any accrued and unpaid interest on the Debentures II are subordinated in right of payment to the prior payment in full of all senior indebtedness of the Company. The terms of the Debentures II are such that they qualify as Tier 1 capital under the Federal Reserve Board s regulatory capital guidelines applicable to bank holding companies. Interest on the Debenture II is payable quarterly on January 30, April 30, July 30, and October 30 of each year at a fixed rate per annum equal to 7.94% until October 2012 and a variable rate per annum, reset quarterly, equal to LIBOR plus 3.35%, thereafter. The interest is deferrable on a cumulative basis for up to five consecutive years following a suspension of dividend payments on all other capital stock. No principal payments are due until maturity on October 30, 2032.

On any interest payment date on or after October 30, 2012 and prior to maturity date, the Debentures II are redeemable for cash at the option of the Company, on at least 30 but not more than 60 days notice, in whole or in part, at a redemption price equal to 100% of the principal amount to be redeemed, plus accrued interest to the date of redemption.

Due to FIN No. 46, *Consolidation of Variable Interest Entities* (see *Recent Accounting Pronouncements*), the Company will no longer consolidate Trust I and Trust II in its financial statements as of January 1, 2004. As a result, the Company s balance sheet will include $10.3 million of subordinated debt, which is currently included on the balance sheet as $10.0 million in long-term debt after a consolidation elimination of $310,000. The overall impact of this deconsolidation is not expected to be material to the Company s consolidated financial statements. In July 2003, the Federal Reserve issued a supervisory letter instructing bank holding companies to include the long-term debt in Tier I capital for regulatory purposes, subject to specified limits, until notice is given to the contrary.

At this time, it is not possible to estimate the effect, if any, on the Company s Tier I regulatory capital as a result of any future action taken by the Federal Reserve.

The following table sets forth the balance of contractual obligations by maturity period as of December 31, 2003 (in thousands):

	Payments due by period				
	Within One Year	After One but Within Three Years	After Three but Within Five Years	After Five Years	Total
Long-term debt	$ -	$ -	$ -	$ 10,000	$ 10,000
Federal Home Loan Bank Advances	6,364	29,034	14,609	410	50,417
Total	$ 6,364	$ 29,034	$ 14,609	$ 10,410	$ 60,417

Capital Resources and Liquidity

Capital management consists of providing equity to support both current and future operations. The Company is subject to capital adequacy requirements imposed by the Federal Reserve and the Bank is subject to capital adequacy requirements imposed by the FDIC and the TDB. Both the Federal Reserve and the FDIC have adopted risk-based capital requirements for assessing bank holding company and bank capital adequacy. These standards define capital and establish minimum capital requirements in relation to assets and off-balance sheet exposure, adjusted for credit risk. The risk-based capital standards currently in effect are designed to make regulatory capital requirements more sensitive to differences in risk profiles among bank holding companies and banks, to account for off-balance sheet exposure and to minimize disincentives for holding liquid assets. Assets and off-balance sheet items are assigned to broad risk categories, each with appropriate relative risk weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance sheet items.

The risk-based capital standards issued by the Federal Reserve require all bank holding companies to have Tier 1 capital of at least 4.0% and total risk-based capital (Tier 1 and Tier 2) of at least 8.0% of total risk-adjusted assets. Tier 1 capital generally includes common shareholders equity and qualifying perpetual preferred stock together with related surpluses and retained earnings, less deductions for goodwill and various other intangibles. Tier 2 capital may consist of a limited amount of intermediate-term preferred stock, a limited amount of term subordinated debt, certain hybrid capital instruments and other debt securities, perpetual preferred stock not qualifying as Tier 1 capital, and a limited amount of the general valuation allowance for loan losses. The sum of Tier 1 capital and Tier 2 capital is total risk-based capital .

The Federal Reserve has also adopted guidelines which supplement the risk-based capital guidelines with a minimum ratio of Tier 1 capital to average total consolidated assets (leverage ratio) of 3.0% for certain institutions with well diversified risk, including no undue interest rate exposure; excellent asset quality; high liquidity; good earnings; and that are generally considered to be strong banking organizations, rated composite 1 under applicable federal guidelines, and that are not experiencing or anticipating significant growth. Other banking organizations are required to maintain a leverage ratio of at least 4.0% to 5.0%. These rules further provide that banking organizations experiencing internal growth or making acquisitions will be expected to maintain capital positions substantially above the minimum supervisory levels and comparable to peer group averages, without significant reliance on intangible assets.

Pursuant to FDICIA, each federal banking agency revised its risk-based capital standards to ensure that those standards take adequate account of interest rate risk, concentration of credit risk and the risks of nontraditional activities, as well as reflect the actual performance and expected risk of loss on multifamily mortgages. The Bank is subject to capital adequacy guidelines of the FDIC that are substantially similar to the Federal Reserve s guidelines. Also pursuant to FDICIA, the FDIC has promulgated regulations setting the levels at which an insured institution such as the Bank would be considered well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. The Bank is classified well capitalized for purposes of the FDIC s prompt corrective action regulations. **See Supervision and Regulation — The Company and — The Bank** .

Shareholders equity increased to $36.4 million at December 31, 2003, from $34.6 million at December 31, 2002, an increase of $1.8 million, or 5.2%. This increase was primarily the result of net earnings of $3.8 million, offset by the payment of common stock dividends of $1.1 million, the net decrease in unrealized gain on available-for-sale securities of $874,000 and the purchase of treasury stock of $161,000.

The following table provides a comparison of the Company s and the Bank s leverage and risk-weighted capital ratios as of December 31, 2003 to the minimum and well-capitalized regulatory standards:

	Minimum Required	To Be Well Capitalized Under Prompt Corrective Action Provisions	Actual Ratio at December 31, 2003
The Company			
Leverage ratio	4.00%(1)	N/A	8.32%
Tier 1 risk-based capital ratio	4.00%	N/A	12.10%
Risk-based capital ratio	8.00%	N/A	13.18%
The Bank			
Leverage ratio	3.00%(2)	5.00%	8.05%
Tier 1 risk-based capital ratio	4.00%	6.00%	11.72%
Risk-based capital ratio	8.00%	10.00%	12.81%

(1) The Federal Reserve may require the Company to maintain a leverage ratio above the required minimum.

(2) The FDIC may require the Bank to maintain a leverage ratio above the required minimum.

At December 31, 2003, the Company s capital ratios exceeded the minimums required by regulatory guidelines. The Company intends to maintain an optimal capital and leverage mix. Liquidity involves the Company s ability to raise funds to support asset growth or reduce assets to meet deposit withdrawals and other payment obligations, to maintain reserve requirements and otherwise to operate the Company on an ongoing basis. The Company s liquidity needs are met primarily by financing activities, which consists mainly of growth in core deposits, supplemented by investment securities and earnings through operating activities. Access to purchased funds from correspondent banks is available and has been utilized on occasion to take advantage of investment opportunities. The cash and federal funds sold position, supplemented by amortizing investments along with payments and maturities within the loan portfolio, have historically created an adequate liquidity position.

The Company s liquidity management objective is to meet maturing debt obligations, fund loan commitments and deposit withdrawals, and manage operations on a cost effective basis. Management believes that sufficient resources are available to meet the Company s liquidity objective through its debt maturity structure, holdings of liquid assets, and access to the capital markets through a variety of funding vehicles. Proper liquidity management is crucial to ensure that the Company is able to take advantage of new business opportunities as well as meet the demands of its customers.

The Bank s traditional funding sources consist primarily of core deposits, established federal funds and other borrowing lines with major banks, proceeds from matured investments, contracts to repurchase investment securities and principal and interest repayments on loans.

Management is not aware of any events that are reasonably likely to have a material adverse effect on the Company s liquidity, capital resources or operations. In addition, management is not aware of any regulatory recommendations regarding liquidity, which if implemented, would have a material adverse effect on the Company.

Off Balance Sheet Items

The Company enters into contractual commitments to extend credit, normally with fixed expiration dates or termination clauses, at specified rates and for specific purposes. Customers use credit commitments to ensure that funds will be available for working capital purposes, for capital expenditures and to ensure access to funds at specified terms and conditions. Substantially all of the Company s commitments to extend credit are contingent

upon customers maintaining specific credit standards at the time of loan funding. Management assesses the credit risk associated with certain commitments to extend credit in determining the level of the allowance for loan losses.

Letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The Company s policies generally require that letters of credit arrangements contain security and debt covenants similar to those contained in loan agreements. In the event the customer does not perform in accordance with the terms of the agreement with the third party, the Company would be required to fund the commitment. The maximum potential amount of future payments the Company could be required to make is represented by the contractual amount shown in the table below. If the commitment were funded, the Company would be entitled to seek recovery from the customer. As of December 31, 2003 and December 31, 2002, no amounts have been recorded as liabilities for the Bank s potential obligations under these guarantees.

Outstanding commitments and letters of credit are approximately as follows:

	Contract or Notional Amount	
	2003	**2002**
	(Dollars in thousand)	
Commitments to extend credit	$ 23,878	$ 27,838
Letters of credit	1,491	1,140

Industry Segments

The principal business of the Company is overseeing the business of the Bank. The Company has no significant assets other than its investment in the Bank; therefore, the banking operation is the Company s only reportable segment.

Recent Accounting Pronouncements

In April 2003, the Financial Accounting Standards Board (FASB) issued *Statement of Financial Accounting Standard (SFAS) No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities* (SFAS 149). SFAS 149 amends and clarifies accounting for derivative instruments and hedging activities under Statement 133. In addition, this Statement clarifies under what circumstances a contract with an initial net investment meets the characteristic of a derivative and when a derivative contains a financing component that warrants special reporting in the statement of cash flows. This statement is effective for contracts entered into or modified after June 30, 2003. The Company s adoption of this statement did not have a material impact on the Company s consolidated financial statements.

In May 2003, the FASB issued *SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity (SFAS 150).* SFAS 150 established standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or asset in some circumstances). The Company adopted SFAS 150 on July 1, 2003 and such adoption did not have a material effect on its financial position or results of operations. The effective date of SFAS 150 has been indefinitely deferred by the FASB for certain mandatory redeemable instruments when certain criteria are met. The Company has no instruments subject to these provisions.

FIN No. 46, *Consolidation of Variable Interest Entities*, an interpretation of Accounting Research Bulletin No. 51, establishes accounting guidance for consolidation of variable interest entities (VIE) that function to support the activities of the primary beneficiary. Prior to the implementation of FIN 46, VIEs were generally consolidated by an enterprise when the enterprise had a controlling financial interest through ownership of a majority of voting interest in the entity. The provisions of FIN 46 were effective immediately for all arrangements entered into after January 31, 2003. In December 2003, the FASB issued a revision to FIN 46 (FIN 46R) which clarified certain implementation issues and revised implementation dates for VIE s created before January 31, 2003. Under the new guidance, special effective date provisions apply to enterprises that have fully or partially applied FIN 46 prior to

issuance of the revised Interpretation. Otherwise, application of FIN 46R (or FIN 46) is required in financial statements of public entities that have interests in special-purpose entities for periods ending after December 15, 2003. Application by public entities, other than small business issuers, for all other types of VIEs is required in financial statements for periods ending after March 15, 2004. The Company has concluded that deconsolidation of the trusts created upon the issuance of the trust preferred securities is necessary by March 31, 2004. In July 2003, the Federal Reserve issued a supervisory letter instructing bank holding companies to include the trust preferred securities in Tier I capital for regulatory purposes until notice is given to the contrary. There can be no assurance that the Federal Reserve will continue to permit institutions to include trust preferred securities in Tier 1 capital for regulatory capital purposes.

The Emerging Issues Task Force (EITF) recently reached a consensus on Issue No. 03-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments,* which is effective for fiscal years ending after December 15, 2003. EITF 03-1 requires additional disclosures related to unrealized losses that are temporary. Investments classified as held to maturity and available for sale with unrealized losses that are temporary must be separated into (i) losses that have existed for less than 12 months and (ii) losses that have existed for more than 12 months. The Company has adopted the disclosure requirements as of December 31, 2003.

Item 7A. ***Quantitative and Qualitative Disclosures About Market Risk.***

The Company s Asset Liability and Funds Management Policy provides management with the necessary guidelines for effective funds management, and the Company has established a measurement system for monitoring its net interest rate sensitivity position. The Company manages its sensitivity position within established guidelines.

Interest rate risk is managed by the Asset Liability Committee (ALCO), which is composed of senior officers of the Company, in accordance with policies approved by the Company s Board of Directors. The ALCO formulates strategies based on appropriate levels in interest rate risk. In determining the appropriate level of interest rate risk, the ALCO considers the impact on earnings and capital based on the current outlook on interest rates, potential changes in interest rates, regional economies, liquidity, business strategies, and other factors. The ALCO meets regularly to review, among other things, the sensitivity of assets and liabilities to interest rate changes, the book and market values of assets and liabilities, unrealized gains and losses, purchase and sale activity, commitments to originate loans, and the maturities of investments and borrowings. Additionally, the ALCO reviews liquidity, cash flow flexibility, maturities of deposits and consumer and commercial deposit activity. Management uses two methodologies to manage interest rate risk: (i) an analysis of relationships between interest-earning assets and interest-bearing liabilities; and (ii) interest rate shock simulation models. The Company has traditionally managed its business to reduce its overall exposure to changes in interest rates, however, under current policies of the Company s Board of Directors, management has been given some latitude to increase the Company s interest rate sensitivity position within certain limits if, in management s judgment, it will enhance profitability. As a result, changes in market interest rates may have a greater impact on the Company s financial performance in the future than they have had historically.

To effectively measure and manage interest rate risk, the Company uses interest rate shock simulation models to determine the impact on net interest income under various interest rate scenarios, balance sheet trends and strategies. From these simulations, interest rate risk is quantified and appropriate strategies are developed and implemented. Additionally, duration and market value sensitivity measures are utilized when they provide added value to the overall interest rate risk management process. The overall interest rate risk position and strategies are reviewed by the Company s Board of Directors on an ongoing basis. The Company manages its exposure to interest rates by structuring its balance sheet in the ordinary course of business. The Company does not currently enter into instruments such as leveraged derivatives, structured notes, interest rate swaps, caps, floors, financial options, financial futures contracts or forward delivery contracts for the purpose of reducing interest rate risk.

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The impact on future net earnings based on interest sensitive assets and liabilities held at December 31, 2003 using the interest rate shock simulation is as follows:

Change in Interest Rates	Net Earnings	Change in Net Earnings
	(Dollars in thousand)	
+ 300	$ 5,936	$ 496
+200	5,933	493
+100	5,746	306
Base	5,440	-
- 100	4,595	(845)
- 200	3,404	(2,036)
- 300	2,008	(3,432)

An interest rate sensitive asset or liability is one that, within a defined time period, either matures or experiences an interest rate change in line with general market interest rates. The management of interest rate risk is performed by analyzing the maturity and repricing relationships between interest-earning assets and interest-bearing liabilities at specific points in time (GAP) and by analyzing the effects of interest rate changes on net interest income over specific periods of time by projecting the performance of the mix of assets and liabilities in varied interest rate environments. Interest rate sensitivity reflects the potential effect on net interest income of a movement in interest rates. A company is considered to be asset sensitive, or having a positive GAP, when the amount of its interest-earning assets maturing or repricing within a given period exceeds the amount of its interest-bearing liabilities also maturing or repricing within that time period. Conversely, a company is considered to be liability sensitive, or having a negative GAP, when the amount of its interest-bearing liabilities maturing or repricing within a given period exceeds the amount of its interest-earning assets also maturing or repricing within that time period. During a period of rising interest rates, a negative GAP would tend to affect net interest income adversely, while a positive GAP would tend to result in an increase in net interest income. During a period of falling interest rates, a negative GAP would tend to result in an increase in net interest income, while a positive GAP would tend to affect net interest income adversely. However, it is management s intent to achieve a proper balance so that incorrect rate forecasts should not have a significant impact on earnings.

The following table sets forth an interest rate sensitivity analysis for the Company at December 31, 2003:

	Volumes Subject to Repricing Within						
	0-30 days	**31-180 days**	**181-365 days**	**1-3 years**	**3-5 years**	**Greater than 5 years**	**Total**
	(Dollars in thousands)						
Interest-earning assets:							
Interest-bearing time deposits	$ -	$ 6,178	$ 598	$ -	$ -	$ -	$ 6,776
Securities	2,011	12,824	12,662	49,535	17,322	5,260	99,614
Loans	71,397	89,299	73,219	127,282	111	4,206	365,514
Federal funds sold	-	-	-	-	-	-	-
Total interest-earning assets	73,408	108,301	86,479	176,817	17,433	9,466	471,904
Interest-bearing liabilities:							
NOW, money market and savings deposits	119,735	-	-	-	-	-	119,735
Certificates of deposit and other time deposits	19,876	69,842	80,404	28,328	17,336	124	215,910
Federal funds purchased	7,295	-	-	-	-	-	7,295
FHLB advances	17	2,585					