GREENVILLE FIRST BANCSHARES INC
Form 10QSB
August 13, 2003

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-QSB

[X] QUARTERLY REPORT UNDER SECTION 13 or 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarter ended June 30, 2003

[ ] TRANSITION REPORT UNDER SECTION 13 or 15(d)
OF THE EXCHANGE ACT OF 1934

For the transition period from ___________ to _____________

Commission file number 333-83851

Greenville First Bancshares, Inc.
(Exact name of registrant as specified in its charter)

South Carolina	58-2459561
(State of Incorporation)	(I.R.S. Employer Identification No.)

112 Haywood Road Greenville, S.C.	29607
(Address of principal executive offices)	(Zip Code)

864-679-9000
(Telephone Number)

Not Applicable
(Former Name, former address
and former fiscal year,
if changed since last report)

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: 1,150,000 shares of common stock, par value $.01 per share, were issued and outstanding as of May 9, 2003.

Transitional Small Business Disclosure Format (check one): Yes __ No_X_

GREENVILLE FIRST BANCSHARES, INC.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

The financial statements of Greenville First Bancshares, Inc. and Subsidiary are set forth in the following pages.

GREENVILLE FIRST BANCSHARES, INC. & SUBSIDIARY
CONSOLIDATED BALANCE SHEETS

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	June 30, 2003 (Unaudited)	December 31, 2002 (Audited)
Assets		
Cash and due from banks	$ 4,426,394	$ 4,503,420
Federal funds sold	4,429,290	41,736
Investment securities available for sale	4,709,690	14,592,190
Other investments, at cost	1,605,000	905,000
Loans, net	173,584,374	148,079,012
Accrued interest	681,683	730,028
Property and equipment	749,280	785,942
Other real estate owned	598,356	524,625
Other assets	689,782	269,840
Total assets	$ 191,547,979	$ 170,357,663
Liabilities and Shareholders' Equity		
Liabilities		
Deposits	$ 144,546,324	$ 133,563,270
Official checks outstanding	3,951,560	889,270
Federal funds purchased and repurchase agreements	-	9,107,000
Federal Home Loan Bank advances	25,500,000	13,000,000
Note payable	-	2,500,000
Trust preferred securities	6,000,000	-
Accrued interest payable	601,857	606,072
Accounts payable and accrued expenses	347,682	460,262
Total liabilities	180,947,423	160,125,874
Commitments and contingencies		
Shareholders' equity		
Preferred stock, par value $.01 per share, 10,000,000 shares authorized, no shares issued	-	-
Common stock, par value $.01 per share, 10,000,000 shares authorized, 1,150,000 issued	11,500	11,500
Additional paid-in capital	10,635,200	10,635,200
Accumulated other comprehensive income	120,119	147,733
Retained deficit	(166,263)	(562,644)
Total shareholders' equity	10,600,556	10,231,789
Total liabilities and shareholders' equity	$ 191,547,979	$ 170,357,663

See notes to consolidated financial statements that are an integral part of these consolidated statements.

GREENVILLE FIRST BANCSHARES, INC. & SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	For the Three Months Ended June 30, 2003	2002
Interest income		
Loans	$ 2,219,654	$ 1,734,959
Investment securities	62,569	188,250
Federal funds sold	5,179	13,511
Total interest income	2,287,402	1,936,720
Interest expense		
Deposits	682,896	841,523
Borrowings	177,924	43,097
Total interest expense	860,820	884,620
Net interest income before provision for loan losses	1,426,582	1,052,100
Provision for loan losses	200,000	220,000
Net interest income after provision for loan losses	1,226,582	832,100
Noninterest income (loss)		
Loan fee income	59,312	27,212
Service fees on deposit accounts	63,567	45,821
Writedown on real estate owned	(100,000)	-
Other income	61,075	48,781
Total noninterest income	83,954	121,814
Noninterest expenses		
Salaries and benefits	488,564	430,024
Professional fees	40,958	43,141
Marketing	43,396	37,786
Insurance	26,580	21,791
Occupancy	137,965	145,708
Data processing and related costs	154,473	109,628
Telephone	5,717	6,554
Other	42,794	38,156
Total noninterest expenses	940,447	832,788
Income before income taxes	370,089	121,126
Income tax expense	140,634	-
Net income	$ 229,455	$ 121,126
Income per common share:		
Basic	$ .20	$ .11

	For the Three Months Ended	
Diluted	$ .18	$ .10
Weighted average common shares outstanding:		
Basic	1,150,000	1,150,000
Diluted	1,257,599	1,162,398

See notes to consolidated financial statements that are an integral part of these consolidated statements.

GREENVILLE FIRST BANCSHARES, INC. & SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOMES
(Unaudited)

	For the Six Months Ended June 30,	
	2003	**2002**
Interest income		
Loans	$ 4,307,650	$ 3,321,614
Investment securities	199,113	369,403
Federal funds sold	11,668	36,061
Total interest income	4,518,431	3,727,078
Interest expense		
Deposits	1,412,376	1,611,120
Borrowings	340,394	119,680
Total interest expense	1,752,770	1,730,800
Net interest income before provision for loan losses	2,765,661	1,996,278
Provision for loan losses	500,000	420,000
Net interest income after provision for loan losses	2,265,661	1,576,278
Noninterest income (loss)		
Loan fee income	103,666	54,445
Service fees on deposit accounts	123,296	81,434
Writedown on real estate operations	(100,000)	-
Other income	104,145	88,885
Total noninterest income	231,107	224,764
Noninterest expenses		
Salaries and benefits	967,842	861,547
Professional fees	74,559	83,200
Marketing	78,745	62,184
Insurance	53,265	43,034
Occupancy	299,362	291,733
Data processing and related costs	287,530	203,527
Telephone	11,187	11,730
Other	84,954	80,148
Total noninterest expenses	1,857,444	1,637,103

	For the Six Months Ended	
Income before income taxes	639,322	163,939
Income tax expense	242,941	-
Net income	$ 396,381	$ 163,939
Income per common share:		
Basic	$ .34	$ .14
Diluted	$ .32	$ .14
Weighted average common shares outstanding:		
Basic	1,150,000	1,150,000
Diluted	1,240,247	1,156,199

See notes to consolidated financial statements that are an integral part of these consolidated statements.

GREENVILLE FIRST BANCSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY
(Unaudited)

	Common stock Shares	Common stock Amount	Additional paid-in capital	Accumulated other comprehensive income	Retained deficit	Total Shareholders' equity
December 31, 2001	1,150,000	$ 11,500	$ 10,635,200	$ 127,779	$ (1,315,060)	$ 9,459,419
Net income	-	-	-	-	163,939	163,939
Comprehensive income (loss), net of tax						
Unrealized holding gain on securities available for sale	-	-	-	11,663	-	11,663
Comprehensive income	-	-	-	-	-	175,602
June 30, 2002	1,150,000	$ 11,500	$ 10,635,200	$ 139,442	$ (1,151,121)	$ 9,635,021
December 31, 2002	1,150,000	$ 11,500	$ 10,635,200	$ 147,733	$ (562,644)	$ 10,231,789
Net income	-	-	-	-	396,381	396,381
Comprehensive income, net of tax						
Change in unrealized holding gain on securities available for sale	-	-	-	(27,614)	-	(27,614)

					Accumulated	
Comprehensive income	-	-	-	-	-	368,767
June 30, 2003	1,150,000	$ 11,500	$ 10,635,200	$ 120,119	$ (166,263)	$ 10,600,556

See notes to consolidated financial statements that are an integral part of these consolidated statements.

GREENVILLE FIRST BANCSHARES, INC.AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	For the Six Months Ended June 30,	
	2003	**2002**
Operating activities		
Net income	$ 396,381	$ 163,939
Adjustments to reconcile net income to cash provided by (used for) operating activities:		
Provision for loan losses	500,000	420,000
Depreciation and other amortization	69,704	101,369
Accretion and amortization of securities discounts and premium, net	50,869	17,017
Increase in other assets, net	(445,328)	(73,769)
	2,959,721	(395,425)
Net cash provided by operating activities	3,531,347	233,131
Investing activities		
Increase (decrease) in cash realized from:		
Origination of loans, net	(26,005,362)	(27,680,931)
Purchase of property and equipment	(33,042)	(53,736)
Purchase of securities available for sale	(800,000)	(7,007,887)
Payments and maturity of securities available for sale	9,889,791	9,491,635
Net cash used for investing activities	(16,948,613)	(25,250,919)
Financing activities		
Increase in deposits, net	10,983,054	31,034,685
Decrease in short-term borrowings	(9,107,000)	(2,407,600)
Increase(decrease) in other borrowings	(2,500,000)	1,000,000
Proceeds from trust preferred securities	6,000,000	-
Increase (decrease) in Federal Home Loan Bank advances	12,500,000	(3,000,000)
Net cash provided by financing activities	17,876,054	26,627,085
Net increase in cash and cash equivalents	4,458,788	1,609,297
Cash and cash equivalents at beginning of the year	4,471,026	2,982,956
Cash and cash equivalents at end of the year	$ 8,929,814	$ 4,592,253

	For the Six Months Ended	
Supplemental information		
Cash paid for		
Interest	$ 1,748,555	$ 1,873,912
Income taxes	$ 382,302	-
Supplemental schedule of non-cash transaction		
Foreclosure of real estate	$ -	$ 362,987
Unrealized gain on securities, net of income taxes	$ (27,614)	$ 11,663

See notes to consolidated financial statements that are an integral part of these consolidated statements.

GREENVILLE FIRST BANCSHARES AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 Nature of Business and Basis of Presentation

Business activity and organization

Greenville First Bancshares, Inc. (the company) is a South Carolina corporation organized for the purpose of owning and controlling all of the capital stock of **Greenville First Bank, N.A** (the bank). The bank is a national bank organized under the laws of the United States located in Greenville County, South Carolina. The bank began operations on January 10, 2000.

The bank is primarily engaged in the business of accepting demand deposits and savings deposits insured by the Federal Deposit Insurance Corporation, and providing commercial, consumer and mortgage loans to the general public.

Basis of Presentation

The accompanying financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-QSB. Accordingly, they do not include all the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three-month and the six-month periods ended June 30, 2003 are not necessarily indicative of the results that may be expected for the year ending December 31, 2003. For further information, refer to the consolidated financial statements and footnotes thereto included in the company s Form 10-KSB (Registration Number 333-83851) as filed with the Securities and Exchange Commission. The consolidated financial statements include the accounts of Greenville First Bancshares, Inc., its wholly owned subsidiaries Greenville First Bank, N.A., and Greenville Statutory Trust I.

Cash and Cash Equivalents

For purposes of the Consolidated Statement of Cash Flows, cash and federal funds sold are included in cash and cash equivalents. These assets have contractual maturities of less than three months.

Note 2 Note Payable

At June 30, 2003, the company had an unused $3.5 million revolving line of credit with another bank with a maturity of March 20, 2004. The line of credit bears interest at a rate of three-month libor plus 2.00%, which at June 30, 2003 was 3.06%. The company has pledged the stock of the bank as collateral for this line of credit. The line of credit agreement contains various covenants related to earnings and asset quality. As of June 30, 2003, the company was in compliance with all covenants.

Note 3 Trust Preferred Securities

On June 26, 2003, Greenville First Bancshares, Inc., through a newly formed wholly-owned subsidiary, issued $6.0 million floating rate trust preferred securities. The initial pricing of the transaction calls for a floating rate coupon beginning at 4.16%. The rate is determined quarterly.

The company used $3.0 million of the proceeds to repay the outstanding balance on a $3.5 million revolving line of credit. The $3.5 million revolving line of credit will remain available. The Company invested $2.7 million in the Company s wholly-owned subsidiary, Greenville First Bank. The remaining balance will be used by the Company to fund operations.

Note 4 Stock Based Compensation

The company has a stock-based employee compensation plan. The company accounts for the plan under the recognition and measurement principles of Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees,* and related Interpretations. No stock-based employee compensation cost is reflected in net income, as all stock options granted under these plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income and earnings per share if the company had applied the fair value recognition provisions of Financial Accounting Standards Board (FASB), SFAS No. 123, *Accounting for Stock-Based Compensation,* to stock-based employee compensation.

	For the Three Months ended June 30,	
	2003	**2002**
Net income, as reported	$ 229,455	$ 121,126
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(19,613)	(17,613)
Pro forma net income	$ 209,842	$ 103,513
Earnings per common share:		
Basic - as reported	$ .20	$ .11
Basic - pro forma	$ .18	$ .09
Diluted - as reported	$ .18	$ .10
Diluted - pro-forma	$ .17	$ .09

	For the Six Months ended June 30,	
	2003	**2002**
Net income, as reported	$ 396,381	$ 163,939
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(39,226)	(35,226)
Pro forma net income	$ 357,155	$ 128,713
Earnings per common share:		
Basic - as reported	$ .34	$ .14
Basic - pro forma	$ .31	$ .11

	For the Six Months ended June 30,	
Diluted - as reported	$ .32	$ .14
Diluted - pro-forma	$ .29	$ .11

The fair value of the option grant is estimated on the date of grant using the Black-Scholes option-pricing model. The following assumptions were used for grants: expected volatility of 10% for 2003 and 2002, risk-free interest rate of 3.00% for 2003 and 2002, respectively, and expected lives of the options 10 years and the assumed dividend rate was zero.

Note 5 Earnings per Share

The following schedule reconciles the numerators and denominators of the basic and diluted earnings per share computations for the three and six months ended June 30, 2003 and 2002. Dilutive common shares arise from the potentially dilutive effect of Greenville First Bancshares, Inc. s stock options and warrants that are outstanding. The assumed conversion of stock options and warrants can create a difference between basic and dilutive net income per common share.

	Three Months Ended June 30, 2003	Three Months Ended June 30, 2002
Basic Earnings Per Share		
Average common shares	1,150,000	1,150,000
Net income	$ 229,455	$ 121,126
Earnings per share	$ .20	$ .11
Diluted Earnings Per Share		
Average common shares outstanding	1,150,000	1,150,000
Average dilutive common shares	107,599	12,398
Adjusted average common shares	1,257,599	1,162,398
Net income	$ 229,455	$ 121,126
Earnings per share	$ .18	$ .10

	Six Months Ended June 30, 2003	Six Months Ended June 30, 2002
Basic Earnings Per Share		
Average common shares	1,150,000	1,150,000
Net income	$ 396,381	$ 163,939
Earnings per share	$ .34	$ .14
Diluted Earnings Per Share		
Average common shares outstanding	1,150,000	1,150,000
Average dilutive common shares	90,247	6,199
Adjusted average common shares	1,240,247	1,156,199
Net income	$ 396,382	$ 163,939
Earnings per share	$ .32	$ .14

Item 2. Management s Discussion and Analysis or Plan of Operation.

DISCUSSION OF FORWARD-LOOKING STATEMENTS

This Report contains statements which constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and the Securities Exchange Act of 1934. These statements are based on many assumptions and estimates and are not guarantees of future performance. Our actual results may differ materially from those projected in any forward-looking statements, as they will depend on many factors about which we are unsure, including many factors that are beyond our control. The words may, would, could, will, expect, anticipa believe, intend, plan, and estimate, as well as similar expressions, are meant to identify such forward-looking statements.

Potential risks and uncertainties include, but are not limited to:

- significant increases in competitive pressure in the banking and financial services industries;
- changes in the interest rate environment which could reduce anticipated or actual margins;
- changes in political conditions or the legislative or regulatory environment;
- the level of allowance for loan loss;
- the rate of delinquencies and amounts of charge-offs;
- the rates of loan growth;
- adverse changes in asset quality and resulting credit risk-related losses and expenses;
- general economic conditions, either nationally or regionally, and especially in primary service area, becoming less favorable than expected resulting in, among other things, a deterioration in credit quality;
- changes occurring in business conditions and inflation;
- changes in technology;
- changes in monetary and tax policies;
- changes in the securities markets; and
- other risks and uncertainties detailed from time to time in our filings with the Securities and Exchange Commission.

CRITICAL ACCOUNTING POLICIES

We have adopted various accounting policies that govern the application of accounting principles generally accepted in the United States in the preparation of our financial statements. Our significant accounting policies are described in the footnotes to the consolidated financial statements at December 31, 2002 as filed on our annual report on Form 10-KSB.

Certain accounting policies involve significant judgments and assumptions by us that have a material impact on the carrying value of certain assets and liabilities. We consider these accounting policies to be critical accounting policies. The judgment and assumptions we use are based on historical experience and other factors, which we believe to be reasonable under the circumstances. Because of the nature of the judgment and assumptions we make, actual results could differ from these judgments and estimates that could have a material impact on our carrying values of assets and liabilities and our results of operations.

We believe the allowance for loan losses is a critical accounting policy that requires the most significant judgment and estimates used in preparation of our consolidated financial statements. Refer to the portion of this discussion that addresses our allowance for loan losses for a description of our processes and methodology for determining our allowance for loan losses.

GENERAL

The following is a discussion of our financial condition as of June 30, 2003 and the results of operations for the three months and six months ended June 30, 2003. These comments should be read in conjunction with our consolidated financial statements and accompanying consolidated footnotes appearing in this report. The significant accounting policies are described throughout the management s discussion section of this document.

NATIONAL AND ECONOMIC EVENTS

During most of the last two and one-half years, the United States experienced a slowing economy following ten years of expansion. During this period, the economy was affected by lower returns and expectations of the stock markets. Economic data led the Federal Reserve to begin an aggressive program of rate cutting, which moved the Federal Funds rate down 11 times during 2001 for a total reduction of 475 basis points, bringing the Federal Funds rate to its lowest level in 40 years. During the fourth quarter of 2002, the Federal Reserve adjusted the Federal Funds rate down an additional 50 basis points. At the end of the second quarter of 2003, the Federal Reserve again reduced Federal Funds rates by an additional 25 basis points. The total reduction during the last two and half years as been 550 basis points.

Despite sharply lower short-term rates, stimulus to the economy has been muted because the yield curve has steepened and consumer demand and business investment activity has been weak. The financial markets are operating now under very low historical interest rates. Under these unusual conditions, many observers expect Congress to pass an economic stimulus plan. Many economists believe the Federal Reserve will begin increasing interest rates in 2004. No assurance can be given that the Federal Reserve will take such action. We continue to believe that the markets we serve generally perform better than national markets, even in times of recession.

INCOME STATEMENT REVIEW

Comparison of the three months ended June 30, 2003 and the three months ended June 30, 2002.

Net Interest Income

Net interest income, the largest component of our income, was $1,426,582 for the three months ended June 30, 2003 compared to $1,052,100 for the same period in 2002, or an increase of 35.6%. The level of net interest income is determined by the balances of earning assets and interest-bearing liabilities combined with the bank s management of the net interest margin. The following events affect the changes in net interest income: interest rates earned on assets and paid on liabilities, the rate of growth of the asset and liability base, the ratio of interest-earning assets to interest-bearing liabilities, and the management of the balance sheet s interest rate sensitivity.

Interest income for the second quarter of 2003 was $2,287,402 and consisted of $2,219,654 on loans, $62,569 in investments and $5,179 on federal funds sold. Interest income for the same period in 2002 was $1,936,720 and included $1,734,959 on loans, $188,250 on investments and $13,511 on federal funds sold.

Interest expense for the second quarter of 2003 was $860,820 and consisted of $682,896 related to deposits and $177,924 related to borrowings. Our interest expense of $884,620 during the second quarter of 2002 consisted of $841,523 related to deposits and $43,097 related to borrowings. Our interest expense decreased $23,800, or 2.7%, while our average deposits and borrowings increased from $127.1 million for the quarter ended June 30, 2002 to $166.8 million for the quarter ended June 30, 2003, an increase of 31.2%. The decrease in our interest expense compared to the increase in our deposits and borrowings resulted from a 72 basis point reduction in the rates paid. The lower borrowing rates resulted from the declining interest rate environment.

The following table sets forth, for the three months ended June 30, 2003 and 2002, information related to our average balance sheet and average yields on assets and average costs of liabilities. We derived these yields by dividing annualized income or expense by the average balance of the corresponding assets or liabilities. We derived average balances from the daily balances throughout the periods indicated.

Average Balances, Income and Expenses, and Rates (in $000's)

	For the Three Months Ended June 30,					
	2003			2002		
	Average Balance	Income Expense	Yield/ Rate	Average Balance	Income Expense	Yield/ Rate
Federal funds sold	$ 1,558	$ 5	1.29%	$ 3,220	$ 14	1.74%
Investment securities	6,815	63	3.71%	15,435	188	4.89%
Loans	165,143	2,219	5.39%	114,706	1,735	6.07%
Total earning-assets	173,516	2,287	5.29%	133,361	1,937	5.83%
Non-interest earning assets	6,404			6,947		
Total assets	$ 179,920			$ 140,308		
NOW accounts	$ 28,902	$ 27	.37%	$ 29,181	$ 95	1.31%
Savings & money market	20,922	29	.56%	22,294	93	1.67%
Time deposits	87,040	627	2.89%	71,248	654	3.68%
Total interest-bearing deposits	136,864	683	2.00%	122,723	842	2.75%
FHLB advances	26,099	148	2.27%	3,000	36	4.81%
Other borrowings	3,807	30	3.16%	1,387	7	2.02%
Total interest-bearing liabilities	166,770	861	2.07%	127,110	885	2.79%
Non-interest bearing liabilities	2,396			3,655		
Shareholders'equity	10,754			9,543		
Total liabilities and shareholders'equity	$ 179,920			$ 140,308		
Net interest spread			3.22%			3.04%
Net interest income/margin		$ 1,426	3.30%		$ 1,052	3.16%

Our net interest spread was 3.22% for the three months ended June 30, 2003 as compared to 3.04% for the three months ended June 30, 2002. The net interest spread is the difference between the yield we earn on our interest-earning assets and the rate we pay on our interest-bearing liabilities.

Our net interest margin for the quarter ended June 30, 2003 was 3.30% as compared to 3.16% for the three months ended June 30, 2002. The net interest margin is calculated as the annualized net interest income divided by quarterly average earning assets.

In pricing deposits, we considered our liquidity needs, the direction and levels of interest rates and local market conditions.

Rate/Volume Analysis

Net interest income can be analyzed in terms of the impact of changing rates and changing volume. The following table sets forth the effect which the varying levels of earning assets and interest-bearing liabilities and the applicable rates have had on changes in net interest income for the periods presented.

Three months ended June 30,	
2003 vs 2002	2002 vs 2001

	Three months ended June 30,							
	Increase (Decrease) Due to				Increase (Decrease) Due to			
	Volume	Rate	Rate/ Volume	Total	Volume	Rate	Rate/ Volume	Total
Interest income								
Loans	$ 763	(194)	(85)	484	1,167	(330)	(317)	520
Investment securities	(105)	(45)	25	(125)	15	(66)	(4)	(55)
Federal funds sold	(7)	(4)	2	(9)	(8)	(47)	14	(41)
Total interest income	651	(243)	(58)	350	1,174	(443)	(307)	424
Interest expense								
Deposits	97	(230)	(26)	(159)	609	(348)	(254)	7
FHLB advances	277	(19)	(146)	112	36	-	-	36
Other borrowings	12	4	7	23	7	-	-	7
Total interest expense	386	(245)	(165)	(24)	652	(348)	(254)	50
Net interest income	$ 265	2	107	374	522	(95)	(53)	374

As the above table demonstrates, the change in our net interest income is primarily due to the increase in our assets and liabilities, reflecting the continued growth of the bank. These increases are partially offset by the decrease in the rates as a result of the significant reduction in market rates over the last two years.

Provision for Loan Losses

Included in the results of operations for the quarters ended June 30, 2003 and 2002 is a non-cash expense of $200,000 and $220,000, respectively, related to the provision for loan losses. The loan loss reserve was $2,313,374 at June 30, 2003 and $1,824,149 at December 31, 2002. The allowance for loan losses as a percentage of gross loans was 1.32% at June 30, 2003 and 1.22% at December 31, 2002. The loan portfolio is periodically reviewed to evaluate the outstanding loans and to measure both the performance of the portfolio and the adequacy of the allowance for loan losses. For information about how we determine the provision for loan losses, please see our discussion under Provision and Allowance for Loan Losses.

For the three months ended June 30, 2003 and 2002, we reported net charge-offs of $5,806 and $101,015, respectively. The $5,806 net charge-offs in the second quarter of 2003 and $1,015 of charge-offs in the second quarter of 2002 relate to consumer loans and credit lines associated with customer checking accounts. In the second quarter of 2002, the bank incurred a write-down on a non-accruing commercial loan in the amount of $100,000.

Noninterest Income and Expenses

Noninterest income in the second quarter of 2003 was $83,954, a decrease of 31.1% compared to noninterest income of $121,814 in the second quarter of 2002. During the second quarter of 2003, the bank incurred a $100,000 write-down on a house that was previously acquired in foreclosure that is under construction. Excluding the $100,000 loss on real estate owned, noninterest income from loan and service fees increased $62,140 or 51.0%. This increase was primarily due to the increases in the volume of service charges on deposits, increases in the volume of fees charged on ATM transactions, and additional loan fees received on the origination of mortgage loans that were sold.

We incurred general and administrative expenses of $940,447 for the three months ended June 30, 2003 compared to $832,788 for the same period in 2002. The $107,659 increase in general and administrative expenses resulted primarily from additional data processing costs and the additional staff hired to handle the increases in both loans and deposits. Salaries and benefits in second quarter 2003 were $488,564, or an increase of $58,540. Salaries and benefits represented 52.0% of the total noninterest expense. Salaries and benefits in second quarter 2002 were $430,024. All other expenses increased only $49,119. This increase relates primarily to $44,845 additional data processing and related costs, resulting from the higher number of loan and deposit accounts.

Income tax expense was $140,634 for three months ended June 30, 2003. No income tax or benefit was record in the 2002 period.

Comparison of the six months ended June 30, 2003 and the six months ended June 30, 2002.

Net Interest Income

Net interest income, the largest component of our income, was $2,765,661 for the six months ended June 30, 2003 compared to $1,996,278 for the same period in 2002, or an increase of 38.5%. The level of net interest income is determined by the balances of earning assets and interest-bearing liabilities combined with the bank s management of the net interest margin. The following events affect the changes in net interest income: interest rates earned on assets and paid on liabilities, the rate of growth of the asset and liability base, the ratio of interest-earning assets to interest-bearing liabilities, and the management of the balance sheet s interest rate sensitivity.

Interest income for the first six months of 2003 was $4,518,431 and consisted of $4,307,650 on loans, $199,113 in investments and $11,668 on federal funds sold. Interest income for the same period in 2002 was $3,727,078 and included $3,321,614 on loans, $369,403 on investments and $36,061 on federal funds sold.

Interest expense for the first six months of 2003 was $1,752,770 and consisted of $1,412,376 related to deposits and $340,394 related to borrowings. Our interest expense of $1,730,800 during the same period in 2002 consisted of $1,611,120 related to deposits and $119,680 related to borrowings. Our interest expense increased $21,970, or 1.3%, while our average deposits and borrowings increased from $121.1 million for the quarter ended June 30, 2002 to $163.2 million for the quarter ended June 30, 2003, an increase of 34.8%. The increase in our interest expense was proportionately less than the increase in our deposits and borrowings because of the declining interest rate environment.

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The following table sets forth, for the six months ended June 30, 2003 and 2002, information related to our average balance sheet and average yields on assets and average costs of liabilities. We derived these yields by dividing annualized income or expense by the average balance of the corresponding assets or liabilities. We derived average balances from the daily balances throughout the periods indicated.

Average Balances, Income and Expenses, and Rates (in $000 s)

	For the Six Months Ended June 30,					
	2003			2002		
	Average Balance	Income Expense	Yield/ Rate	Average Balance	Income Expense	Yield/ Rate
Federal funds sold	$ 1,953	$ 12	1.24%	$ 4,105	$ 36	1.77%
Investment securities	10,274	199	3.91%	14,400	369	5.17%
Loans	159,722	4,308	5.44%	109,691	3,322	6.11%
Total earning-assets	171,949	4,519	5.30%	128,196	3,727	5.86%
Non-interest earning assets	6,306			6,389		
Total assets	$ 178,255			$ 134,585		
NOW accounts	$ 28,248	$ 59	.42%	$ 24,551	$ 142	1.178%
Savings & money market	20,712	62	.60%	22,296	187	1.69%
Time deposits	85,908	1,291	3.03%	66,915	1,282	3.86%
Total interest-bearing deposits	134,868	1,412	2.14%	113,762	1,611	2.86%
FHLB advances	23,646	266	2.27%	4,425	86	3.92%
Other borrowings	6,739	75	2.24%	2,917	34	2.35%
Total interest-bearing liabilities	165,253	1,753	2.17%	121,104	1,731	2.88%

	For the Six Months Ended June 30,					
Non-interest bearing liabilities	2,375			3,983		
Shareholders'equity	10,627			9,498		
Total liabilities and shareholders'equity	$ 178,255			$ 134,585		
Net interest spread			3.13%			2.98%
Net interest income/margin		$ 2,766	3.24%		$ 1,996	3.14%

Our net interest spread was 3.13% for the six months ended June 30, 2003 as compared to 2.98% for the six months ended June 30, 2002. The net interest spread is the difference between the yield we earn on our interest-earning assets and the rate we pay on our interest-bearing liabilities.

Our net interest margin for the quarter ended June 30, 2003 was 3.24% as compared to 3.14% for the six months ended June 30, 2002. The net interest margin is calculated as the annualized net interest income divided by quarterly average earning assets.

In pricing deposits, we considered our liquidity needs, the direction and levels of interest rates and local market conditions.

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Rate/Volume Analysis

Net interest income can be analyzed in terms of the impact of changing rates and changing volume. The following table sets forth the effect which the varying levels of earning assets and interest-bearing liabilities and the applicable rates have had on changes in net interest income for the periods presented.

	Six months ended June 30,							
	2003 vs 2002				2002 vs 2001			
	Increase (Decrease) Due to				Increase (Decrease) Due to			
	Volume	Rate	Rate/ Volume	Total	Volume	Rate	Rate/ Volume	Total
Interest income								
Loans	$ 1,515	(363)	(166)	986	2,331	(680)	(675)	976
Investment securities	(106)	(90)	26	(170)	22	(109)	(6)	(93)
Federal funds sold	(19)	(11)	6	(24)	(4)	(85)	8	(81)
Total interest income	1,390	(464)	(134)	792	2,349	(874)	(673)	802
Interest expense								
Deposits	270	(402)	(67)	(199)	1,203	(707)	(520)	(24)
FHLB advances	374	(36)	(157)	181	86	-	-	86
Other borrowings	45	(2)	(2)	41	34	-	-	34
Total interest expense	689	(440)	(226)	24	1,323	(707)	(520)	96
Net interest income	$ 701	(24)	92	768	1,026	(167)	(153)	706

As the above table demonstrates, the change in our net interest income is primarily due to the increase in our assets and liabilities, reflecting the continued growth of the bank. This increase is partially offset by the decrease in the rates as a result of the significant reduction in market rates over the last two years.

Provision for Loan Losses

Included in the results of operations for the six months ended June 30, 2003 and 2002 is a non-cash expense of $500,000 and $420,000, respectively, related to the provision for loan losses. The loan loss reserve was $2,313,374 at June 30, 2003 and $1,824,149 at December 31, 2002. The allowance for loan losses as a percentage of gross loans was 1.32% at June 30, 2003 and 1.22% at December 31, 2002. The loan portfolio is periodically reviewed to evaluate the outstanding loans and to measure both the performance of the portfolio and the adequacy of the allowance for loan losses. For information about how we determine the provision for loan losses, please see our discussion under Provision and Allowance for Loan Losses.

For the six months ended June 30, 2003 and 2002, we reported net charge-offs of $10,775 and $105,136, respectively. The $10,775 net charge-offs in the 2003 period and $5,136 of charge-offs in the 2002 same period relate to consumer loans and credit lines associated with customer checking accounts. In the second quarter of 2002, the bank incurred a write-down on a non-accruing commercial loan in the amount of $100,000.

Noninterest Income and Expenses

Noninterest income in the first six months of 2003 was $231,107, an increase of 2.8% over noninterest income of $224,764 in the same period in 2002. During the second quarter of 2003, the bank incurred a $100,000 write-down on a house that was previously acquired in foreclosure that is under construction. Excluding the $100,000 loss on real estate owned, noninterest income from loan and service fees increased $106,343, or 47.3%. This increase was primarily due to the increases in the volume of service charges on deposits, increases in the volume of fees charged on ATM transactions, and additional loan fees received on the origination of mortgage loans that were sold.

We incurred general and administrative expenses of $1,857,444 for the six months ended June 30, 2003 compared to $1,637,103 for the same period in 2002. The $220,341 increase in general and administrative expenses resulted primarily from additional data processing costs and the additional staff hired to handle the increases in both loans and deposits. Salaries and benefits in second quarter 2003 were $967,842, or an increase of $106,295. Salaries and benefits represented 52.1% of the total noninterest expense. Salaries and benefits in first six months of 2002 were $861,547. All other expenses increased only $114,046. This increase relates primarily to $84,003 additional data processing and related costs, resulting from the higher number of loan and deposit accounts.

Income tax expense was $242,941 for six months ended June 30, 2003. No income tax or benefit was record in the 2002 period.

BALANCE SHEET REVIEW

General

At June 30, 2003, we had total assets of $191.5 million, consisting principally of $173.6 million in loans, $10.7 million in investments and $4.5 million in cash and due from banks. Liabilities at June 30, 2003 totaled $180.9 million, consisting principally of $144.5 million in deposits, $25.5 million in FHLB advances and $6.0 million in trust preferred securities. At June 30, 2003, shareholders equity was $10.6 million.

Investments

At June 30, 2003, the $4.7 million of investment securities portfolio available for sale represented approximately 2.5% of our total assets. We invested in U.S. Government agency securities and mortgage-backed securities with a fair value of $4.7 million and an amortized cost of $4.5 million for an unrealized gain of $181,998.

Contractual maturities and yields on our investments available for sale at June 30, 2003 are shown in the following table (dollars in thousands). Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Within one year	Yield	After one but Within five Years	Yield	Over Five years	Yield	Total	Yield
U.S.Government								