

GREENVILLE FIRST BANCSHARES INC
Form 10QSB
November 14, 2003

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-QSB

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

For the quarter ended September 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
(State of Incorporation)

58-2459561
(I.R.S. Employer Identification No.)

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

29607
(Zip Code)

864-679-9000
(Telephone Number)

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

Check whether the issuer (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 No

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, \$.01 par value per share, issued and outstanding as of November 4, 2003.

Transitional Small Business Disclosure Format (check one): Yes No

GREENVILLE FIRST BANCSHARES, INC.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

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**GREENVILLE FIRST BANCSHARES, INC. & SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS**

	<u>September 30,</u>	<u>December 31,</u>
	<u>2003</u>	<u>2002</u>
	<u>(Unaudited)</u>	<u>(Audited)</u>
Assets		
Cash and due from banks	\$ 6,336,670	\$ 4,429,290
Federal funds sold	3,377,356	41,736
Investment securities available for sale	3,929,272	14,592,190
Investments securities held to maturity	10,026,925	-
Other investments, at cost	2,485,150	905,000
Loans, net	185,889,884	148,079,012
Accrued interest	690,016	730,028
Property and equipment	798,120	785,942
Other real estate owned	691,147	524,625
Other assets	532,557	269,840
	<u>\$ 214,757,097</u>	<u>\$ 170,357,663</u>
Liabilities and Shareholders' Equity		
Liabilities		
Deposits	\$ 156,093,718	\$ 133,563,270
Official checks outstanding	867,588	889,270
Federal funds purchased and repurchase agreements	-	9,107,000
Federal Home Loan Bank advances	40,000,000	13,000,000
Note payable	-	2,500,000
Trust preferred securities	6,000,000	-
Accrued interest payable	524,894	606,072
Accounts payable and accrued expenses	443,653	460,262
	<u>203,929,853</u>	<u>160,125,874</u>
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	79,325	147,733
Retained earnings (deficit)	101,219	(562,644)
	<u>10,827,244</u>	<u>10,231,789</u>
Total liabilities and shareholders' equity	<u>\$ 214,757,097</u>	<u>\$ 170,357,663</u>

	September 30,	December 31,
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See notes to consolidated financial statements that are an integral part of these consolidated statements.

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

	For the Three Months Ended September 30,	
	2003	2002
Interest income		
Loans	\$ 2,352,898	\$ 1,984,879
Investment securities	139,249	176,433
Federal funds sold	2,957	7,640
	2,495,104	2,168,952
Interest expense		
Deposits	685,441	791,346
Borrowings	246,944	92,437
	932,385	883,783
Net interest income before provision for loan losses	1,562,719	1,285,169
Provision for loan losses	250,000	300,000
	1,312,719	985,169
Noninterest income (loss)		
Loan fee income	50,446	42,589
Service fees on deposit accounts	67,838	47,634
Write-down on real estate owned	(70,000)	-
Other income	67,034	49,309
	115,318	139,532
Noninterest expenses		
Salaries and benefits	494,979	451,044
Professional fees	56,947	42,457
Marketing	44,128	27,962
Insurance	28,171	24,031
Occupancy	141,899	145,516
Data processing and related costs	169,240	139,792
Telephone	5,517	6,257
Other	55,733	28,013
	996,614	865,072
Income before income taxes	431,423	259,629
Income tax expense	163,941	-

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	For the Three Months Ended	
	<u> </u>	<u> </u>
Net income	\$ 267,482	\$ 259,629
	<u> </u>	<u> </u>
Income per common share-adjusted for 3 for 2 stock split:		
Basic	\$.16	\$.15
	<u> </u>	<u> </u>
Diluted	\$.14	\$.15
	<u> </u>	<u> </u>
Weighted average common shares outstanding -adjusted for 3 for 2 split:		
Basic	1,725,000	1,725,000
	<u> </u>	<u> </u>
Diluted	1,886,399	1,772,564
	<u> </u>	<u> </u>

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

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

	For the Nine Months Ended September 30,	
	<u> </u>	<u> </u>
	2003	2002
	<u> </u>	<u> </u>
Interest income		
Loans	\$ 6,660,548	\$ 5,306,493
Investment securities	338,362	545,836
Federal funds sold	14,625	43,701
	<u> </u>	<u> </u>
Total interest income	7,013,535	5,896,030
Interest expense		
Deposits	2,097,817	2,402,466
Borrowings	587,338	212,117
	<u> </u>	<u> </u>
Total interest expense	2,685,155	2,614,583
	<u> </u>	<u> </u>
Net interest income before provision for loan losses	4,328,380	3,281,447
Provision for loan losses	750,000	720,000
	<u> </u>	<u> </u>
Net interest income after provision for loan losses	3,578,380	2,561,447
	<u> </u>	<u> </u>
Noninterest income (loss)		
Loan fee income	154,112	97,034
Service fees on deposit accounts	191,134	129,068
Write-down on real estate owned	(170,000)	-
Other income	171,178	138,194
	<u> </u>	<u> </u>
Total noninterest income	346,424	364,296
	<u> </u>	<u> </u>
Noninterest expenses		
Salaries and benefits	1,462,821	1,312,591
Professional fees	131,506	125,657
Marketing	122,873	90,146

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	For the Nine Months Ended	
Insurance	81,436	67,065
Occupancy	441,261	437,249
Data processing and related costs	456,770	343,319
Telephone	16,704	17,987
Other	140,688	108,161
	<hr/>	<hr/>
Total noninterest expenses	2,854,059	2,502,175
	<hr/>	<hr/>
Income before income taxes	1,070,745	423,568
	<hr/>	<hr/>
Income tax expense	406,882	-
	<hr/>	<hr/>
Net income	\$ 663,863	\$ 423,568
	<hr/>	<hr/>
Income per common share-adjusted for 3 for 2 stock split:		
Basic	\$.38	\$.25
	<hr/>	<hr/>
Diluted	\$.35	\$.24
	<hr/>	<hr/>
Weighted average common shares outstanding adjusted for 3 for 2 stock split:		
Basic	1,725,000	1,725,000
	<hr/>	<hr/>
Diluted	1,874,780	1,747,227
	<hr/>	<hr/>

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

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

	<u>Common stock</u>		<u>Additional paid-in capital</u>	<u>Accumulated other comprehensive income</u>	<u>Retained Earnings (deficit)</u>	<u>Total Shareholders' Equity</u>
	<u>Shares</u>	<u>Amount</u>				
December 31, 2001	1,150,000	\$ 11,500	\$ 10,635,200	\$ 127,779	\$ (1,315,060)	\$ 9,459,419
Net income	-	-	-	-	423,568	423,568
Comprehensive income (loss), net of tax						
Unrealized holding gain on securities available for sale	-	-	-	12,137	-	12,137
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Comprehensive income	-	-	-	-	-	435,705
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
September 30, 2002	1,150,000	\$ 11,500	\$ 10,635,200	\$ 139,916	\$ (891,492)	\$ 9,895,124
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
December 31, 2002	1,150,000	\$ 11,500	\$ 10,635,200	\$ 147,733	\$ (562,644)	\$ 10,231,789

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	Accumulated					
Net income	-	-	-	-	663,863	663,863
Comprehensive income, net of tax						
Change in unrealized holding gain on securities available for sale	-	-	-	(68,408)	-	(68,408)
Comprehensive income	-	-	-	-	-	595,455
September 30, 2003	1,150,000	\$ 11,500	\$ 10,635,200	\$ 79,325	\$ 101,219	\$ 10,827,244

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

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

	For the Nine Months Ended September 30,	
	2003	2002
Operating activities		
Net income	\$ 663,863	\$ 423,568
Adjustments to reconcile net income to cash provided by (used for) operating activities:		
Provision for loan losses	750,000	720,000
Depreciation and other amortization	109,904	154,730
Accretion and amortization of securities discounts and premium, net	77,309	26,552
Increase in other assets, net	(389,226)	57,735
Increase (decrease) in other liabilities, net	(84,229)	903,147
Net cash provided by operating activities	<u>1,127,621</u>	<u>2,285,732</u>
Investing activities		
Increase (decrease) in cash realized from:		
Origination of loans, net	(38,560,872)	(41,102,470)
Purchase of property and equipment	(122,082)	(65,293)
Purchase of securities available for sale	-	(11,144,137)
Purchase of securities held to maturity	(10,158,438)	-
Purchase of other investment	(2,785,150)	(100,000)
Payments and maturity of securities:		
Available for sale	10,484,108	13,713,600
Held to maturity	129,365	-
Other investments	1,205,000	-
Net cash used for investing activities	<u>(39,808,069)</u>	<u>(38,698,300)</u>
Financing activities		
Increase in deposits, net	22,530,448	38,341,775
Decrease in short-term borrowings	(9,107,000)	(3,680,350)
Increase (decrease) in other borrowings	(2,500,000)	1,700,000

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	For the Nine Months Ended	
Proceeds from trust preferred securities	6,000,000	-
Increase (decrease) in Federal Home Loan Bank advances	27,000,000	2,000,000
	<u>43,923,448</u>	<u>38,361,425</u>
Net cash provided by financing activities	43,923,448	38,361,425
	<u>5,243,000</u>	<u>1,948,857</u>
Net increase in cash and cash equivalents	5,243,000	1,948,857
Cash and cash equivalents at beginning of the year	<u>4,471,026</u>	<u>2,982,956</u>
Cash and cash equivalents at end of the year	<u>\$ 9,714,026</u>	<u>\$ 4,931,813</u>
Supplemental information		
Cash paid for		
Interest	<u>\$ 2,766,333</u>	<u>\$ 2,834,889</u>
Income taxes	<u>\$ 37,188</u>	<u>-</u>
Supplemental schedule of non-cash transaction		
Foreclosure of real estate	<u>\$ -</u>	<u>\$ 362,987</u>
Unrealized gain (loss) on securities, net of income taxes	<u>\$ (120,119)</u>	<u>\$ 12,137</u>

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

**GREENVILLE FIRST BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

Note 1 Nature of Business and Basis of Presentation

Business activity

Greenville First Bancshares, Inc. (the company) is a South Carolina corporation that owns all of the capital stock of Greenville First Bank, N.A. (the bank) and all of the stock of Greenville First Statutory Trust I (the Trust). The bank is a national bank organized under the laws of the United States located in Greenville County, South Carolina. 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. The Trust is a special purpose subsidiary for the sole purpose of issuing trust preferred securities.

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 nine month periods ended September 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., and 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

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At September 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 September 30, 2003 was 3.17%. 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 September 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.

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Note 4 Stock Split

On November 17, 2003, shareholders of record as of November 3, 2003, will receive one additional share of stock for every two shares of stock owned prior to the 3 for 2 stock split. All fractional shares will be paid in cash. The earnings per share amounts for all periods shown have been adjusted to reflect the 3 for 2 split.

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 nine months ended September 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. The numbers of shares and the earnings per share have been adjusted for the 3 for 2 stock split.

	Three Months ended Sept. 30, 2003	Three Months ended Sept. 30, 2002
Basic Earnings Per Share		
Average common shares	1,725,000	1,725,000
Net income	\$ 267,482	\$ 259,629
Earnings per share	\$.16	\$.15
Diluted Earnings Per Share		
Average common shares outstanding	1,725,000	1,725,000
Average dilutive common shares	161,399	47,564
Adjusted average common shares	1,886,399	1,772,564
Net income	\$ 267,482	\$ 259,629
Earnings per share	\$.14	\$.15
	Nine Months ended Sept. 30, 2003	Nine Months ended Sept. 30, 2002
Basic Earnings Per Share		
Average common shares	1,725,000	1,725,000
Net income	\$ 663,863	\$ 423,568
Earnings per share	\$.38	\$.25
Diluted Earnings Per Share		
Average common shares outstanding	1,725,000	1,725,000

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	Nine Months 149,780	Nine Months 22,227
Average dilutive common shares	149,780	22,227
Adjusted average common shares	1,874,780	1,747,227
Net income	\$ 663,863	\$ 423,568
Earnings per share	\$.35	\$.24

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Note 6 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), Statement of Financial Accounting Standards (SFAS) SFAS No. 123, *Accounting for Stock-Based Compensation*, to stock-based employee compensation.

	For the Three Months ended September 30,	
	2003	2002
Net income, as reported	\$ 267,482	\$ 259,629
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	\$ 247,869	\$ 242,016
Earnings per common share-adjusted for 3 for 2 stock split:		
Basic - as reported	\$.16	\$.15
Basic - pro forma	\$.14	\$.14
Diluted - as reported	\$.14	\$.15
Diluted - pro-forma	\$.13	\$.14

	For the Nine Months ended September 30,	
	2003	2002
Net income, as reported	\$ 663,863	\$ 423,568
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(58,839)	(52,839)
Pro forma net income	\$ 605,024	\$ 370,729

	For the Nine Months ended	
Earnings per common share-adjusted for 3 for 2 stocks split:		
Basic - as reported	\$.38	\$.25
	<u> </u>	<u> </u>
Basic - pro forma	\$.35	\$.21
	<u> </u>	<u> </u>
Diluted - as reported	\$.35	\$.24
	<u> </u>	<u> </u>
Diluted - pro-forma	\$.32	\$.21
	<u> </u>	<u> </u>

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.

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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, anticipate, 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:

- o significant increases in competitive pressure in the banking and financial services industries;
- o changes in the interest rate environment which could reduce anticipated or actual margins;
- o changes in political conditions or the legislative or regulatory environment;
- o the level of allowance for loan loss;
- o the rate of delinquencies and amounts of charge-offs;
- o the rates of loan growth;
- o adverse changes in asset quality and resulting credit risk-related losses and expenses;
- o 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;
- o changes occurring in business conditions and inflation;
- o changes in technology;
- o changes in monetary and tax policies;
- o changes in the securities markets; and
- o 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

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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 September 30, 2003 and the results of operations for the three months and nine months ended September 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 three 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 third quarter of 2003, the Federal Reserve again reduced Federal Funds rates by an additional 25 basis points. During the last three years, the total reduction has 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 the last half of 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 September 30, 2003 and the three months ended September 30, 2002.

Net Interest Income

Net interest income, the largest component of our income, was \$1,562,719 for the three months ended September 30, 2003 compared to \$1,285,169 for the same period in 2002, or an increase of 21.6%. 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 third quarter of 2003 was \$2,495,104 and consisted of \$2,352,898 on loans, \$139,249 in investments and \$2,957 on federal funds sold. Interest income for the same period in 2002 was \$2,168,952 and included \$1,984,879 on loans, \$176,433 on investments and \$7,640 on federal funds sold.

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Interest expense for the third quarter of 2003 was \$932,385 and consisted of \$685,441 related to deposits and \$246,944 related to borrowings. Our interest expense of \$883,783 during the third quarter of 2002 consisted of \$791,346 related to deposits and \$92,437 related to borrowings. Our interest expense increased \$48,602, or 5.5%, while our average interest-bearing deposits and borrowings increased from \$141.3 million for the quarter ended September 30, 2002 to \$189.4 million for the quarter ended September 30, 2003, an increase of 34.0%. The 5.5% increase in our interest expense compared to the 34.0% increase in our deposits and borrowings resulted from a 53 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 September 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 September 30,					
	Average Balance	<u>2003</u> Income Expense	Yield/ Rate	Average Balance	<u>2002</u> Income Expense	Yield/ Rate
Federal funds sold	\$ 1,182	\$ 3	1.01%	\$ 1,753	\$ 7	1.58%
Investment securities	13,392	139	4.12%	15,027	177	4.67%
Loans	181,401	2,353	5.15%	130,472	1,985	6.04%
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Total earning-assets	195,975	2,495	5.05%	147,252	2,169	5.84%
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Non-interest earning assets	6,541			6,806		
	<hr/>			<hr/>		
Total assets	\$ 202,516			\$ 154,058		
	<hr/>			<hr/>		
NOW accounts	\$ 31,015	\$ 33	.42%	\$ 31,058	\$ 75	.96%
Savings & money market	23,608	36	.60%	23,033	73	1.26%
Time deposits	93,464	617	2.62%	73,239	643	3.48%
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Total interest-bearing deposits	148,087	686	1.84%	127,330	791	2.46%
FHLB advances	28,458	158	2.20%	7,185	54	2.98%
Other borrowings	12,814	88	2.72%	6,816	39	2.27%
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Total interest-bearing liabilities	189,359	932	1.95%	141,331	884	2.48%
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Non-interest bearing liabilities	2,302			2,914		
Shareholders' equity	10,855			9,813		
	<hr/>			<hr/>		
Total liabilities and shareholders' equity	\$ 202,516			\$ 154,058		
	<hr/>			<hr/>		
Net interest spread			3.10%			3.36%
Net interest income/margin		\$ 1,563	3.16%		\$ 1,285	3.46%
		<hr/>			<hr/>	

Our net interest spread was 3.10% for the three months ended September 30, 2003 as compared to 3.36% for the three months ended September 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 September 30, 2003 was 3.16% as compared to 3.46% for the three months ended September 30, 2002. The net interest margin is calculated as the annualized net interest income divided by quarterly average earning assets. The decline in the net interest margin resulted from the bank having more earning assets than interest-bearing liabilities that re-priced to lower rates as a result of the 75 basis point market reduction in short-term rates during the twelve month period ended September 30, 2003.

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 September 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	\$ 775	(293)	(114)	368	1,145	(287)	(240)	618
Investment securities	(19)	(21)	2	(38)	(8)	(54)	2	(60)
Federal funds sold	(2)	(3)	1	(4)	(3)	(17)	4	(16)
Total interest income	754	(317)	(111)	326	1,134	(358)	(234)	542
Interest expense								
Deposits	129	(201)	(33)	(105)	515	(342)	(212)	(39)
FHLB advances	160	(14)	(42)	104	38	-	-	38
Other borrowings	34	8	7	49	7	-	-	7
Total interest expense	323	(207)	(68)	48	560	(342)	(212)	6
Net interest income	\$ 431	(110)	(43)	278	574	(16)	(22)	536

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 September 30, 2003 and 2002 is a non-cash expense of \$250,000 and \$300,000, respectively, related to the provision for loan losses. The loan loss reserve was \$2,461,310 at September 30, 2003 and \$1,824,149 at December 31, 2002. The allowance for loan losses as a percentage of gross loans was 1.31% at September 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 September 30, 2003 and 2002, we reported net charge-offs of \$102,064 and \$101,015, respectively. All charge-offs in the third quarter of 2003 were related to commercial loans. Included in the third quarter of 2002 was a write-down on a non-accruing commercial loan in the amount of \$100,000. The remaining \$1,015 of net charge-offs in the 2002 period relate to consumer loans and credit lines associated with customer checking accounts.

Noninterest Income and Expenses

Noninterest income in the third quarter of 2003 was \$115,318, a decrease \$24,214 compared to noninterest income of \$139,532 in the third quarter of 2002. During the third quarter of 2003, the bank incurred a \$70,000 write-down on a house that was previously acquired in foreclosure that is under construction. Excluding the \$70,000 loss on real estate owned, noninterest income from loan and service fees increased \$45,786, or 32.8%. 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 \$996,614 for the three months ended September 30, 2003 compared to \$865,072 for the same period in 2002. The \$131,542 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 third quarter 2003 were \$494,979, or an increase of \$43,935. Salaries and benefits represented 50.0% of the total noninterest expense. Salaries and benefits in third quarter 2002 were \$451,044. All other expenses increased \$87,607. This increase relates primarily to \$29,448 additional data processing and related costs, \$14,490 additional professional fees, an additional \$16,166 of marketing expense and \$27,720 additional other expense related primarily to higher postage and supplies. The majority of the increased expense resulted from the higher number of loan and deposit accounts.

Income tax expense was \$163,941 for three months ended September 30, 2003. No income tax or benefit was record in the 2002 period.

Comparison of the nine months ended September 30, 2003 and the nine months ended September 30, 2002.**Net Interest Income**

Net interest income, the largest component of our income, was \$4,328,380 for the nine months ended September 30, 2003 compared to \$3,281,447 for the same period in 2002, or an increase of 31.9%. 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 nine months of 2003 was \$7,013,535 and consisted of \$6,660,548 on loans, \$338,362 in investments and \$14,625 on federal funds sold. Interest income for the same period in 2002 was \$5,896,030 and included \$5,306,493 on loans, \$545,836 on investments and \$43,701 on federal funds sold.

Interest expense for the first nine months of 2003 was \$2,685,155 and consisted of \$2,097,817 related to deposits and \$587,338 related to borrowings. Our interest expense of \$2,614,583 during the same period in 2002 consisted of \$2,402,466 related to deposits and \$212,117 related to borrowings. Our interest expense increased \$70,572, or 2.7%, while our average deposits and borrowings increased from \$128.7 million for the quarter ended September 30, 2002 to \$173.4 million for the quarter ended September 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 nine months ended September 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 Nine months Ended September 30,

	<u>Average Balance</u>	<u>2003 Income Expense</u>	<u>Yield/ Rate</u>	<u>Average Balance</u>	<u>2002 Income Expense</u>	<u>Yield/ Rate</u>
Federal funds sold	\$ 1,693	\$ 15	1.18%	\$ 3,312	\$ 44	1.78%
Investment securities	11,325	338	3.99%	14,611	546	5.00%
Loans	167,028	6,660	5.33%	116,694	5,306	6.08%
	<u>180,046</u>	<u>7,013</u>	<u>5.21%</u>	<u>134,617</u>	<u>5,896</u>	<u>5.86%</u>
Total earning-assets						
Non-interest earning assets	6,385			6,530		

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For the Nine months Ended September 30,

Total assets	\$ 186,431			\$ 141,147		
NOW accounts	\$ 29,180	\$ 92	.42%	\$ 26,744	\$ 217	1.08%
Savings & money market	21,688	98	.60%	22,545	260	1.54%
Time deposits	88,454	1,908	2.88%	69,766	1,926	3.69%
Total interest-bearing deposits	139,322	2,098	2.01%	119,055	2,403	2.70%
FHLB advances	25,268	424	2.24%	5,355	140	3.50%
Other borrowings	8,786	163	2.48%	4,231	72	2.28%
Total interest-bearing liabilities	173,376	2,685	2.07%	128,641	2,615	2.72%
Non-interest bearing liabilities	2,351			2,902		
Shareholders' equity	10,704			9,604		
Total liabilities and shareholders' equity	\$ 186,431			\$ 141,147		
Net interest spread			3.14%			3.14%
Net interest income/margin		\$ 4,328	3.21%		\$ 3,281	3.26%

Our net interest spread was 3.14% for both of the nine months periods ended September 30, 2003 and 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 September 30, 2003 was 3.21% as compared to 3.26% for the nine months ended September 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.

Nine months ended September 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	\$ 2,289	(653)	(282)	1,354	3,482	(975)	(914)	1,593
Investment securities	(123)	(110)	25	(207)	15	(164)	(4)	(153)
Federal funds sold	(22)	(15)	7	(29)	(7)	(102)	13	(96)
Total interest income	2,144	(778)	(250)	1,118	3,490	(1,241)	(905)	1,344

Interest expense

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Nine months ended September 30,

Deposits	409	(610)	(104)	(305)	1,741	(1,057)	(746)	(62)
FHLB advances	521	(50)	(186)	284	124	--	--	124
Other borrowings	78	6	7	91	65	--	--	65
	<u>1,008</u>	<u>(654)</u>	<u>(284)</u>	<u>70</u>	<u>1,930</u>	<u>(1,057)</u>	<u>(746)</u>	<u>127</u>
Total interest expense								
Net interest income	\$ 1,136	(124)	35	1,047	1,560	(184)	(159)	1,217

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 nine months ended September 30, 2003 and 2002 is a non-cash expense of \$750,000 and \$720,000, respectively, related to the provision for loan losses. The loan loss reserve was \$2,461,310 at September 30, 2003 and \$1,824,149 at December 31, 2002. The allowance for loan losses as a percentage of gross loans was 1.31% at September 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 nine months ended September 30, 2003 and 2002, we reported net charge-offs of \$112,839 and \$258,293, respectively. During the nine months ended September 30, of 2003, the bank charged-off \$102,064 on a commercial loan. During the same period in 2002, the bank incurred a write-down on a non-accruing commercial loan in the amount of \$250,000. The remaining net charge-offs in each period relate to consumer loans and credit lines associated with customer checking accounts.

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Noninterest Income and Expenses

Noninterest income in the first nine months of 2003 was \$346,424, a decrease of \$17,872 compared to noninterest income of \$364,296 in the same period in 2002. During the 2003 period, the bank incurred a \$170,000 write-down on a house that was previously acquired in foreclosure that is under construction. Excluding the \$170,000 loss on real estate owned, noninterest income from loan and service fees increased \$152,128, or 41.8%. 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 \$2,854,059 for the nine months ended September 30, 2003 compared to \$2,502,175 for the same period in 2002. The \$351,884 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 for the 2003 period were \$1,462,821, or an increase of \$150,230. Salaries and benefits represented 51.3% of the total noninterest expense. Salaries and benefits in first nine months of 2002 were \$1,312,591. All other expenses increased \$201,654. This increase relates primarily to \$113,451 additional data processing and related costs, resulting from the higher number of loan and deposit accounts.

Income tax expense was \$406,882 for nine months ended September 30, 2003. No income tax or benefit was record in the 2002 period.

BALANCE SHEET REVIEW

General

At September 30, 2003, we had total assets of \$214.8 million, consisting principally of \$185.9 million in loans, \$19.8 million in investments and \$6.3 million in cash and due from banks. Liabilities at September 30, 2003 totaled \$203.9 million, consisting principally of \$156.1 million in deposits, \$40.0 million in FHLB advances and \$6.0 million in trust preferred securities. At September 30, 2003, shareholders equity was \$10.8 million.

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Investments

At September 30, 2003, the \$3.9 million of investment securities portfolio available for sale represented approximately 1.8% of our total assets. The \$10.0 million of investment securities held to maturity represented 4.7% of our assets. We invested in U.S. Government agency securities and mortgage-backed securities with a fair value of \$14.0 million and an amortized cost of \$13.8 million for an unrealized gain of \$181,998.

Contractual maturities and yields on our investments available for sale at September 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.

	<u>Within one year</u>	<u>Yield</u>	<u>After one but Within five Years</u>	<u>Yield</u>	<u>Over Five years</u>	<u>Yield</u>	<u>Total</u>	<u>Yield</u>
U.S. Government agencies	\$ -	-	\$ 1,111	5.38%	\$ -	-	\$ 1,111	5.29%
Mortgage-backed securities	-	-	-	-	12,456	4.53%	\$ 12,456	4.53%
Total	-	-	\$ 1,111	5.38%	\$ 12,456	4.53%	\$ 13,567	4.60%

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At September 30, 2003, the \$3.4 million of short-term investments in federal funds sold on an overnight basis comprised 1.57% of total assets at September 30, 2003, as compared to \$41,736, or .02% of total assets, at December 31, 2002.

Loans

Since loans typically provide higher interest yields than do other types of interest earning assets, it is our intent to channel a substantial percentage of our earning assets into the loan portfolio. Average loans for the nine months ended September 30, 2003 and 2002 were \$167.0 million and \$116.7 million, respectively. Total loans outstanding at September 30, 2003 and December 31, 2002 were \$185.9 million and \$148.1 million, respectively, before allowance for loan losses.

The following table summarizes the composition of the loan portfolio:

September 30, 2003 December 31, 2002 Amount Percentage Amount Percentage

Real estate:					
Commercial					
Owner occupied	\$ 35,674,778	18.94%	\$ 22,653,311	15.11%	
Non-owner occupied	48,580,271	25.79%	43,076,993	28.74%	
Construction	7,033,483	3.74%	4,007,650	2.67%	
	<u>91,288,532</u>	<u>48.47%</u>	<u>69,737,954</u>	<u>46.52%</u>	
Consumer					
Residential	30,541,147	16.22%	25,499,625	17.01%	
Home Equity	22,817,315	12.11%	18,069,407	12.06%	
Construction	4,457,402	2.37%	4,199,848	2.80%	
	<u>57,815,864</u>	<u>30.70%</u>	<u>47,768,880</u>	<u>31.87%</u>	
Total real-estate	149,104,396	79.16%	117,506,834	78.39%	
Commercial business	35,358,273	18.77%	28,192,407	18.81%	
Consumer-other	4,333,797	2.30%	4,590,552	3.06%	
Deferred origination fees, net	(445,272)	(.24%)	(386,632)	(.26%)	

Loans

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	188,351,194	100.00%	149,903,161	100.00%
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Less allowance for loan Losses	(2,461,310)		(1,824,149)	
	<hr style="width: 100%;"/>		<hr style="width: 100%;"/>	
Total loans, net	\$ 185,889,884		\$ 148,079,012	
	<hr style="width: 100%;"/>		<hr style="width: 100%;"/>	

The principal component of our loan portfolio at September 30, 2003 and at December 31, 2002 was loans secured by real estate mortgages. Due to the short time the portfolio has existed, the current mix of loans may not be indicative of the ongoing portfolio mix. Management will attempt to maintain a relatively diversified loan portfolio to help reduce the risk inherent in concentration of collateral.

Provision and Allowance for Loan Losses

We have developed policies and procedures for evaluating the overall quality of our credit portfolio and the timely identification of potential credit problems.

We have established an allowance for loan losses by expensing a provision for loan losses on our statement of operations. The allowance represents an amount that we believe will be adequate to absorb probable losses on existing loans that may become uncollectible. Our judgment in determining the adequacy of the allowance is based on evaluations of the collectibility of loans, including consideration of factors such as the balance of impaired loans; the quality, mix and size of our overall loan portfolio; economic conditions that may affect the borrower's ability to repay; the amount and quality of collateral securing the loans; our historical loan loss experience and a review of specific problem loans. We

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increase the allowance periodically by additional provisions for loan losses. We charge recognized losses to the allowance and add subsequent recoveries back to the allowance.

Our evaluation is inherently subjective, as it requires estimates that are susceptible to significant change. We do not allocate the allowance for loan losses to specific categories of loans but evaluate the adequacy on an overall portfolio basis utilizing our credit grading system that we apply to each loan. We have engaged an independent consultant to review the loan files on a test basis to verify that the lenders have properly graded each loan. Due to our limited operating history, the provision for loan losses has been made primarily as a result of management's assessment of general loan loss risk as compared to banks of similar size and maturity. In addition, regulatory agencies periodically review our allowance for loan losses as part of their examination process, and they may require us to record additions to the allowance based on their judgment about information available to them at the time of their examinations. Our losses will undoubtedly vary from our estimates, and there is a possibility that charge-offs in future periods will exceed the allowance for loan losses as estimated at any point in time.

At September 30, 2003 and at December 31, 2002, the allowance for loan losses was \$2.5 million and \$1.8 million, respectively, or 1.31% of outstanding loans at September 30, 2003 and 1.22% at December 31, 2002. During the nine months ended September 30, 2003 and 2002, we charged off loans of \$112,839 and \$258,293, respectively.

At September 30, 2003, nonaccrual loans totaled \$406,857, which represented .22% of total loans. Included in the \$406,857 are nonaccrual commercial loans of \$262,068 and consumer loans of \$144,789. During the third quarter of 2002, we obtained ownership through foreclosure procedures on the residential construction loan that was on nonaccrual status at December 31, 2001. At September 30, 2003, we carried this asset as real estate owned with a carrying value of approximately \$691,147. We are in the process of completing the construction of this home. We carry all real estate acquired through foreclosure at the lower of cost or market value.

Generally, a loan is placed on nonaccrual status when it becomes 90 days past due as to principal or interest, or when management believes, after considering economic and business conditions and collection efforts, that the borrower's financial condition is such that collection of the loan is doubtful.

Maturities and Sensitivity of Loans to Changes in Interest Rates

The information in the following table is based on the contractual maturities of individual loans, including loans, which may be subject to renewal at their contractual maturity. Renewal of such loans is subject to review and credit approval, as well as modification of terms upon their maturity. Actual repayments of loans may differ from maturities reflected below because borrowers have the right to prepay obligations with or without prepayment penalties.

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The following table summarizes the loan maturity distribution, by type, and related interest rate characteristics at September 30, 2003 (dollars in thousands):

	<u>One year or less</u>	<u>After one but Within five Years</u>	<u>After five years</u>	<u>Total</u>
Commercial	\$ 20,145	\$ 15,183	\$ 30	\$ 35,358
Real estate - construction	6,425	3,098	1,968	11,491
Real estate- mortgage	21,118	112,141	3,909	137,180
Consumer and other	1,925	2,146	263	4,334
	<hr/>	<hr/>	<hr/>	<hr/>
Total loans	\$ 49,613	\$ 132,568	\$ 6,170	\$ 188,351
	<hr/>	<hr/>	<hr/>	<hr/>

Loans maturing after one year with:

Fixed interest rates	\$ 36,072
Floating interest rates	\$ 102,666

Deposits and Other Interest-Bearing Liabilities

Our primary sources of funds for loans and investments are our deposits, advances from the FHLB, and short-term repurchase agreements. We believe that conditions in 2003 were favorable for deposit growth and those factors such as the low returns on investments and mutual funds may have increased traditional deposit inflows during 2003.

The following is a table of deposits by category (dollars in thousands):

	<u>September 30, 2003</u>		<u>December 31, 2002</u>	
Demand deposit accounts	\$ 16,512	10.58%	\$ 13,809	10.34%
NOW accounts	16,013	10.26%	15,378	11.51%
Money market accounts	23,629	15.14%	19,727	14.77%
Savings accounts	1,726	1.10%	1,774	1.33%
Time deposits less than \$100,000	31,639	20.27%	32,024	23.98%
Time deposits of \$100,000 or more	66,575	42.65%	50,851	38.07%
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Total deposits	\$ 156,094	100.00%	\$ 133,563	100.00%
	<hr/>	<hr/>	<hr/>	<hr/>

Core deposits, which traditionally exclude time deposits of \$100,000 or more, provide a relatively stable funding source for our loan portfolio and other earning assets. Our core deposits were \$89.5 million and \$82.7 million at September 30, 2003 and December 31, 2002, respectively. Our loan-to-deposit ratio was 119.09% and 110.87% at September 30, 2003 and December 31, 2002, respectively.

A significant portion of the time deposits over \$100,000 relate to deposits that were obtained outside of our local market. The maturities on these deposits range from three months to five years. These deposits were obtained at rates that were either comparable to or lower than rates paid in the local market.

The maturity distribution of our time deposits of \$100,000 or more is as follows:

	<u>September 30, 2003</u>	<u>December 31, 2002</u>
	<u>(Dollars in thousands)</u>	
Three months or less	\$ 14,612	\$ 13,226
Over three through nine months	19,423	9,155
Over six through twelve months	17,045	10,391
Over twelve months	15,495	18,079
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	<u>September 30, 2003</u>	<u>December 31, 2002</u>
Total	\$ 66,575	\$ 50,851

Borrowings

At September 30, 2003, we had two unused federal funds purchased line of credit totaling \$6,700,000. These lines of credit are unsecured and bear interest at the daily rate of federal funds plus 25 basis points (1.25% at September 30, 2003).

At September 30, 2003, we had \$40,000,000 of advances from the FHLB. Included in the \$40.0 million of advance outstanding at September 30, 2003, is \$14.5 million that reprice daily with no set maturity. From time to time the bank utilizes short-term borrowings from the FHLB to fund loan growth or to replace higher yielding short-term borrowings. The rate at September 30, 2003 was 1.24%. The advances are secured with approximately \$79,400,000 of first mortgage loans and our stock in the FHLB. We had collateral available to borrow an additional \$10,000,000 advances at September 30, 2003. Listed below is a summary of the term and maturities of the advances:

- o The maturity on \$5,000,000 of the advances with a weighted rate of 1.63% is July 16, 2004. The FHLB has the option to re-price this advance as of April 16, 2003.
- o The maturity on \$7,500,000 of the advances with a weighted rate of 1.21% is March 10, 2006. The FHLB has the option to re-price this advance as of March 10, 2004.
- o The maturity on \$5,000,000 of the advances with a weighted rate of 1.56% is October 15, 2007. The FHLB has the option to re-price this advance as of October 15, 2003.
- o The maturity on \$3,000,000 of the advances with a weighted rate of 4.86% is August 24, 2011. The FHLB has the option to re-price this advance as of August 24, 2006.
- o The maturity on \$5,000,000 of the advances with a weighted rate of 3.36% is January 30, 2013. The FHLB has the option to re-price this advance as of January 30, 2008.

At September 30, 2003, we had an unused \$3,500,000 revolving line of credit with another bank with a maturity of September 20, 2004. The line of credit bears interest at a rate of the three-month libor rate plus 200 basis points, which at September 30, 2003 was 3.30%. We have pledged all of our stock of our subsidiary, Greenville First Bank, as collateral for this line of credit. The line of credit agreement contains various covenants related to net income and asset quality. As of September 30, 2003, we believe we are in compliance with all covenants.

On September 26, 2003, we 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.

We 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. We will invest \$2.7 million in our wholly-owned subsidiary, Greenville First Bank. We plan to use the remaining balance to fund operations at the holding company level, or for potential future investments in the bank.

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CAPITAL RESOURCES

Total shareholders' equity amounted to \$10.8 million at September 30, 2003 and \$10.2 million at December 31, 2002. The increase during the nine months ended September 30, 2003 resulted from \$663,863 of net income partly offset by \$68,408 decrease in the unrealized gains on investment securities.

The following table shows the annualized return on average assets (annualized net income divided by average total assets), return on average equity (annualized net income divided by average equity), and equity to assets ratio (average equity divided by average total assets). Since our inception, we have not paid any cash dividends.

<u>September 30, 2003</u>	<u>December 31,</u> <u>2002</u>
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	<u>September 30, 2003</u>	<u>December 31, 2002</u>
Return on average assets	.48%	.051%
Return on average equity	8.29%	7.73%
Equity to assets ratio	5.04%	6.57%

The Federal Reserve Board and bank regulatory agencies require bank holding companies and financial institutions to maintain capital at adequate levels based on a percentage of assets and off-balance sheet exposures, adjusted for risk weights ranging from 0% to 100%.

Under the capital adequacy guidelines, capital is classified into two tiers. These guidelines require an institution to maintain a certain level of Tier 1 and Tier 2 capital to risk-weighted assets. Tier 1 capital consists of common stockholders' equity, excluding the unrealized gain or loss on securities available for sale, plus a portion of trust preferred securities subject to certain limitations, minus certain intangible assets. In determining the amount of risk-weighted assets, all assets, including certain off-balance sheet assets, are multiplied by a risk-weight factor of 0% to 100% based on the risks believed inherent in the type of asset. Tier 2 capital consists of Tier 1 capital plus the remaining portion of trust preferred securities not included in Tier 1, plus the general reserve for loan losses subject to certain limitations. The bank is also required to maintain capital at a minimum level based on total average assets, which is known as the Tier 1 leverage ratio.

The bank is subject to various regulatory capital requirements administered by the federal banking agencies. Under these capital guidelines, we must maintain a minimum total risk-based capital of 8%, with at least 4% being Tier 1 capital. In addition, we must maintain a minimum Tier 1 leverage ratio of at least 4%. To be considered well-capitalized, we must maintain total risk-based capital of at least 10%, Tier 1 capital of at least 6%, and a leverage ratio of at least 5%.

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The following table sets forth the company's and the bank's various capital ratios at September 30, 2003 and December 31, 2002. At September 30, 2003 and December 31, 2002, both the company and the bank were in compliance with each of the applicable regulatory capital requirements and were both considered to be well capitalized.

	<u>September 30, 2003</u>		<u>December 31, 2002</u>	
	<u>Company</u>	<u>Bank</u>	<u>Company</u>	<u>Bank</u>
Total risk-based capital	11.0%	10.8%	8.6%	10.3%
Tier 1 risk-based capital	8.3%	9.5%	7.4%	9.1%
Leverage capital	7.0%	8.1%	6.1%	7.5%

Our objective is to maintain the capital levels such that the bank will continue to be considered well capitalized.

EFFECT OF INFLATION AND CHANGING PRICES

The effect of relative purchasing power over time due to inflation has not been taken into effect in our financial statements. Rather, the statements have been prepared on an historical cost basis in accordance with generally accepted accounting principles in the United States of America.

Unlike most industrial companies, the assets and liabilities of financial institutions such as our company and bank are primarily monetary in nature. Therefore, the effect of changes in interest rates will have a more significant impact on our performance than will the effect of changing prices and inflation in general. In addition, interest rates may generally increase as the rate of inflation increases, although not necessarily in the same magnitude. As discussed previously, we seek to manage the relationships between interest sensitive assets and liabilities in order to protect against wide rate fluctuations, including those resulting from inflation.

OFF-BALANCE SHEET RISK

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any material condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require the payment of a fee. At September 30, 2003, unfunded commitments to extend credit were \$47.6 million, of which approximately \$12.4 million was at fixed rates and \$35.2 million was at variable rates. The significant portion of the unfunded commitments relates to consumer equity lines of credit. The bank anticipates, based on historical experience, that the significant portion of these lines of credit will not be funded. The bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the bank upon extension of credit, is based on management's credit evaluation of the borrower. Collateral varies but may include accounts receivable, inventory, property, plant and equipment, and commercial and residential real estate.

At September 30, 2003, there was a \$1.5 million commitment under a letter of credit. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Collateral varies but may include accounts receivable, inventory,

equipment, marketable securities and property. Since most of the letters of credit are expected to expire without being drawn upon, they do not necessarily represent future cash requirements.

Except as disclosed in this report, we are not involved in off-balance sheet contractual relationships, unconsolidated related entities that have off-balance sheet arrangements, or transactions that result in liquidity needs or other commitments that we believe are likely to significantly impact earnings.

MARKET RISK

Market risk is the risk of loss from adverse changes in market prices and rates, which principally arises from interest rate risk inherent in our lending, investing, deposit gathering and borrowing activities. Other types of market risks, such as foreign currency exchange rate risk and commodity price risk, do not normally arise in the normal course of our business. We actively monitor and manage our interest rate risk exposure.

The principal interest rate risk monitoring technique we employ is the measurement of our interest sensitivity gap, which is the positive or negative dollar difference between assets and liabilities that are subject to interest rate repricing within a given period of time. Interest rate sensitivity can be managed by repricing assets or liabilities, selling securities available-for-sale, replacing an asset or liability at maturity, or adjusting the interest rate during the life of an asset or liability. Managing the amount of assets and liabilities repricing in this same time interval helps to hedge the risk and minimize the impact on net interest income of rising or falling interest rates. We generally would benefit from increasing market rates of interest when we have an asset-sensitive gap position and generally would benefit from decreasing market rates of interest when we are liability-sensitive.

Because approximately 74% of our loans are variable rate loans at September 30, 2003, we are currently asset sensitive over the one-year time frame. However, our gap analysis is not a precise indicator of our interest sensitivity position. The analysis presents only a static view of the timing of maturities and repricing opportunities, without taking into consideration that changes in interest rates do not affect all assets and liabilities equally. For example, rates paid on a substantial portion of core deposits may change contractually within a relatively short time frame, but those rates are viewed by management as significantly less interest-sensitive than market-based rates such as those paid on non-core deposits. Net interest income may be impacted by other significant factors in a given interest rate environment, including changes in the volume and mix of earning assets and interest-bearing liabilities.

LIQUIDITY & INTEREST RATE SENSITIVITY

Liquidity management involves monitoring our sources and uses of funds in order to meet our day-to-day cash flow requirements while maximizing profits. Liquidity represents the ability of a company to convert assets into cash or cash equivalents without significant loss and to raise additional funds by increasing liabilities. Liquidity management is made more complicated because different balance sheet components are subject to varying degrees of management control. For example, the timing of maturities of the investment portfolio is fairly predictable and subject to a high degree of control at the time the investment decisions are made. However, net deposit inflows and outflows are far less predictable and are not subject to nearly the same degree of control.

At September 30, 2003 and December 31, 2002, our liquid assets, consisting of cash, due from banks and federal funds sold, amounted to \$9.7 million and \$4.5 million, representing 4.5% and 2.6% of total assets, respectively. Investment securities at September 30, 2003 and December 31, 2002 amounted to \$16.4 million and \$15.5 million, representing 7.7% and 9.1% of total assets, respectively; these securities provide a secondary source of liquidity since they can be converted into cash in a timely manner. Our ability to maintain and expand our deposit base and borrowing capabilities also serves as a source of liquidity.

We plan to meet our future cash needs through the liquidation of temporary investments, maturities and sale of loans, maturity of investment securities, generation of deposits and additional borrowings. During 2003, we have utilized proceeds from the short-term advances from the FHLB and

short-term repurchase agreements from brokerage firms, proceeds from sales of participations in loans originated, and an increase in deposits to fund the significant portion of the 2003 loan production. By utilizing the various short-term sources of funding, we have been able to reduce the bank's level of interest sensitivity while obtaining low cost funds. The bank is a member of the Federal Home Loan Bank of Atlanta from which applications for borrowings can be made for leverage purposes, if so desired. The FHLB requires securities, qualifying single family and commercial mortgage loans, and stock of the FHLB owned by the bank is pledged to secure any advances from the FHLB. The unused borrowing capacity at September 30, 2003 that is currently available from the FHLB based on the amount of collateral pledged is approximately

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\$10.0 million. In addition, we maintain two federal funds purchased line of credit with a correspondent bank, totaling \$6.7 million. At September 30, 2003, the unused portion of the lines was \$6.7 million. We have also obtained a \$10.0 million line of credit that is available from a brokerage firm based on the amount of collateral held by the firm. At September 30, 2003, the firm held \$10.0 million of investment securities as collateral. As of September 30, 2003, we had no outstanding borrowings from the brokerage firm.

During the second quarter of 2003, we announced our intention to open two branch locations. The two branches are expected to open during the second half of 2004 or the first half of 2005. We anticipate being able to fund this expansion program from operations.

We believe that our existing stable base of core deposits, borrowings from the FHLB, and short-term repurchase agreements will enable us to successfully meet our liquidity needs for the foreseeable future.

Asset/liability management is the process by which we monitor and control the mix and maturities of our assets and liabilities. The essential purposes of asset/liability management are to ensure adequate liquidity and to maintain an appropriate balance between interest sensitive assets and liabilities to minimize potentially adverse impacts on earnings from changes in market interest rates. The bank's asset/liability management committee (ALCO) monitors and considers methods of managing exposure to interest rate risk. The ALCO consists of members of the board of directors and senior management of the bank and meets at least quarterly. The ALCO is charged with the responsibility to maintain the level of interest rate sensitivity of the bank's interest sensitive assets and liabilities within board-approved limits. With historical low levels of interest rates, the bank has invested a significant portion of its assets in variable rate loans, which has resulted in an asset sensitive position.

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The following table presents our rate sensitivity at each of the time intervals indicated as of September 30, 2003. The table may not be indicative of our rate sensitivity position at other points in time. In addition, the table's maturity distribution may differ from the contractual maturities of the earning assets and interest bearing liabilities presented due to consideration of prepayment speeds under various interest rate change scenarios in the application of the interest rate sensitivity methods described above.

	<u>Within three months</u>	<u>After three but within twelve months</u>	<u>After one but within five years</u>	<u>After five years</u>	<u>Total</u>
(Dollars in thousands)					
Interest-earning assets:					
Federal funds sold	\$ 3,378	\$ -	\$ -	\$ -	\$ 3,378
Investment securities	889	2,592	5,866	4,609	13,956
Loans	140,237	11,053	34,920	2,551	188,761
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total earning assets	\$ 144,504	\$ 13,645	\$ 40,786	\$ 7,160	\$ 206,095
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Interest-bearing liabilities:					
Money market and NOW	\$ 39,608	\$ -	\$ -	\$ -	\$ 39,608
Regular savings	1,726	-	-	-	1,726
Time deposits	22,162	52,801	23,251	-	98,214
Trust preferred securities	6,000	-	-	-	6,000
FHLB advances	24,500	7,500	8,000	-	40,000
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total interest-bearing liabilities	\$ 93,996	\$ 60,301	\$ 31,251	\$ -	\$ 185,548
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Period gap	\$ 50,508	\$ (46,656)	\$ 9,535	\$ 7,160	\$ 20,547
Cumulative gap	\$ 50,508	\$ 3,852	\$ 13,387	\$ 20,547	\$ 20,547
Ratio of cumulative gap to total earning assets	24.5%	1.9%	6.5%	10.0%	

ACCOUNTING, REPORTING AND REGULATORY MATTERS

Accounting standards have been issued or proposed by the Financial Accounting Standards Board and are not required to be adopted until a future date and are not expected to have a material impact on the consolidated financial statements upon adoption.

Item 3. Controls and Procedures

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures as defined in Exchange Act Rule 13a-15(e). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our current disclosure controls and procedures are effective as of September 30, 2003.

The design of any system of controls and procedures is based in part upon certain assumptions about the likelihood of future events. There can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

There are no material pending legal proceedings to which the company is a party or of which any of its property is the subject.

Item 2. Changes in Securities

None

Item 3. Defaults Upon Senior Securities

Not applicable

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

None

Item 5. Other Information

None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits: See Exhibit Index attached hereto.

	<u>Exhibit</u>	<u>Description</u>
31		Certifications of Chief Executive Officer and Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32		Certifications of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. This exhibit is not filed for purposes of Section 18 of the Securities Exchange Act of 1934 but is instead furnished as provided by applicable rules of the Securities and Exchange Commission.

(b) Reports on Form 8-K

The following reports were filed on Form 8-K during the third quarter ended September 30, 2003.

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The Company filed a Form 8-K on July 10, 2003 to announce the issuance of \$6.0 million in floating rate trust preferred securities.

The Company filed a Form 8-K on July 15, 2003 to disclose the issuance of a press release announcing its financial results for the second quarter ended June 30, 2003.

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SIGNATURES

Pursuant to the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

GREENVILLE FIRST BANCSHARES, INC.

Date: November 13, 2003

/s/ R. Arthur Seaver, Jr.
R. Arthur Seaver, Jr.
Chief Executive Officer

Date: November 13, 2003

/s/ James M. Austin, III
James M. Austin, III
Chief Financial Officer

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INDEX TO EXHIBITS

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