TAYLOR CALVIN B BANKSHARES INC
Form 10-Q
August 08, 2002

SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13(a) OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTER ENDED JUNE 30, 2002

Commission File Number: 0001003986

CALVIN B. TAYLOR BANKSHARES, INC.

I.R.S. Employer Identification No.: 52-1948274
State of incorporation: Maryland

Address of principal executive offices:
24 North Main Street, Berlin, Maryland 21811
Issuer's telephone number: (410) 641-1700

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

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: The registrant had 3,240,000 shares of common stock ($1.00 par) outstanding as of July 31, 2002.

Calvin B. Taylor Bankshares, Inc. and Subsidiaries
Form 10-Q
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Calvin B. Taylor Bankshares, Inc. and Subsidiaries
Part I - Financial Information
Consolidated Balance Sheets

	(unaudited) June 2002	December 2001
Assets		
Cash and due from banks	$ 16,641,473	$ 18,397,266
Federal funds sold	47,181,444	54,389,656
Interest-bearing deposits	979,518	879,000
Investment securities available for sale	4,035,534	3,974,099
Investment securities held to maturity (approximate fair value of $98,673,000 and $85,604,080)	97,807,644	84,398,152
Loans, less allowance for loan losses of $2,167,627 and $2,195,922	172,579,860	166,501,512
Premises and equipment	6,016,694	5,895,275
Accrued interest income	2,129,605	1,753,816
Deferred income taxes	113,215	134,639
Other assets	398,071	501,152
	$347,883,058	$336,824,567
Liabilities and Stockholders' Equity		
Deposits		
Noninterest-bearing	$ 67,322,928	$ 60,508,663
Interest-bearing	217,193,200	213,640,518
	284,516,128	274,149,181
Securities sold under agreements to repurchase	4,526,498	4,555,323
Accrued interest payable	354,707	529,348
Note payable	207,433	215,702
Accrued income taxes	123,758	2,298
Other liabilities	1,822	130,145
	289,730,346	279,581,997
Stockholders' equity		
Common stock, par value $1 per share authorized 10,000,000 shares, issued and outstanding 3,240,000 shares	3,240,000	3,240,000
Additional paid in capital	17,290,000	17,290,000
Retained earnings	37,150,192	36,274,102
	57,680,192	56,804,102
Net unrealized gain on		

securities available for sale	472,520	438,468
	58,152,712	57,242,570
	$347,883,058	$336,824,567

Calvin B. Taylor Bankshares, Inc. and Subsidiaries
Consolidated Statements of Income (unaudited)

	For the three months ended June 30, 2002	2001
Interest and dividend revenue		
Loans, including fees	$ 3,379,640	$ 3,622,418
U.S. Treasury and Agency securities	927,630	798,692
State and municipal securities	62,122	92,535
Federal funds sold	169,215	351,967
Deposits with banks	10,417	12,076
Equity securities	6,948	4,769
Total interest and dividend revenue	4,555,972	4,882,457
Interest expense		
Deposit interest	1,027,029	1,526,482
Other	9,036	15,801
Total interest expense	1,036,065	1,542,283
Net interest income	3,519,907	3,340,174
Provision for loan losses	-	-
Net interest income after provision for loan losses	3,519,907	3,340,174
Other operating revenue		
Service charges on deposit accounts	253,727	206,734
Miscellaneous revenue	138,097	160,814
Total other operating revenue	391,824	367,548
Other expenses		
Salaries and employee benefits	858,642	810,247
Occupancy	105,010	76,655
Furniture and equipment	119,319	147,687
Other operating	459,583	399,662
Total other expenses	1,542,554	1,434,251
Income before income taxes	2,369,177	2,273,471
Income taxes	829,000	781,979
Net income	$ 1,540,177	$ 1,491,492
Basic earnings per share	$ 0.47	$ 0.46

Calvin B. Taylor Bankshares, Inc. and Subsidiaries
Consolidated Statements of Income (unaudited)

	For the six months ended June 30, 2002	2001
Interest and dividend revenue		
Loans, including fees	$ 6,640,117	$ 7,198,542

U.S. Treasury and Agency securities	1,802,016	1,695,103
State and municipal securities	123,160	186,948
Federal funds sold	389,732	613,251
Deposits with banks	20,939	24,048
Equity securities	22,106	19,472
Total interest and dividend revenue	8,998,070	9,737,364
Interest expense		
Deposit interest	2,187,427	3,039,738
Other	19,418	31,844
Total interest expense	2,206,845	3,071,582
Net interest income	6,791,225	6,665,782
Provision for loan losses	-	-
Net interest income after provision for loan losses	6,791,225	6,665,782
Other operating revenue		
Service charges on deposit accounts	472,447	409,121
Miscellaneous revenue	232,555	243,327
Total other operating revenue	705,002	652,448
Other expenses		
Salaries and employee benefits	1,722,832	1,652,394
Occupancy	224,326	204,687
Furniture and equipment	276,804	290,157
Other operating	931,975	812,232
Total other expenses	3,155,937	2,959,470
Income before income taxes	4,340,290	4,358,760
Income taxes	1,520,200	1,510,412
Net income	$ 2,820,090	$ 2,848,348
Basic earnings per share	$ 0.87	$ 0.88

Calvin B. Taylor Bankshares, Inc. and Subsidiaries
Consolidated Statements of Cash Flows (unaudited)

	For the six months ended June 30, 2002	2001
Cash flows from operating activities		
Interest received	$ 8,571,635	$ 9,575,982
Fees and commissions received	704,900	691,617
Interest paid	(2,381,486)	(3,053,758)
Cash paid to suppliers and employees	(2,895,906)	(2,837,651)
Income taxes paid	(1,396,787)	(1,475,723)
	2,602,356	2,900,467
Cash flows from investing activities		
Proceeds from maturities of investment securities	34,875,000	32,185,000
Purchase of investment securities held to maturity	(43,239,805)	(17,133,193)

Certificates of deposit purchased, net of redemptions	(100,518)	-
Purchases of premises, equipment, and intangibles	(408,542)	(437,589)
Loans made, net of principal collected	(6,078,348)	(3,012,571)
Proceeds from sales of equipment	-	17,000
	(14,952,213)	11,618,647
Cash flows from financing activities		
Net change in time deposits	(6,301,875)	5,158,643
Net change in other deposits	16,668,822	4,661,410
Net change in repurchase agreements	(28,825)	1,153,018
Payment on mortgage obligation	(8,270)	(7,789)
Dividend paid	(1,944,000)	-
	8,385,852	10,965,282
Net increase (decrease) in cash	(3,964,005)	25,484,396
Cash and equivalents at beginning of period	72,786,922	31,499,806
Cash and equivalents at end of period	$ 68,822,917	$ 56,984,202
Reconciliation of net income to net cash provided from operating activities		
Net income	$ 2,820,090	$ 2,848,348
Adjustments		
Depreciation and amortization	307,928	241,113
Deferred income tax	-	-
Provision for loan losses	-	-
Security discount accretion, net of premium amortization	(50,646)	(34,900)
(Gain) loss on disposition of assets	8,343	(13,932)
Decrease (increase) in accrued interest receivable and other assets	(301,856)	(113,960)
Increase (decrease) in accrued interest payable and other liabilities	(181,503)	(26,202)
	$ 2,602,356	$ 2,900,467

Calvin B. Taylor Bankshares, Inc. and Subsidiaries
Notes to Financial Statements

1. Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q. 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 considered necessary for a fair presentation have been made. These adjustments are of a normal recurring nature. Results of operations for the six months ended June 30, 2002 are not necessarily indicative of the results that may be expected for the year ending December 31, 2002. For further information, refer to the audited consolidated financial statements and related footnotes for the Registrant's fiscal period ended December 31, 2001.

Consolidation has resulted in the elimination of all significant intercompany accounts and transactions.

Cash Flows

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks and overnight investments in federal funds sold.

Per share data

Earnings per common share and dividends per common share are determined by dividing net income and dividends by the 3,240,000 shares outstanding, giving retroactive effect to stock dividends distributed.

2. Comprehensive Income

Comprehensive income consists of:

	Six months ended June 30, 2002	2001
Net income	$ 2,820,090	$ 2,848,348
Unrealized gain (loss) on investment securities available for sale, net of income taxes	34,052	(35,381)
Comprehensive income	$ 2,854,142	$ 2,812,967

Calvin B. Taylor Bankshares, Inc. and Subsidiaries
Part I. Financial Information
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion contains certain forward-looking statements within the meaning of and made pursuant to the safe harbor provisions of the Private Litigation Securities Reform Act of 1995.

The following discussion of the financial condition and results of operations of the Registrant (the Company) should be read in conjunction with the Company's financial statements and related notes and other statistical information included elsewhere herein.

General

Calvin B. Taylor Bankshares, Inc. (the "Company") was incorporated as a Maryland corporation on October 31, 1995. The Company owns all of the stock of two banks. The

Company currently engages in no business other than owning and managing the Banks.

Calvin B. Taylor Banking Company of Berlin, Maryland (the "Maryland bank") is a commercial bank that was established in 1890 and incorporated under the laws of the State of Maryland on December 17, 1907. This bank operates nine banking offices in Worcester County with the Bank's main office located in Berlin, Maryland. It is engaged in a general commercial and retail banking business serving individuals, businesses, and governmental units in Worcester County, Maryland and neighboring counties.

Calvin B. Taylor Bank of Delaware (the "Delaware bank") was incorporated in the state of Delaware in 1997. This one-branch bank opened late in the second quarter of 1998, offering the same services as the Maryland bank,.

Financial Condition

Total assets of the Company increased $11.1 million from December 31, 2001 to June 30, 2002. Combined deposits and customer repurchase agreements increased $10.3 million during the same period. During the first quarter of the year, the banks typically experience a decline in deposits since business customers are using their deposits to meet cash flow needs. Generally, this situation reverses late in the second quarter of the year as the banks receive loan repayments from seasonal business customers, and deposits from summer residents and tourists. During this year-to-date, this traditional pattern has not applied. Management believes that adverse conditions in the stock markets have contributed to an unusually large increase in deposits throughout the first half of 2002.

During the first six months of 2002, the banks' loan portfolios have increased $6.1 million. Funding for these loans was provided by the deposit influx which has occurred over the past three quarters. This increase in loans does not negatively impact the Company's ability to meet liquidity demands.

The allowance for loan losses represents a reserve for potential losses in the loan portfolio. The adequacy of the allowance for loan losses is evaluated periodically based on a review of all significant loans, with a particular emphasis on non-accruing, past due, and other loans that management believes require attention. The determination of the reserve level rests upon management's judgment about factors affecting loan quality and anticipated changes in the composition and size of the portfolio, as well as assumptions about the economy. Historically, the Company has low loan charge-offs. The banks' target levels for their allowances as a percentage of gross loans range from approximately 1.00% to 1.35%. Based on review of the consolidated loan portfolio, the Company determined that an allowance of 1.24% of gross loans was adequate as of June 30, 2002. At December 31, 2001, the allowance was 1.30% of gross loans. At June 30, 2002, there were no non-accruing loans. Loans delinquent ninety days or more totaled $207,331 or .12% of the portfolio.

Liquidity

The company's major sources of liquidity are loan repayments, maturities of short-term investments including federal funds sold, and increases in core deposits. Throughout the first quarter of the year, when the banks typically experience a decline in deposits, federal funds sold and investment securities are primary sources of liquidity. During the second quarter of the year, additional sources of liquidity become more readily available as business borrowers start repaying loans, and the banks receive seasonal deposits. Throughout the second and third quarters the banks maintain a high liquidity level. Funds from seasonal deposits are generally invested in short-term U.S. Treasury Bills and overnight federal funds. Average liquid assets (cash and amounts due from banks, interest bearing deposits in other banks, federal funds sold, and investment securities) compared to average deposits were 57.28% for the second quarter of 2002 compared to 58.36% for the first quarter of 2002 and 48.05% for the second quarter of 2001. This increase in liquidity is primarily due to the rapid growth in deposits which has not been accompanied by a corresponding increase in demand for loans.

Results of Operations

Net income for the three months ended June 30, 2002, was $1,540,177 or $.47 per share, compared to $1,491,492 or $.46 per share for the first quarter of 2001. This represents an increase of $48,685 or 3.26% from the prior year. Year to date net income has decreased $28,258 or $.01 per share from $2,848,348 or $.88 per share in 2001 to $2,820,090 or $.87 per share in 2002. The key components of net income are discussed in the following paragraphs.

Net interest income increased $125,443 in the first six months of 2002 as compared to the first six months of 2001. This increase is attributable to a higher volume of earning assets. The Company's net interest income is one of the most important factors in evaluating its financial performance. Management uses interest sensitivity analysis to determine the effect of rate changes. Net interest income is projected over a one-year period to determine the effect of an increase or decrease in the prime rate of 100 basis points. If prime were to decrease one hundred basis points, and all assets and liabilities maturing within that period were fully adjusted for the rate change, the Company would experience a decrease of less than five percent in net interest income. The sensitivity analysis does not consider the likelihood of these rate changes nor whether management's reaction to this rate change would be to reprice its loans or deposits.

No provision for loan losses was made in the first half of 2002 or 2001. Net charge-offs during the second quarter of 2002 and the year-to-date were $20,920 and $28,295, respectively.

Personnel expenses are higher for the six months ended June 30, 2002 compared to the same period in 2001 due to general increases in salaries and increased cost of group insurance. The banks employed 102 full time equivalent employees as of June 30, 2002, a decrease of four employees from June 30, 2001. The Maryland bank hires seasonal employees during the summer. The Company has no employees other than those hired by the banks.

The Company's occupancy expense increased $19.6 thousand from first half 2001 to 2002. This is due to the amortization of prepaid property taxes which began in mid-2001, netted against reductions in repairs and maintenance costs due to improved classification of equipment repairs. In the same six month period, furniture and equipment expense decreased by $13.4 thousand. Increases in depreciation and repairs and maintenance costs were offset by improved classification of software maintenance contracts from furniture and equipment to other operating expense. Also, in 2001 the company paid two years' personal property taxes due to the timing of municipal billings. As a result of upgrades to the Company's computer systems made throughout 2001, depreciation and hardware and software maintenance costs have increased, as expected.

Other operating expenses are $119.7 thousand higher in the first half of 2002 versus the first half of 2001. Telephone expense has increased $38.8 thousand due to internet and network demands, and correspondent bank fees are $49.8 thousand higher as a result of low interest rates generating less earning credit to offset fees. Software maintenance contract costs contribute $48.7 thousand of this increase due to improved classification as other operating expense versus furniture and equipment expense.

Income taxes are higher on lower pre-tax income due to an increase in the Company's effective tax rate. This is the result of tax-favored income becoming a smaller percentage of total revenues.

Plans of Operation

The banks conduct general commercial banking businesses in their service areas, of Worcester County, Maryland and Sussex County, Delaware, emphasizing the banking needs of individuals and small- to medium-sized businesses and professional concerns. The banks offer a full range of federally insured deposit services that are typically available in most banks and savings and loan associations, including checking accounts, NOW accounts, savings accounts and other time deposits of various types ranging from daily money market accounts to longer-term certificates of deposit.

The Company, through its banks, offers a full range of short- to medium-term commercial and personal loans, and originates mortgage loans, including real estate construction and acquisition loans. The banks have the intent and the ability to hold loans that they originate in their portfolios.

Other bank services include cash management services, safe deposit boxes, travelers' checks, direct deposit of payroll and social security checks, debit cards, and automatic drafts for various accounts. The Company is associated with the MAC/STAR network of automated teller machines that may be used by customers throughout Maryland, Delaware and other regions. The Company offers credit card services through a correspondent bank.

The banks have submitted applications to their primary regulators, State of Maryland Division of Financial Regulation and Delaware State Bank Commissioner, and to the Federal Deposit Insurance Corporation, to combine by merger and branch acquisition into one commercial bank effective at the close of business on September 26, 2002. The resultant bank will be Calvin B. Taylor Banking Company of Berlin, Maryland. Calvin B. Taylor Bank of Delaware will cease to exist, and the location that has served as its main office and its only branch will continue to serve customers as a branch of the Maryland bank. Service, hours and staff will not change significantly at the Delaware location as a result of this transaction. Convenience will increase for customers of the Delaware bank due to availability of certain additional services, such as Internet banking, which will be offered to Delaware-based customers after the merger. Because the banks are both 100% owned by the Company, this transaction will be recorded as a pooling of interests. No assets, liabilities or equity accounts will transfer to the resultant bank at other than their book value immediately prior to combination. The boards of directors of each bank and of the Company, as sole shareholder of the banks, have approved this merger and branch acquisition.

Capital Resources and Adequacy

Total stockholders' equity increased $910,142 from December 31, 2001 to June 30, 2002. This increase is attributable to the comprehensive income of $2,854,142 recorded during the period, as detailed in Note 2 of the Notes to Financial Statements, reduced by payment of a cash dividend of $1,944,000.

Under the capital guidelines of the Federal Reserve Board and the FDIC, the Company and its banks are currently required to maintain a minimum risk-based total capital ratio of 8%, with at least 4% being Tier 1 capital. Tier 1 capital consists of common shareholders' equity, qualifying perpetual preferred stock, and minority interests in equity accounts of consolidated subsidiaries, less certain intangibles. In addition, the Company and the banks must maintain a minimum Tier 1 leverage ratio (Tier 1 capital to total assets) of at least 3%, but this minimum ratio is increased by 100 to 200 basis points for other than the highest-rated institutions.

Tier one risk-based capital ratios of the Company as of June 30, 2002 and 2001 were 36.26% and 35.80%, respectively. Both are substantially in excess of regulatory minimum requirements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company's principal market risk exposure relates to interest rates on interest-earning assets and interest-bearing liabilities. Unlike most industrial companies, the assets and liabilities of financial institutions such as the Company and the banks are primarily monetary in nature. Therefore, interest rates have a more significant effect on the Company's performance than do the effects of changes in the general rate of inflation and change in prices. In addition, interest rates do not necessarily move in the same direction or in the same magnitude as the prices of goods and services. As discussed previously, management monitors and seeks to manage the relationships between interest sensitive assets and liabilities in order to protect against wide interest rate fluctuations, including those resulting from inflation.

At June 30, 2002 the Company's interest rate sensitivity, as measured by gap analysis, showed the Company was asset-sensitive with a one-year cumulative gap of 20.12%, as a percentage of interest-earning assets. Generally asset-sensitivity indicates that assets reprice more quickly than liabilities and in a rising rate environment net interest income typically increases. Conversely, if interest rates decrease, net interest income would decline. Both banks have classified their demand mortgage and commercial loans as immediately repricing. Unlike loans tied to prime, these rates do not necessarily change as prime changes since the decision to call the loans and change the rates rests with management.

Calvin B. Taylor Bankshares, Inc. and Subsidiaries
Part II. Other Information

Item 1 Legal Proceedings
Not applicable

Item 2 Changes in Securities and Use of Proceeds
Not applicable

Item 3 Defaults Upon Senior Securities
Not applicable

Item 4 Submission of Matters to a Vote of Security Holders
The Company held its annual meeting on May 8, 2002, during which the items detailed in the proxy statement dated March 15, 2002, were approved. This includes the reelection of the Board of Directors.

Item 5 Other information
Not applicable.

Item 6 Exhibits and Reports on Form 8-K
a) Exhibits
2. Proxy Statement dated March 15, 2002, is incorporated by reference.

b) Reports on Form 8-K
There were no reports on Form 8-K filed for the quarter ended June 30, 2002.

SIGNATURES

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

Calvin B. Taylor Bankshares, Inc.

Date: August 8, 2002 By: /s/ Reese F. Cropper, Jr.
Reese F. Cropper, Jr.,
Chairman & Chief Executive Officer

Date: August 8, 2002 By: /s/ Jennifer G. Hawkins
Jennifer G. Hawkins
Treasurer

Certification of Principal Executive Officer
and Principal Financial Officer
Pursuant to 18 U.S.C. 1350
(Section 906 of the Sarbanes-Oxley Act of 2002)

We, the undersigned, certify that to the best of our knowledge, based upon a review of the Quarterly Report on Form 10-Q for the period ended June 30, 2002 of the Registrant (the "Report"):

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

Calvin B. Taylor Bankshares, Inc.

Date: August 8, 2002 By: /s/ Reese F. Cropper, Jr.
Reese F. Cropper, Jr.,
Chairman & Chief Executive Officer
(Principal Executive Officer)

Date: August 8, 2002

By: /s/ Jennifer G. Hawkins
Jennifer G. Hawkins
Treasurer
(Principal Financial Officer)