TAYLOR CALVIN B BANKSHARES INC
Form 10-Q
May 08, 2003

SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

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

FOR THE QUARTER ENDED MARCH 31, 2003

Commission File Number: 000-50047

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 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 April 30, 2003.

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Calvin B. Taylor Bankshares, Inc. and Subsidiary
Part I - Financial Information

Consolidated Balance Sheets

	(unaudited) March 2003	December 2002
Assets		
Cash and due from banks	18,128,997	21,051,412
Federal funds sold	43,560,048	54,821,617
Interest-bearing deposits	1,632,294	1,432,205
Investment securities available for sale	8,388,060	8,390,550
Investment securities held to maturity (approximate fair value of 117,510,526 and 115,470,092)	116,570,170	114,181,749
Loans, less allowance for loan losses of 2,182,665 and 2,181,135	167,819,932	161,824,677
Premises and equipment	6,096,967	5,745,842
Accrued interest income	1,402,520	1,405,587
Other assets	398,807	389,307
	363,997,795	369,242,946
Liabilities and Stockholders' Equity		
Deposits		
Noninterest-bearing	63,968,675	73,289,541
Interest-bearing	229,535,328	228,205,925
	293,504,003	301,495,466
Securities sold under agreements to repurchase	3,496,842	4,029,100
Pending purchases of investment securities	4,445,000	2,990,830
Accrued interest payable	204,433	243,468
Note payable	194,555	198,912
Accrued income taxes	742,756	106,514
Other liabilities	59,746	163,370
	302,647,335	309,227,660
Stockholders' equity		
Common stock, par value $1 per share authorized 10,000,000 shares, issued and 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	40,140,523	38,788,018
	60,670,523	59,318,018
Net unrealized gain on securities available for sale	679,937	697,268
	61,350,460	60,015,286
	363,997,795	369,242,946

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

	For the three months ended March 31, 2003	2002
Interest and dividend revenue		
	363,997,795	369,242,946
Loans, including fees	3,026,791	3,260,478
U.S. Treasury and Agency securities	756,863	874,386
State and municipal securities	49,045	61,038
Federal funds sold	133,640	220,517
Deposits with banks	10,042	10,522
Equity securities	17,040	15,158
Total interest and dividend revenue	3,993,421	4,442,099
Interest expense		
Deposit interest	657,727	1,160,399
Other	5,830	10,382
Total interest expense	663,557	1,170,781
Net interest income	3,329,864	3,271,318
Provision for loan losses	-	-
Net interest income after provision for loan losses	3,329,864	3,271,318
Other operating revenue		
Service charges on deposit accounts	257,571	218,719
Miscellaneous revenue	115,485	94,458
Total other operating revenue	373,056	313,177
Other expenses		
Salaries and employee benefits	921,320	864,189
Occupancy	128,638	119,316
Furniture and equipment	142,282	157,485
Other operating	424,175	472,392
Total other expenses	1,616,415	1,613,382
Income before income taxes	2,086,505	1,971,113
Income taxes	734,000	691,200
Net income	1,352,505	1,279,913
Basic earnings per share	0.42	0.40

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

	For the three months ended March 31, 2003	2002
Cash flows from operating activities		
Interest received	3,961,786	4,454,002
Fees and commissions received	372,813	313,169
Interest paid	(702,594)	(1,242,958)
Cash paid to suppliers and employees	(1,538,160)	(1,556,159)
Income taxes paid	(97,758)	(2,679)
	1,996,087	1,965,375
Cash flows from investing activities		
Proceeds from maturities of investment securities held to maturity	29,910,000	17,365,000
Purchase of investment securities held to maturity	(30,835,292)	(20,481,124)
Purchases of premises, equipment, and intangibles	(531,356)	(291,262)
Loans made, net of principal collected	(5,995,255)	(1,110,602)
	(7,451,903)	(4,517,988)
Cash flows from financing activities		
Net change in time deposits	(1,346,600)	(23,586,913)
Net change in other deposits	(6,644,863)	24,514,861
Net change in repurchase agreements	(532,258)	(8,441)
Payment on mortgage obligation	(4,357)	(4,104)
Dividend paid	-	(1,944,000)
	(8,528,078)	(1,028,597)
Net increase (decrease) in cash	(13,983,894)	(3,581,210)
Cash and equivalents at beginning of period	75,873,029	72,786,922
Cash and equivalents at end of period	61,889,135	69,205,712
Reconciliation of net income to net cash provided from operating activities		
Net income	1,352,505	1,279,913
Adjustments		
Depreciation and amortization	168,492	153,964
Security discount accretion, net of premium amortization	(34,702)	(27,881)
(Gain) loss on disposition of assets	-	8,343
Decrease (increase) in accrued interest receivable and other assets	(53,946)	65,844
Increase (decrease) in accrued interest payable and other liabilities	563,738	485,192
	1,996,087	1,965,375

Calvin B. Taylor Bankshares, Inc. and Subsidiary
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 of financial position and results of operations have been made. These adjustments are of a normal recurring nature. Results of operations for the three months ended March 31, 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 audited consolidated financial statements and related footnotes for the Registrant's fiscal period ended December 31, 2002.

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 the stock dividends distributed.

2. Comprehensive Income

Comprehensive income consists of:

	For the three months ended March 31, 2003	2002
Net income	1,352,505	1,279,913
Unrealized gain (loss) on investment securities available for sale, net of income taxes	(17,331)	(34,183)
Comprehensive income	1,335,174	1,245,730

3. Loan commitments

Loan commitments are agreements to lend to customers as long as there is no violation of any conditions of the contracts. Outstanding loan commitments and letters of credit consist of:

	March 31, 2003	December 31, 2002
Loan commitments	22,091,092	22,434,081
Standby letters of credit	1,914,777	1,726,127

Calvin B. Taylor Bankshares, Inc. and Subsidiary
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 Calvin B. Taylor Banking Company (the "Maryland Bank"), 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, Maryland and one banking office in Ocean View, Delaware. The Bank's administrative office is located in Berlin, Maryland.

The Maryland Bank is engaged in a general commercial and retail banking business serving individuals, businesses, and governmental units in Worcester County, Maryland, Ocean View, Delaware, and neighboring counties.

The Company currently engages in no business other than owning and managing the Maryland Bank.

Financial Condition, Liquidity and Sources of Capital

Total assets of the Company decreased $5.2 million from December 31, 2002 to March 31, 2003. During the first quarter of the year, the Bank typically experiences 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 Bank receives loan repayments from seasonal business customers, and deposits from summer residents and tourists.

During the first quarter of 2003, the Bank's loan portfolio increased $6.0 million. Funding for these loans was provided primarily by a reduction in overnight federal funds sold. As loans earn at a higher rate than federal funds sold, this shift has a positive impact on earnings.

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 relies on 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 Bank's target levels for the allowance as a percentage of gross loans range from approximately 1.00% to

Financial Condition, Liquidity and Sources of Capital (continued)

1.35%. Based on review of the consolidated loan portfolio, the Company determined that an allowance of 1.28% of gross loans was adequate as of March 31, 2003. At December 31, 2002, the allowance was 1.33% of gross loans. At March 31, 2003, there were no non-accruing loans and loans delinquent ninety days or more, excluding non-accruing loans, totaled $227,041 or .13% of the portfolio.

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 Bank typically experiences 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 Bank receives seasonal deposits. Throughout the second and third quarters the Bank maintains 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 62.54% for the first quarter of 2003, compared to 58.36% for the first quarter of 2002.

At March 31, 2003, the Company's interest rate sensitivity, as measured by gap analysis, showed the Company was asset-sensitive with a one-year cumulative gap of 12.86%, 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. The Bank has classified its demand mortgage and commercial loans as immediately repriceable. 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.

Tier one risk-based capital ratios of the Company as of March 31, 2003 and 2002 were 38.89% and 34.60%, respectively. Both are substantially in excess of regulatory minimum requirements.

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.

Net income for the three months ended March 31, 2003, was $1,352,505 or $.42 per share, compared to $1,279,913 or $.40 per share for the first quarter of 2002. This represents an increase of $72,592. The primary reasons for the increase in net income are higher net interest income and other operating revenues. Net interest income increased $58,546 in the first quarter of 2003 as compared to the first quarter of 2002 due an improved interest spread and higher balances of both interest-earning assets and interest-bearing liabilities. Although rates on both assets and liabilities are lower than they were for the same period last year, the Bank has tried to maintain loan rates while making timely reductions in deposit rates in response to market conditions. Market rate reductions have also diminished rates of return on federal funds sold and investment securities.

Results of Operations (continued)

Net interest income of the company is one of the most important factors in evaluating the financial performance of the Company. The Company 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 quarters of 2003 or 2002. Loans charged-off during the first quarter of 2003 totaled $1,736. Loans charged-off during the first quarter of 2002 totaled $7,775.

Other operating revenues exceed last year primarily due to additional activity fees on a larger deposit portfolio and increases to the Bank's fee schedule in Spring 2002.

Other expense variances include an increase in salaries and benefits of $57.1 thousand, of which $32.3 thousand is increased salaries. The Bank employed 97 full time equivalent employees as of March 31, 2003. The Bank hires seasonal employees during the summer. The Company has no employees other than those hired by the Bank.

Other expense variances also include a decrease of $48.2 thousand in other operating expenses. Significant downward variances in postage and stationery & supplies expense may be due, in part, to the timing of payments, in addition to reflecting an effort to reduce unnecessary mailings. A $16.9 thousand decrease in telephone expense is due to changing vendors.

Income taxes are $42,800 higher than last year, on a pre-tax income increase of $115,392.

Plans of Operation

The Bank conducts general commercial banking businesses in its service area of Worcester County, Maryland and Sussex County, Delaware, while also emphasizing the banking needs of individuals and small- to medium-sized businesses and professional concerns. The Bank offers 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 time deposits of various types ranging from daily money market accounts to longer-term certificates of deposit.

The Company, through the Bank, 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 Bank has the intent and the ability to hold loans that their portfolios.

Other bank services include cash management services, 24-hour ATM's, credit cards, debit cards, safe deposit boxes, travelers' checks, direct deposit of payroll and social security checks, and automatic drafts for various accounts. The Bank offers bank-by-phone and Internet banking services, including electronic bill-payment, to both commercial and retail customers.

Capital Resources and Adequacy

Total stockholders' equity increased $1,335,174 from December 31, 2002 to March 31, 2003. This change is attributable to the comprehensive income recorded during the period, as detailed in Note 2 of the Notes to Financial Statements.

Under the capital guidelines of the Federal Reserve Board and the FDIC, the Company and the Bank 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 Bank 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.

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 Bank 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.

Item 4. Controls and procedures

Within the ninety days prior to the date of this report, the Company's management performed an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures and its internal controls and procedures for financial reporting. Disclosure Controls are procedures that are designed to ensure that information required to be disclosed in the Company's publicly filed reports is reported in a timely manner. As part of these controls, Management reviews information gathered through systems developed for that purpose to determine the nature of required disclosure.

Internal controls are procedures designed to provide management with reasonable assurance that assets are safeguarded, and that transactions are properly authorized, executed, and recorded to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal controls, errors or irregularities may occur and not be detected. The projection of an evaluation of controls to future periods is subject to the risk that procedures may become inadequate due to changes in conditions including the degree of compliance with procedures.

The Chief Executive Officer and the Treasurer of the Company have concluded, based on the evaluation of disclosure controls and internal controls that the financial information and disclosures included in periodic SEC filings and the Company's financial statements are fairly presented in conformity with generally accepted accounting principles.

Changes in Internal Controls

There were no significant changes in the company's internal controls or in other factors that could significantly affect internal controls, including corrective actions with regard to significant deficiencies and material weaknesses.

Calvin B. Taylor Bankshares, Inc. and Subsidiary
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
Not applicable

Item 5 Other information
Not applicable.

Item 6 Exhibits and Reports on Form 8-K

a) Exhibits
Proxy Statement dated March 18, 2003, is incorporated by reference.

b) Reports on Form 8-K
There were no reports on Form 8-K filed for the quarter ended March 31, 2003.

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: May 9, 2003 By:/s/Reese F. Cropper, Jr.
Reese F. Cropper, Jr.,
Chairman & Chief Executive Officer
(Principal Executive Officer)

Date: May 9, 2003 By:/s/Jennifer G. Hawkins
Jennifer G. Hawkins
Treasurer
(Principal Financial Officer)

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 March 31, 2003 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: May 9, 2003 By:/s/Reese F. Cropper, Jr.
Reese F. Cropper, Jr.,
Chairman & Chief Executive Officer
(Principal Executive Officer)

Date: May 9, 2003 By:/s/Jennifer G. Hawkins
Jennifer G. Hawkins
Treasurer
(Principal Financial Officer)

Certification of Principal Executive Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Reese F. Cropper, Jr., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Calvin B. Taylor Bankshares, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial

information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a. designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiary, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b. evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of the quarterly report (the "Evaluation Date"); and

c. presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):

a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in the quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Calvin B. Taylor Bankshares, Inc.

Date: May 9, 2003 By:/s/Reese F. Cropper, Jr.
Reese F. Cropper, Jr.,
Chairman & Chief Executive Officer
(Principal Executive Officer)

Certification of Principal Financial Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Jennifer G. Hawkins, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Calvin B. Taylor Bankshares, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a. designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiary, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b. evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of the quarterly report (the "Evaluation Date"); and

c. presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):

a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in the quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Calvin B. Taylor Bankshares, Inc.

Date: May 9, 2003 By:/s/Jennifer G. Hawkins
Jennifer G. Hawkins
Treasurer
(Principal Financial Officer)