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TAYLOR CALVIN B BANKSHARES INC

Form 10-K

March 11, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549
Form 10-K

Annual Report Pursuant to Section 13 or 15(d) of the Securities
Exchange Act of 1934

For the fiscal year ended December 31, 2003

Commission File No. 000-50047

Calvin B. Taylor Bankshares, Inc.
(Exact name of registrant as specified in its Charter)

Maryland (State of incorporation or organization)
52-1948274 (I.R.S. Employer Identification No.)

24 North Main Street, Berlin, Maryland 21811
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (410) 641-1700

Securities registered under Section 12(b) of the Exchange Act:
None

Securities registered under Section 12(g) of the Exchange Act:
Common Stock Par Value \$1.00

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

Check if there is no disclosure of delinquent filers in response to Item
405 of Regulation S-K contained in this form, and no disclosure will be
contained, to the best of the registrant's knowledge, in definitive proxy
or information statements incorporated by reference in Part III of this
Form 10-K or any amendment to this Form 10-K. []

Check if the registrant is an accelerated filer (as defined in Rule 12b-2
of the Act). []

The aggregate market value of the Common Stock held by non-affiliates of
the registrant on December 31, 2003, was \$104,258,822. This calculation is
based upon the last price known to the registrant at which its Common
Stock was sold as of the last business day of the registrant's most
recently completed second fiscal quarter, June 30, 2003, which is \$37.00
per share. There is not an active trading market for the Common Stock and
it is not possible to identify precisely the market value of the Common
Stock.

On February 29, 2004, 3,227,966 shares of the registrant's common stock
were issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

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The Company's Proxy Statement for Annual Meeting of Shareholders to be held on May 12, 2004, is incorporated by reference in this Form 10-K in Part III, Item 10, Item 11, Item 12, Item 13, and Item 14.

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 appear in a number of places in this Report and include all statements regarding the intent, belief or current expectations of the Company, its directors, or its officers with respect to, among other things: (i) the Company's financing plans; (ii) trends affecting the Company's financial condition or results of operations; (iii) the Company's growth strategy and operating strategy; and (iv) the declaration and payment of dividends. Investors are cautioned that any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties, and that actual results may differ materially from those projected in the forward-looking statements as a result of various factors discussed herein and those factors discussed in detail in the Company's filings with the Securities and Exchange Commission.

PART I

Item 1. Description of Business

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 of Berlin, Maryland (the "Bank"). The Bank is a commercial bank incorporated under the laws of the State of Maryland on December 17, 1907, which operates nine banking offices in Worcester County, Maryland and one banking office in Ocean View, Delaware. The Bank's main office is 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, Sussex County, Delaware, and neighboring counties.

The Company's holding company structure can assist the bank in maintaining its required capital ratios because the Company may, subject to compliance with debt guidelines implemented by the Board of Governors of the Federal Reserve System (the "Board of Governors" or the "Federal Reserve"), borrow money and contribute the proceeds to the bank as primary capital. The holding company structure also permits greater flexibility in issuing stock for cash, property, or services and in reorganization transactions. Moreover, subject to certain regulatory limitations, a holding company can purchase shares of its own stock, which the bank may not do without regulatory approval. A holding company may also engage in certain non-banking activities which the Board of Governors has deemed to be closely related to banking and proper incidents to the business of a bank holding company. These activities include making or servicing loans and certain types of leases; performing certain data processing services; acting as a fiduciary or investment or financial advisor; acting as a management consultant for other depository institutions; providing courier, appraisal, and consumer financial counseling services; providing tax planning and preparation services; providing check guaranty and collection agency services; engaging in limited real estate investment activities; underwriting, brokering, and selling credit life and disability insurance; engaging in certain other limited insurance activities; providing discount brokerage services; underwriting and dealing in certain government obligations and money market instruments and providing portfolio investment

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advice; acting as a futures commission merchant with respect to certain financial instrument transactions; providing foreign exchange advisory and transactional services; making investments in certain corporations for projects designed primarily to promote community welfare; and owning and operating certain healthy savings and loan associations. Although the Company has no present intention of engaging in any of these services, if circumstances should lead the Company's management to believe that there is a need for these services in the bank's marketing areas and that such activities could be profitably conducted, the management of the Company would have the flexibility of commencing these activities upon filing notice thereof with the Board of Governors.

Location and Service Area

The Company conducts general commercial banking in its primary service areas, emphasizing the banking needs of individuals and small- to medium-sized businesses and professional concerns. The Bank operates from nine branches located throughout Worcester County, Maryland and one branch located in Sussex County, Delaware. The Bank draws most of its customer deposits and conducts most of its lending transactions from within its primary service area, which encompasses Worcester County, Maryland, Sussex County, Delaware and neighboring counties.

Both Sussex County, Delaware and Worcester County, Maryland are located along the shores of the Atlantic Ocean and have experienced population growth in recent years. The area is growing as both a resort and a retirement community.

The principal components of the economy of the counties are tourism and agriculture. Berlin has a strong component of health-care related businesses. The tourist businesses of Ocean City, Maryland and Bethany, Delaware and the health-care facilities in Berlin, Maryland (including Berlin Nursing Home and Atlantic General Hospital) are the largest employers in the counties. The largest industrial employers are Perdue Farms and Tyson Foods.

Banking Services

The Bank offers a full range of deposit services including checking, NOW, Money Market, and savings accounts, and time deposits including certificates of deposit. The transaction accounts and time certificates are tailored to the Bank's principal market areas at rates competitive to those offered in the area. In addition, the Bank offers certain retirement account services, such as Individual Retirements Accounts ("IRAs"). All deposits are insured by the Federal Deposit Insurance Corporation (the "FDIC") up to the maximum amount allowed by law (generally, \$100,000 per depositor subject to aggregation rules). The Bank solicits these accounts from individuals, businesses, associations and organizations, and governmental authorities.

The Company, through the Bank, also offers a full range of short- to medium-term commercial and personal loans. Commercial loans include both secured and unsecured loans for working capital (including inventory and receivables), business expansion (including acquisition of real estate and improvements), and purchase of equipment and machinery. Consumer loans include secured and unsecured loans for financing automobiles, home improvements, education, and personal investments. The Company originates commercial and residential mortgage loans and real estate construction and acquisition loans. These lending activities are subject to a variety of lending limits imposed by state and federal law. The Bank may not make any loans to any director or officer (except for commercial loans to directors who are not officers or employees) unless the Board of Directors of the Bank

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approves the loans. The Board of Directors must review any such loans every six months.

Other bank services include cash management services, 24-hour ATM's, 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.

Competition

The Company faces strong competition in all areas of its operations. The competition comes from entities operating in Worcester County, Maryland and Sussex County, Delaware and neighboring counties and includes branches of some of the largest banks in Maryland, Delaware, and Virginia. Its most direct competition for deposits historically has come from other commercial banks, savings banks, savings and loan associations, and credit unions operating in its service areas. The Bank also competes for deposits with money market mutual funds and corporate and government securities. The Bank competes for loans with the same banking entities, as well as mortgage banking companies and other institutional lenders. The competition for loans varies from time to time depending on certain factors. These factors include, among others, the general availability of lendable funds and credit, general and local economic conditions, current interest rate levels, conditions in the mortgage market, and other factors which are not readily predictable.

The Bank employs traditional marketing media including local newspapers and radio, to attract new customers. Bank officers, directors, and employees are active in numerous community organizations and participate in community-based events. These activities and referrals of satisfied customers result in new business.

Employees

As of December 31, 2003, the Bank employed 93 full-time equivalent employees. The Company's operations are conducted through the Bank. Consequently, the Company does not have separate employees. None of the employees of the Bank are represented by any collective bargaining unit. The Bank considers its relations with its employees to be good.

SUPERVISION AND REGULATION

The Company and the Bank are subject to state and federal banking laws and regulations which impose specific requirements or restrictions on, and provide for general regulatory oversight with respect to, virtually all aspects of operations. These laws and regulations are generally intended to protect depositors, not shareholders. The following is a brief summary of certain statutes, rules, and regulations affecting the Company and the Bank.

To the extent that the following summary describes statutory or regulatory provisions, it is qualified in its entirety by reference to the particular statutory and regulatory provisions. Beginning with the enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) and following with the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), numerous additional regulatory requirements have been placed on the banking industry, and additional changes have been proposed. Legislative changes and the policies of various regulatory authorities may affect the operations of the Company and the Bank and those effects may be material. The Company is unable to predict the nature or the extent of the effect on its business and earnings that fiscal or monetary policies, economic controls, or new federal or state legislation may have in the future.

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Gramm-Leach-Bliley Act

On November 12, 1999, the Gramm-Leach-Bliley Act was signed into law. Among other things, the Act repeals the restriction, contained in the Glass-Steagall Act, on banks affiliating with securities firms. The Act permits bank holding companies to engage in a statutorily provided list of financial activities, including insurance and securities underwriting and agency activities, merchant banking, and insurance company portfolio investment activities. The Act also authorizes activities that are "complementary" to financial activities. The Act is intended to grant certain powers to community banks that larger institutions have accumulated on an ad hoc basis. The Act may have the result of increasing competition that the Company and the Bank face from larger institutions and other types of companies. In fact, it is not possible to predict the full effect that the Act will have on the Company and the Bank.

The Company

Because it owns the outstanding common stock of the bank, the Company is a bank holding company within the meaning of the federal Bank Holding Company Act of 1956 (the "BHCA"). Under the BHCA, the Company is subject to periodic examination by the Federal Reserve and is required to file periodic reports of its operations and such additional information as the Federal Reserve may require. The Company's and the Bank's activities are limited to banking, managing or controlling banks, furnishing services to or performing services for its Subsidiary, or engaging in any other activity that the Federal Reserve determines to be so closely related to banking or managing and controlling banks as to be a proper incident thereto.

Investments, Control, and Activities. With certain limited exceptions, the BHCA requires every bank holding company to obtain the prior approval of the Federal Reserve before (i) acquiring substantially all the assets of any bank, (ii) acquiring direct or indirect ownership or control of any voting shares of any bank if after such acquisition it would own or control more than 5% of the voting shares of such bank (unless it already owns or controls the majority of such shares), or (iii) merging or consolidating with another bank holding company.

In addition, and subject to certain exceptions, the BHCA and the Change in Bank Control Act, together with regulations thereunder, require Federal Reserve approval (or, depending on the circumstances, no notice of disapproval) prior to any person or company acquiring "control" of a bank holding company, such as the Company. Control is conclusively presumed to exist if an individual or company acquires 25% or more of any class of voting securities of the bank holding company. Because the Company's Common Stock is registered under the Securities Exchange Act of 1934, under Federal Reserve regulations, control will be rebuttably presumed to exist if a person acquires at least 10% of the outstanding shares of any class of voting securities of the Company. The regulations provide a procedure for challenge of the rebuttable control presumption.

Under the BHCA, the Company is generally prohibited from engaging in, or acquiring direct or indirect control of more than 5% of the voting shares of any company engaged in non-banking activities, unless the Federal Reserve, by order or regulation, has found those activities to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. Some of the activities that the Federal Reserve has determined by regulation to be proper incidents to the business of banking include making or servicing loans and certain types of leases, engaging in certain insurance

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and discount brokerage activities, performing certain data processing services, acting in certain circumstances as a fiduciary or investment or financial advisor, owning savings and loan associations, and making investments in certain corporations or projects designed primarily to promote community welfare.

Source of Strength; Cross-Guarantee. In accordance with Federal Reserve policy, the Company is expected to act as a source of financial strength to the Bank and to commit resources to support the Bank in circumstances in which the Company might not otherwise do so. Under the BHCA, the Federal Reserve may require a bank holding company to terminate any activity or relinquish control of a nonbank subsidiary (other than a nonbank subsidiary of a bank) upon the Federal Reserve's determination that such activity or control constitutes a serious risk to the financial soundness or stability of any subsidiary depository institution of the bank holding company. Further, federal bank regulatory authorities have additional discretion to require a bank holding company to divest itself of any bank or nonbank subsidiary if the agency determines that divestiture may aid the depository institution's financial condition. The Bank may be required to indemnify, or cross-guarantee, the FDIC against losses it incurs with respect to any other bank controlled by the Company, which in effect makes the Company's equity investments in healthy bank subsidiaries available to the FDIC to assist any failing or failed bank subsidiary of the Company.

The Bank

General. The Bank operates as a state nonmember banking association incorporated under the laws of the State of Maryland. It is subject to examination by the FDIC and the state department of banking regulation for each state in which it has a branch. Deposits in the Bank are insured by the FDIC up to a maximum amount (generally \$100,000 per depositor, subject to aggregation rules). The States and FDIC regulate or monitor all areas of the Bank's operations, including security devices and procedures, adequacy of capitalization and loss reserves, loans, investments, borrowings, deposits, mergers, issuances of securities, payment of dividends, interest rates payable on deposits, interest rates or fees chargeable on loans, establishment of branches, corporate reorganizations, maintenance of books and records, and adequacy of staff training to carry on safe lending and deposit gathering practices. The FDIC requires the Bank to maintain certain capital ratios and imposes limitations on the Bank's aggregate investment in real estate, bank premises, and furniture and fixtures. The Bank is required by the FDIC to prepare quarterly reports on the Bank's financial condition.

Under provisions of the FDICIA, all insured institutions must undergo periodic on-site examination by the appropriate banking agency. The cost of examinations of insured depository institutions and any affiliates may be assessed by the agency against each institution or affiliate, as it deems necessary or appropriate. Insured institutions are required to submit annual reports to the FDIC and the appropriate agency (and state supervisor when applicable). FDICIA also directs the FDIC to develop with other appropriate agencies a method for insured depository institutions to provide supplemental disclosure of the estimated fair market value of assets and liabilities, to the extent feasible and practicable, in any balance sheet, financial statement, report of condition, or other report of any insured depository institution. FDICIA also requires the federal banking regulatory agencies to prescribe, by regulation, standards for all insured depository institutions and depository institution holding companies relating, among other things, to: (i) internal controls, information systems, and audit systems; (ii) loan documentation; (iii) credit underwriting; (iv) interest rate risk exposure; and (v) asset quality.

Transactions With Affiliates and Insiders. The Bank is subject to

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Section 23A of the Federal Reserve Act, which places limits on the amount of loans or extensions of credit to, or investment in, or certain other transactions with, affiliates and on the amount of advances to third parties collateralized by the securities or obligations of affiliates. The aggregate of all covered transactions is limited in amount, as to any one affiliate, to 10% of the Bank's capital and surplus and, as to all affiliates combined, to 20% of the Bank's capital and surplus. In addition, each covered transaction must meet specific collateral requirements. The Bank is also subject to Section 23B of the Federal Reserve Act which, among other things, prohibits an institution from engaging in certain transactions with certain affiliates unless the transactions are on terms substantially the same, or at least as favorable to such institution or its subsidiaries, as those prevailing at the time for comparable transactions with nonaffiliated companies. The Bank is subject to certain restrictions on extensions of credit to executive officers, directors, certain principal shareholders, and their related interests. Such extensions of credit (i) must be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with third parties, and (ii) must not involve more than the normal risk of repayment or present other unfavorable features.

Branching. Under Maryland law, the Maryland bank may open branches statewide, subject to the prior approval of the State Department of Financial Regulation and the FDIC. Maryland law permits banking organizations in other states to acquire Maryland banking organizations, as long as such states grant similar privileges to banking organizations in Maryland to acquire banking organizations in their states, by opening a de novo branch, by acquiring an existing branch from a Maryland depository institution, or as a result of an interstate merger with a Maryland banking organization. Delaware law also allows branches statewide with prior approval of the Office of the State Bank Commissioner and the FDIC. Delaware law is more restrictive allowing other state banking organizations to branch to Delaware only through opening a de novo bank, or as the result of an interstate merger.

Community Reinvestment Act. The Community Reinvestment Act requires that each insured depository institution shall be evaluated by its primary federal regulator with respect to its record in meeting the credit needs of its local community, including low and moderate income neighborhoods, consistent with the safe and sound operation of those institutions. These factors are also considered in evaluating mergers, acquisitions, and applications to open a branch or facility. Failure to adequately meet these criteria would impose additional requirements and limitations on the Bank. The Bank received a satisfactory rating in its most recent evaluation.

Other Regulations. Interest and certain other charges collected or contracted for by the Bank are subject to state and federal laws concerning interest rates. The Bank's loan operations are also subject to certain federal laws applicable to credit transactions, such as the federal Truth-In-Lending Act governing disclosures of credit terms to consumer borrowers, the Home Mortgage Disclosure Act of 1975 requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves, the Equal Credit Opportunity Act prohibiting discrimination on the basis of race, creed, or other prohibited bases in extending credit, the Fair Credit Reporting Act of 1978 governing the use and provision of information to credit reporting agencies, the Fair Debt Collection Act governing the manner in which consumer debts may be collected by collection agencies, and the rules and regulations of the various federal agencies charged with the responsibility of implementing such federal laws. The deposit operations of the Bank are also subject to the Right to Financial Privacy Act which imposes a duty to maintain

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confidentiality of customers' financial records and prescribes procedures for complying with administrative subpoenas of financial records, and the Electronic Funds Transfer Act as implemented by the Federal Reserve Board's Regulation E which governs automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services.

Deposit Insurance

The FDIC establishes rates for the payment of premiums by federally insured banks and thrifts for deposit insurance. Separate insurance funds are maintained for commercial banks (BIF) and thrifts (SAIF), with insurance premiums from the industry used to offset losses from insurance payouts when banks and thrifts fail. Since 1993, insured depository institutions like the Bank have paid for deposit insurance under a risk-based premium system. Under this system, until mid-1995 depository institutions paid to BIF or SAIF from \$0.23 to \$0.31 per \$100 of insured deposits depending on the capital levels and risk profile of the institution, as determined by its primary federal regulator on a semi-annual basis. When BIF reached its legally mandated reserve ratio in mid-1995, the FDIC lowered premiums for well-capitalized banks, eventually to a level of \$.00 per \$100 of insured deposits, with a minimum semiannual assessment of \$1,000. In 1996, congress enacted the Deposit Insurance Funds Act of 1996, which eliminated this minimum assessment. The BIF insurance assessment rate for the first semiannual assessment period of 2004 is proposed to remain at \$.00 to \$.27 per \$100 in deposits. In addition to the amount paid for deposit insurance, banks are assessed an additional amount to service the interest on the bond obligations of the Financial Corporation (FICO). Any increase in deposit insurance premiums for the Bank will increase the Bank's cost of funds, and there can be no assurance that such costs can be passed on to the Bank's customers.

Dividends

The principal source of the Company's cash revenues comes from dividends received from the Bank. The amount of dividends that may be paid by the Bank to the Company depends on the Bank's earnings and capital position and is limited by federal and state laws, regulations, and policies. The Federal Reserve has stated that bank holding companies should refrain from or limit dividend increases or reduce or eliminate dividends under circumstances in which the bank holding company fails to meet minimum capital requirements or in which earnings are impaired.

The Company's ability to pay any cash dividends to its shareholders in the future will depend primarily on the Bank's ability to pay dividends to the Company. In order to pay dividends to the Company, the Bank must comply with the requirements of all applicable laws and regulations. Under Maryland law, the Bank must pay a cash dividend only from the following, after providing for due or accrued expenses, losses, interest, and taxes: (i) its undivided profits, or (ii) with the prior approval of the Department of Financial Regulation, its surplus in excess of 100% of its required capital stock. Under FDICIA, the Bank may not pay a dividend if, after paying the dividend, the Bank would be undercapitalized. See "Capital Regulations" below. See Item 5 for a discussion of dividends paid by the Bank in the past three years.

In addition to the availability of funds from the Bank, the future dividend policy of the Company is subject to the discretion of the Board of Directors and will depend upon a number of factors, including future earnings, financial condition, cash needs, and general business conditions. The amount of dividends that might be declared in the future presently cannot be estimated and it cannot be known whether such dividends would continue for

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future periods.

Capital Regulations

The federal bank regulatory authorities have adopted risk-based capital guidelines for banks and bank holding companies that are designed to make regulatory capital requirements more sensitive to differences in risk profile among banks and bank holding companies, account for off-balance sheet exposure, and minimize disincentives for holding liquid assets. The resulting capital ratios represent qualifying capital as a percentage of total risk-weighted assets and off-balance sheet items. The guidelines are minimums, and the regulators have noted that banks and bank holding companies contemplating significant expansion programs should not allow expansion to diminish their capital ratios and should maintain ratios well in excess of the minimums.

Current guidelines require bank holding companies and federally regulated banks to maintain a minimum ratio of total capital to risk-based assets equal to 8%, of which at least 4% must be Tier 1 capital. Tier 1 capital includes common shareholders' equity before the unrealized gains and losses on securities available for sale, qualifying perpetual preferred stock, and minority interests in equity accounts of consolidated subsidiaries, but excludes goodwill and most other intangibles, and excludes the allowance for loan and lease losses. Tier 2 capital includes the excess of any preferred stock not included in Tier 1 capital, mandatory convertible securities, hybrid capital instruments, subordinated debt and intermediate term-preferred stock, and general reserves for loan and lease losses up to 1.25% of risk-weighted assets. Total capital is the sum of Tier 1 plus Tier 2 capital.

Under the guidelines, banks' and bank holding companies' assets are given risk-weights of 0%, 20%, 50%, and 100%. In addition, certain off-balance sheet items are given credit conversion factors to convert them to asset equivalent amounts to which an appropriate risk-weight will apply. These computations result in the total risk-weighted assets.

The federal bank regulatory authorities have also implemented a leverage ratio, which is Tier 1 capital as a percentage of average total assets less intangibles, to be used as a supplement to the risk-based guidelines. The principal objective of the leverage ratio is to place a constraint on the maximum degree to which a bank holding company may leverage its equity capital base. The minimum required leverage ratio for top-rated institutions is 3%, but most institutions are required to maintain an additional cushion of at least 100 to 200 basis points.

FDICIA established a new capital-based regulatory scheme designed to promote early intervention for troubled banks and requires the FDIC to choose the least expensive resolution of bank failures. The new capital-based regulatory framework contains five categories for compliance with regulatory capital requirements, including "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized," and "critically undercapitalized." To qualify as a "well capitalized" institution, a bank must have a leverage ratio of no less than 5%, a Tier 1 risk-based ratio of no less than 6%, and a total risk-based capital ratio of no less than 10%, and the bank must not be under any order or directive from the appropriate regulatory agency to meet and maintain a specific capital level. As of December 31, 2003, the Company and the Bank were qualified as "well capitalized." For further discussions, see "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation - Capital."

Recent Legislative Developments

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Periodically, the federal and state legislatures consider bills with respect to the regulation of financial institutions. Some of these proposals could significantly change the regulation of banks and the financial services industry. The Company cannot predict if such proposals will be adopted or the affect to the Company.

Item 2. Description of Property

The Company has ten branch locations, all of which are owned by the Company or the Bank. The Bank leases the land on which the East Berlin branch is located. The locations are described as follows:

Office	Location	Square Footage
Main Office, Maryland	24 North Main Street, Berlin, Maryland 21811	24,229
East Berlin Office	10524 Old Ocean City Boulevard, Berlin, Maryland 21811	1,500
20th Street Office	100 20th Street, Ocean City, Maryland 21842	3,100
Ocean Pines Office	11003 Cathell Road, Berlin, Maryland 21811	2,420
Mid-Ocean City Office	9105 Coastal Highway, Ocean City, Maryland 21842	1,984
North Ocean City Office	14200 Coastal Highway, Ocean City, Maryland 21842	2,545
West Ocean City Office	9923 Golf Course Road, Ocean City, Maryland 21842	2,496
Pocomoke Office	2140 Old Snow Hill Road, Pocomoke, Maryland 21851	2,624
Snow Hill Office	108 West Market Street, Snow Hill, Maryland 21863	3,773
Ocean View, Delaware Office	50 Atlantic Avenue, Ocean View, Delaware 19970	4,900
Office	Location	Square Footage

The Berlin office is the centralized location for the Company and the Bank; that is to say that all proof and bookkeeping is performed there. Each branch has a manager that also serves as its loan officer, with exception of the East Berlin office, which does not have a loan officer. All offices participate in normal day-to-day banking operations. The Company operates automated teller machines in all branches except the East Berlin office, and at one non-branch location in a local hospital.

Item 3. Legal Proceedings

There are no material pending legal proceedings to which the Company or the Bank or any of their properties are subject.

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

There were no matters submitted to a vote of the shareholders of the Company during the fourth quarter of the fiscal year for which this report is filed.

PART II

Item 5. Market for Common Equity and Related Stockholder Matters

The Company's Articles of Incorporation, as amended, authorize it to

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issue up to 10,000,000 shares of common stock.

As of February 29, 2004 there were approximately 1,013 holders of record of the common stock and 3,227,966 shares of Common Stock issued and outstanding. There is no established public trading market in the stock, and there is no likelihood that a trading market will develop in the near future. Transactions in the common stock are infrequent and are negotiated privately between the persons involved in those transactions. In 2003, the Board of Directors of the Company approved a plan to purchase up to 10% of the Company's common stock. Common shares repurchased under this plan are retired. As of December 31, 2003, 12,034 shares had been repurchased and retired at an average cost of \$35.98 per share.

All outstanding shares of common stock of the Company are entitled to share equally in dividends from funds legally available, when, as, and if declared by the Board of Directors. The Company paid dividends of \$.60 per share in 2003, \$1.00 per share in 2002, and \$.37 per share in 2001. Included are special cash dividends of \$.60 per share in 2002, and \$.25 per share in 2000, which are not expected to be an annual event.

Item 6. Selected Financial Data

The following table presents selected financial data for the five years ended December 31, 2003. Prior period per share data is restated to reflect the 100% stock dividend paid in 2000.

	2003	2002	2001	2000	1999
(Dollars in thousands, except for per share data)					
At Year End					
Total assets	\$386,486	\$369,243	\$336,825	\$289,048	\$288,921
Total deposits	\$317,946	\$301,495	\$274,149	\$231,926	\$238,726
Total loans, net of unearned income and allowance for loan losses	\$162,243	\$161,825	\$166,502	\$168,571	\$152,001
Total stockholders' equity	\$63,636	\$60,015	\$57,243	\$53,085	\$49,220
For the Year					
Net interest income	\$13,647	\$13,741	\$13,297	\$13,580	\$12,221
Net income	\$5,540	\$5,754	\$5,414	\$5,625	\$5,020
Per share data					
Book value	\$19.71	\$18.52	\$17.67	\$16.38	\$15.19
Net income	\$ 1.71	\$ 1.78	\$ 1.67	\$ 1.74	\$ 1.55
Cash dividends declared	\$.60	\$ 1.00	\$.37	\$.61	\$.60

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation

BUSINESS OF THE COMPANY

Calvin B. Taylor Bankshares, Inc. (the "Company") is a bank holding company that was incorporated in the State of Maryland on October 31, 1995. Calvin B. Taylor Banking Company (the "Bank"), which commenced operation in 1890, was incorporated under the laws of the State of Maryland on December 17, 1907, and is a state nonmember bank under the laws of the State of Maryland. The Bank is engaged in a general commercial banking business, emphasizing in its marketing the Company's local management and ownership, from its main office and branches located

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in its primary service area of Worcester County, Maryland and Sussex County, Delaware, and neighboring counties. The Bank offers a full range of deposit services, including checking accounts, NOW, Money Market, and savings accounts and other time deposits, including certificates of deposit. In addition, the Bank offers certain retirement account services, such as Individual Retirement Accounts. The Bank also offers a full range of short- to medium-term commercial and personal loans. The Bank originates fixed rate mortgage loans and real estate construction and acquisition loans. These loans generally have a demand feature. 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 Bank also offers bank-by-phone and Internet banking services, including electronic bill payment.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

Overview

Consolidated income of the Company is derived primarily from operations of the banks. The 2003 net income was \$5,540,214 compared to \$5,753,916 for 2002, and \$5,414,404 for 2001. The Company had a return on average equity of 9.22% and return on average assets of 1.46% for 2003, compared to returns on average equity of 9.83% and 9.54%, and returns on average assets of 1.65% and 1.75%, for 2002 and 2001, respectively.

Results of Operations

The Company's net income of \$5,540,214, or \$1.71 per share, for the year ended December 31, 2003, was a decrease of \$213,702, or 3.71%, from the net income of \$5,753,916, or \$1.78 per share, for the year ended December 31, 2002. Primarily responsible for this decrease was the \$267,844 gain on the sale of unimproved real estate in Ocean View, Delaware which contributed \$164,403 net of tax, to 2002 net income.

The Company reported net income of \$5,753,916, or \$1.78 per share, for the year ended December 31, 2002, which was an increase of \$339,512, or 6.27%, from the net income of \$5,414,404, or \$1.67 per share, for the year ended December 31, 2001. Primarily responsible for this increase was the increase in net interest income and a gain on sale of real estate. Net interest income increased \$444,322, or 3.34%, to \$13,741,288 in 2002, from \$13,296,966 in 2001. This increase was the result of a decrease in interest revenue of \$1,766,469, which was exceeded, by the decrease in interest expense of \$2,210,791. Average interest-earning assets of \$325,721,244 yielded 5.56%, while average interest-bearing liabilities of \$225,183,449 paid 1.79% for an overall net interest spread of 3.76%. A \$267,844 gain on the sale of unimproved real estate in Ocean View, Delaware contributed \$164,403 net of tax, to net income.

Noninterest income decreased by 9.62% during 2003 compared to 2002, while noninterest expense increased by 1.87% during the same period. Included in noninterest income for 2002 is a \$267,844 gain on the sale of an unimproved property in Ocean View, Delaware. Without that gain, noninterest income would increase from 2002 to 2003 by 6.93%. Noninterest

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income and noninterest expense increased by 33.04% and 4.40%, respectively, during 2002 compared to 2001. Eliminating the gain on the Ocean View property, noninterest income would have increased 12.44%.

The Company's net income of \$1,308,544 or \$.40 per share, for the quarter ended December 31, 2003, was a decrease of \$133,285, or 9.25%, from the net income of \$1,441,829, or \$.45 per share, for the quarter ended December 31, 2002. Eliminating the fourth quarter 2002 net gain of \$164,403 on the Ocean View property, net income would have increased \$31,118 or 2.15%.

The Company reported net income of \$1,441,829 or \$.45 per share, for the quarter ended December 31, 2002, which was an increase of \$276,685, or 23.75%, from the net income of \$1,165,144, or \$.36 per share, for the quarter ended December 31, 2001. Primarily responsible was the increase in quarterly net interest income to \$3,392,428 in fourth quarter 2002 from \$3,253,986 in fourth quarter 2001. Management attributes this \$138,442 or 4.25% increase in net interest income to the Company's focus on maintaining a profitable net interest spread. Throughout 2002, Management responded to market conditions by lowering deposit rates, while attempting to control rate reductions in the loan portfolio. Increased volume of federal funds sold and investment securities also contributed to the increase in net income. Also, a \$267,844 gain on the sale of unimproved real estate in Ocean View, Delaware contributed \$164,403 net of tax, to net income in fourth quarter 2002.

Net Interest Income

The primary source of income for the Company is net interest income, which is the difference between revenue on interest-earning assets, such as investment securities and loans, and interest incurred on interest-bearing sources of funds, such as deposits and borrowings. The level of net interest income is determined primarily by the average balance of interest-earning assets and funding sources and the various rate spreads between the interest-earning assets and the Company's funding sources. Changes in net interest income from period to period result from increases or decreases in the volume of interest-earning assets and interest-bearing liabilities, and increases or decreases in the average rates earned and paid on such assets and liabilities. The volume of interest-earning assets and interest-bearing liabilities is affected by the ability to manage the earning-asset portfolio, which includes loans, and the availability of particular sources of funds, such as noninterest bearing deposits.

The key performance measure for net interest income is the "net margin on interest-earning assets," or net interest income divided by average interest-earning assets. The Company's net interest margin for 2003 was 3.96% compared to 4.32% for 2002 and 4.74% for 2001. Because most of the Bank's loans are written with a demand feature, the income of the Bank should not change dramatically as interest rates change. Management of the Company expects to maintain the net margin on interest-earning assets. The net margin may decline, however, if competition increases, loan demand decreases, or the cost of funds rises faster than the return on loans and securities. Although such expectations are based on management's judgment, actual results will depend on a number of factors that cannot be predicted with certainty, and fulfillment of management's expectations cannot be assured.

Average Balances, Interest, and Yields

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(Dollars stated in thousands)

	For the Year Ended December 31, 2003			For the Year Ended December 31, 2002			For the Year Ended December 31, 2001	
	Average Balance	Interest	Yield	Average Balance	Interest	Yield	Average Balance	Interest
Assets								
Federal funds sold	\$ 53,715	\$ 541	1.01%	\$ 57,005	\$ 923	1.62%	\$ 41,265	\$1,413
Interest-bearing deposits	1,706	42	2.48%	1,504	42	2.77%	803	46
Investment securities								
U. S. Treasury	99,711	2,411	2.42%	74,482	2,806	3.77%	47,478	2,577
U. S. Government Agency	18,172	531	2.92%	18,231	802	4.40%	18,180	1,121
State and municipal	12,119	332	2.74%	7,697	337	4.38%	8,773	493
Other	1,600	70	4.40%	1,508	62	4.08%	1,508	49
Total investment securities	131,602	3,344	2.54%	101,918	4,007	3.93%	75,939	4,240
Loans:								
Commercial	13,780	987	7.16%	15,022	1,197	7.97%	15,722	1,330
Mortgage	150,491	10,879	7.23%	148,399	11,545	7.78%	151,521	12,398
Consumer	3,108	284	9.15%	4,054	387	9.54%	5,061	475
Total loans	167,379	12,150	7.26%	167,475	13,129	7.84%	172,304	14,203
Allowance for loan losses	2,185			2,182			2,188	
Total loans, net of allowance	165,194	12,150	7.36%	165,293	13,129	7.94%	170,116	14,203
Total interest-earning assets	352,217	16,077	4.56%	325,720	18,101	5.56%	288,123	19,902
Noninterest-bearing								
cash	17,404	-		15,400	-		13,437	-
Premises and equipment	6,567	-		5,904	-		5,800	-
Other assets	3,219	-		2,171	-		2,137	-
Total assets	\$379,407	\$16,077		\$349,195	\$18,101		\$309,497	\$19,902
Interest-bearing deposits								
Savings and NOW	\$110,638	\$422	0.38%	\$90,124	\$776	0.86%	\$76,033	\$1,409
Money market	50,141	305	0.61%	46,890	581	1.24%	35,804	864
Other time	77,668	1,384	1.78%	83,008	2,641	3.18%	79,894	3,900
Total interest-bearing deposits	238,447	2,111	0.89%	220,022	3,998	1.82%	191,731	6,173
Securities sold under agreements to repurchase								
Borrowed funds	4,135	10	0.24%	4,955	28	0.57%	4,126	62
	189	11	6.05%	207	12	6.04%	223	13
Total interest-bearing liabilities	242,771	2,132	0.88%	255,184	4,038	1.79%	196,080	6,248
Noninterest-bearing deposits								
	75,898	-		64,916	-		55,879	-
	318,669	2,132	0.67%	290,100	4,038	1.39%	251,959	6,248
Other liabilities	651	-		536	-		759	-
Stockholders' equity	60,087	-		58,559	-		56,779	-
Total liabilities and stockholders' equity	\$379,407	\$2,132		\$349,195	\$4,038		\$309,497	\$6,248
Net interest spread			3.69%			3.76%		
Net interest income		\$13,945			\$14,063			\$13,654

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Net margin on interest-earning assets 3.96% 4.32%

Dividends and interest on tax-exempt securities and loans are reported on fully taxable equivalent basis.

Tax equivalent adjustment included in:

Investment income	\$263	\$288	\$333
Loan income	\$ 35	\$ 34	\$ 24

Analysis of Changes in Net Interest Income (Dollars stated in thousands)

	Year ended December 31, 2003 compared with 2002 variance due to			Year ended December 31, 2002 compared with 2001 variance due to		
	Total	Rate	Volume	Total	Rate	Volume
Earning assets						
Federal funds sold	(382)	(329)	(53)	(490)	(1,029)	539
Interest-bearing deposits	1	(5)	6	(5)	(45)	40
Investment securities:						
U. S. Treasury	(396)	(1,347)	951	229	(1,237)	1,466
U. S. Government Agency	(273)	(270)	(3)	(319)	(322)	3
State and municipals	(5)	(199)	194	(155)	(95)	(60)
Other	9	5	4	12	12	-
Loans:						
Commercial	(210)	(111)	(99)	(133)	(74)	(59)
Mortgage	(666)	(829)	163	(853)	(598)	(255)
Consumer	(102)	(12)	(90)	(88)	7	(95)
Total interest revenue	(2,024)	(3,097)	1,073	(1,802)	(3,381)	1,579
Interest-bearing liabilities						
Savings and NOW	(354)	(531)	177	(633)	(894)	261
Money market	(276)	(316)	40	(284)	(551)	267
Other time deposits	(1,257)	(1,087)	(170)	(1,260)	(1,412)	152
Other borrowed funds	(19)	(13)	(6)	(34)	(45)	11
Total interest expense	(1,906)	(1,947)	41	(2,211)	(2,902)	691
Net interest income	(118)	(1,150)	1,032	409	(479)	888

Dividends and interest on tax-exempt securities and loans are reported on fully taxable equivalent basis. The variance that is both rate/volume related is reported with the rate variance.

Composition of Loan Portfolio

Because loans are expected to produce higher yields than investment securities and other interest-earning assets (assuming that loan losses are not excessive), the absolute volume of loans and the volume as a percentage of total earning assets is an important determinant of net interest margin. Average loans, net of the allowance for loan losses, were \$165,194,000, \$165,293,144, and \$170,116,213 during 2003, 2002, and 2001, respectively, which constituted 46.90%, 50.75%, and 59.04% of average interest-earning assets for the periods. The Company's loan to deposit ratio was 51.03%, 53.67%, and 60.73% at December 31, 2003, 2002, and 2001, respectively. Average loans to average deposits were 52.55%,

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58.01%, and 68.70% for the same periods. The decrease in the loan to deposit ratio over the periods presented is primarily attributable to continued increases in deposit volume.

The Company extends loans primarily to customers located in and near Worcester County, Maryland and Sussex County, Delaware. There are no industry concentrations in the Company's loan portfolio. The Company does, however, have a substantial portion of its loans in real estate and performance will be influenced by the real estate market in the region.

The following table sets forth the composition of the Company's loan portfolio as of December 31, 2003, 2002, and 2001, respectively.

	Composition of Loan Portfolio					
	December 31, 2003		December 31, 2002		December 31, 2001	
	Amount	Percent of total	Amount	Percent of total	Amount	Percent of total
Commercial	\$ 13,199,879	8.03%	\$ 12,765,723	7.78%	\$ 15,341,122	9.09%
Real estate	127,722,747	77.67%	139,354,241	84.97%	146,258,549	86.70%
Construction	20,877,036	12.70%	8,447,354	5.15%	2,117,685	1.26%
Consumer	2,630,623	1.60%	3,438,494	2.10%	4,980,078	2.95%
Total loans	164,430,285	100.00%	164,005,812	100.00%	168,697,434	100.00%
Less allowance for loan losses	2,187,277		2,181,135		2,195,922	
Net loans	\$162,243,008		\$161,824,677		\$166,501,512	

The following table sets forth the maturity distribution, classified according to sensitivity to changes in interest rates, for selected components of the Company's loan portfolio as of December 31, 2003.

	Loan Maturity Schedule and Sensitivity to Changes in Interest Rates			
	December 31, 2003			
	One year or less	Over one Through five years	Over five years	Total
Commercial	\$ 13,199,879	\$ -	\$ -	\$ 13,199,879
Real estate	127,722,747	-	-	127,722,747
Construction	20,877,036	-	-	20,877,036
Consumer	336,440	2,031,134	263,049	2,630,623
Total	\$162,136,102	\$2,031,134	\$263,049	\$164,430,285
Fixed interest rate	\$ 336,440	\$2,031,134	\$263,049	\$ 2,630,623
Variable interest rate (or demand)	161,799,662	-	-	161,799,662
Total	\$162,136,102	\$2,031,134	\$263,049	\$164,430,285

As of December 31, 2003, \$161,799,662 or 98.40%, of the total loans were either variable rate loans or loans written on demand.

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The Company has the following commitments, lines of credit, and letters of credit outstanding as of December 31, 2003, 2002, and 2001, respectively.

	2003	2002	2001
Construction loans	\$ 10,495,735	\$ 10,557,644	\$ 6,456,910
Other loan commitments	15,036,346	11,876,437	8,639,337
Standby letters of credit	2,957,508	1,726,127	3,243,063
Total	\$ 28,489,589	\$ 24,160,208	\$ 18,339,310

Loan commitments are agreements to lend to a customer as long as there is no violation of any condition to the contract. Loan commitments may have interest fixed at current rates, fixed expiration dates, and may require the payment of a fee. Letters of credit are commitments issued to guarantee the performance of a customer to a third party. Loan commitments and letters of credit are made on the same terms, including collateral, as outstanding loans. The Company's exposure to credit loss in the event of nonperformance by the borrower is represented by the contract amount of the commitment.

Loan Quality

The allowance for loan losses represents an allowance 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 allowance rests upon management's judgment about factors affecting loan quality and assumptions about the economy. Management considers the year-end allowance appropriate and adequate to cover possible losses in the loan portfolio; however, management's judgment is based upon a number of assumptions about future events, which are believed to be reasonable, but which may or may not prove valid. Thus, there can be no assurance that charge-offs in future periods will not exceed the allowance for loan loss or that additional increases in the loan loss allowance will not be required. The Company has a history of low loan charge-offs.

For significant problem loans, management's review consists of evaluation of the financial strengths of the borrowers and guarantors, the related collateral, and the effects of economic conditions. The overall evaluation of the adequacy of the total allowance for loan losses is based on an analysis of historical loan loss ratios, loan charge-offs, delinquency trends, and previous collection experience, along with an assessment of the effects of external economic conditions. It is the Company's policy to evaluate loan portfolio risk for the purpose of establishing an adequate allowance. The allowance may be increased for reserves for specific loans identified as substandard during management's loan review. Generally, the Company will not require a negative provision to reduce the allowance as a result of either net recoveries or a decrease in loans, even though this may cause the allowance as a percentage of gross loans to exceed the Company's target.

The provision for loan losses is a charge to earnings in the current period to replenish the allowance and maintain it at a level management has determined to be adequate. As of December 31, 2003, 2002, and 2001, the respective allowances for loan losses were 1.33%, 1.33%, and 1.30% of outstanding loans.

No provision for loan losses was made in 2003 due to the low level

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of delinquencies and the year's net recoveries of previously charged-off loans. The provision for loan losses was \$25,000 in 2002, an increase of \$2,015 from the \$22,985 provision in 2001.

	Allocation of Allowance for Loan Losses					
	2002		2001		2000	
Commercial	\$ 163,059	7.46%	\$ 139,005	6.37%	\$ 218,414	9.95%
Real estate, including construction	868,828	39.72	864,111	39.62	913,449	41.60
Consumer	81,845	3.74	112,875	5.17	174,671	7.94
General	1,073,545	49.08	1,065,144	48.84	889,388	40.51
Total	\$ 2,187,277	100.00%	\$ 2,181,135	100.00%	\$ 2,195,922	100.00%

	Allowance for Loan Losses		
	2003	2002	2001
Balance at beginning of year	\$2,181,135	\$2,195,922	\$2,192,755
Loan losses:			
Commercial	-	6,816	3,741
Mortgages	-	-	-
Consumer	3,423	41,954	20,983
Total loan losses	3,423	48,770	24,724
Recoveries on loans previously charged off:			
Commercial	533	1,000	4,056
Consumer	9,032	7,983	850
Total loan recoveries	9,565	8,983	4,906
Net loan losses	(6,142)	39,787	19,818
Provision for loan losses charged to expense	-	25,000	22,985
Balance at end of year	\$2,187,277	\$2,181,135	\$2,195,922
 Allowance for loan losses to loans outstanding at end of year	 1.33%	 1.33%	 1.30%
Net charge-offs to average loans	0.00%	0.02%	0.01%

As a result of management's ongoing review of the loan portfolio, loans are classified as nonaccrual when it is not reasonable to expect collection of interest under the original terms. These loans are classified as nonaccrual even though the presence of collateral or the borrower's financial strength may be sufficient to provide for ultimate repayment. Interest on nonaccrual loans is recognized only when received. A delinquent loan is generally placed in nonaccrual status when it becomes 90 days or more past due. When a loan is placed in nonaccrual status, all interest that has been accrued on the loan but remains unpaid is reversed and deducted from earnings as a reduction of reported interest income. No additional interest is accrued on the loan balance until the collection of both principal and interest becomes reasonably certain. The Company had no nonperforming loans at December 31, 2003, or 2001. The Company had one loan with a balance of \$2,222 on which the accrual of interest had been discontinued as of December 31, 2002.

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Where real estate acquired by foreclosure and held for sale is included with nonperforming loans, the result comprises nonperforming assets. There were no nonperforming assets at December 31, 2003, 2002, or 2001. Loans are classified as impaired when the collection of contractual obligations, including principal and interest, is doubtful. Management has identified no significant impaired loans as of December 31, 2003, 2002, or 2001.

Liquidity and Interest Rate Sensitivity

The primary objective of asset/liability management is to ensure the steady growth of the Company's primary source of earnings, net interest income. Net interest income can fluctuate with significant interest rate movements. To lessen the impact of these margin swings, the balance sheet should be structured so that repricing opportunities exist for both assets and liabilities in roughly equivalent amounts at approximately the same time intervals. Imbalances in these repricing opportunities at any point in time constitute interest rate sensitivity.

Liquidity represents the ability to provide steady sources of funds for loan commitments and investment activities, as well as to provide sufficient funds to cover deposit withdrawals and payment of debt and operating obligations. These funds can be obtained by converting assets to cash or by attracting new deposits.

Average liquid assets (cash and amounts due from banks, interest bearing deposits in other banks, federal funds sold, and investment securities) were 65.03% of average deposits for 2003, compared to 61.71% and 53.08% for 2002 and 2001, respectively.

As of December 31, 2003, \$76,892,594, or 49.21% of the investment debt securities mature in one year or less. Funds invested in federal funds sold provide liquidity so the banks do not need a large portfolio of securities classified as "available-for-sale." Other sources of liquidity include letters of credit, overnight federal funds, and reverse repurchase agreements available from correspondent banks. The total lines of credit available from correspondent banks at December 31, 2003, and 2002 were \$18,000,000. At December 31, 2001, they were \$19,000,000.

Interest rate sensitivity refers to the responsiveness of interest-bearing assets and liabilities to changes in market interest rates. The rate-sensitive position, or gap, is the difference in the volume of rate-sensitive assets and liabilities at a given time interval. The general objective of gap management is to actively manage rate-sensitive assets and liabilities to reduce the impact of interest rate fluctuations on the net interest margin. Management generally attempts to maintain a balance between rate-sensitive assets and liabilities as the exposure period is lengthened to minimize the overall interest rate risk to the Company.

Interest rate sensitivity may be controlled on either side of the balance sheet. On the asset side, management exercises some control over maturities. Also, loans are written to provide repricing opportunities on fixed rate notes. The Company's investment portfolio, including federal funds sold, provides the most flexible and fastest control over rate sensitivity since it can generally be restructured more quickly than the loan portfolio.

On the liability side, deposit products are structured to offer incentives to attain the maturity distribution desired. Competitive factors sometimes make control over deposits more difficult and, therefore, less effective as an interest rate sensitivity management tool.

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The asset mix of the balance sheet is continually evaluated in terms of several variables; yield, credit quality, appropriate funding sources, and liquidity. Management of the liability mix of the balance sheet focuses on expanding the various funding sources.

The Company was asset-sensitive for all time horizons. For asset-sensitive institutions, if interest rates should decrease, the net interest margins should decline. Since all interest rates and yields do not adjust at the same velocity, the gap is only a general indicator of rate sensitivity.

Interest Sensitivity Analysis December 31, 2003

	Within Three Months	After three but within twelve months	After one but within five years	After five years	Total
Assets					
Earning assets					
Federal funds sold	\$29,525,781	\$ -	\$ -	\$ -	\$ 29,525,781
Interest-bearing deposits	350,132	1,541,687	389,518	-	2,281,337
Investment debt securities	25,031,814	51,860,780	76,795,464	2,559,062	156,247,120
Loans	161,092,488	1,043,615	2,031,134	263,048	164,430,285
Total earning assets	\$216,000,215	\$54,446,082	\$79,216,116	\$ 2,822,110	\$352,484,523
Liabilities					
Interest-bearing deposits					
Money market	\$ 50,318,633	-	-	-	\$ 50,318,633
Savings and NOW	114,896,131	-	-	-	114,896,131
Certificates \$100,000 and over	6,430,433	8,640,956	4,966,374	-	20,037,763
Certificates under \$100,000	20,401,576	27,191,807	9,648,815	-	57,242,198
Securities sold under agreements to repurchase	4,113,154	-	-	-	4,113,154
Note payable	4,626	14,300	88,115	74,045	181,086
Total interest-bearing liabilities	\$196,164,553	\$35,847,063	\$14,703,304	\$ 74,045	\$246,788,965
Period gap	\$ 19,835,662	\$18,599,019	\$ 64,512,812	\$ 2,748,065	\$105,695,558
Cumulative gap	\$ 19,835,662	\$38,434,681	\$102,947,493	\$105,695,558	
Ratio of cumulative gap to total earning assets	5.63%	10.90%	29.21%	29.99%	

Investment Securities Maturity Distribution and Yields

	December 31, 2003		December 31, 2002		December 31, 2001	
	Amount	Percent	Amount	Percent	Amount	Percent
US Treasury						
One year or less	68,496,088	0.97%	50,003,569	2.87%	31,483,510	4.81%

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Over one through						
five years	51,965,421	1.74%	40,065,506	2.58%	26,563,088	3.96%
Over ten years	2,559,062	7.28%	2,603,120	7.28%	2,336,880	7.28%
Total U.S. Treasury securities	123,020,571	1.43%	92,672,195	2.87%	60,383,478	4.52%
U.S. Government Agencies						
One year or less	2,000,810	4.65%	1,000,000	4.49%	5,900,000	5.68%
Over one through						
five years	15,000,000	2.31%	18,902,908	3.30%	13,505,013	4.84%
Total U. S. Government Agencies	17,000,810	2.59%	19,902,908	3.35%	19,405,013	5.09%
State, county, and municipal						
One year or less	6,395,697	1.72%	4,009,906	2.45%	4,138,392	5.54%
Over one through						
five years	9,830,041	1.35%	4,203,610	2.34%	2,808,149	5.23%
Total state, county, and municipal	16,225,738	1.49%	8,213,516	2.39%	6,946,541	5.43%
Total debt securities						
One year or less	76,892,595	1.13%	55,013,475	2.87%	41,521,902	5.01%
Over one through						
five years	76,795,462	1.80%	63,172,024	2.78%	42,876,250	4.32%
Over ten years	2,559,062	7.28%	2,603,120	7.28%	2,336,880	7.28%
Total debt securities	156,247,119	1.56%	120,788,619	2.92%	86,735,032	4.73%
Equity securities	2,685,158	2.70%	1,783,680	2.51%	1,637,219	3.03%
Total securities	158,932,277	1.58%	122,572,299	2.91%	88,372,251	4.70%

Deposits and Other Interest-Bearing Liabilities

Average interest-bearing liabilities increased \$17,588,168, or 7.81%, to \$242,771,617 in 2003, from \$225,183,449 in 2002. Average interest-bearing deposits increased \$18,425,292, or 8.37%, to \$238,447,362 in 2003, from \$220,022,070 in 2002, while average non-interest bearing demand deposits increased \$10,982,926, or 16.92% to \$75,898,439 in 2003, from \$64,915,513 in 2002. At December 31, 2003, total deposits were \$317,946,053, compared to \$301,495,466 at December 31, 2002, an increase of 5.46%.

Average interest-bearing liabilities increased \$29,103,756, or 14.84%, from \$196,079,693 in 2001, to \$225,183,449 in 2002. Average interest-bearing deposits increased \$28,291,212, or 14.76%, from \$191,730,858 in 2001, to \$220,022,070 in 2002, while average demand deposits increased \$9,036,119, or 16.17% from \$55,879,394 in 2001, to \$64,915,513 in 2002. At December 31, 2002, total deposits were \$301,495,466, compared to \$274,149,181 at December 31, 2001, an increase of 9.97%.

The following table sets forth the deposits of the Company by category as of December 31, 2003, 2002, and 2001, respectively.

December 31,

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	2003		2002		2001	
	Amount	Percent of deposits	Amount	Percent of deposits	Amount	Percent of deposits
Demand deposits	\$ 75,601,460	23.78%	\$ 73,289,541	24.31%	\$ 60,508,663	22.07%
NOW accounts	63,400,879	19.94%	57,009,892	18.91%	45,639,869	16.65%
Money market	50,168,501	15.78%	46,942,638	15.57%	40,739,491	14.86%
Savings accounts	51,495,252	16.20%	45,514,226	15.10%	38,306,292	13.97%
Time deposits less than \$100,000	57,242,198	18.00%	62,897,083	20.86%	68,212,949	24.88%
Time deposits of \$100,000 or more	20,037,763	6.30%	15,842,086	5.25%	20,741,917	7.57%
Total deposits	\$317,946,053	100.00%	\$301,495,466	100.00%	\$274,149,181	100.00%

Core deposits, which exclude certificates of deposit of \$100,000 or more, provide a relatively stable funding source for the Company's loan portfolio and other earning assets. The Company's core deposits increased \$12,254,910 and \$32,246,116 during 2003 and 2002, respectively. Management believes that this increase is largely attributable to a migration of funds from the stock market into insured deposits. Deposits, and particularly core deposits, have been the Company's primary source of funding and have enabled the Company to meet both its short-term and long-term liquidity needs. Management anticipates that such deposits will continue to be the Company's primary source of funding in the future.

The maturity distribution of the Company's time deposits over \$100,000 at December 31, 2003, is shown in the following table.

Maturities of Certificates of Deposit and Other Time Deposits of \$100,000 or More

	Within three months	After three through six months	After six through Twelve months	After twelve months	Total
Certificates of deposit of \$100,000 or more	\$ 6,430,433	\$ 2,134,033	\$ 6,506,923	\$ 4,966,374	\$20,037,763

Large certificate of deposit customers tend to be extremely sensitive to interest rate levels, making these deposits less reliable sources of funding for liquidity planning purposes than core deposits. Some financial institutions partially fund their balance sheets using large certificates of deposit obtained through brokers. These brokered deposits are generally expensive and are unreliable as long-term funding sources. Accordingly, the Company does not accept brokered deposits.

Noninterest Income

Noninterest income for 2003 decreased \$166,469, or 9.62% from the previous year. This includes a decrease of \$267,844 related to a 2002 gain on the sale of property in Ocean View, Delaware. Service charges on deposit accounts increased \$35,004 primarily due to increased deposit balances. Other non-interest income increase \$66,371, of which \$54,035 was the increase in cash surrender value of bank owned life insurance policies with a face value of \$4,000,000 which were purchased in August 2003.

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Noninterest income for 2002 increased \$429,671, or 33.04% over the previous year. Of this, \$267,844 was the gain on the sale of unimproved real estate in Ocean View, Delaware. Service charges on deposit accounts contributed \$140,195 of the increase due to fee increases implemented in May and the growth of deposits.

The following table presents the principal components of noninterest income for the years ended December 31, 2003, 2002, and 2001, respectively.

	Noninterest Income		
	2003	2002	2001
Service charges on deposit accounts	\$ 1,028,306	\$ 993,302	\$ 853,107
Other noninterest revenue	535,531	469,160	447,528
Gain on sale of real estate	—	267,844	—
Total noninterest income	\$ 1,563,837	\$ 1,730,306	\$ 1,300,635
Noninterest income as a percentage of average total assets	0.41%	0.50%	0.42%

Noninterest Expense

Noninterest expense increased \$121,481, or 1.87%, from 2002 to 2003. Increased personnel costs of \$204,573 were due to annual raises, increased 401(k) expense, and increased cost of group insurance. Occupancy expense increased due increase depreciation related to recent building construction and renovation, as well as increased maintenance costs incurred to improve and maintain the grounds surrounding branches. Furniture and equipment expense decreased \$36,346 mainly due to decreases in service contract costs, and improved classification of certain maintenance expenses. Of the \$127,364 decrease in other operating expense, approximately \$62,000 was directly attributable to the Ocean View branch location, which previously operated as Calvin B. Taylor Bank of Delaware, and its merger into the Calvin B. Taylor Bank of Berlin, Maryland.

Noninterest expense increased by \$274,193, or 4.40%, from 2001 to 2002. Increased personnel costs of \$86,181 were due to annual raises, increased 401(k) expense, and increased costs of group insurance. Occupancy expense increased by \$63,152 due to the Bank's adoption in 2001 of accrual basis accounting for real property taxes, which were previously recorded on the cash basis. Furniture and equipment expense decreased \$95,517 largely due to improved accounting classification of software maintenance costs. Of the \$220,377 increase in other operating expense, \$138,091 was attributable to increased amortization expense resulting from the Bank's 2001 data processing system upgrades, and improved accounting classification of software maintenance costs.

The following table presents the principal components of noninterest expense for the years ended December 31, 2003, 2002, and 2001, respectively.

	Noninterest Expense		
	2003	2002	2001

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Compensation and related expenses	\$ 3,827,414	\$ 3,622,841	\$ 3,536,660
Occupancy expense	536,269	455,651	392,499
Furniture and equipment expense	542,433	578,779	674,296
Advertising	152,358	154,382	144,983
Business and product development	66,480	64,448	60,189
Computer software amortization	91,736	115,453	68,503
Computer software maintenance	97,570	91,141	-
Courier service	93,457	96,120	96,726
Deposit insurance	46,975	47,800	43,413
Director fees	84,240	80,600	83,025
Dues, donations, and subscriptions	80,842	81,171	80,024
Freight	67,517	62,294	57,806
Liability insurance	47,160	60,042	44,608
Postage	168,083	181,567	155,002
Professional fees	37,551	72,399	52,400
Stationery and supplies	125,593	158,965	252,686
Telephone	117,602	130,172	100,455
ATM fees	182,168	182,487	154,289
Miscellaneous	256,213	263,868	228,423
Total noninterest expense	\$ 6,621,661	\$ 6,500,180	\$ 6,225,987

Noninterest expense as a percentage of average total assets	1.75%	1.86%	2.01%
---	-------	-------	-------

Capital

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.

At December 31, 2003, the Company and the Bank exceeded the minimum regulatory capital ratios, as set forth in the following table.

Analysis of Capital

	Analysis of Capital			
	Required Minimums	Consolidated Company	Maryland Bank	Delaware Bank
2003				
Total risk-based capital ratio	8.0%	39.1%	37.1%	
Tier I risk-based capital ratio	4.0%	37.6%	35.9%	
Tier I leverage ratio	3.0%	16.0%	14.9%	
2002				
Total risk-based capital ratio	8.0%	40.7%	38.9%	
Tier I risk-based capital ratio	4.0%	39.4%	37.7%	
Tier I leverage ratio	3.0%	15.9%	15.1%	
2001				
Total risk-based capital ratio	8.0%	36.8%	33.2%	60.9%

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Tier I risk-based capital ratio	4.0%	35.6%	31.9%	59.7%
Tier I leverage ratio	3.0%	17.1%	15.5%	22.4%

Accounting Rule Changes

The following recent accounting pronouncements would apply to the Company if the Company or the Bank entered into an applicable activity.

FASB Statement No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities, improves financial reporting by requiring that contracts with comparable characteristics be accounted for similarly. In particular, this statement (1) clarifies under what circumstances a contract with an initial net investment meets the characteristic of a derivative discussed in paragraph 6(b) of Statement No. 133, (2) clarifies when a derivative contains a financing component, and (3) amends certain other pronouncements. This Statement is effective for contracts and hedging relationships entered into or modified after September 30, 2003.

FASB Statement No. 150, Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity, requires that an issuer classify a financial instrument that is within its scope as a liability. This Statement is effective for financial instruments entered into or modified after May 31, 2003.

FASB Interpretation No. 46, Consolidation of Variable Interest Entities, An Interpretation of ARB No. 51, requires consolidation of variable interest entities by the primary beneficiary. This Interpretation is effective for the first interim period or fiscal year beginning after June 15, 2003, for variable interest entities created before February 1, 2003. For entities created after January 31, 2003, the effective date was immediate.

SOP 03-3, Accounting for Certain Loans or Debt Securities Acquired in a Transfer, prohibits the "carrying over" of valuation allowances in loans and securities acquired in a transfer. At transfer, the assets are to be recorded at the total of cash flows expected to be collected. The SOP is effective for loans acquired in fiscal years beginning after December 31, 2004.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Impact of Inflation

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 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. See "Liquidity and Interest Rate Sensitivity" above.

Item 8. Financial Statements and Supplementary Data

In response to this Item, the information included on pages 1 through 21 of the Company's Annual Report to Shareholders for the year ended December 31, 2003, is incorporated herein by reference.

PART III

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Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosures

There have been no changes in or disagreements with accountants on accounting or financial disclosure during the fiscal year covered by this report.

Item 9A. Controls and Procedures

Evaluation of disclosure 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.

Audit Committee and Financial Expert

The Board of Directors has adopted a written Audit Policy, which serves as a charter for the Audit Committee. The Audit Committee is comprised of seven independent directors, including Chairman James R. Bergey, Jr. who serves as the financial expert.

Item 10. Directors and Executive Officers

In response to this item, the information included on page 4 of the Company's Proxy Statement for Annual Meeting of Shareholders To Be Held on May 12, 2004, is incorporated herein by reference.

Item 11. Executive Compensation

In response to this item, the information included on page 4 of the Company's Proxy Statement for Annual Meeting of Shareholders To Be Held on May 12, 2004, is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management

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In response to this item, the information included on page 5 of the Company's Proxy Statement for Annual Meeting of Shareholders to be held May 12, 2004, is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions

In response to this item, the information included on page 4 of the Company's Proxy Statement for Annual Meeting of Shareholders to be held May 12, 2004, is incorporated herein by reference.

Item 14. Principal Accounting Fees and Services

In response to this item, the information included on page 6 of the Company's Proxy Statement for Annual Meeting of Shareholders to be held May 12, 2004, is incorporated herein by reference.

PART IV

Item 15. Exhibits, Financial Statement Schedules, and Reports on Form 8-K

(a) Exhibits

- 3.1 Articles of Incorporation of the Company, incorporated by reference to Exhibit 3.1 of Registration Statement Form S-4, File No. 33-99762.
- 3.2 Bylaws of the Company, incorporated by reference to Exhibit 3.2 of Registration Statement Form S-4, File No. 33-99762.
- 13 Annual Report to Shareholders for the year ended December 31, 2003.

(b) Reports on Form 8-K

No reports on Form 8-K were filed during the fourth quarter of the year ended December 31, 2003.

SIGNATURES

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

CALVIN B. TAYLOR BANKSHARES, INC.
(Registrant)

Date: March 10, 2004 By: /s/ Reese F. Cropper, Jr.
Reese F. Cropper, Jr.
Chief Executive Officer
Chairman of the Board of Directors

Date: March 10, 2004 By: /s/ Jennifer G. Hawkins
Jennifer G. Hawkins
Treasurer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Date: March 10, 2004 By: /s/ James R. Bergey, Jr.
James R. Bergey, Jr., Director

Date: March 10, 2004 By: /s/ James R. Bergey, Sr.
James R. Bergey, Sr., Director

Date: _____ By:

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George H. Bunting, Jr., Director

Date: March 10, 2004 By: /s/ John H. Burbage, Jr.
John H. Burbage, Jr., Director

Date: March 10, 2004 By: /s/ Reese F. Cropper, Jr.
Reese F. Cropper, Jr.
Chief Executive Officer
Chairman of the Board of Directors

Date: _____ By:
Reese F. Cropper, III, Director

Date: _____ By:
Hale Harrison, Director

Date: March 10, 2004 By: /s/ Gerald T. Mason
Gerald T. Mason, Director

Date: March 10, 2004 By: /s/ William H. Mitchell
William H. Mitchell,
Vice President and Director

Date: March 10, 2004 By: /s/ Joseph E. Moore
Joseph E. Moore, Director

Date: March 10, 2004 By: /s/ Michael L. Quillin
Michael L. Quillin, Sr., Director

Date: March 10, 2004 By: /s/ D. Bruce Rogers
D. Bruce Rogers, Director

Date: March 10, 2004 By: /s/ Raymond M. Thompson
Raymond M. Thompson,
President and Director

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 Annual Report on Form 10-K for the period ended December 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: March 10, 2004 By: /s/ Reese F. Cropper, Jr.
Reese F. Cropper, Jr.
Chairman & Chief Executive Officer
(Principal Executive Officer)

Date: March 10, 2004 By: /s/ Jennifer G. Hawkins

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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 annual report on Form 10-K of Calvin B. Taylor Bankshares, Inc.;
2. Based on my knowledge, this annual 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 annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual 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 annual 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 subsidiaries, is made known to us by others within those entities, particularly during the quarterly period in which this annual 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 annual report (the "Evaluation Date");and
 - a. presented in this annual 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 annual 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.

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Date: March 10, 2004 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 annual report on Form 10-K of Calvin B. Taylor Bankshares, Inc.;
2. Based on my knowledge, this annual 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 annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual 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 annual 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 subsidiaries, is made known to us by others within those entities, particularly during the quarterly period in which this annual 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 annual report (the "Evaluation Date"); and
 - c. presented in this annual 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 annual 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.

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Date: March 10, 2004 By: /s/ Jennifer G. Hawkins
Jennifer G. Hawkins
Treasurer
(Principal Financial Officer)

EXHIBIT 13

ANNUAL REPORT TO SHAREHOLDERS
FOR THE YEAR ENDED DECEMBER 31, 2003

Calvin B. Taylor Bankshares, Inc.
and Subsidiary

Financial Statements

December 31, 2003

Calvin B. Taylor Bankshares, Inc.
and Subsidiary

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Report of Independent Auditors

The Board of Directors and Stockholders
Calvin B. Taylor Bankshares, Inc. and Subsidiary
Berlin, Maryland

We have audited the accompanying consolidated balance sheets of Calvin B. Taylor Bankshares, Inc. and Subsidiary as of December 31, 2003, 2002, and 2001, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the

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Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Calvin B. Taylor Bankshares, Inc. and Subsidiary as of December 31, 2003, 2002, and 2001, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ Rowles & Company, LLP

Salisbury, Maryland
January 15, 2004

Calvin B. Taylor Bankshares, Inc. and Subsidiary Consolidated Balance Sheets

	2003	December 31, 2002	2001
Assets			
Cash and due from banks	\$ 20,482,866	\$ 21,051,412	\$ 18,397,266
Federal funds sold	29,525,781	54,821,617	54,389,656
Interest-bearing deposits	2,281,337	1,432,205	879,000
Investment securities available for sale	9,265,471	8,390,550	3,974,099
Investment securities held to maturity (approximate market value of \$150,075,211, \$115,470,092, and \$85,604,080)	149,666,806	114,181,749	84,398,152
Loans, less allowance for loan losses of \$2,187,277, \$2,181,135, and \$2,195,922	162,243,008	161,824,677	166,501,512
Premises and equipment	7,064,970	5,745,842	5,895,275
Accrued interest income	1,344,613	1,405,587	1,753,816
Computer software	265,961	283,303	355,549
Deferred income taxes	-	-	134,639
Bank owned life insurance	4,054,035	-	-
Other assets	291,553	106,004	145,603
	\$386,486,401	\$369,242,946	\$336,824,567

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Liabilities and Stockholders' Equity			
Deposits			
Noninterest-bearing	\$ 75,601,460	\$ 73,289,541	\$ 60,508,663
Interest-bearing	242,344,593	228,205,925	213,640,518
	317,946,053	301,495,466	274,149,181
Securities sold under			
agreements to repurchase	4,113,154	4,029,100	4,555,323
Pending purchases of investment			
securities	-	2,990,830	-
Accrued interest payable	145,044	243,468	529,348
Note payable	181,087	198,912	215,702
Deferred income taxes	355,632	70,156	-
Other liabilities	109,399	199,728	132,443
	322,850,369	309,227,660	279,581,997
Stockholders' equity			
Common stock, par value \$1 per			
share; authorized 10,000,000			
shares; issued and outstanding			
3,227,966 shares at December 31,			
2003 and 3,240,000 shares at			
December 31, 2002 and 2001			
	3,227,966	3,240,000	3,240,000
Additional paid-in capital	16,869,085	17,290,000	17,290,000
Retained earnings	42,391,363	38,788,018	36,274,102
	62,488,414	59,318,018	56,804,102
Accumulated other			
comprehensive income			
	1,147,618	697,268	438,468
	63,636,032	60,015,286	57,242,570
	\$386,486,401	\$369,242,946	\$336,824,567

The accompanying notes are an integral part of these financial statements.

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

	Years Ended December 31,		
	2003	2002	2001
0Interest and dividend revenue			
Loans, including fees	\$ 12,115,447	\$ 13,095,218	\$ 14,179,181
U. S. Treasury and government			
agency securities	2,817,600	3,456,932	3,540,767
State and municipal securities	219,806	224,662	332,035
Federal funds sold	540,804	922,620	1,412,927
Time certificates of deposit	42,363	41,661	46,354
Equity securities	43,227	37,792	34,090
Total interest and dividend			
revenue	15,779,247	17,778,885	19,545,354
Interest expense			
Deposit interest	2,110,465	3,996,749	6,173,101
Other	21,493	40,848	75,287
Total interest expense	2,131,958	4,037,597	6,248,388
Net interest income	13,647,289	13,741,288	13,296,966

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Provision for loan losses	-	25,000	22,985
Net interest income after provision for loan losses	13,647,289	13,716,288	13,273,981
Other operating revenue			
Service charges on deposit accounts	1,028,306	993,302	853,107
Other noninterest revenue	535,530	469,160	447,528
Gain on sale of real estate	-	267,844	-
Total other operating revenue	1,563,836	1,730,306	1,300,635
Other expenses			
Salaries	3,092,919	2,994,325	2,943,241
Employee benefits	734,495	628,516	593,419
Occupancy	536,269	455,651	392,499
Furniture and equipment	542,433	578,779	674,296
Other operating	1,715,545	1,842,909	1,622,532
Total other expenses	6,621,661	6,500,180	6,225,987
Income before income taxes	8,589,464	8,946,414	8,348,629
Income taxes	3,049,250	3,192,498	2,934,225
Net income	\$5,540,214	\$5,753,916	\$5,414,404
Earnings per common share	\$1.71	\$1.78	\$1.67

The accompanying notes are an integral part of these financial statements.

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Calvin B. Taylor Bankshares, Inc.
and Subsidiary
Consolidated Statements of Changes in Stockholders' Equity

	Common stock Shares	Common stock Par value	Additional Paid-in	Retained earnings	Accumulated other comprehensive income	Comprehensive income
Balance, December 31, 2000	3,240,000	\$3,240,000	\$17,290,000	\$32,058,498	\$496,711	
Net income	-	-	-	5,414,404	-	\$5,414,404
Unrealized loss on investment securities available for sale net of income taxes	-	-	-	-	(58,243)	(58,243)
Comprehensive income						\$5,356,161

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Cash dividend, \$.37 per share	-	-	-	(1,198,800)	-	
Balance, December 31, 2001	3,240,000	3,240,000	17,290,000	36,274,102	438,468	
Net income	-	-	-	5,753,916	-	\$5,753,916
Unrealized gain on investment securities available for sale net of income taxes	-	-	-	-	258,800	258,800
Comprehensive income						\$6,012,716
Cash dividend, \$1.00 per share	-	-	-	(3,240,000)	-	
Balance, December 31, 2002	3,240,000	3,240,000	17,290,000	38,788,018	697,268	
Net income	-	-	-	5,540,214	-	\$5,540,214
Unrealized gain on investment securities available for sale net of income taxes	-	-	-	-	450,350	450,350
Comprehensive income						\$5,990,564
Common shares retired	(12,034)	(12,034)	(420,915)	-	-	
Cash dividend, \$.60 per share	-	-	-	(1,936,869)	-	
Balance, December 31, 2003	3,227,966	\$ 3,227,966	\$16,869,085	\$42,391,363	\$1,147,618	

The accompanying notes are an integral part of these financial statements.

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

	Years Ended December 31,		
	2003	2002	2001
Cash flows from operating activities			
Interest received	\$ 15,761,248	\$ 17,961,046	\$ 19,541,166
Fees and commissions received	1,507,872	1,462,551	1,361,593
Interest paid	(2,230,381)	(4,323,477)	(6,222,559)
Cash paid to suppliers and employees	(6,026,828)	(5,909,413)	(5,731,055)
Income taxes paid	(3,232,338)	(2,997,807)	(3,075,025)
	5,779,573	6,192,900	5,874,120
Cash flows from investing activities			

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Certificates of deposits purchased, net of maturities	(699,000)	(553,205)	(95,000)
Purchase of investments available for sale	(182,500)	(3,994,520)	-
Proceeds from maturities of investments held to maturity	107,310,000	91,445,000	57,857,000
Purchase of investments held to maturity	(145,709,919)	(118,071,995)	(65,799,078)
Loans made, net of principal collected	(418,331)	4,651,835	2,046,702
Proceeds from sale of premises and equipment	-	503,160	17,000
Purchases of and deposits on premises, equipment, and computer software	(1,941,071)	(650,339)	(1,063,655)
Purchase of bank owned life insurance	(4,000,000)	-	-
	(45,640,821)	(26,670,064)	(7,037,031)
Cash flows from financing activities			
Net increase (decrease) in			
Time deposits	(1,459,208)	(10,215,697)	15,567,519
Other deposits	17,909,795	37,561,982	26,655,470
Securities sold under agreements to repurchase	84,054	(526,223)	1,441,652
Payments on note payable	(17,825)	(16,791)	(15,814)
Purchases and retirement of common shares	(432,949)	-	-
Dividends paid	(1,936,869)	(3,240,000)	(1,198,800)
	14,146,998	23,563,271	42,450,027
Net increase (decrease) in cash and cash equivalents	(25,714,250)	3,086,107	41,287,116
Cash and cash equivalents at beginning of year	75,873,029	72,786,922	31,499,806
Cash and cash equivalents at end of year	\$50,158,779	\$75,873,029	\$72,786,922

The accompanying notes are an integral part of these financial statements.

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

Years Ended December 31,
2003 2002 2001

Reconciliation of net income to net cash provided by operating activities			
Net income	\$ 5,540,214	\$ 5,753,916	\$ 5,414,404

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Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation and amortization	633,383	629,738	528,247
Provision for loan losses	-	25,000	22,985
Deferred income taxes	46,409	41,961	9,234
Amortization of premiums and accretion of discounts, net	(78,972)	(166,068)	(198,571)
(Gain) loss on disposition of assets	5,902	(260,880)	(12,365)
Decrease (increase) in			
Accrued interest receivable	60,974	348,229	194,383
Cash surrender value of bank owned life insurance	(54,035)	-	-
Other assets	(185,549)	(8,914)	(54,566)
Increase (decrease) in			
Accrued interest payable	(98,424)	(285,880)	25,829
Accrued income taxes	-	152,730	(101,520)
Other liabilities	(90,329)	(36,932)	46,060
	\$ 5,779,573	\$ 6,192,900	\$ 5,874,120

Composition of cash and cash equivalents			
Cash and due from banks	\$ 20,482,866	\$ 21,051,412	\$ 18,397,266
Federal funds sold	29,525,781	54,821,617	54,389,656
Interest-bearing deposits, except for time deposits	150,132	-	-
	\$ 50,158,779	\$ 75,873,029	\$ 72,786,922

The accompanying notes are an integral part of these financial statements.

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

1. Summary of Significant Accounting Policies

Calvin B. Taylor Bankshares, Inc. is a bank holding company. Its subsidiary, Calvin B. Taylor Banking Company, is a financial institution operating primarily in Worcester County, Maryland and Sussex County, Delaware. The accounting and reporting policies reflected in the financial statements conform to generally accepted accounting principles and to general practices within the banking industry. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. These estimates and assumptions may affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Principles of consolidation

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The consolidated financial statements of Calvin B. Taylor Bankshares, Inc. include the accounts of its wholly owned subsidiary, Calvin B. Taylor Banking Company. All significant intercompany balances and transactions have been eliminated in consolidation.

Cash equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks and federal funds sold and interest-bearing deposits except for time deposits. Federal funds are purchased and sold for one-day periods.

Investment securities

As securities are purchased, management determines if the securities should be classified as held to maturity or available for sale. Securities which management has the intent and ability to hold to maturity are recorded at amortized cost which is cost adjusted for amortization of premiums and accretion of discounts to maturity. Securities classified as available-for-sale are recorded at fair value.

Gains and losses on disposal are determined using the specific-identification method.

Loans and allowance for loan losses

Loans are stated at face value less the allowance for loan losses. Interest on loans is credited to income based on the principal amounts outstanding. The accrual of interest is discontinued when any portion of the principal or interest is ninety days past due and collateral is insufficient to discharge the debt in full.

The allowance for loan losses is maintained at a level deemed appropriate by management to provide adequately for known and inherent risks in the loan portfolio. The minimum range of the allowance for loan losses is calculated by applying risk-weighted percentages to loans based on their delinquency and underlying collateral. The portion of the allowance that is a result of geographic and industry concentrations and current economic conditions is not allocated to specific loans. At December 31, 2003, the allowance included approximately \$1,073,546 that was not allocated to specific loans. Management has historically maintained the allowance at a level of approximately 1.30% to 1.35% of gross loans.

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

1. Summary of Significant Accounting Policies (Continued)

Loans and allowance for loan losses (continued)

If the current economy or real estate market were to suffer a severe downturn, the estimate for uncollectible accounts would need to be increased. Loans that are deemed to be uncollectible are charged off and deducted from the allowance. The provision for loan losses and recoveries on loans previously charged off are added to the allowance.

Loans are considered impaired when, based on current information, management considers it unlikely that collection of principal and interest payments will be made according to contractual terms. Generally, loans are not reviewed for impairment until the accrual of interest has been discontinued.

Premises and equipment

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Premises and equipment are recorded at cost less accumulated depreciation. Depreciation is computed under both straight-line and accelerated methods over the estimated useful lives of the assets.

Computer software

The Company amortizes software costs over their useful lives using the straight-line method.

Bank owned life insurance

The Company records increases in cash surrender value of bank owned life insurance as current period income based on projections provided by the underwriting company.

Advertising

Advertising costs are expensed as incurred.

Income taxes

The provision for income taxes includes taxes payable for the current year and deferred income taxes. Deferred income taxes are provided for the temporary differences between financial and taxable income. Tax expense and tax benefits are allocated to the banks and company based on their proportional share of taxable income.

Per share data

Earnings per common share are determined by dividing net income by the weighted average of shares outstanding for the period. The weighted average of common shares outstanding was 3,235,767, 3,240,000, and 3,240,000 shares outstanding, for the years ended December 31, 2003, 2002, and 2001, respectively.

2. Cash and Due From Banks

The Company normally carries balances with other banks that exceed the federally insured limit. The average balances carried in excess of the limit, including unsecured federal funds sold to the same banks, were \$53,869,724 for 2003, \$59,942,898 for 2002, and \$53,138,449 for 2001.

Banks are required to carry noninterest-bearing cash reserves at specified percentages of deposit balances. The Company's normal amount of cash on hand and on deposit with other banks is sufficient to satisfy the reserve requirements.

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

3. Investment Securities

Included in investment securities are purchase commitments entered into before December 31, 2002, for settlement after December 31, 2002. The obligation for these commitments is recorded as pending purchases of investment securities. Investment securities are summarized as follows:

Amortized cost	Unrealized gains	Unrealized losses	Market value
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December 31, 2003

Available for sale

U.S. Treasury	\$ 5,991,862	\$ 588,451	\$ -	\$ 6,580,313
Equity	1,448,208	1,236,950	-	2,685,158
	\$ 7,440,070	\$1,825,401	\$ -	\$ 9,265,471

Held to maturity

U.S. Treasury	\$116,440,258	\$ 416,411	\$ 34,334	\$116,822,335
U.S. Government agency	17,000,810	69,385	60,879	17,009,316
State and municipal	16,225,738	34,016	16,195	16,243,559
	\$149,666,806	\$ 519,812	\$111,408	\$150,075,210

December 31, 2002

Available for sale

U.S. Treasury	\$ 5,988,858	\$ 618,012	\$ -	\$ 6,606,870
Equity	1,265,708	552,416	34,444	1,783,680
	\$ 7,254,566	\$1,170,428	\$ 34,444	\$ 8,390,550

Held to maturity

U.S. Treasury	\$ 86,065,325	\$ 992,655	\$ -	\$ 87,057,980
U.S. Government agency	19,902,908	211,063	-	20,113,971
State and municipal	8,213,516	85,275	650	8,298,141
	\$114,181,749	\$1,288,993	\$ 650	\$115,470,092

December 31, 2001

Available for sale

U.S. Treasury	\$ 1,994,041	\$ 42,839	\$ -	\$ 2,336,880
Equity	1,265,708	455,713	84,202	1,637,219
	\$ 3,259,749	\$ 798,552	\$ 84,202	\$ 3,974,099

Held to maturity

U.S. Treasury	\$ 58,046,598	\$ 920,257	\$ 5,952	\$ 58,960,903
U.S. Government agency	19,405,013	230,276	12,389	19,622,900
State and municipal	6,946,541	73,832	96	7,020,277
	\$ 84,398,152	\$1,224,365	\$ 18,437	\$ 85,604,080

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

3. Investment Securities (Continued)

All investment securities with unrealized losses have been in a continuous loss position for less than twelve months. The table below summarizes investment securities with unrealized losses as of December 31, 2003.

	Amortized cost	Unrealized losses	Market value
December 31, 2003			
Held to maturity			
U.S. Treasury	\$ 14,988,119	\$ 34,334	\$ 14,953,785
U.S. Government Agency	8,750,000	60,879	8,689,121
State and municipal	5,778,066	16,195	5,761,871
	\$ 29,516,185	\$111,408	\$ 29,404,777

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The amortized cost and estimated market value of debt securities, by contractual maturity and the amount of pledged securities, follow. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	December 31, 2003		December 31, 2002		December 31, 2001	
	Amortized cost	Market value	Amortized cost	Market value	Amortized cost	Market value
Available for sale due						
In one year	\$3,997,243	\$4,021,251	\$ -	\$ -	\$ -	\$ -
After one year through five years	-	-	3,994,528	4,003,750	-	-
After ten years	1,994,619	2,559,062	1,994,330	2,603,120	1,994,041	2,336,880
	\$5,991,862	\$6,580,313	\$5,988,858	\$6,606,870	\$1,994,041	\$2,336,880
Held to maturity due						
In one year	\$72,871,344	\$73,184,592	\$55,013,475	\$55,394,968	\$41,521,902	\$42,125,457
After one year through five years	76,795,462	76,890,618	59,168,274	60,075,124	42,876,250	43,478,623
	\$149,666,806	\$150,075,210	\$114,181,749	\$115,470,092	\$84,398,152	\$85,604,080
Pledged securities						
	\$21,790,367	\$21,870,641	\$20,868,000	\$21,248,011	\$21,058,134	\$21,517,135

Investments are pledged to secure deposits of federal and local governments. Pledged securities also serve as collateral for securities sold under agreements to repurchase.

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

4. Lines of Credit

The Company has available lines of credit, including overnight federal funds, reverse repurchase agreements and letters of credit, totaling \$18,000,000 as of December 31, 2003 and December 31, 2002, and \$19,000,000 as of December 31, 2001.

5. Loans and Allowance for Loan losses

Major classifications of loans are as follows:

	2003	2002	2001
Commercial	\$ 13,199,879	\$ 12,765,723	\$ 15,341,122
Real estate	127,722,747	139,354,241	146,258,549
Construction	20,877,036	8,447,354	2,117,685
Consumer	2,630,623	3,438,494	4,980,078

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	164,430,285	164,005,812	168,697,434
Allowance for loan losses	2,187,277	2,181,135	2,195,922
Loans, net	\$162,243,008	\$161,824,677	\$166,501,512

The rate repricing distribution of the loan portfolio follows:

Immediately	\$160,730,764	\$160,567,318	\$164,098,147
Within one year	1,405,338	813,678	1,728,296
Over one to five years	2,031,134	2,197,969	2,648,073
Over five years	263,049	426,847	222,918
	\$164,430,285	\$164,005,812	\$168,697,434

Outstanding loan commitments, lines of credit, and letters of credit are as follows:

Loan commitments and lines of credit			
Construction and land development	\$ 10,495,735	\$ 10,557,644	\$ 6,456,910
Other	15,036,346	11,876,437	8,639,337
	\$ 25,532,081	\$ 22,434,081	\$ 15,096,247
Standby letters of credit	\$ 2,957,508	\$ 1,726,127	\$ 3,243,063

Loan commitments are agreements to lend to customers as long as there is no violation of any conditions of the contracts. Loan commitments generally have interest at current market rates, fixed expiration dates, and may require payment of a fee.

Letters of credit are commitments issued to guarantee the performance of a customer to a third party.

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

5. Loans and Allowance for Loan losses (Continued)

Loan commitments and letters of credit are made on the same terms, including collateral, as outstanding loans. The Company's exposure to loan loss in the event of nonperformance by the borrower is represented by the contract amount of the commitment.

The Company makes loans to customers located primarily in the Delmarva region. Although the loan portfolio is diversified, its performance will be influenced by the economy of the region.

Transactions in the allowance for loan losses were as follows:

	2003	2002	2001
Beginning balance	\$ 2,181,135	\$ 2,195,922	\$ 2,192,755

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Provision charged to operations	-	25,000	22,985
Recoveries	9,565	8,983	4,906
	2,190,700	2,229,905	2,220,646
Loans charged off	3,423	48,770	24,724
Ending balance	\$ 2,187,277	\$ 2,181,135	\$ 2,195,922

Amounts past due 90 days or more, and still accruing interest, are as follows:

Commercial	\$ 55,795	\$ 17,370	\$ 122,420
Real estate	251,658	250,206	343,136
Consumer	7,942	15,280	50,883
	\$ 315,395	\$ 282,856	\$ 516,439

Management has identified no impaired loans at December 31, 2003, 2002, and 2001. Accrual of interest had been discontinued on one loan with a balance of \$2,222 at December 31, 2002. There were no non-accruing loans at December 31, 2003 and 2001.

6. Lease Commitments

The Company leases the land on which the Route 50 branch in East Berlin is located. The lease obligation, which expires August 31, 2009, requires payments as follows:

Period	Minimum rentals
2004	15,000
2005	15,000
2006	15,000
2007	15,000
2008	15,000
2009	10,000
	\$ 85,000

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

7. Premises and Equipment

A summary of premises and equipment and the related depreciation is as follows:

	Estimated useful life	2003	2002	2001
Land		\$ 1,893,946	\$ 1,659,793	\$ 1,891,950
Premises	5 - 50 years	6,423,636	5,028,225	4,826,954
Furniture and equipment	5 - 40 years	3,446,813	3,326,082	3,652,244
Construction in progress		-	210,583	-

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	11,764,395	10,224,683	10,371,148
Accumulated depreciation	4,699,425	4,478,841	4,475,873
Net premises and equipment	\$ 7,064,970	\$ 5,745,842	\$ 5,895,275
Depreciation expense	\$ 541,647	\$ 514,285	\$ 459,744

8. Deposits

Major classifications of interest-bearing deposits are as follows:

	2003	2002	2001
Money market	\$ 50,168,501	\$ 46,942,638	\$ 40,739,491
Savings and NOW	114,896,131	102,524,118	83,946,161
Other time	77,279,961	78,739,169	88,954,866
	\$242,344,593	\$228,205,925	\$213,640,518

The rate repricing distribution of other time deposits follows:

Three months or less	\$ 26,832,009	\$ 28,235,099	\$ 28,071,706
Over three through twelve months	35,832,764	36,006,763	48,240,152
Over one through two years	14,615,188	14,497,307	12,643,008
	\$ 77,279,961	\$ 78,739,169	\$ 88,954,866

Included in other time deposits are certificates of deposit of \$100,000 or more as follows:

Amount outstanding	\$ 20,037,763	\$ 15,842,086	\$ 20,741,917
Interest expense	\$ 324,822	\$ 597,603	\$ 987,329

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

9. Securities Sold Under Agreements to Repurchase

Securities sold under agreements to repurchase represent overnight borrowings from customers. The government agency securities that collateralize these agreements are owned by the Company but maintained in the custody of an unaffiliated bank designated by the Company. Additional information follows.

	2003	2002	2001
Maximum month-end amount outstanding	\$ 6,542,540	\$ 6,531,215	\$ 5,383,038
Average amount outstanding	4,134,892	4,957,151	4,125,782
Average rate paid during the year	.24%	.57%	1.50%
Investment securities underlying the agreements at year end			
Carrying value	16,993,472	15,994,905	13,991,479
Estimated fair value	17,050,781	16,306,570	14,327,220

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10. Note Payable

The Company purchased real estate, financing 100% of the purchase price. The 6% unsecured note has a final maturity of September, 2011. Maturities of this note are as follows:

2004	\$ 18,925
2005	20,092
2006	21,332
2007	22,647
2008	24,044
Remaining years	74,047
	\$181,087

11. Profit Sharing Plan

In 1999, the Company adopted a defined contribution profit sharing plan under Section 401(k) of the Internal Revenue Code. The plan covers substantially all of the employees and allows discretionary Company contributions. Annually, the Board of Directors approves a discretionary contribution in addition to matching 50% of employee contributions to a maximum of 6% of the employee wages.

The total cost of the profit sharing plan for 2003, 2002, and 2001, were \$170,395, \$146,568, and \$140,620, respectively.

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

12. Other Operating Expenses

The components of other operating expenses follow:

	2003	2002	2001
Advertising	\$ 152,358	\$ 154,382	\$ 144,983
Business and product development	66,480	64,448	60,189
Computer software amortization	91,736	115,453	68,503
Computer software maintenance contracts	97,570	91,141	-
Courier service	93,457	96,120	96,726
Deposit insurance	46,975	47,800	43,413
Director fees	84,240	80,600	83,025
Dues, donations, and subscriptions	80,842	81,171	80,024
Freight	67,517	62,294	57,806
Liability insurance	47,160	60,042	44,608
Postage	168,083	181,567	155,002
Professional fees	37,551	72,399	52,400
Stationery and supplies	125,593	158,965	252,686
Telephone	117,602	130,172	100,455
ATM fees	182,168	182,487	154,289
Miscellaneous	256,213	263,868	228,423
	\$1,715,545	\$1,842,909	\$1,622,532

13. Related Party Transactions

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The executive officers and directors of the Company enter into loan transactions with the Banks in the ordinary course of business.

The terms of these transactions are similar to the terms provided to other borrowers entering into similar loan transactions.

	2003	2002	2001
Beginning balance	\$ 11,133,959	\$ 11,079,167	\$ 12,293,244
Advances	8,550,318	6,034,153	4,833,136
Other increases	-	-	-
	19,684,277	17,113,320	17,126,380
Repayments	9,729,587	5,884,153	5,911,658
Other decreases	-	95,208	135,555
Ending balance	\$ 9,954,690	\$ 11,133,959	\$ 11,079,167

Officers, directors, and employees are depositors of the Bank. They receive the same deposit rates and terms as other customers with similar deposits. As of December 31, 2003, the individual deposits in excess of \$100,000 of executive officers, directors, and their related interests represented less than 3.0% of total deposits.

The Company obtains legal services from a law firm in which one of the principal attorneys is also a member of the Board of Directors. Fees charged for these services are at similar rates charged by unrelated law firms for similar legal work. Amounts paid to this related party totaled \$3,490, \$1,235, and \$2,003 during the years ended December 31, 2003, 2002, and 2001.

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

14. Income Taxes

The components of income tax expense are as follows:

	2003	2002	2001
Current			
Federal	\$2,613,587	\$2,772,796	\$2,598,069
State	389,254	377,740	326,922
	3,002,841	3,150,536	2,924,991
Deferred	46,409	41,962	9,234
	\$3,049,250	\$3,192,498	\$2,934,225

The components of the deferred tax (benefit) are as follows:

Provision for loan losses	\$ (2372)	\$ 2,656	\$ (754)
Non-accrual loan interest	43	(43)	-
Depreciation	47,512	32,334	5,317
Discount accretion	(128)	3,191	412
Net operating loss carryforward for state income tax	(163)	-	-
Organization costs	1,517	3,824	4,259

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\$ 46,409 \$ 41,962 \$ 9,234

The components of the net deferred tax asset (liability) are as follows:

Deferred tax asset			
Allowance for loan losses	\$ 603,495	\$ 601,123	\$ 603,779
Non-accrual loan interest	-	43	-
Net operating loss carryforward for state income tax	163	-	-
Organization costs		1,517	5,341
	603,658	602,683	609,120
Deferred tax liabilities			
Depreciation	268,112	220,601	188,267
Discount accretion	13,395	13,523	10,332
Unrealized gain on securities available for sale	677,783	438,715	275,882
	959,290	672,839	474,481
Net deferred tax asset (liability)	\$ (355,632)	\$ (70,156)	\$ 134,639

A reconciliation of the provision for taxes on income from the statutory federal income tax rates to the effective income tax rates follows:

Statutory federal income tax rate	34.0 %	34.0 %	34.0 %
Increase (decrease) in tax rate resulting from			
Tax-exempt income	(1.5)	(1.1)	(1.5)
State income taxes net of federal income tax benefit	3.0	2.8	2.6
	35.5 %	35.7 %	35.1 %

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15. Fair Value of Financial Instruments

The estimated fair values of the Company's financial instruments are summarized below. The fair values of a significant portion of these financial instruments are estimates derived using present value techniques prescribed by the Financial Accounting Standards Board and may not be indicative of the net realizable or liquidation values. The calculation of estimated fair values is based on market conditions at a specific point in time and may not reflect current or future fair values. The fair value of financial instruments equals the carrying value of the instruments except as follows.

December 31, 2003	December 31, 2002	December 31, 2001
Carrying Fair	Carrying Fair	Carrying Fair

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	amount	value	amount	value	amount	value
Financial assets						
Cash and due from banks	\$20,482,866	\$20,632,954	\$21,051,412	\$21,163,525	\$18,397,266	\$18,510,175
Interest-bearing deposits	2,281,337	2,305,344	1,432,205	1,469,452	879,000	906,928
Investment securities	158,932,277	159,340,681	122,572,299	123,860,642	88,372,251	89,578,179
Loans, net	162,243,008					
Financial liabilities						
Interest-bearing deposits	\$242,344,593	\$242,471,838	\$228,205,925	\$228,558,735	\$213,640,518	\$214,497,142
Note payable	181,087	176,288	198,912	193,045	215,702	206,453

The fair value of silver coin included with cash is determined based on quoted market prices.

The fair value of interest-bearing deposits with other financial institutions is estimated based on quoted interest rates for certificates of deposit with similar remaining terms.

The fair values of equity securities are determined using market quotations. The fair values of debt securities are estimated using a matrix that considers yield to maturity, credit quality, and marketability.

The fair value of fixed-rate loans is estimated to be the present value of scheduled payments discounted using interest rates currently in effect for loans of the same class and term. The fair value of variable-rate loans, including loans with a demand feature, is estimated to equal the carrying amount. The valuation of loans is adjusted for possible loan losses.

The fair value of interest-bearing checking, savings, and money market deposit accounts is equal to the carrying amount. The fair value of fixed-rate time deposits is estimated based on interest rates currently offered for deposits of similar remaining maturities.

It is not practicable to estimate the fair value of outstanding loan commitments, unused lines, and letters of credit.

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16. Capital Standards

The Federal Reserve Board and the Federal Deposit Insurance Corporation have adopted risk-based capital standards for banking organizations. These standards require ratios of capital to assets for minimum capital adequacy and to be classified as well capitalized under prompt corrective action provisions. The capital ratios and minimum capital requirements of the Company are as

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follows:

(in thousands)	Actual		Minimum capital adequacy		To be well capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2003						
Total capital						
(to risk weighted assets)	\$65,082	39.1%	\$13,299	8.0%	\$16,624	10.0%
Tier 1 capital						
(to risk-weighted assets)	\$62,488	37.6%	\$ 6,650	4.0%	\$ 9,974	6.0%
Tier 1 capital						
(to average fourth quarter assets)	\$62,488	16.0%	\$15,636	4.0%	\$19,545	5.0%
December 31, 2002						
Total capital						
(to risk weighted assets)	\$61,255	40.7%	\$12,032	8.0%	\$15,040	10.0%
Tier 1 capital						
(to risk-weighted assets)	\$59,318	35.6%	\$ 6,016	4.0%	\$ 9,024	6.0%
Tier 1 capital						
(to average fourth quarter assets)	\$59,318	15.9%	\$14,902	4.0%	\$18,628	5.0%
December 31, 2001						
Total capital						
(to risk weighted assets)	\$58,800	36.8%	\$12,791	8.0%	\$15,989	10.0%
Tier 1 capital						
(to risk-weighted assets)	\$56,804	35.6%	\$ 6,396	4.0%	\$ 9,593	6.0%
Tier 1 capital						
(to average fourth quarter assets)	\$56,804	17.1%	\$13,329	4.0%	\$16,661	5.0%

Tier 1 capital consists of common stock, additional paid in capital, and retained earnings. Total risk-based capital includes a limited amount of the allowance for loan losses. In calculating risk-weighted assets, specific risk percentages are applied to each category of asset and off-balance sheet items.

Failure to meet the capital requirements could affect the Company's ability to pay dividends and accept deposits, and may significantly affect the operations of the Company.

In the most recent regulatory report, the Company was determined to be well capitalized. Management has no plans that should change the classification of the capital adequacy.

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17. Parent Company Financial Information

	December 31,		
Balance Sheets	2003	2002	2001

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Assets

Cash and due from banks	\$ 52,244	\$ 353,604	\$ 57,513
Interest-bearing deposits	650,132	-	1,512,125
Investment securities available for sale	2,685,158	1,783,680	1,637,219
Investment securities held to maturity	499,692	499,230	-
Investment in subsidiary bank	58,798,328	56,226,822	52,445,405
Premises and equipment	1,342,696	1,375,315	1,640,946
Other assets	163,001	3,630	55,688
Total assets	\$ 64,191,251	\$ 60,242,281	\$ 57,348,896

Liabilities and Stockholders' Equity

Liabilities			
Deferred income taxes	\$ 393,950	\$ 118,136	\$ 61,492
Other liabilities	161,269	108,859	44,834
	555,219	226,995	106,326
Stockholders' equity			
Common stock	3,227,966	3,240,000	3,240,000
Additional paid-in capital	16,869,085	17,290,000	17,290,000
Retained earnings	42,391,363	38,788,018	36,274,102
Accumulated other comprehensive income	1,147,618	697,268	438,468
Total stockholders' equity	63,636,032	60,015,286	57,242,570
Total liabilities and stockholders' equity	\$ 64,191,251	\$ 60,242,281	\$ 57,348,896

Statements of Income	Years Ended December 31,		
	2003	2002	2001
Interest revenue	\$ 12,678	\$ 37,066	\$ 25,816
Dividend revenue	43,227	37,792	34,090
Dividends from subsidiary	2,936,869	1,944,000	2,698,800
Equity in undistributed income of subsidiary	2,562,464	3,612,515	2,695,465
Gain on sale of real estate	-	267,844	-
Rental income and other fees	2,028	2,748	2,700
	5,557,266	5,901,965	5,456,871
Expenses			
Occupancy	3,777	15,831	6,115
Furniture and equipment	1,167	2,014	1,968
Other	20,272	21,263	36,044
	25,216	39,108	44,127
Income before income taxes	5,532,050	5,862,857	5,412,744
Income taxes (benefit)	(8,164)	108,941	(1,660)
Net income	\$ 5,540,214	\$ 5,753,916	\$ 5,414,404

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Calvin B. Taylor Bankshares, Inc.
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17. Parent Company Financial Information (Continued)

	Years Ended December 31,		
	2003	2002	2001

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Statements of Cash Flows

Cash flows from operating activities

Interest and dividends received	\$ 2,992,141	\$ 2,012,520	\$ 2,749,579
Rental payments received	35,629	24,348	35,700
Cash paid for operating expenses	(26,197)	(27,234)	(44,008)
Income taxes refunded	(100,483)	1,727	22,445
	2,901,090	2,011,361	2,763,716

Cash flows from investing activities

Certificates of deposit purchased, net of maturities	(500,000)	1,500,000	(1,500,000)
Purchase of investments available for sale	(182,500)	-	(15,767)
Proceeds from maturities of investments held to maturity	-	1,500,000	-
Purchase of investments held to maturity	-	(1,987,395)	-
Proceeds from sale of premises and equipment	-	500,000	-
Purchase of premises and equipment	(682,500)	-	(64,126)
	(682,500)	1,512,605	(1,579,893)

Cash flows from financing activities

Purchases and retirement of common shares	(432,949)	-	-
Dividends paid	(1,936,869)	(3,240,000)	(1,198,800)
Net increase (decrease) in cash	(151,228)	283,966	(14,977)
Cash at beginning of year	353,604	69,638	84,615
Cash at end of year	\$ 202,376	\$ 353,604	\$ 69,638

Reconciliation of net income to net cash provided by operating activities

Net income	\$ 5,540,214	\$ 5,753,916	\$ 5,414,404
Adjustments to reconcile net income to net cash used in operating activities			
Undistributed net income of subsidiary	(2,562,464)	(3,612,515)	(2,695,465)
Accretion of discount on debt securities	(462)	(11,835)	-
Depreciation	32,619	33,475	33,120
Gain on sale of assets	-	(267,844)	-
Increase (decrease) in deferred income taxes and other liabilities	50,554	64,106	44,900
Decrease (increase) in other assets	(159,371)	52,058	(33,243)
	\$ 2,901,090	\$ 2,011,361	\$ 2,763,716

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Calvin B. Taylor Bankshares, Inc.
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18. Quarterly Results of Operations (Unaudited)

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	December 31,	Three months ended		March 31,
		September 30,	June 30,	
2003				
Interest revenue	\$3,826,749	\$3,934,534	\$4,024,543	\$3,993,421
Interest expense	435,526	473,779	559,096	663,557
Net interest income	3,391,223	3,460,755	3,465,447	3,329,864
Provision for loan losses	-	-	-	-
Net income	1,308,544	1,429,125	1,450,040	1,352,505
Comprehensive income	1,372,451	1,288,388	1,994,551	1,335,174
Earnings per share	\$0.40	\$0.44	\$0.45	\$0.42
2002				
Interest revenue	\$4,227,559	\$4,553,255	\$4,555,972	\$4,442,099
Interest expense	835,131	995,620	1,036,065	1,170,781
Net interest income	3,392,428	3,557,635	3,519,907	3,271,318
Provision for loan losses	25,000	-	-	-
Net income	1,441,829	1,491,997	1,540,177	1,279,913
Comprehensive income	1,500,543	1,658,031	1,608,412	1,245,730
Earnings per share	\$0.45	\$0.46	\$0.47	\$0.40
2001				
Interest revenue	\$4,804,117	\$5,003,872	\$4,882,457	\$4,854,908
Interest expense	1,550,131	1,626,675	1,542,283	1,529,299
Net interest income	3,253,986	3,377,197	3,340,174	3,325,609
Provision for loan losses	22,985	-	-	-
Net income	1,165,144	1,400,912	1,491,492	1,356,856
Comprehensive income	1,126,589	1,416,605	1,453,466	1,359,501
Earnings per share	\$0.36	\$0.43	\$0.46	\$0.42