GREENE COUNTY BANCSHARES INC
Form 10-K
March 10, 2004

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

FOR ANNUAL AND TRANSITION REPORTS
PURSUANT TO SECTIONS 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

(Mark One)

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

For the fiscal year ended December 31, 2003

OR

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

For the transition period from __to __

Commission file number **0-14289**

GREENE COUNTY BANCSHARES, INC.

(Exact name of registrant as specified in its charter)

Tennessee	**62-1222567**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
100 North Main Street, Greeneville, Tennessee	**37743-4992**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: **(423) 639-5111**.

Securities registered pursuant to Section 12(b) of the Act: **None**

Securities registered pursuant to Section 12(g) of the Act:

Common Stock - $2.00 par value

Indicate by check mark whether the registrant (1) has 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 x NO o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of 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. o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2 of the Act.) YES x NOo

The aggregate market value of the voting stock held by non-affiliates of the registrant on June 30, 2003 was $126.2 million. The market value calculation was determined using the closing sale price of the registrant s common stock on June 30, 2003, as reported on the Nasdaq Stock Market National Market System. For purposes of this calculation, the term affiliate refers to all directors, executive officers and 10% shareholders of the registrant. As of the close of business on March 10, 2004, 7,661,635 shares of the registrant s common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

The following lists the documents incorporated by reference and the Part of the Form 10-K into which the document is incorporated:

1. Portions of Proxy Statement for 2004 Annual Meeting of Shareholders. (Part III)

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PART I

Forward-Looking Statements

The information contained herein contains forward-looking statements that involve a number of risks and uncertainties. A number of factors, including those discussed herein, could cause results to differ materially from those anticipated by such forward-looking statements. In addition, such forward-looking statements are necessarily dependent upon assumptions, estimates and data that may be incorrect or imprecise. Accordingly, any forward-looking statements included herein do not purport to be predictions of future events or circumstances and may not be realized. Forward-looking statements can be identified by, among other things, the use of forward-looking terminology such as intends, believes, expects, may, will, should, seeks, anticipates, or the negatives thereof, or other variations thereon of comparable terminology, or by discussions of strategy or intentions. All forward-looking statements herein are based on information available to us as of the date the Company s Annual Report on Form 10-K was filed with the Securities and Exchange Commission (SEC).

ITEM 1. BUSINESS

Presentation of Amounts

All dollar amounts set forth below, other than share and per-share amounts and percentages, are in thousands unless otherwise noted.

The Company

Greene County Bancshares, Inc. (the Company) was formed in 1985 and serves as the bank holding company for Greene County Bank (the Bank), which is a Tennessee-chartered commercial bank that conducts the principal business of the Company. At December 31, 2003, and based on information provided by Sheshunoff Information Services as of June 30, 2003, the Company was the fifth largest bank holding company headquartered in the state of Tennessee. At December 31, 2003, the Company maintained a main office in Greeneville, Tennessee and 39 bank branches (of which seven are in leased operating premises) and 10 separate locations operated by the Bank s subsidiaries.

The Company s assets consist primarily of its investment in the Bank and liquid investments. Its primary activities are conducted through the Bank. At December 31, 2003, the Company s consolidated total assets were $1,108,522, its consolidated net loans, including loans held for sale, were $941,207, its total deposits were $907,115 and its total shareholders equity was $101,935.

The Company s net income is dependent primarily on its net interest income, which is the difference between the interest income earned on its loans, investment assets and other interest-earning assets and the interest paid on deposits and other interest-bearing liabilities. To a lesser extent, the Company s net income also is affected by its non-interest income derived principally from service charges and fees as well as the level of non-interest expenses such as salaries and employee benefits.

The operations of the Company are significantly affected by prevailing economic conditions, competition and the monetary, fiscal and regulatory policies of governmental agencies. Lending activities are influenced by the general credit needs of individuals and small and medium-sized businesses in the Company s market area, competition among lenders, the level of interest rates and the availability of funds. Deposit flows and costs of funds are influenced by prevailing market rates of interest, primarily the rates paid on competing investments, account maturities and the levels of personal income and savings in the Company s market area.

The principal executive offices of the Company are located at 100 North Main Street, Greeneville, Tennessee 37743-4992 and its telephone number is (423) 639-5111.

The Bank

The Bank is a Tennessee-chartered commercial bank established in 1890 and which has its principal executive offices in Greeneville, Tennessee. The principal business of the Bank consists of attracting deposits from the general public and investing those funds, together with funds generated from operations and from principal and interest payments on loans, primarily in commercial loans, commercial and residential real estate loans, and installment consumer loans. The Bank also provides collection and other banking services, directly and through its finance, acceptance and title subsidiary corporations. At December 31, 2003, the Bank had 36 full service banking offices located throughout East Tennessee, including Greene, Washington, Blount, Knox, Hamblen, McMinn, Loudon, Hawkins, Sullivan, Cocke and Monroe Counties, and in Middle Tennessee, Sumner and Rutherford Counties. The Bank also had one full service branch located in nearby Madison County, North Carolina. Further, the Bank operates a trust and money management function doing business as President s Trust from offices in Wilson County, Tennessee, a loan production office doing business as First Bristol Loans in Bristol, Virginia and a mortgage loan operation in Knox County, Tennessee. These functions and operations are defined as Bank branches but are not considered to be full service branches.

The Bank also conducts separate businesses through three wholly owned subsidiaries. Through Superior Financial Services, Inc. (Superior Financial), the Bank operates 9 consumer finance company offices located in Greene, Blount, Hamblen, Washington, Sullivan, Sevier, Knox and Bradley Counties, Tennessee. The Bank also operates a mortgage banking operation through its main office in Knox County, Tennessee and it also has representatives located throughout the Company s branch system. Through GCB Acceptance Corporation (GCB Acceptance), the Bank operates a sub-prime automobile lending company with a sole office in Johnson City, Tennessee. Through Fairway Title Co., the Bank operates a title company headquartered in Knoxville, Tennessee.

Deposits of the Bank are insured by the Bank Insurance Fund (BIF) of the Federal Deposit Insurance Corporation (FDIC) to a maximum of $100,000 for each insured depositor. The Bank is subject to supervision and regulation by the Tennessee Department of Financial Institutions (the Banking Department) and the FDIC. See Regulation, Supervision and Governmental Policy.

On November 21, 2003, the Company entered the Middle Tennessee market by completing its acquisition of Gallatin, Tennessee-based Independent Bankshares Corporation (IBC). IBC was the bank holding company for First Independent Bank, which had four offices in Gallatin and Hendersonville, Tennessee, and Rutherford Bank and Trust, with three offices in Murfreesboro and Smyrna, Tennessee. First Independent Bank and Rutherford Bank and Trust were subsequently merged with the Bank, with the Bank as the surviving entity. Consideration in the transaction included the issuance of 836,114 shares of the Company s common stock and payment of approximately $9,060 in cash and $198 in stock options in exchange for all outstanding IBC common stock. The Company now has 7,661,635 common shares outstanding.

Growth and Business Strategy

The Company expects that, over the intermediate term, its growth from mergers and acquisitions, including acquisitions of both entire financial institutions and selected branches of financial institutions, will continue. De novo branching will also be a method of growth, particularly in high-growth and other demographically-desirable markets.

The Company s strategic plan outlines a geographic expansion policy within a 300-mile radius of its major markets. This policy could result in the Company expanding westward and eastward up to and including Nashville, Tennessee and Roanoke, Virginia, respectively, east/southeast up to and including the Piedmont area of North Carolina and western North Carolina, southward to northern Georgia and northward into eastern and central Kentucky. In particular, the Company believes the markets in and around Knoxville and Nashville, Tennessee are highly desirable areas with respect to expansion and growth plans.

In addition to the Company s business model, which is summarized in the paragraphs above entitled The Company and The Bank , the Company is continuously investigating and analyzing other lines and areas of business. These include, but are not limited to, various types of insurance, real estate activities, etc. Conversely, the Company frequently evaluates and analyzes the profitability, risk factors and viability of its various business lines and segments and, depending upon the results of these evaluations and analyses, may conclude to exit certain segments and/or business lines. Further, in conjunction with these ongoing evaluations and analyses, the Company may decide to sell, merge or close certain branch facilities.

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Lending Activities

General. The loan portfolio of the Company is composed of commercial, commercial and residential real estate and installment consumer loans. Such loans are primarily originated within the Company s market areas of East and Middle Tennessee and are generally secured by residential or commercial real estate or business or personal property located in the counties of Greene, Washington, Hamblen, Sullivan, Hawkins, Blount, Knox, McMinn, Loudon, Monroe, Cocke, Sumner and Rutherford Counties, Tennessee.

Loan Composition. The following table sets forth the composition of the Company s loans at December 31 for each of the periods indicated.

	2003	2002	2001	2000	1999
Commercial	$134,823	$ 93,836	$ 96,122	$ 87,680	$ 68,793
Commercial real estate	445,104	342,407	295,002	288,254	242,574
Residential real estate	295,528	233,128	210,489	218,007	181,960
Loans held for sale	3,546	6,646	7,945	1,725	1,210
Consumer	81,624	77,644	80,314	74,882	59,508
Other	6,134	14,938	13,779	12,493	16,774
Total	966,759	768,599	703,651	683,041	570,819
Less:					
Unearned Income	(10,988)	(11,696)	(13,159)	(14,248)	(13,590)
Allowance for loan losses	(14,564)	(12,586)	(11,221)	(11,728)	(10,332)
Net loans	$941,207	$744,317	$679,271	$657,065	$546,897

Loan Maturities. The following table reflects at December 31, 2003 the dollar amount of loans maturing based on their contractual terms to maturity. Demand loans, loans having no stated schedule of repayments and loans having no stated maturity are reported as due in one year or less.

	Due in One Year or Less	Due After One Year Through Five Years	Due After Five Years	Total
Commercial	$ 89,801	$ 40,723	$ 4,299	$134,823
Commercial real estate	174,313	232,284	38,507	445,104
Residential real estate	47,273	94,109	154,146	295,528

Loans held-for-sale	3,546			3,546
Consumer	18,075	62,478	1,071	81,624
Other	4,482	1,411	241	6,134
Total	$337,490	$ 431,005	$198,264	$966,759

The following table sets forth the dollar amount of the loans maturing subsequent to the year ending December 31, 2004 distinguished between those with predetermined interest rates and those with floating, or variable, interest rates.

	Fixed Rate	**Variable Rate**	**Total**
Commercial	$ 30,027	$ 14,995	$ 45,022
Commercial real estate	162,427	108,364	270,791
Residential real estate	136,182	112,073	248,255
Loans held-for-sale			
Consumer	63,015	534	63,549
Other	1,180	472	1,652
Total	$392,831	$236,438	$629,269

Commercial Loans. Commercial loans are made for a variety of business purposes, including working capital, inventory and equipment and capital expansion. At December 31, 2003, commercial loans outstanding totaled $134,823, or 14.32%, of the Company s net loan portfolio. Such loans are usually amortized over one to seven years and generally mature within five years. Commercial loan applications must be supported by current financial information on the borrower and, where appropriate, by adequate collateral. Commercial loans are generally underwritten by addressing cash flow (debt service coverage), primary and secondary sources of repayment, financial strength of any guarantor, liquidity, leverage, management experience, ownership structure, economic conditions and industry-specific trends and collateral. The loan to value ratio depends on the type of collateral. Generally speaking, accounts receivable are financed at 70% of accounts receivable less than 90 days past due. If other collateral is taken to support the loan, the loan to value of accounts receivable may approach 85%. Inventory financing will range between 50% and 60% depending on the borrower and nature of inventory. The Company requires a first lien position for such loans. These types of loans are generally considered to be a higher credit risk than other loans originated by the Company.

Commercial Real Estate Loans. The Company originates commercial loans, generally to existing business customers, secured by real estate located in the Company s market area. At December 31, 2003, commercial real estate loans totaled $445,104, or 47.29%, of the Company s net loan portfolio. Such loans are usually amortized over 10 to 20 years, generally mature within five years and are priced based in part upon the prime rate, as reported in *The Wall Street Journal*. Commercial real estate loans are generally underwritten by addressing cash flow (debt service coverage), primary and secondary source of repayment, financial strength of any guarantor, strength of the tenant (if any), liquidity, leverage, management experience, ownership structure, economic conditions and industry specific trends and collateral. Generally, the Company will loan up to 80-85% of the value of improved property, 65% of the value of raw land and 75% of the value of land to be acquired and developed. A first lien on the property and assignment of lease is required if the collateral is rental property, with second lien positions considered on a case-by-case basis.

Residential Real Estate. The Company also originates one-to-four family, owner-occupied residential mortgage loans secured by property located in the Company s primary market area. The majority of the Company s residential mortgage loans consists of loans secured by owner-occupied, single-family residences. At December 31, 2003, the Company had $295,528, or 31.40%, of its net loan portfolio in residential real estate loans. Residential real estate loans generally have a loan-to-value ratio of 85%. These loans are underwritten by giving consideration to the ability to pay, stability of employment or source of income, credit history and loan-to-value ratio. Home equity loans make up approximately 26% of residential real estate loans. Home equity loans may have higher loan-to-value ratios when the borrower s repayment capacity and credit history conform to underwriting standards. Superior Financial extends sub-prime mortgages to borrowers who generally have a higher risk of default than mortgages extended by the Bank. Sub-prime mortgages totaled $12,213, or 4.13%, of the Company s residential real estate loans.

The Company sells most of its one-to-four family mortgage loans in the secondary market to Freddie Mac and other mortgage investors through the Bank s mortgage banking operation. Sales of such loans to Freddie Mac and other mortgage investors totaled $78,478 during 2003 and the related mortgage servicing rights were sold together with the loans.

Installment Consumer Loans. At December 31, 2003, the Company s installment consumer loan portfolio totaled $81,624, or 8.67%, of the Company s total net loan portfolio. The Company s consumer loan portfolio is composed of secured and unsecured loans originated by the Bank, Superior Financial and GCB Acceptance. The consumer loans of the Bank have a higher risk of default than other loans originated by the Bank. Further, consumer loans originated by Superior Financial and GCB Acceptance, which are finance companies rather than a bank, generally have a greater risk of default than such loans originated by commercial banks and, accordingly, carry a higher interest rate. Superior Financial and GCB Acceptance installment consumer loans totaled approximately $31,744, or 38.89%, of the Company s installment consumer loans. The performance of consumer loans will be affected by the local and regional economy as well as the rates of personal bankruptcies, job loss, divorce and other individual-specific characteristics.

Past Due, Special Mention, Classified and Non-Accrual Loans. The Company classifies its problem loans into three categories: past due loans, special mention loans and classified loans (both accruing and non-accruing interest).

When management determines that a loan is no longer performing, and that collection of interest appears doubtful, the loan is placed on non-accrual status. All loans that are 90 days past due are considered non-accrual unless they are adequately secured and there is reasonable assurance of full collection of principal and interest. Management closely monitors all loans that are contractually 90 days past due, treated as special mention or otherwise classified or on non-accrual status. Non-accrual loans that are 120 days past due without assurance of repayment are charged off against the allowance for loan losses.

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The following table sets forth information with respect to the Company s non-performing assets at the dates indicated. At these dates, the Company did not have any restructured loans within the meaning of Statement of Financial Accounting Standards No. 15.

	At December 31,				
	2003	2002	2001	2000	1999
Loans accounted for on a non-accrual basis	$4,305	$ 7,475	$5,857	$4,813	$2,952
Accruing loans which are contractually past due 90 days or more as to interest or principal payments	224	307	871	475	996
Total non-performing loans	4,529	7,782	6,728	5,288	3,948
Real estate owned:					
Foreclosures	3,599	4,805	2,589	1,937	1,546
Other real estate held and repossessed assets	627	767	623	350	826
Total non-performing assets	$8,755	$13,354	$9,940	$7,575	$6,320

The Company s continuing efforts to resolve non-performing loans occasionally include foreclosures, which result in the Company s ownership of the real estate underlying the mortgage. If non-accrual loans at December 31, 2003 had been current according to their original terms and had been outstanding throughout 2003, or since origination if originated during the year, interest income on these loans would have been approximately $507. Interest actually recognized on these loans during 2003 was not significant.

Foreclosed real estate decreased $1,206, or 25.10%, to $3,599 at December 31, 2003 from $4,805 at December 31, 2002. The real estate consists of 30 properties, of which three are commercial properties with a carrying value of $2,050, and 27 are residential properties with a carrying value of $1,549. Management expects to liquidate these properties during 2004. Management has recorded these properties at fair value less estimated selling cost and the subsequent sale of such properties is not expected to result in any adverse effect on the Company, subject to business and marketing conditions at the time of sale. Other repossessed assets decreased $140, or 18.25%, to $627 at December 31, 2003 from $767 at December 31, 2002. This decrease is primarily due to improved repossession results at Superior Financial and GCB Acceptance.

Total impaired loans increased by $1,075, or 11.25%, from $9,557 at December 31, 2002 to $10,632 at December 31, 2003. This increase is primarily reflective of additional impaired loans in the Bank resulting primarily from loans obtained via the IBC acquisition.

At December 31, 2003, the Company had approximately $6,354 in loans that are not currently classified as non-accrual or 90 days past due or otherwise restructured but which known information about possible credit problems of borrowers caused management to have concerns as to the ability of the borrowers to comply with present loan repayment terms. Such loans were considered classified by the Company and were composed primarily of various commercial, commercial real estate and consumer loans. These loans are adequately secured and management does not expect any material loss.

Allowance for Loan Losses. The allowance for loan losses is maintained at a level which management believes is adequate to absorb all probable losses on loans then present in the loan portfolio. The amount of the allowance is affected by: (1) loan charge-offs, which decrease the allowance; (2) recoveries on loans previously charged-off, which increase the allowance; and (3) the provision of possible loan losses charged to income, which increases the allowance. In determining the provision for possible loan losses, it is necessary for management to monitor fluctuations in the allowance resulting from actual charge-offs and recoveries, and to periodically review the size and composition of the loan portfolio in light of current and anticipated economic conditions in an effort to evaluate portfolio risks. If actual losses exceed the amount of the allowance for loan losses, earnings of the Company could be adversely affected. The amount of the provision is based on management s judgment of those risks. During the year ended December 31, 2003, the Company s provision for loan losses decreased by $1,290 to $5,775 as the Company adjusted the allowance for loan losses to a level it deemed adequate as of December 31, 2003.

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The following is a summary of activity in the allowance for loan losses for the periods indicated:

	Year Ended December 31,				
	2003	**2002**	**2001**	**2000**	**1999**
Balance at beginning of year	$12,586	$11,221	$11,728	$10,332	$10,253
Reserve acquired in acquisition	1,340				
Subtotal	13,926	11,221	11,728	10,332	10,253
Charge-offs:					
Commercial	(1,007)	(1,216)	(411)	(429)	(298)
Commercial real estate	(664)	(956)	(997)	(537)	(302)
Subtotal	(1,671)	(2,172)	(1,408)	(966)	(600)
Residential real estate	(745)	(740)	(669)	(800)	(407)
Consumer	(4,381)	(4,736)	(5,753)	(6,022)	(3,010)
Other					
Total charge-offs	(6,797)	(7,648)	(7,830)	(7,788)	(4,017)
Recoveries:					
Commercial	195	54	11	43	295
Commercial real estate	92	239	54	137	
Subtotal	287	293	65	180	295
Residential real estate	92	141	102	69	93
Consumer	1,281	1,514	1,197	926	575
Other					
Total recoveries	1,660	1,948	1,364	1,175	963
Net charge-offs	(5,137)	(5,700)	(6,466)	(6,613)	(3,054)
Provision for loan losses	5,775	7,065	5,959	8,009	3,133
Balance at end of year	$14,564	$12,586	$11,221	$11,728	$10,332
	.64%	.80%	0.94%	1.09%	0.60%

Ratio of net charge-offs to average loans outstanding, net of unearned discount, during the period					
Ratio of allowance for loan losses to non-performing loans	321.57%	161.73%	166.78%	221.79%	261.70%
Ratio of allowance for loan losses to total loans	1.51%	1.65%	1.61%	1.72%	1.81%

Breakdown of allowance for loan losses by category. The following table presents an allocation among the listed categories of the Company s allowance for loan losses at the dates indicated and the percentage of loans in each category to the total amount of loans at the respective year-ends.

	At December 31,									
	2003		2002		2001		2000		1999	
Balance at end of period applicable to:	**Amount**	**Percent of loan in each category to total loans**	**Amount**	**Percent of loan in each category to total loans**	**Amount(1)**	**Percent of loan in each category to total loans**	**Amount(1)**	**Percent of loan in each category to total loans**	**Amount(1)**	**Percent of loan in each category to total loans**
Commercial	$ 3,001	13.95%	$ 1,998	12.21%	$ 2,072	13.66%	$ 1,482	12.84%	$ 1,213	12.05%
Commercial real estate	4,737	46.04%	3,961	44.56%	3,144	41.93%	4,443	42.20%	3,705	42.50%
Residential real estate	2,037	30.57%	2,031	30.33%	1,951	29.91%	2,067	29.90%	1,802	29.83%
Loans held-for-sale	8	.37%	12	.86%	14	1.13%	4	0.25%	2	0.21%
Consumer	4,080	8.44%	4,153	10.10%	3,581	11.41%	3,268	12.98%	3,092	12.47%
Other	701	.63%	431	1.94%	459	1.96%	464	1.83%	518	2.94%
Totals	$14,564	100.00%	$12,586	100.00%	$11,221	100.00%	$11,728	100.00%	$10,332	100.00%

(1) Balances related to certain loan categories have been reclassified in prior years to reflect revised allocation methods used in 2002.

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Investment Activities

General. The Company maintains a portfolio of investments to provide liquidity and an additional source of income.

Securities by Category. The following table sets forth the carrying value of the securities, by major categories, held by the Company at December 31, 2003, 2002 and 2001.

	At December 31,		
	2003	2002	2001
Securities Held to Maturity:			
U.S. Treasury securities and obligations of U.S. Government, corporations and agencies	$ 748		
Obligations of state and political subdivisions	4,136	$ 448	$ 833
Corporate Securities	748		
Total	$ 5,632	$ 448	$ 833
Securities Available for Sale:			
U.S. Treasury securities and obligations of U.S. Government, corporations and agencies	$24,720	$25,769	$20,695
Obligations of state and political subdivisions	1,880	1,053	1,372
Trust Preferred Securities	6,599	6,500	6,500
Total	$33,199	$33,322	$28,567

Maturity Distributions of Securities. The following table sets forth the distributions of maturities of securities at amortized cost as of December 31, 2003.

	Due in One Year or Less	Due After One Year through Five Years	Due After Five Years through 10 Years	Due After 10 Years	Total
Federal agency obligations available for sale	$ 6	$ 14,686	$ 5,523	$ 4,369	$24,584
Federal agency obligations held to maturity		748			748

Obligations of state and political subdivisions available for sale		820	995		1,815
Obligations of state and political subdivisions held to maturity	300	1,676	1,810	350	4,136
Other securities available for sale				6,500	6,500
Other securities held to maturity			748		748
Subtotal	$ 306	$ 17,930	$ 9,076	$ 11,219	$38,531
Market value adjustment on available-for-sale securities		66	67	167	300
Total	$ 306	$ 17,996	$ 9,143	$ 11,386	$38,831
Weighted average yield (a)	7.20%	3.37%	4.58%	4.98%	4.18%

(a) Actual yields on tax-exempt obligations do not differ materially from yields computed on a tax equivalent basis.

Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

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Deposits

Deposits are the primary source of funds for the Company. Such deposits consist of checking accounts, regular savings deposits, NOW accounts, Money Market Accounts and market rate Certificates of Deposit. Deposits are attracted from individuals, partnerships and corporations in the Company s market area. In addition, the Company obtains deposits from state and local entities and, to a lesser extent, U.S. Government and other depository institutions. The Company s policy permits the acceptance of limited amounts of brokered deposits.

The following table sets forth the average balances and average interest rates based on daily balances for deposits for the periods indicated.

	Year Ended December 31,					
	2003		2002		2001	
	Average Balance	Average Rate Paid	Average Balance	Average Rate Paid	Average Balance	Average Rate Paid
Types of deposits (all in domestic offices):						
Non-interest-bearing demand deposits	$ 73,432		$ 63,373		$ 49,773	
Interest-bearing demand deposits	225,508	.61%	217,249	1.06%	162,917	2.00%
Savings deposits	54,857	.36%	51,854	.95%	45,137	1.80%
Time deposits	384,836	2.87%	344,059	3.62%	375,825	5.47%
Total deposits	$738,633		$676,535		$633,652	

The following table indicates the amount of the Company s certificates of deposit of $100,000 or more by time remaining until maturity as of December 31, 2003.

Maturity Period	Certificates of Deposits
Three months or less	$ 49,748
Over three through six months	22,612
Over six through twelve months	40,843
Over twelve months	20,100
Total	$133,303

Competition

To compete effectively, the Company relies substantially on local commercial activity; personal contacts by its directors, officers, other employees and shareholders; personalized services; and its reputation in the communities it serves.

According to data as of June 30, 2003 published by SNL Financial LC and using information from the FDIC, the Bank ranked as the largest independent commercial bank headquartered in East Tennessee, and its major market areas include Greene, Hamblen, Hawkins, Sullivan, Washington, Madison, Loudon, Blount, Knox, McMinn, Sumner and Rutherford Counties, Tennessee and portions of Cocke, Monroe and Jefferson Counties, Tennessee. In Greene County, there were seven commercial banks and one savings bank, operating 22 branches and holding an aggregate of approximately $800 million in deposits as of June 30, 2003. The Bank had a 35.3% deposit share in Greene County as of June 30, 2003, according to data published by SNL Financial LC.

Under the federal Bank Holding Company Act of 1956 (the Holding Company Act), as amended by the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the Riegle-Neal Act), Tennessee banks and their holding companies may be acquired by out-of-state banks or their holding companies, and Tennessee banks and their holding companies may acquire out-of-state banks without regard to whether the transaction is prohibited by the laws of any state. In addition, the federal banking agencies may approve interstate merger transactions without regard to whether such transactions are prohibited by the law of any state, unless the home state of one of the banks opts out of the Riegle-Neal Act by adopting a law that applies equally to all out-of-state banks and expressly prohibits merger transactions involving out-of-state banks. The effect of the Riegle-Neal Act may be to

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increase competition within the state of Tennessee among banking institutions located in Tennessee and from banking companies located anywhere in the country.

Employees

As of December 31, 2003 the Company employed 451 full-time equivalent employees. None of the Company s employees are presently represented by a union or covered under a collective bargaining agreement. Management considers relations with employees to be good.

Regulation, Supervision and Governmental Policy

The following is a brief summary of certain statutes, rules and regulations affecting the Company and the Bank. A number of other statutes and regulations have an impact on their operations. The following summary of applicable statutes and regulations does not purport to be complete and is qualified in its entirety by reference to such statutes and regulations.

Bank Holding Company Regulation. The Company is registered as a bank holding company under the Holding Company Act and, as such, is subject to supervision, regulation and examination by the Board of Governors of the Federal Reserve Board (the FRB).

Acquisitions and Mergers. Under the Holding Company Act, a bank holding company must obtain the prior approval of the FRB before (1) acquiring direct or indirect ownership or control of any voting shares of any bank or bank holding company if, after such acquisition, the bank holding company would directly or indirectly own or control more than 5% of such shares; (2) acquiring all or substantially all of the assets of another bank or bank holding company; or (3) merging or consolidating with another bank holding company. Also, any company must obtain approval of the FRB prior to acquiring control of the Company or the Bank. For purposes of the Holding Company Act, control is defined as ownership of more than 25% of any class of voting securities of the Company or the Bank, the ability to control the election of a majority of the directors, or the exercise of a controlling influence over management or policies of the Company or the Bank.

The Holding Company Act, as amended by the Riegle-Neal Act, generally permits the FRB to approve interstate bank acquisitions by bank holding companies without regard to any prohibitions of state law. See Competition.

The Change in Bank Control Act and the related regulations of the FRB require any person or persons acting in concert (except for companies required to make application under the Holding Company Act), to file a written notice with the FRB before such person or persons may acquire control of the Company or the Bank. The Change in Bank Control Act defines control as the power, directly or indirectly, to vote 25% or more of any voting securities or to direct the management or policies of a bank holding company or an insured bank.

Bank holding companies like the Company are currently prohibited from engaging in activities other than banking and activities so closely related to banking or managing or controlling banks as to be a proper incident thereto. The FRB s regulations contain a list of permissible nonbanking activities that are closely related to banking or managing or controlling banks. A bank holding company must file an application or notice with the FRB prior to acquiring more than 5% of the voting shares of a company engaged in such activities. The Gramm-Leach-Bliley Act of 1999 (the GLB Act), however, greatly broadened the scope of activities permissible for bank holding companies. Effective March 11, 2000, the GLB Act permits bank holding companies, upon classification as financial holding companies, to engage in a broad variety of activities financial in nature.

Capital Requirements. The Company is also subject to FRB guidelines that require bank holding companies to maintain specified minimum ratios of capital to total assets and capital to risk-weighted assets. See Capital Requirements.

Dividends. The FRB has the power to prohibit dividends by bank holding companies if their actions constitute unsafe or unsound practices. The FRB has issued a policy statement expressing its view that a bank holding company should pay cash dividends only to the extent that the company s net income for the past year is sufficient to cover both the cash dividends and a rate of earnings retention that is consistent with the company s capital needs, asset quality, and overall financial condition. The Company does not believe compliance with this policy statement will limit the Company s activity to maintain its dividend payment rate.

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Support of Banking Subsidiaries. Under FRB policy, the Company is expected to act as a source of financial strength to its banking subsidiaries and, where required, to commit resources to support each of such subsidiaries. Further, if the Bank s capital levels were to fall below minimum regulatory guidelines, the Bank would need to develop a capital plan to increase its capital levels and the Company would be required to guarantee the Bank s compliance with the capital plan in order for such plan to be accepted by the federal regulatory authority.

Under the cross guarantee provisions of the Federal Deposit Insurance Act (the FDI Act), any FDIC-insured subsidiary of the Company such as the Bank could be liable for any loss incurred by, or reasonably expected to be incurred by, the FDIC in connection with (i) the default of any other FDIC-insured subsidiary also controlled by the Company or (ii) any assistance provided by the FDIC to any FDIC-insured subsidiary of the Company in danger of default.

Transactions with Affiliates. The Federal Reserve Act imposes legal restrictions on the quality and amount of credit that a bank holding company or its non-bank subsidiaries (affiliates) may obtain from bank subsidiaries of the holding company. For instance, these restrictions generally require that any such extensions of credit by a bank to its affiliates be on nonpreferential terms and be secured by designated amounts of specified collateral. Further, a bank s ability to lend to its affiliates is limited to 10% per affiliate (20% in the aggregate to all affiliates) of the bank s capital and surplus.

Bank Regulation. As a Tennessee banking institution, the Bank is subject to regulation, supervision and regular examination by the Tennessee Department of Financial Institutions. The deposits of the Bank are insured by the FDIC to the maximum extent provided by law (a maximum of $100,000 for each insured depositor). Tennessee and federal banking laws and regulations control, among other things, required reserves, investments, loans, mergers and consolidations, issuance of securities, payment of dividends, and establishment of branches and other aspects of the Bank s operations. Supervision, regulation and examination of the Company and the Bank by the bank regulatory agencies are intended primarily for the protection of depositors rather than for holders of the Common Stock of the Company.

Extensions of Credit. Under joint regulations of the federal banking agencies, including the FDIC, banks must adopt and maintain written policies that establish appropriate limits and standards for extensions of credit that are secured by liens or interests in real estate or are made for the purpose of financing permanent improvements to real estate. These policies must establish loan portfolio diversification standards, prudent underwriting standards, including loan-to-value limits that are clear and measurable, loan administration procedures and documentation, approval and reporting requirements. A bank s real estate lending policy must reflect consideration of the Interagency Guidelines for Real Estate Lending Policies (the Interagency Guidelines) that have been adopted by the federal bank regulators. The Interagency Guidelines, among other things, call upon depository institutions to establish internal loan-to-value limits for real estate loans that are not in excess of the loan-to-value limits specified in the Guidelines for the various types of real estate loans. The Interagency Guidelines state that it may be appropriate in individual cases to originate or purchase loans with loan-to-value ratios in excess of the supervisory loan-to-value limits. The aggregate amount of loans in excess of the supervisory loan-to-value limits, however, should not exceed 100% of total capital and the total of such loans secured by commercial, agricultural, multifamily and other non-one-to-four family residential properties should not exceed 30% of total capital.

Federal Deposit Insurance. The Bank is subject to FDIC deposit insurance assessments. The FDIC has established a risk-based deposit insurance assessment system for insured depository institutions, under which insured institutions are assigned assessment risk classifications based upon capital levels and supervisory evaluations. Insurance assessment rates for BIF-insured banks such as the Bank depend on the capital category and supervisory category to which a bank is assigned and currently range from $0.00 to $0.27 per $100 of insured deposits.

Safety and Soundness Standards. The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) required the federal bank regulatory agencies to prescribe, by regulation, non-capital safety and soundness standards for all insured depository institutions and depository institution holding companies. The FDIC and the other federal banking agencies have adopted guidelines prescribing safety and soundness standards pursuant to FDICIA. The safety and soundness guidelines establish general standards relating to internal controls and information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, and compensation, fees and benefits. Among other things, the guidelines require banks to maintain appropriate systems and practices to identify and manage risks and exposures identified in the guidelines.

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Capital Requirements. The FRB has established guidelines with respect to the maintenance of appropriate levels of capital by registered bank holding companies, and the FDIC has established similar guidelines for state-chartered banks that are not members of the FRB. The regulations of the FRB and FDIC impose two sets of capital adequacy requirements: minimum leverage rules, which require the maintenance of a specified minimum ratio of capital to total assets, and risk-based capital rules, which require the maintenance of specified minimum ratios of capital to risk-weighted assets. At December 31, 2003, the Company and the Bank satisfied the minimum required regulatory capital requirements. See Note 11 of Notes to Consolidated Financial Statements.

The FDIC has issued final regulations that classify insured depository institutions by capital levels and require the appropriate federal banking regulator to take prompt action to resolve the problems of any insured institution that fails to satisfy the capital standards. Under such regulations, a well-capitalized bank is one that is not subject to any regulatory order or directive to meet any specific capital level and that has or exceeds the following capital levels: a total risk-based capital ratio of 10%, a Tier 1 risk-based capital ratio of 6%, and a leverage ratio of 5%. As of December 31, 2003, the Bank was well-capitalized as defined by the regulations. See Note 11 of Notes to Consolidated Financial Statements for further information.

Legislative, Legal and Regulatory Developments: The banking industry is generally subject to extensive regulatory oversight. The Company, as a publicly held bank holding company, and the Bank, as a state-chartered bank with deposits insured by the FDIC, are subject to a number of laws and regulations. Many of these laws and regulations have undergone significant change in recent years. These laws and regulations impose restrictions on activities, minimum capital requirements, lending and deposit restrictions and numerous other requirements. Future changes to these laws and regulations, and other new financial services laws and regulations, are likely and cannot be predicted with certainty. Future legislative or regulatory change, or changes in enforcement practices or court rulings, may have a dramatic and potentially adverse impact on the Company and its bank and other subsidiaries.

FDIC. The FDIC and members of the United States Congress have recently proposed new legislation that would reform the bank deposit insurance system. This reform could merge BIF and SAIF insurance funds, increase the deposit insurance coverage limits and index future coverage limitations, among other changes. Most significantly, reform proposals could allow the FDIC to raise or lower (within certain limits) the currently mandated designated reserve ratio requiring the FDIC to maintain a 1.25% reserve ratio ($1.25 against $100 of insured deposits), and require certain changes in the calculation methodology. Although it is too early to predict the ultimate impact of such proposals, they could, if adopted, result in the imposition of new deposit insurance premium costs on the Company.

USA Patriot Act. The President of the United States signed the USA Patriot Act (USA-PA), into law on October 26, 2001. The USA-PA establishes a wide variety of new and enhanced ways of combating international terrorism. The provisions that affect national banks (and other financial institutions) most directly are contained in Title III of the act. In general, Title III amends current law - primarily the Bank Secrecy Act - to provide the Secretary of Treasury (Treasury) and other departments and agencies of the federal government with enhanced authority to identify, deter, and punish international money laundering and other crimes.

Among other things, the USA-PA prohibits financial institutions from doing business with foreign shell banks and requires increased due diligence for private banking transactions and correspondent accounts for foreign banks. In addition, financial institutions will have to follow new minimum verification of identity standards for all new accounts and will be permitted to share information with law enforcement authorities under circumstances that were not previously permitted. These and other provisions of the USA-PA became effective at varying times and the Treasury and various federal banking agencies are responsible for issuing regulations to implement the new law.

Additional Information

The Company maintains a website at www.mybankconnection.com and is not including the information contained on this website as a part of, or incorporating it by reference into, this Annual Report on Form 10-K. The Company makes available free of charge (other than an investor s own internet access charges) through its website its Annual Report on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K, and amendments to these reports, as soon as reasonably practicable after the Company electronically files such material with, or furnishes such material to, the SEC.

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ITEM 2. PROPERTIES

At December 31, 2003, the Company maintained a main office in Greeneville, Tennessee and 39 bank branches (of which seven are in leased operating premises) and 10 separate locations operated by the Bank s subsidiaries.

ITEM 3. LEGAL PROCEEDINGS

From time to time, the Company and its subsidiaries are parties to various legal proceedings incident to its business. At December 31, 2003, there were no legal proceedings which management anticipates would have a material adverse effect on the Company.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted during the fourth quarter of 2003 to a vote of security holders of the Company through a solicitation of proxies or otherwise.

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PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

On March 10, 2004, Greene County Bancshares had 7,661,635 shares of common stock outstanding. The Company s shares began trading on the Nasdaq National Market on October 1, 2002, under the symbol GCBS. Prior to that time, there was no established trading market for the Company s Stock. As of March 10, 2004, the Company estimates that it had approximately 2,760 shareholders, including approximately 2,150 shareholders of record and approximately 610 beneficial owners holding shares in nominee or street name.

Since October 1, 2002, the Company s common stock has been traded on the Nasdaq National Market System. Prior to that time there was no established trading market for the Company s common stock. The following table shows the high and low bid price information for the Company s common stock on the Nasdaq National Market for 2003 and that period of 2002 during which the common stock was traded on the Nasdaq National Market. For the period prior to October 1, 2002, there was no established public trading market for the Company s common stock nor were there any uniformly quoted prices for such shares. Management was therefore unable to determine the high and low bid prices for each quarter in that period on a consistent and reliable basis. Accordingly, quarter end sales prices, which management believes are the best pricing information available prior to the listing on the Nasdaq National Market, are set forth below for the period prior to October 1, 2002. The table also sets forth the dividends per share paid each quarter during 2003 and 2002.

	Sales Price at Quarter-End	**High/Low Bid Price During Quarter(1)**	**Dividends Declared Per Share(1)**
2003:			
First quarter	$	$ 25.87/18.46	$ 0.12
Second quarter		32.00/18.87	0.12
Third quarter		27.01/20.12	0.12
Fourth quarter		25.99/22.00	0.23
			$ 0.59
2002:			
First quarter	$ 16.00	$	$ 0.12
Second quarter	16.50		0.12
Third quarter	16.50		0.12
Fourth quarter		19.75/16.90	0.22
			$ 0.58

(1) For information regarding restrictions on the payment of dividends by the Bank to the Company, see Management s Discussion and Analysis of Financial Condition and Results of Operation Liquidity and Capital Resources in this Annual Report. See also Note 11 of Notes to Consolidated Financial Statements.

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ITEM 6. SELECTED FINANCIAL DATA

	2003	2002	2001	2000	1999
			(Dollars in Thousands)		
Total interest income	$ 56,737	$ 59,929	$ 67,964	$ 67,696	$ 55,229
Total interest expense	15,914	18,680	28,463	29,143	19,742
Net interest income	40,823	41,249	39,501	38,553	35,487
Provision for loan losses	(5,775)	(7,065)	(5,959)	(8,009)	(3,133)
Net interest income after provision for loan losses	35,048	34,184	33,542	30,544	32,354
Non-interest income:					
Investment securities gains		46			
Other income	11,588	10,484	9,593	6,568	6,331
Non-interest expense	(30,618)	(29,199)	(28,665)	(29,393)	(24,610)
Income before income taxes	16,018	15,515	14,470	7,719	14,075
Income tax expense	(5,781)	(5,702)	(5,047)	(2,206)	(5,250)
Net income	$ 10,237	$ 9,813	$ 9,423	$ 5,513	$ 8,825
Per Share Data:[1]					
Net income, basic	$ 1.48	$ 1.44	$ 1.38	$ .81	$ 1.30
Net income, assuming dilution	$ 1.47	$ 1.43	$ 1.38	$ .80	$ 1.29
Dividends declared	$ .59	$ .58	$ 0.56	$ 0.55	$ 0.52
Book value	$ 13.31	$ 10.94	$ 10.06	$ 9.24	$ 8.94
Tangible book value[2]	$ 10.57	$ 10.53	$ 9.64	$ 9.01	$ 8.67
Financial Condition Data:					
Assets	$1,108,522	$899,396	$811,612	$789,117	$656,012
Loans, net	$ 941,207	$744,317	$679,271	$657,065	$546,897
Cash and investments	$ 80,910	$ 61,980	$ 57,470	$ 76,816	$ 72,223
Federal funds sold	$ 5,254	$ 39,493	$ 25,621	$ 8,130	$
Deposits	$ 907,115	$719,323	$653,913	$648,641	$522,382
Notes Payable	$ 63,030	$ 82,359	$ 67,978	$ 59,949	$ 46,309
Subordinated debentures	$ 10,310	$	$	$	$
Federal funds purchased and repurchase agreements	$ 12,896	$ 10,038	$ 10,375	$ 4,713	$ 14,581
Shareholders equity	$ 101,935	$ 74,595	$ 68,627	$ 63,010	$ 60,772
Tangible shareholders equity[2]	$ 80,965	$ 71,799	$ 65,721	$ 61,413	$ 58,908
Selected Ratios:					

Interest rate spread	4.59%	4.99%	4.98%	5.18%	5.90%
Net yield on interest-earning assets	4.83%	5.29%	5.41%	5.67%	6.39%
Return on average assets	1.12%	1.17%	1.20%	0.75%	1.47%
Return on average equity	12.59%	13.40%	13.96%	8.58%	14.90%
Return on average tangible equity[2]	13.38%	13.93%	14.30%	8.82%	15.38%
Average equity to average assets	8.87%	8.72%	8.59%	8.78%	9.89%
Dividend payout ratio	41.20%	40.31%	40.53%	68.22%	40.02%
Ratio of nonperforming assets to total assets assets	0.79%	1.48%	1.22%	0.96%	0.96%
Ratio of allowance for loan losses to Nonperforming assets	166.35%	94.24%	112.89%	154.83%	163.48%
Ratio of allowance for loan losses to total loans loans	1.51%	1.65%	1.61%	1.72%	1.81%

1 Amounts have been restated to reflect the effect of the Company s five-for-one stock split effected May 2001.

2 Tangible shareholders equity is shareholders equity less goodwill and intangible assets.

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ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Critical Accounting Policies and Estimates

The Company s consolidated financial statements and accompanying notes have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reported periods.

Management continually evaluates the Company s accounting policies and estimates it uses to prepare the consolidated financial statements. In general, management s estimates are based on historical experience, information from regulators and third party professionals and various assumptions that are believed to be reasonable under the facts and circumstances. Actual results could differ from those estimates made by management.

The Company believes its critical accounting policies and estimates include the valuation of the allowance for loan losses and the fair value of financial instruments and other accounts. Based on management s calculation, an allowance of $14,564, or 1.51%, of total loans was an adequate estimate of losses within the loan portfolio as of December 31, 2003. This estimate resulted in a provision for loan losses on the income statement of $5,775 during 2003. If the mix and amount of future charge-off percentages differ significantly from those assumptions used by management in making its determination, the allowance for loan losses and provision for loan losses on the income statement could be materially affected. For further discussion of the allowance for loan losses and a detailed description of the methodology management uses in determining the adequacy of the allowance, see BUSINESS Lending Activities Allowance for Loan Losses located earlier, and Changes in Results of Operations Provision for Loan Losses located below.

The consolidated financial statements include certain accounting and disclosures that require management to make estimates about fair values. Estimates of fair value are used in the accounting for securities available for sale, loans held for sale, goodwill, other intangible assets, and acquisition purchase accounting adjustments. Estimates of fair values are used in disclosures regarding securities held to maturity, stock compensation, commitments, and the fair values of financial instruments. Fair values are estimated using relevant market information and other assumptions such as interest rates, credit risk, prepayments and other factors. The fair values of financial instruments are subject to change as influenced by market conditions.

Changes in Results of Operations

Net income. Net income for 2003 was $10,237, an increase of $424, or 4.32%, as compared to net income of $9,813 for 2002. The increase is primarily attributable to an increase in non-interest income of $1,058, or 10.05%, to $11,588 in 2003 from $10,530 in 2002 and a reduction of $1,290, or 18.26%, in the provision for loan losses to $5,775 in 2003 from $7,065 in 2002. Offsetting, in part, these positive effects on net income was an increase in non-interest expense of $1,419, or 4.86%, to $30,618 in 2003 from $29,199 in 2002. The increase in non-interest income resulted primarily from fees related to deposit products, as well as additional income from the Company s mortgage division. The reduction in the provision for loan losses resulted primarily from the decrease in the Company s non-performing assets during and as of the year ended December 31, 2003 as a result of improving credit quality in the Bank and Superior Financial. The increase in non-interest expense resulted principally from increases in communication/data transmission expenses, charges related to credit cards and various expenses related to collections and repossessions. As discussed in Business The Bank located earlier, the Company completed its acquisition of Gallatin-based IBC in November, 2003. As the acquisition was consummated quite late in the year, it did not have a material effect on the

Company s earnings for the year ended December 31, 2003.

Net income for 2002 was $9,813, an increase of $390, or 4.14%, as compared to net income of $9,423 for 2001. The increase is primarily attributable to an increase in net interest income of $1,748, or 4.43%, to $41,249 in 2002 from $39,501 in 2001 and an increase in noninterest income of $937, or 9.77%, to $10,530 in 2002 from $9,593 in 2001, offset, in part, by an increase of $1,106, or 18.56%, in the provision for loan losses to $7,065 in 2002 from $5,959 in 2001. The increase in net interest income primarily reflects an increased volume in loans and investment securities that more than offset the overall negative rate effect associated with the downward repricing of both the Company s interest-earning assets and interest-bearing liabilities. The increase in noninterest income resulted from the Company s continued emphasis on fee-based income, particularly in the non-deposit products and electronic banking areas. The increase in the provision for loan losses results primarily from the increase in the Company s non-performing assets during and as of the year ended December 31, 2002 as a result of declining credit quality in the Bank.

Net Interest Income. The largest source of earnings for the Company is net interest income, which is the difference between interest income on interest-earning assets and interest paid on deposits and other interest-bearing liabilities. The primary factors that affect net interest income are changes in volume and yields of earning assets and interest-bearing liabilities, which are affected in part by management s responses to changes in interest rates through asset/liability management. During 2003, net interest income was $40,823 as compared to $41,249 in 2002, a decrease of 1.03%. The Company experienced good growth in average balances of interest-earning assets, with average total interest-earning assets increasing by $65,514, or 8.40%, to $845,492 in 2003 from $779,978 in 2002. All of the growth occurred in loans, with average loan balances increasing by $85,412, or 11.94%, to $800,859 in 2003 from $715,447 in 2002. Average balances of other interest-earning assets declined, as the Company elected to channel some of its liquidity into higher-yielding loans. Average balances of total interest-bearing liabilities also increased in 2003 from 2002, with average total deposit balances increasing by $52,039, or 8.49%, to $665,201 in 2003 from $613,162 in 2002, as the Company emphasized various types of deposits as a loan funding source. The increase in average balances of interest-earning assets, offset, in part, by such increase in average balances of interest-bearing liabilities, would have increased net interest income significantly had the Company s net interest margin not continued to decline. However, due to the continued decline in short-term market rates during 2003 and the Company s aggressive loan pricing in order to obtain market share in new markets and increase share in existing markets, the Company s yield on average loans declined to 6.92% in 2003 from 8.09% in 2002. Further, due to the Company s asset sensitivity, a situation in which rate-sensitive assets reprice quicker than rate-sensitive liabilities, resulting in net interest margin compression in a declining rate environment, the Company s net interest margin declined to 4.83% in 2003 from 5.29% in 2002, representing the fifth consecutive year of net interest margin declines. In view of the Company s asset-sensitive position, management anticipates further declines in net interest margin if product mixes remain relatively unchanged and interest rates continue to decline. In addition, even if interest rates remain stable, the Company s net interest margin could decline slightly due to the anticipated continued downward adjustment in loans tied to market rates and the Company s inability to significantly reduce its liability costs.

Average Balances, Interest Rates and Yields. Net interest income is affected by (i) the difference between yields earned on interest-earning assets and rates paid on interest-bearing liabilities (interest rate spread) and (ii) the relative amounts of interest-earning assets and interest-bearing liabilities. The Company s interest rate spread is affected by regulatory, economic and competitive factors that influence interest rates, loan demand and deposit flows. When the total of interest-earning assets approximates or exceeds the total of interest-bearing liabilities, any positive interest rate spread will generate net interest income. An indication of the effectiveness of an institution s net interest income management is its net yield on interest-earning assets, which is net interest income divided by average interest-earning assets.

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The following table sets forth certain information relating to the Company s consolidated average interest-earning assets and interest-bearing liabilities and reflects the average yield on assets and average cost of liabilities for the periods indicated. Such yields and costs are derived by dividing income or expense by the average daily balance of assets or liabilities, respectively, for the periods presented.

	2003			2002			2001		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
Interest-earning assets:									
Loans[1]									
Real estate loans	$612,528	$37,311	6.09%	$535,037	$37,139	6.94%	$496,304	$41,219	8.31%
Commercial loans	105,629	5,532	5.24%	93,525	5,724	6.12%	98,260	7,789	7.93%
Consumer and other loans- net[2]	82,702	9,516	11.51%	86,885	10,233	11.78%	95,769	11,610	12.12%
Fees on loans		3,085			4,763			5,352	
Total loans (including fees)	$800,859	$55,444	6.92%	$715,447	$57,859	8.09%	$690,333	$65,970	9.56%
Investment securities[3]									
Taxable	$ 28,297	$ 946	3.34%	$ 37,790	$ 1,490	3.94%	$ 16,294	$ 1,010	6.20%
Tax-exempt[4]	1,189	40	3.37%	787	25	3.18%	1,973	87	4.41%
FHLB and Bankers Bank Stock	5,378	193	3.59%	4,615	209	4.53%	4,367	289	6.62%
Total investment securities	$ 34,864	$ 1,179	3.38%	$ 43,192	$ 1,724	3.99%	$ 22,634	$ 1,386	6.12%
Other short-term Investments	9,769	114	1.17%	21,339	346	1.62%	17,007	608	3.57%
Total interest-Earning assets	$845,492	$56,737	6.71%	$779,978	$59,929	7.68%	$729,974	$67,964	9.31%
Non-interest-earning assets:									
Cash and due from banks	$ 26,926			$ 22,615			$ 21,163		
Premises and equipment	27,879			25,776			25,092		

Other, less allowance for loan losses	16,190	11,669	9,567
Total non-interest-Earning assets	$ 70,995	$ 60,060	$ 55,822
Total Assets	$916,487	$840,038	$785,796

1 Average loan balances include nonaccrual loans. Interest income collected on nonaccrual loans has been included.

2 Installment loans are stated net of unearned income.

3 The average balance of and the related yield associated with securities available for sale are based on the cost of such securities.

4 Tax exempt income has not been adjusted to tax-equivalent basis since it is not material.

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	2003			2002			2001		
	Average Balance	**Interest**	**Average Rate**	**Average Balance**	**Interest**	**Average Rate**	**Average Balance**	**Interest**	**Average Rate**
Interest-bearing liabilities:									
Deposits									
Savings, NOW Accounts, and money markets	$280,365	$ 1,576	0.56%	$269,103	$ 2,803	1.04%	$208,054	$ 4,066	1.95%
Time deposits	384,836	11,055	2.87%	344,059	12,463	3.62%	375,825	20,557	5.47%
			&nbs						