SUMMIT BANCSHARES INC /TX/
Form 10-K
March 11, 2005

# 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, 2004** **Commission File Number 0-11986**

# SUMMIT BANCSHARES, INC.

**(Exact name of registrant as specified in its charter)**

| **Texas** | **75-1694807** |
|---|---|
| **(State or other jurisdiction of organization or incorporation)** | **(I.R.S. Employer Identification No.)** |

**3880 Hulen St., Fort Worth, Texas 76107**

**(Address of principal executive offices, including zip code)**

**(817) 336-6817**

**(Registrant s telephone number, including area code)**

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

**None**

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

**Common Stock, $1.25 Par Value, and attached Stock Purchase Rights**

**(Title of Class)**

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 | No |
|---|---|
| x | 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 the registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Annual Report on Form 10-K or any amendment to this Annual Report on Form 10-K. Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).

| Yes | No |
|---|---|
| x | o |

As of June 30, 2004, the last business day of the registrant s most recently completed second fiscal quarter, the aggregate market value of the shares of common stock of the registrant held by non-affiliates was approximately $151,983,000, based upon the closing price of $14.55 (as adjusted to reflect the two-for-one stock split effected on December 31, 2004) per share as reported on NASDAQ.

The number of shares of Common Stock outstanding at March 1, 2005 was 12,379,416 shares.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant s Proxy Statement, which will be filed within 120 days after December 31, 2004, pursuant to the Securities Exchange Act of 1934 in connection with the registrant s 2005 Annual Meeting of Shareholders are incorporated by reference into Part III of this Annual Report on Form 10-K.

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**SUMMIT BANCSHARES, INC.**
**ANNUAL REPORT ON FORM 10-K**

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## PART I

### ITEM 1. BUSINESS.

### GENERAL

Summit Bancshares, Inc. (the Corporation ) was incorporated under the laws of the state of Texas in 1979. The Corporation is a bank holding company registered under the Bank Holding Company Act of 1956, as amended (the BHC Act ), and became a financial holding company under the Gramm-Leach-Bliley Act (the GLB Act ) in February 2002. The Corporation maintains its principal executive offices at 3880 Hulen Street, Suite 300, Fort Worth, Texas 76107. At December 31, 2004, the Corporation had consolidated total assets of $989.1 million, consolidated total loans of $702.6 million, consolidated total deposits of $792.3 million and consolidated total shareholders equity of $74.5 million.

The Corporation s principal activity is the ownership and management of its direct and indirect wholly-owned subsidiaries, Summit Delaware Financial Corporation, Summit Bank, National Association (the Bank ) and SIA Insurance Agency, Inc. ( SIA ). The Corporation provides advice and services to the Bank and coordinates its activities in the areas of financial accounting controls and reports, internal audit programs, regulatory compliance, financial planning and employee benefit programs, although the Bank operates under the day-to-day management of its own officers and directors.

### PRODUCTS AND SERVICES

The products and services offered by the Corporation through its subsidiaries are generally those offered by commercial banks of comparable size, including:

***Commercial Banking Services.*** The Bank provides general commercial banking services for corporate and other business clients principally located in Tarrant County, Texas. Loans are made for a wide variety of purposes, including interim construction and mortgage financing on real estate and financing of equipment and inventories.

***Consumer Banking Services.*** The Bank provides a full range of consumer banking services, including interest and noninterest-bearing checking accounts, various savings programs, installment and real estate loans, money transfers, on-site ATM facilities and safe deposit facilities.

***Trust Services.*** The Bank provides a wide range of trust, investment, agency and custodial services for individual and corporate clients. These services include the administration of estates and personal trusts, as well as the management of investment accounts for individuals, employee benefit plans and charitable foundations. At December 31, 2004, the estimated fair value of trust assets was approximately $52.8 million, including managed assets of $38.4 million and custody assets of $14.4 million.

***Securities Services.*** The Corporation offers full-service brokerage services through an agreement with Raymond James Financial Services, Inc., including securities brokerage services relating to tax-free municipals, government securities, stocks, mutual funds and annuities, and asset management and financial planning services. Raymond James Financial Services, Inc. is a registered broker-dealer and a member of the National Association of Securities Dealers, Inc.

***Insurance Products and Services.*** SIA is a full-service insurance agency that provides commercial property and casualty insurance as well as life, health and disability insurance and benefits planning to the Corporation s existing and prospective commercial customers. These services are offered through an alignment the Corporation has established with local agencies Wm. Rigg Insurance Co. for property and casualty insurance and CSG/Hull Benefits, Inc. for life and benefits insurance.

### AVAILABLE INFORMATION

The Corporation s website is www.summitbank.net. The Corporation makes copies of its annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, and any amendments to those reports, publicly available free of charge through its website under the Investor Relations section as soon as reasonably practicable after it electronically files or furnishes such materials with the Securities and Exchange Commission (the SEC ). The Corporation also makes information relating to its corporate governance policies and practices publicly available free of charge through its website. Copies of the foregoing materials may also be obtained by written request to the Corporation at 3880 Hulen Street, Suite 300, Fort Worth, Texas 76107, Attention: Corporate Secretary.

### COMPETITION

The Corporation and its subsidiaries encounter intense competition for their products and services from bank holding companies and other financial institutions located in Tarrant County, Texas, including banks, savings and loan associations, credit unions, factors, insurance companies and commercial and captive finance companies, many of which are larger than the Corporation and its subsidiaries in terms of

capital, resources and personnel.

**EMPLOYEES**

As of December 31, 2004, the Corporation and the Bank collectively had a total of 242 full-time employees and 24 part-time employees.

**REGULATION AND SUPERVISION**

The Corporation and its subsidiaries are subject to federal and state laws applicable to financial institutions and businesses generally. This regulatory framework is intended primarily for the protection of depositors, federal deposit insurance funds and the banking system as a whole, and not for the protection of shareholders and creditors of the Corporation. The following summary of statutory and regulatory provisions is not intended to be a complete description of all of the statutes and regulations to which the Corporation and its subsidiaries are subject and is qualified in its entirety by reference to the applicable statutes and regulations. Any change in applicable statutes, regulations or policies of regulatory authorities could have a material effect on the business, results of operations and financial condition of the Corporation and its subsidiaries.

**The Corporation**

***General***. As a bank holding company and a financial holding company, the Corporation is subject to regulation under the BHC Act, the GLB Act and to inspection, supervision and examination by the Board of Governors of the Federal Reserve System (the FRB ). Under the BHC Act, the GLB Act and other federal laws, regulations and policies, the Corporation is subject to restrictions on the types of activities in which it may engage and is subject to regulatory enforcement actions for any violations of such laws, regulations and policies.

***Scope of Permissible Activities***. The BHC Act generally prohibits the Corporation from directly or indirectly engaging in, or from directly or indirectly acquiring 5.0% or more of any class of voting securities of any company engaged in any activities other than banking, managing or controlling banks or other activities determined by the FRB to be so closely related to banking as to be a proper incident thereto. Some activities that the FRB has determined to be closely related to banking include making or servicing loans, performing certain data processing services, acting as an investment or financial adviser and providing certain securities brokerage services.

The GLB Act amended the BHC Act in November 1999 to permit the creation of a financial holding company, a new type of bank holding company with powers exceeding those of a traditional bank holding company. As a financial holding company under the GLB Act, the Corporation may provide a wide variety of financial services previously reserved for insurance companies and securities firms, including services such as lending, investing for others, safeguarding money or securities, underwriting insurance, issuing annuities, acting as an insurance principal, agent or broker and providing financial or investment advice.

Under the GLB Act, the Corporation may also engage in, and acquire and retain shares of any company engaged in any activity that the FRB determines to be financial in nature or incidental thereto or complementary to a financial activity, provided that such activity does not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally. The GLB Act also generally permits the Corporation to invest in non-financial companies as a part of a bona fide underwriting or merchant or investment banking activities if it holds an investment only for a period of time to enable its sale or disposition on a reasonable basis consistent with the financial viability of the foregoing activities.

***Source of Strength to the Bank***. Under FRB regulations, the Corporation is expected to serve as a source of financial and managerial strength to the Bank and, under appropriate circumstances, commit resources to its support. This support may be required at times when the Corporation may not be able to provide such support. If the Corporation fails to meet its obligations to serve as a source of strength to the Bank, the FRB may find the Corporation to be engaged in an unsafe or unsound banking practice and in violation of FRB regulations.

***Restrictions on Payment of Dividends***. Under FRB regulations, the FRB has the authority to prohibit bank holding companies from engaging in activities that the FRB considers unsafe or unsound banking practices. Under certain circumstances, the FRB may take the position that payment of dividends by the Corporation would constitute an unsafe or unsound banking practice in light of the financial condition of the Corporation. Under FRB policies, a bank holding company should pay cash dividends on its common stock only out of income available over the past year and should not pay cash dividends if such payment would undermine its ability to serve as a source of strength to its banking subsidiaries. The Corporation s ability to pay cash dividends is further limited by its obligation to maintain adequate levels of capital in accordance with the FRB s capital adequacy guidelines. See Business - The Corporation - Capital Adequacy Requirements.

***Capital Adequacy Requirements***. The FRB has established guidelines to assess the capital adequacy of bank holding companies. The guidelines impose two sets of capital adequacy requirements on bank holding companies: (i) risk-based capital guidelines, which require bank holding companies to maintain a specified minimum ratio of qualifying total capital to risk-weighted assets, and (ii) leverage ratios, which require bank holding companies to maintain a specified minimum ratio of capital to total assets. Failure to comply with these capital adequacy guidelines could subject the Corporation to a variety of enforcement actions as well as certain limitations on its business, including, but not limited to, restrictions on the payment of dividends to its shareholders.

Under the risk-based capital guidelines, the FRB requires bank holding companies to maintain a minimum ratio of qualifying total capital to risk-weighted assets of at least 8.0% (of which at least 4.0% must be in the form of Tier 1 capital). A bank holding company s qualifying total capital represents the sum of its Tier 1 and Tier 2 capital (with Tier 2 capital being limited to 100% of Tier 1 capital), less investments in certain unconsolidated subsidiaries. Tier 1 capital generally includes common shareholders equity, qualifying preferred stock and minority interests in consolidated subsidiaries, less goodwill, intangible assets and certain other adjustments. Tier 2 capital generally includes certain other preferred stock, qualifying debt instruments and allowances for loan losses. Risk-weighted assets are calculated by multiplying asset balances by corresponding risk weights generally based on perceived credit risk. At December 31, 2004, the Corporation s ratios of Tier 1 and qualifying total capital to risk-weighted assets were 10.1% and 11.4%, respectively, both of which exceeded regulatory minimums.

The FRB guidelines also require bank holding companies with high regulatory ratings to maintain minimum leverage ratios of at least 3.0%, which are calculated by dividing Tier 1 capital by adjusted average total consolidated assets. Other bank holding companies with supervisory, financial or managerial weaknesses, as well as those anticipating or experiencing significant growth, are expected to maintain leverage ratios in excess of 3.0%. At December 31, 2004, the Corporation s ratio of Tier 1 capital to adjusted average total consolidated assets was 7.9%, which exceeded the regulatory minimum.

***Liability for Undercapitalized Subsidiaries***. The Federal Deposit Insurance Corporation Improvements Act of 1991 ( FDICIA ) requires bank regulators to take prompt corrective action against an insured depository institution if that institution does not meet certain capital adequacy guidelines. In the event an insured depository institution becomes undercapitalized under the FDICIA capital adequacy guidelines, it must submit a capital restoration plan to its federal regulatory agency. Before regulatory authorities will approve an undercapitalized institution s capital restoration plan, each company that controls the institution must guarantee, up to certain limits, the institution s compliance with the capital restoration plan. Because the Bank is an insured depository institution under FDICIA that is controlled by the Corporation, the Corporation would be required to guarantee the Bank s compliance with a capital restoration plan in the event the Bank becomes undercapitalized under the FDICIA capital adequacy guidelines. See Business - the Bank - Capital Adequacy Requirements for additional information regarding the FDICIA capital adequacy guidelines.

Under FDICIA, liability for the fulfillment of any such guarantee could extend up to 5.0% of the undercapitalized institution s assets at the time it became undercapitalized or the amount necessary to bring the undercapitalized institution into compliance with the capital adequacy guidelines. In addition, a bank holding company controlling an undercapitalized institution may be required to obtain FRB approval prior to paying cash dividends or engaging in other activities. Under certain circumstances, the FRB may also require a bank holding company to divest itself of an undercapitalized institution or other affiliates of the bank holding company.

***Liability of Commonly Controlled Institutions***. The Financial Institution Reform, Recovery and Enforcement Act of 1989 ( FIRREA ) contains a cross-guarantee provision under which commonly controlled insured depository institutions can be held liable to the Federal Deposit Insurance Corporation (the FDIC ) for any losses incurred, or reasonably expected to be incurred, by the FDIC due to the default of an insured depository institution, and for any assistance provided by the FDIC to an insured depository institution that is in danger of default. A FDIC cross-guarantee claim against an insured depository institution for administrative expenses and claims of such institution s depositors (including the FDIC, as subrogee of such depositors) has priority over the rights of such institution s shareholders and other creditors.

***Acquisitions by Bank Holding Companies***. Under the BHC Act, prior FRB approval is required before a bank holding company merges or consolidates with, or acquires direct or indirect control of more than 5.0% of the outstanding shares of any class of voting securities or substantially all of the assets of, any bank or bank holding company. In approving any of the foregoing transactions, the FRB is required to consider the financial and managerial resources and future prospects of the banks and bank holding companies concerned, the convenience and needs of the communities to be served and other various competitive factors.

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the Interstate Banking Act ) provides that the FRB may approve an application of an adequately capitalized and managed bank holding company to acquire banks located in other states, regardless of whether the acquisition would be prohibited by applicable state laws. Any such approval, however, would be subject to applicable state age laws. An out-of-state bank holding company seeking to acquire ownership or control of a bank located in Texas must obtain the prior approval of both the FRB and the Banking Commissioner of Texas (the Commissioner ) if the Texas bank has not been in existence for five years. If the FRB approves an acquisition that the Commissioner disapproves, the Commissioner may accept the FRB decision or attempt to have the decision overturned by a federal court.

The Interstate Banking Act also provides that a bank holding company and its affiliates may not acquire a bank located in Texas if, as a result of the acquisition, the bank holding company and its affiliates would control more than 10.0% of total deposits in insured depository institutions nationwide or 30.0% or more of total deposits in insured depository institutions in the home state of the bank to be acquired. However, states may adopt deposit concentration caps that are more restrictive than those set forth in the Interstate Banking Act, and Texas has adopted a deposit concentration cap of 20.0% of in-state insured deposits that will apply in connection with acquisitions of banks located in Texas.

***Acquisitions of Bank Holding Companies***. The Change in Bank Control Act of 1978 (the CBC Act ) prohibits a person or group of persons from acquiring control of a bank holding company unless the FRB has been given prior notice and has not disapproved the acquisition. For purposes of the CBC Act, the acquisition of 25.0% or more of any class of voting securities of a bank holding company constitutes an acquisition of control. The FRB presumes that the acquisition of 10.0% or more of any class of voting securities of a bank holding company constitutes acquisition of control if either the bank holding company has a class of equity securities registered under Section 12 of the Securities Exchange Act of 1934 or if no other person will own or control a greater percentage of that class of securities immediately after the acquisition. This presumption can be rebutted by showing that the acquisition will not in fact result in an acquisition of control of the bank holding company under the CBC Act.

***Enforcement***. The FRB has broad supervisory enforcement authority over bank holding companies and their non-banking subsidiaries. The FRB may seek various administrative remedies in connection with activities and practices of bank holding companies and their non-banking subsidiaries that constitute violations of federal laws and FRB regulations, including issuing cease and desist orders that may, among other things, require affirmative action to correct improper conditions, restitution, reimbursement, indemnification, guaranty against loss, restrictions on growth, disposal of certain assets or such other action as the FRB determines to be appropriate.

FIRREA significantly expanded the FRB s enforcement powers over bank holding companies and their non-banking subsidiaries. Under FIRREA, the scope of individuals and entities against whom enforcement may be sought and penalties assessed was expanded to include, among others, directors, officers, employees or controlling shareholders of bank holding companies and their non-banking subsidiaries. FIRREA also increased the amount of civil penalties that the FRB and other regulatory agencies may assess for knowingly or recklessly committing certain activities that cause a substantial loss to a depository institution.

**The Bank**

***General***. The Bank is a national banking association organized under the National Bank Act, as amended (the National Bank Act ), and is subject to supervision and examination by the Office of the Comptroller of the Currency (the OCC ). The OCC regulates national banks with respect to, among other matters, capital adequacy, reserves, loan portfolios, investments and management practices, and the OCC may seek various administrative remedies in connection with activities and practices of national banks that are unsafe or unsound or constitute violations of law. The Bank is also subject to regulation and supervision by the FDIC because the Bank s deposits are insured by the Bank Insurance Fund ( BIF ) of the FDIC. The FRB also has supervisory and regulatory authority over the activities and practices of the Bank.

***Scope of Permissible Activities***. Under the National Bank Act, a national bank may engage in making, arranging, purchasing or selling loans, purchasing, holding and conveying real estate under certain conditions, dealing in investment securities under certain circumstances and, generally, engaging in the business of banking and activities that are incidental thereto. Activities that are deemed to be incidental to the business of banking include, among others, borrowing and lending of money, receiving deposits, holding or selling securities or other property acquired in connection with security on a loan, discounting and negotiating evidences of debt, issuing letters of credit to or on behalf of its customers, operating a safe deposit business, providing check guarantee plans, issuing credit cards, operating a loan production office, selling loans under repurchase agreements and verifying and collecting checks.

***Branching***. National banks with a main office or a branch in Texas may establish branches anywhere in Texas with prior OCC approval. In acting on a branch application of a national bank, the OCC considers a number of factors, including the bank s financial history, capital adequacy and earnings prospects, the character of its management and needs of the community.

The Interstate Banking Act also permits banks to merge across state lines and thereafter have interstate branches by continuing to operate, as a main office or a branch, any office of any bank acquired in connection with an interstate bank acquisition. The Interstate Banking Act also allows a bank to open new branches in a state in which it does not already have banking operations if the laws of that state permit a de novo branch of an out-of-state bank. A de novo branch is a branch office of a bank that was originally established as a branch rather than as a result of an acquisition or merger. Under Texas law, an out-of-state bank may establish a de novo branch in Texas if the laws of the home state of the out-of-state bank permit a Texas bank to establish a de novo branch in such state. An out-of-state bank that has established or acquired a branch in Texas may establish or acquire additional in-state branches to the same extent as a Texas bank.

***Restrictions on Transactions with Affiliates***. The Bank is subject to federal statutes which limit transactions between the Bank and its affiliates. Section 23A of the Federal Reserve Act places limitations on the Bank s ability to make loans to, purchase assets from and make investments in, its affiliates, and it also requires certain levels of collateral for loans made by the Bank to its affiliates. Transactions between the Bank and its affiliates are also subject to Section 23B of the Federal Reserve Act which requires, among other things, that certain transactions between the Bank and its affiliates must be on terms substantially the same, or at least as favorable to the Bank, as those prevailing at the time for comparable transactions with or involving other nonaffiliated companies.

The Federal Reserve Act and FRB Regulation O also impose restrictions on the ability of the Bank and its affiliates to make loans to their directors, executive officers, principal shareholders and their related interests. These restrictions include limits on loans to one borrower and conditions that must be met before such loans can be made. There is also an aggregate limitation on all loans to insiders and their related interests. In the aggregate, these loans generally may not exceed the institution s total unimpaired capital and surplus. Directors, executive officers, principal shareholders and their related interests are subject to enforcement actions for knowingly accepting loans in violation of these restrictions.

***Interest Rate Limits and Lending Regulations***. The Bank is subject to various state and federal statutes relating to the extension of credit and the making of loans. The National Banking Act generally defers to state law for the maximum rate of interest which may be charged by national banks. The maximum legal rate of interest that the Bank may charge on a loan under Texas law depends on a variety of factors, including the type of borrower, the purpose of the loan, the amount of the loan and the date on which the loan is made. Penalties are provided by law for charging interest in excess of the maximum lawful rate.

Loans made by banks located in Texas are subject to numerous other federal and state laws and regulations, including the Truth-in-Lending Act, the Texas Finance Code, the Equal Credit Opportunity Act, the Real Estate Settlement Procedures Act and the Home Mortgage Disclosure Act. Failure to comply with these laws could result in certain remedies for borrowers and penalties for lenders. The scope and requirements of these

and similar laws and regulations have expanded in recent years and, as a result, claims by borrowers under these laws and regulations may increase in the future.

***Restrictions on Payment of Dividends***. The principal source of the Corporation s revenues is cash dividends received from the Bank. The National Bank Act provides that the Bank may pay dividends out of its current or retained net profits but may not pay dividends out of its paid-in capital. The National Bank Act further restricts the Bank s payment of dividends by prohibiting the Bank from declaring a dividend until its surplus fund equals the amount of its capital stock or, if its surplus fund does not equal the amount of its capital stock, until one-tenth of the Bank s net profits for the preceding half year, in the case of quarterly or semi-annual dividends, or the preceding two half-year periods, in the case of annual dividends, are transferred to the surplus fund. OCC approval is required prior to the

payment of a dividend if the total of all dividends declared by the Bank in any calendar year would exceed the total of its net profits for that year combined with its retained net profits for the two preceding years. The Bank s ability to pay dividends is further restricted by the FDICIA capital adequacy guidelines. See Business - The Bank - Capital Adequacy Requirements. In addition, certain regulatory authorities are authorized to prohibit the Bank from paying dividends if any such payment would constitute an unsafe and unsound banking practice.

***Capital Adequacy Requirements***. FDICIA established a system of supervision of the capital adequacy of insured depository institutions based upon minimum risk-based capital ratios and leverage ratios which are similar to those established by the FRB for bank holding companies. The OCC regulations establish five capital categories ranging from well capitalized to critically undercapitalized. A depository institution is considered well capitalized if it has a total risk-based capital ratio of 10.0% or greater, a Tier 1 risk-based capital ratio of 6.0% or greater, a leverage ratio of 5.0% or greater and is not subject to an order, written agreement, capital directive or prompt corrective action directive to meet and maintain a specific capital level for any capital measure. A depository institution is considered adequately capitalized if it has a total risk-based capital ratio of 8.0% or greater, a Tier 1 risk-based capital ratio of 4.0% or greater and a leverage ratio of 4.0% or greater (or a leverage ratio of 3.0% or greater if the institution was given the highest rating in its most recent report of examination) and the institution does not meet the definition of a well capitalized institution. A depository institution is considered undercapitalized if it has a total risk-based capital ratio that is less than 8.0%, a Tier 1 risk-based capital ratio that is less than 4.0% or a leverage ratio that is less than 4.0% (or a leverage ratio that is less than 3.0% if the institution received the highest rating in its most recent report of examination). An institution is significantly undercapitalized if it has a total risk-based capital ratio that is less than 6.0%, a Tier 1 risk-based capital ratio that is less than 3.0% or a leverage ratio that is less than 3.0%. A depository institution is critically undercapitalized if it has a ratio of tangible equity to total assets that is equal to or less than 2.0%. At December 31, 2004, the Bank qualified as a well capitalized institution under the OCC regulations.

***Prompt Corrective Measures for Capital Deficiencies***. FDICIA requires federal banking regulators to take prompt corrective action with respect to capital-deficient insured depository institutions with the overall goal of limiting losses to the BIF. With certain exceptions, a depository institution is prohibited from making capital distributions or paying management fees to its bank holding company if the payment of such distributions or fees will cause the institution to become undercapitalized. Furthermore, an undercapitalized institution must file a capital restoration plan with the OCC, which must be guaranteed by each company that controls such institution. See Business - The Corporation - Liability for Undercapitalized Subsidiaries. Undercapitalized institutions also are subject to restrictions on growth, acquisitions, branching and engaging in new lines of business unless they have an approved capital restoration plan that otherwise permits such activities. An institution that is not well capitalized may not accept brokered deposits without prior regulatory approval and will be subject to limitations on interest rates that it offers on its deposits. In addition, the OCC may, among other things, require an undercapitalized institution to issue securities or other obligations to raise funds to recapitalize the institution or, under certain circumstances, divest one or more of its subsidiaries for such purpose.

The OCC and other Federal banking agencies are authorized by FDICIA to take various enforcement actions against any significantly undercapitalized institution and action may be taken against an institution that fails to submit an acceptable capital restoration plan or fails to implement a capital restoration plan approved by the OCC. Such actions may include, among other things, prohibiting asset growth or requiring asset reduction, restricting interest rates paid, requiring FRB prior approval of any capital distributions by any bank holding company which controls the institution, requiring divestiture by the institution of its subsidiaries or by the holding company of the institution itself, requiring an election of new directors of the institution and requiring the dismissal of its directors and officers.

Critically undercapitalized institutions may be subject to more extensive control and supervision. A critically undercapitalized institution may be prohibited from, among other things, entering into any material transaction not in the ordinary course of business, amending its charter or bylaws or engaging in certain transactions with affiliates. In addition, critically undercapitalized institutions generally will be prohibited from making payments of principal or interest on outstanding subordinated debt. Within 90 days of the date on which an institution becomes critically undercapitalized, the OCC must appoint a receiver or conservator unless certain findings are made with respect to the prospect for the institution s continued viability.

***Deposit Insurance Assessments***. Under FDICIA, the FDIC is required to assess premiums on an insured depository institution s deposits in order to adequately fund the BIF. The FDIC has established a risk-based insurance premium assessment system that is used to calculate deposit insurance assessments made on BIF member banks. Under the assessment system, each insured depository institution is assigned to one of nine risk classifications based upon certain capital and supervisory measures and, depending upon its classification, assessed insurance premiums on its deposits. Insured depository institutions are required to pay insurance premiums ranging from 0% of insured deposits to 0.27% of insured deposits. The Bank currently qualifies for the 0% insurance premium assessment.

Under the Deposit Insurance Funds Act of 1996 (the Funds Act ), banks insured under the BIF were required to pay a part of the interest on bonds issued by the Financing Corporation ( FICO ) in the late 1980s to recapitalize the defunct Federal Savings and Loan Insurance Corporation. Before the Funds Act, FICO payments were made only by depository institutions which were members of the Savings Association Insurance Fund (the SAIF ). Prior to January 1, 2000, the Funds Act provided that BIF members were assessed for FICO payments at only one-fifth the rate of assessment on SAIF members. However, beginning January 1, 2000, the Funds Act provided that all BIF- and SAIF-insured institutions must pay FICO assessments at the same rate. For the first quarter of 2005, FICO rates have been set at .0144% for both BIF and SAIF members. The FICO assessment rates for both BIF and SAIF members for 2004 were as follows:

| | |
|---|---|
| Fourth Quarter | .0146% |
| Third Quarter | .0148% |
| Second Quarter | .0148% |
| First Quarter | .0154% |

***Community Reinvestment Act***. The Community Reinvestment Act of 1977 ( CRA ) and the regulations issued by the OCC thereunder are intended to encourage banks to help meet the credit needs of their service area, including low and moderate income neighborhoods, consistent with the safe and sound operations of the banks. These regulations also provide for regulatory assessment of a bank s record in meeting the needs of its service area when considering applications to establish branches, merger applications and applications to acquire the assets of another bank. FIRREA requires federal banking agencies to publicly disclose the rating of a bank s performance under the CRA. In the case of a bank holding company, the CRA performance record of its subsidiary bank is reviewed in connection with the filing of an application to acquire ownership or control of securities or assets of a bank or to merge with any other bank holding company. An unsatisfactory record can substantially delay or block the transaction. A less than satisfactory CRA rating can limit the extent to which a bank holding company and its affiliates can take advantage of the expanded range of activities permitted by the GLB Act.

**Customer Privacy**

Under the GLB Act, federal banking regulators have adopted rules limiting the ability of banks and other financial institutions to disclose nonpublic information about consumers. These rules require each financial institution to establish an information security program and a written plan containing policies and procedures designed to prevent the disclosure of nonpublic information about consumers. The plan must be adjusted on a continuing basis for changes in technology, the sensitivity of consumer information and internal and external threats to information security. A financial institution s policy for protecting nonpublic information about consumers must be disclosed to the customer at the time the customer relationship is established and at least annually thereafter.

**Changing Regulatory Structure**

Various proposals relating to the regulation of banks and other financial institutions are introduced from time to time by Congress, states and other regulatory authorities. If enacted or otherwise adopted, any of such proposals could significantly change the regulation of banks and other financial institutions in substantial and unexpected ways. The Corporation cannot predict whether any such proposals will be enacted or otherwise adopted or, if enacted or adopted, the extent to which such proposals would affect the business, results of operations and financial condition of the Corporation or the Bank.

**Monetary Policy and Economic Controls**

The business, results of operations and financial condition of the Corporation and the Bank are affected by the policies of regulatory authorities, including the monetary policies of the FRB. An important function of the FRB is to promote orderly economic growth by influencing interest rates and the supply of money and credit. Among the methods that have been used by the FRB to achieve this objective are open market operations in United States government securities, control of borrowings at the discount window, changes in the discount rate for member bank borrowing, changes in reserve requirements against member bank deposits and certain borrowings by banks and their affiliates and the placement of limitations on interest rates that member banks may pay on time and savings deposits. FRB monetary policies have materially affected the business, results of operations and financial condition of banks and other financial institutions in the past and are expected to continue to do so in the future. The Corporation cannot predict the nature of any future monetary policies or the effect that such policies may have on the business, results of operations and financial condition of the Corporation and the Bank.

**ITEM 2. PROPERTIES.**

The principal executive offices of the Corporation are located at 3880 Hulen Street, Suite 300, Fort Worth, Texas 76107. The Corporation and the Bank lease space at this address from an unrelated third party through a lease that expires in May 2010. This banking facility opened in May 2003. The Bank also owns a detached motor bank facility at 4620 Hartwood Drive, Fort Worth, Texas, on land that is leased from an unrelated third party under a lease agreement expiring in October 2019.

The Camp Bowie office of the Bank is located at 3859 Camp Bowie Boulevard, Fort Worth, Texas. The Bank owns the building located at this address.

The Downtown office of the Bank is located at 1300 Summit Avenue, Fort Worth, Texas. The Bank leases space for its Downtown office from an unrelated third party under a lease agreement expiring in December 2009. The Bank also owns a detached motor bank facility at 1401 Summit Avenue, Fort Worth, Texas.

The Alta Mesa office of the Bank is located at 3000 Alta Mesa Boulevard, Fort Worth, Texas. The Bank owns the building located at this address. The Bank uses approximately 20% of the facilities for its operations and leases the remainder of the facilities to others.

The Northeast office and a motor bank facility of the Bank are located at 9001 Airport Freeway, North Richland Hills, Texas. The Bank leases these facilities from an unrelated third party under a lease agreement expiring in April 2008. The Bank owns a tract of land adjacent to the Northeast office on which it intends to build a new motor bank facility that would be owned by the Bank.

The Fossil Creek office of the Bank is located at 3851 NE Loop 820, Fort Worth, Texas. The building located at this address is owned by a joint venture between the Bank and an unrelated third party. The Fossil Creek office occupies approximately 28% of the building pursuant to a long-term lease with the joint venture.

The Davis office of the Bank is located at 8501 Davis Boulevard, North Richland Hills, Texas. The Bank owns the building at this address.

The Euless office of the Bank is located at 350 Westpark Way, Euless, Texas. The Bank leases this facility from an unrelated third party under a lease agreement expiring in October 2009 with options for an additional six years. This banking facility opened in October 2004.

The Cooper office of the Bank is located at 5901 South Cooper Street, Arlington, Texas. The Bank acquired ownership of this facility through the Bank s acquisition of ANB Financial Corporation which was effective May 2004.

The Abram office of the Bank is located at 410 West Abram Street, Arlington, Texas. The Bank leases this facility from an unrelated third party under a lease agreement expiring in September 2007 with options for an additional six years. The Bank assumed this lease through the Bank s acquisition of ANB Financial Corporation which was effective May 2004.

The Lake Arlington office of the Bank is located at 5500 West Arkansas Lane, Arlington, Texas. The Bank leases this facility from an unrelated third party under a lease agreement expiring in July 2005 with options that extend to July 2028. The Bank assumed this lease through the Bank s acquisition of ANB Financial Corporation which was effective May 2004.

The Collins office of the Bank is located at 1060 Northeast Green Oaks Boulevard, Arlington, Texas. The Bank leases this facility from an unrelated third party under a lease agreement expiring in September 2013 with options that extend to September 2024. The Bank assumed this lease through the Bank s acquisition of ANB Financial Corporation which was effective May 2004.

**ITEM 3. LEGAL PROCEEDINGS.**

Although the Corporation and the Bank are routinely involved in legal proceedings incidental to their businesses, the Corporation believes that neither it nor the Bank is currently a party to any material legal proceeding.

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

No matters were submitted to a vote of security holders during the fourth quarter of 2004.

## PART II

### ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

**Market Information**. Since May 3, 1993, the Common Stock of the Corporation has traded on the Nasdaq National Market System under the symbol SBIT. The following table sets forth the high and low bid prices for the Common Stock for the periods indicated (as adjusted to reflect the two-for-one stock split effected on December 31, 2004):

| 2004 Fiscal Year | High | Low | 2003 Fiscal Year | High | Low |
|---|---|---|---|---|---|
| First Quarter | $ 16.08 | $ 13.83 | First Quarter | $ 10.00 | $ 9.43 |
| Second Quarter | 15.13 | 13.50 | Second Quarter | 12.70 | 9.48 |
| Third Quarter | 16.63 | 14.30 | Third Quarter | 14.25 | 11.74 |
| Fourth Quarter | 18.95 | 16.33 | Fourth Quarter | 14.48 | 13.23 |

On June 30, 2004, the closing price reported for the Common Stock was $14.55 (as adjusted to reflect the two-for-one stock split effected on December 31, 2004). The foregoing quotations reflect prices quoted by market makers of the Common Stock, without retail markup, markdown or commissions, and may not necessarily represent actual transactions.

**Shareholders**. At the close of business on March 1, 2005, there were 486 shareholders of record of the Common Stock.

**Dividends**. The Corporation has paid regular cash dividends on the Common Stock on a quarterly basis since 1993. The following table sets forth the quarterly dividends paid by the Corporation on the Common Stock for the indicated periods (as adjusted to reflect the two-for-one stock split effected on December 31, 2004):

| 2004 Fiscal Year | Dividends Per Share | 2003 Fiscal Year | Dividends Per Share |
|---|---|---|---|
| First Quarter | $ 0.07 | First Quarter | $ 0.06 |
| Second Quarter | 0.07 | Second Quarter | 0.06 |
| Third Quarter | 0.07 | Third Quarter | 0.07 |
| Fourth Quarter | 0.07 | Fourth Quarter | 0.07 |

Although the Corporation intends to continue to pay quarterly cash dividends on the Common Stock in the future, there can be no assurance that the Corporation will pay cash dividends in the future or, if paid, that such cash dividends will be comparable to cash dividends previously paid by the Corporation. The Corporation s future dividend policy is subject to the discretion of the Board of Directors of the Corporation and will depend upon a number of factors, including the Corporation s future earnings, financial condition and cash needs, general business conditions and the amount of dividends paid to the Corporation by the Bank. See Business - The Corporation - Restrictions on Payment of Dividends and Business - The Bank - Restrictions on Payment of Dividends for additional factors that may limit the ability of the Corporation and the Bank to pay cash dividends.

On April 20, 2004, the Board of Directors of the Corporation approved a stock repurchase plan (the Repurchase Plan ) authorizing the Corporation to purchase up to 615,360 shares of its common stock (as adjusted to reflect the two-for-one stock split effected on December 31, 2004) over the twelve-month period beginning April 20, 2004 through open market purchases or in privately negotiated transactions in accordance with all applicable state and federal laws and regulations. The following table provides information regarding purchases by the Corporation of shares of its common stock during each calendar month of the fourth quarter of 2004 pursuant to the Repurchase Plan:

| Period | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs |
|---|---|---|---|---|
| 10/01/04 - 10/31/04 | 4,250 | $ 16.53 | 4,250 | 570,110 |
| 11/01/04 - 11/30/04 | 2,500 | 16.95 | 2,500 | 567,610 |
| 12/01/04 - 12/31/04 | 16 | 17.00 | 16 | 567,594 |
| Total | 6,766 | $ 16.69 | 6,766 | 567,594 |

**ITEM 6. SELECTED FINANCIAL DATA.**

The following table sets forth selected financial data of the Corporation for the past five years (dollars in thousands except ratios and per share data). The information set forth below is not necessarily indicative of future results, and should be read in conjunction with Item 7: Management s Discussion and Analysis of Financial Condition and Results of Operations and the Corporation s consolidated financial statements and notes thereto included in Item 8 of this Annual Report on Form 10-K. Share and per share data have been adjusted to reflect the two-for-one stock split effected on December 31, 2004.

| | Years Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2004 | 2003 | 2002 | 2001 | 2000 |
| Summary of Earnings: | | | | | |
| Interest Income | $ 46,857 | $ 38,527 | $ 38,657 | $ 44,497 | $ 47,609 |
| Interest Expense | 9,506 | 7,437 | 8,512 | 15,527 | 18,870 |
| Net Interest Income | 37,351 | 31,090 | 30,145 | 28,970 | 28,739 |
| Provision for Loan Losses | 1,790 | 880 | 3,140 | 1,755 | 2,606 |
| Securities Gains (Losses) | 32 | 230 | 165 | -0- | (2) |
| Non-interest Income | 7,210 | 5,798 | 5,302 | 4,516 | 3,780 |
| Non-interest Expense | 26,190 | 21,453 | 18,309 | 18,265 | 16,170 |
| Earnings Before Income Taxes | 16,613 | 14,785 | 14,163 | 13,466 | 13,741 |
| Income Tax Expense | 5,851 | 5,017 | 4,846 | 4,664 | 4,765 |
| Net Income | $ 10,762 | $ 9,768 | $ 9,317 | $ 8,802 | $ 8,976 |
| Balance Sheet Data (at period-end): | | | | | |
| Total Assets | $ 989,117 | $ 795,478 | $ 687,733 | $ 635,956 | $ 619,121 |
| Investment Securities | 223,351 | 195,959 | 173,512 | 160,136 | 149,647 |
| Loans, Net of Unearned Discount | 702,619 | 553,769 | 469,145 | 430,754 | 380,016 |
| Allowance for Loan Losses | 10,187 | 7,784 | 6,706 | 6,015 | 5,399 |
| Demand Deposits | 235,399 | 192,877 | 167,745 | 150,040 | 146,083 |
| Total Deposits | 792,264 | 641,381 | 581,949 | 543,803 | 539,666 |
| Other Borrowings | 118,094 | 82,234 | 37,255 | 28,366 | 19,910 |
| Shareholders Equity | 74,490 | 68,684 | 64,938 | 60,536 | 55,571 |
| Per Share Data: | | | | | |
| Net Income - Basic | $ 0.87 | $ 0.79 | $ 0.75 | $ 0.70 | $ 0.71 |
| Net Income - Diluted | 0.85 | 0.77 | 0.73 | 0.68 | 0.69 |
| Book Value - Period-End | 6.03 | 5.59 | 5.29 | 4.84 | 4.37 |
| Dividends Declared and Paid | 0.28 | 0.26 | 0.24 | 0.22 | 0.20 |
| Weighted Average Shares Outstanding (000) | 12,326 | 12,322 | 12,448 | 12,636 | 12,728 |
| Average Common Share Equivalents (000) | 353 | 312 | 344 | 306 | 320 |
| Selected Performance Ratios: | | | | | |
| Return on Average Assets | 1.16% | 1.32% | 1.39% | 1.41% | 1.54% |
| Return on Average Shareholders Equity | 15.04 | 14.43 | 14.74 | 15.01 | 17.57 |
| Dividend Payout Ratio | 32.09 | 32.81 | 32.05 | 31.61 | 28.38 |
| Net Interest Margin (tax equivalent) | 4.31 | 4.48 | 4.80 | 4.93 | 5.25 |
| Efficiency Ratio | 58.55 | 57.57 | 51.26 | 54.55 | 49.71 |
| Asset Quality Ratios: | | | | | |
| Non-Performing Loans to Total Loans - Period-End | 0.37% | 0.43% | 0.46% | 0.96% | 0.58% |
| Non-Performing Assets to Total Assets - Period-End | 0.26 | 0.30 | 0.50 | 0.72 | 0.61 |
| Allowance for Loan Losses to Total Loans - Period-End | 1.45 | 1.41 | 1.43 | 1.40 | 1.42 |
| Allowance for Loan Losses to Non-Performing Loans - Period-End | 394.0 | 331.0 | 314.0 | 146.0 | 247.0 |
| | 0.10 | (0.04) | 0.53 | 0.28 | 0.64 |

| | | | | | |
|---|---|---|---|---|---|
| Net Charge-Offs (Recoveries) to Average Loans | | | | | |
| Capital Ratios: | | | | | |
| Shareholders Equity to Total Assets - Period-End | 7.53% | 8.63% | 9.44% | 9.52% | 8.98% |
| Average Shareholders Equity to Average Assets | 7.74 | 9.15 | 9.45 | 9.40 | 8.74 |
| Total Risk-based Capital to Risk Weighted Assets - Period-End* | 11.40 | 12.70 | 13.41 | 14.34 | 14.97 |
| Leverage Ratio - Period-End* | 7.85 | 8.62 | 8.96 | 9.20 | 8.88 |

*Calculated in accordance with Federal Reserve guidelines currently in effect.

**Quarterly Results (Unaudited)**

A summary of the unaudited results of operations for each quarter of 2004 and 2003 is set forth below (dollars in thousands except for per share data). Per share data has been adjusted to reflect the two-for-one stock split effected on December 31, 2004.

| | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
|---|---|---|---|---|
| 2004 | | | | |
| Interest Income | $ 10,198 | $ 11,302 | $ 12,361 | $ 12,995 |
| Interest Expense | 1,915 | 2,274 | 2,533 | 2,782 |
| Net Interest Income | 8,283 | 9,028 | 9,828 | 10,213 |
| Provision for Loan Losses | 605 | 400 | 495 | 290 |
| Gain on Sale of Securities | -0- | -0- | 32 | -0- |
| Non-interest Income | 1,567 | 1,723 | 2,109 | 1,811 |
| Non-interest Expense | 5,530 | 6,350 | 7,109 | 7,202 |
| Earnings Before Income Taxes | 3,715 | 4,001 | 4,365 | 4,532 |
| Income Tax Expense | 1,264 | 1,405 | 1,569 | 1,613 |
| Net Income | $ 2,451 | $ 2,596 | $ 2,796 | $ 2,919 |
| Per Share Data: | | | | |
| Net Income: | | | | |
| Basic | $ 0.20 | $ 0.21 | $ 0.23 | $ 0.23 |
| Diluted | 0.19 | 0.21 | 0.22 | 0.23 |
| Dividends Paid | 0.07 | 0.07 | 0.07 | 0.07 |
| Stock Price Range: | | | | |
| High | 16.08 | 15.13 | 16.63 | 18.95 |
| Low | 13.83 | 13.50 | 14.30 | 16.33 |
| Close | 15.05 | 14.55 | 16.63 | 18.75 |

| | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
|---|---|---|---|---|
| 2003 | | | | |
| Interest Income | $ 9,251 | $ 9,547 | $ 9,709 | $ 10,020 |
| Interest Expense | 1,816 | 1,934 | 1,834 | 1,853 |
| Net Interest Income | 7,435 | 7,613 | 7,875 | 8,167 |
| Provision for Loan Losses | 300 | 240 | 46 | 294 |
| Gain on Sale of Securities | -0- | 12 | 89 | 129 |
| Non-interest Income | 1,347 | 1,586 | 1,494 | 1,371 |
| Non-interest Expense | 4,797 | 5,246 | 5,656 | 5,754 |
| Earnings Before Income Taxes | 3,685 | 3,725 | 3,756 | 3,619 |
| Income Tax Expense | 1,252 | 1,268 | 1,281 | 1,216 |
| Net Income | $ 2,433 | $ 2,457 | $ 2,475 | $ 2,403 |
| Per Share Data: | | | | |
| Net Income: | | | | |
| Basic | $ 0.20 | $ 0.20 | $ 0.20 | $ 0.19 |
| Diluted | 0.19 | 0.20 | 0.19 | 0.19 |
| Dividends Paid | 0.06 | 0.06 | 0.07 | 0.07 |

| Stock Price Range: | | | | |
|---|---|---|---|---|
| High | 10.00 | 12.70 | 14.25 | 14.48 |
| Low | 9.43 | 9.48 | 11.74 | 13.23 |
| Close | 9.56 | 11.74 | 13.50 | 13.81 |

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

*The following discussion should be read in conjunction with the consolidated financial statements, accompanying notes and selected financial data appearing elsewhere in this Annual Report on Form 10-K and may contain certain forward-looking statements that are based on current management expectations. Generally, verbs in the future tense and the words, believe, expect, anticipate, intends, opinion, potential and similar expressions identify forward-looking statements. Examples of this forward-looking information can be found in, but are not limited to, the expected effects of accounting pronouncements and government regulation applicable to the Corporation s operations, the discussion of allowance for loan losses, litigation and any quantitative and qualitative disclosure about market and interest rate risk. The actual results of the Corporation could differ materially from those management expectations. Further information concerning the Corporation and its business, including additional risk factors and uncertainties that could cause actual results to differ materially from the forward-looking statements contained in this Annual Report on Form 10-K are set forth below. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. The forward-looking statements contained herein speak only as of the date of this Annual Report on Form 10-K, and, except as may be required by applicable law and regulation, the Corporation does not undertake, and specifically disclaims any obligation, to publicly update or revise such statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.*

**Overview**. The Corporation s business has been conducted primarily through its wholly-owned subsidiaries, the Bank, Summit Delaware Financial Corporation, SIA and SBI Trust. As of December 31, 2004, the Bank operated its branch offices in twelve locations in Tarrant County, Texas. At December 31, 2003, the Bank had seven branch offices. The increase during 2004 was due to the May 2004 acquisition of the four branches of Arlington National Bank and the October 2004 opening of a branch in Euless, Texas. In May 2004, the Corporation completed its acquisition of ANB Financial Corporation and its wholly-owned subsidiary, Arlington National Bank (collectively, ANB ), and ANB s results of operations have been included in the Corporation s results of operations since the acquisition date. On December 31, 2004, the Corporation effected a two-for-one stock split on its common stock payable in the form of a 100% stock dividend, and all share and per share data included herein has been adjusted to reflect this stock split.

The Corporation s results of operations are primarily dependent on net interest income, which is the difference between the income earned on its loan and investment portfolios and its cost of funds, consisting of the interest paid on deposits and borrowings. Results of operations are also affected by the Corporation s allowance for loan losses, investment activities, loan servicing fees and other fees. The Corporation s non-interest expense principally consists of compensation and benefits, occupancy and equipment expense, advertising, data processing expense and other expenses.

Net income for 2004 was $10.8 million, an increase of $1.0 million, or 10.2%, compared to $9.8 million recorded for 2003. On a weighted average share basis, net income for 2004 was $0.85 per diluted share as compared to $0.77 per diluted share for 2003, an increase of 10.4%. The increase in earnings during 2004 was primarily due to an increase in net interest income of $6.3 million over 2003. The increase in net interest income during 2004 was primarily due to growth in average loans of 28.4%, which more than offset the impact of the low interest rate environment and a declining net interest margin during 2004 compared to 2003. Excluding ANB, which added $40.8 million to average loans in 2004, average loans increased 20.3% over 2003. Non-interest income in 2004 increased $1.2 million, or 20.1% over 2003. ANB accounted for $1.0 million of this increase. Non-interest expenses increased $4.7 million during 2004 compared to 2003. The increase in non-interest expenses was primarily due to ANB, the Euless location and Sarbanes-Oxley compliance costs which added $2.5 million, $0.4 million and $0.3 million, respectively, to the 2004 expenses. In addition, the expense for the provision for loan losses in 2004 increased $0.9 million over 2003, virtually matching the increase in net charge-offs over 2003. Net charge-offs for 2004 remain at low levels relative to the Corporation s five-year average.

Continuing to reflect an improving economy in the Corporation s market area as well as the ANB acquisition, total loans at December 31, 2004 were $702.6 million, which represented an increase of 26.9% over total loans for 2003. Total funding (deposits and borrowings) for 2004 also experienced growth, increasing 25.8% over the prior year period to $910.4 million. Shareholders equity was $74.5 million at December 31, 2004, which represented an increase of 8.5% compared to December 31, 2003.

Net income for 2003 was $9.8 million, an increase of $0.5 million, or 4.8%, compared to $9.3 million recorded for 2002. On a weighted average share basis, net income for 2003 was $0.77 per diluted share as compared to $0.73 per diluted share for 2002, an increase of 6.2%. The increase in earnings during 2003 was primarily due to an increase in net interest income of $1.0 million over 2002. The increase in net interest income was primarily due to growth in average loans of 8.9%, which more than offset the impact of the low interest rate environment and a declining net interest margin. The increase in non-interest expenses during 2003 was primarily attributable to strategic investment in new technology, new branches, new support facilities and additional lending staff. These expenses were offset during 2003 by a significant reduction in the provision for loan losses as compared to 2002. In 2003, loan recoveries exceeded loan losses, as credit quality and the local economy both continued to improve.

The following table shows selected performance ratios over the last three years that management believes to be key indicators of the Corporation s performance:

| | 2004 | 2003 | 2002 |
|---|---|---|---|
| Return on Average Assets (ROAA) | 1.16% | 1.32% | 1.39% |
| Return on Average Shareholders Equity (ROAE) | 15.04 | 14.43 | 14.74 |
| Shareholders Equity to Assets - Average | 7.74 | 9.15 | 9.45 |
| Dividend Payout Ratio | 32.09 | 32.81 | 32.05 |
| Net Interest Margin (tax equivalent) | 4.31 | 4.48 | 4.80 |
| Efficiency Ratio | 58.55 | 57.57 | 51.26 |

The return on average assets ratio is calculated by dividing net income by average total assets for the year. Management believes the Corporation s return on average assets ratio of 1.16% in 2004 is comparable to the return on average assets ratio of other financial institutions in the Corporation s peer group, which averaged 1.27% in 2004. The Corporation s peer group is comprised of other publicly traded bank holding companies headquartered in Texas and was selected by management of the Corporation.

The return on average shareholders equity ratio is calculated by dividing net income by average shareholders equity for the year. Management believes the Corporation s return on average shareholders equity ratio of 15.04% in 2004 compares favorably to the return on average shareholders equity ratio of other financial institutions in the Corporation s peer group, which averaged 14.23% in 2004.

The shareholders equity to assets ratio is calculated by dividing average shareholders equity by average total assets for the year. Management believes the Corporation s average shareholders equity to average assets ratio of 7.74% in 2004 is comparable to the return on average shareholders equity to average asset ratio of other financial institutions in the Corporation s peer group, which averaged 8.95% in 2004. The Corporation s ratio is lower than its historical levels due to the ANB acquisition and the significant increase in assets added. With the ANB acquisition being a cash acquisition, it resulted in the leveraging of the Corporation s capital position, thus creating a lower shareholders equity to assets ratio than what the Corporation has historically reported.

The dividend payout ratio is determined by dividing the total dividends paid by net income for the year. In 2004, the Corporation s dividend payout ratio resulted in a yield-to-market price return comparable to the average dividend payout ratio of the Corporation s peer group.

Net interest margin is calculated by dividing net interest income on a tax equivalent basis by average total earning assets. Management believes the Corporation s net interest margin ratio of 4.31% in 2004 compares favorably to the net interest margin ratio of other financial institutions in the Corporation s peer group, which was 4.10% in 2004.

The efficiency ratio is calculated by dividing non-interest expenses by the sum of total non-interest income and net interest income for the year. The efficiency ratio provides a measure of the extent to which the Corporation s revenues are absorbed by its non-interest expenses. Management believes the Corporation s efficiency ratio of 58.55% in 2004 compares favorably to the weighted average efficiency ratio of other financial institutions in the Corporation s peer group, which was 60.32% in 2004.

**Net Interest Income**. Net interest income is the difference between the interest earned by the Corporation on its earning assets and the interest paid by the Corporation for the funds, primarily deposits, supporting those assets. The largest category of the Corporation s earning assets consists of loans to businesses and individuals. The second largest category of the Corporation s earning assets is investment securities. Interest rate fluctuations, as well as changes in the amount and type of earning assets and sources of funds supporting those assets, affect net interest income. Interest rates primarily are determined by national and international market trends, as well as competitive pressures in the Corporation s operating markets. For analytical purposes, income from tax-exempt assets, which consists primarily of securities issued by or loans made to state and local governments, is adjusted by an increment which equates income from tax-exempt assets to income from taxable assets.

Net interest income (tax equivalent) for 2004 was $37.5 million, which represented an increase of $6.3 million, or 20.0%, compared to 2003. The net increase in net interest income in 2003 reflected a $8.3 million increase in interest income which was offset by a $2.0 million increase in interest expense.

The increases in interest income and interest expense in 2004 were due to significant increases (partly attributable to ANB) in the Corporation s loans and deposits which offset decreases in the Corporation s yield on earning assets and rates paid on its interest-bearing liabilities. The yield on earning assets decreased to 5.40% for 2004 from 5.54% for 2003, and the rates paid on interest-bearing liabilities decreased to 1.49% for 2004 from 1.50% for 2003. These decreases resulted in the net interest margin decreasing to 4.31% in 2004 from 4.48% for 2003. The decreases reflect the maturities of earning assets and time deposits originated in prior periods when market rates were higher. Market rates began increasing during the second quarter of 2004, as measured by the increase in the average prime rate from 2003 to 2004 (as published by

the *Wall Street Journal*) of 21 basis points.

The increase in net interest income for 2004 was primarily due to the 28.4% growth in average loans and the 20.9% growth in average deposits during the same period, which offset the 17 basis point decline in net interest margin between the years of 2004 and 2003. Average non-interest bearing demand deposits as a percent of average total deposits increased to 28.9% in 2004 from 28.4% in 2003.

Net interest income (tax equivalent) for 2003 was $31.2 million, which represented an increase of $1.0 million, or 3.3%, compared to 2002. The net increase in net interest income in 2003 reflected a $0.1 million decrease in interest income which was offset by a $1.1 million decrease in interest expense.

The decreases in interest income and interest expense in 2003 were primarily due to decreases in the Corporation s yield on earning assets and rates paid on its interest-bearing liabilities. The yield on earning assets decreased to 5.54% for 2003 from 6.15% for 2002, and the rates paid on interest-bearing liabilities decreased to 1.50% for 2003 from 1.91% for 2002. These decreases resulted in the net interest margin decreasing to 4.48% in 2003 from 4.80% for 2002. The decreases in the yields earned on earning assets and the rates paid on interest-bearing liabilities reflect the decline in market rates from 2002 to 2003, as measured by the decline in average prime rates over the same period (as published by the *Wall Street Journal*) of 55 basis points.

The increase in net interest income for 2003 was primarily due to the 8.9% growth in average loans and the 8.2% growth in average deposits during the same period, which offset the 32 basis point decline in net interest margin. Average non-interest bearing demand deposits as a percent of average total deposits increased to 28.4% in 2003 from 27.9% in 2002.

**Summary of Earning Assets and Interest-Bearing Liabilities**

Although the year-end detail provides satisfactory indicators of general trends, management believes the daily average balance sheets are more meaningful for analytical purposes than year-end data because averages reflect the day-to-day fluctuations that are common to bank balance sheets. Average balances for earning assets and interest-bearing liabilities also can be related directly to the components of interest income and interest expense on the consolidated statements of income. This data provides the basis for analyzing rates earned and paid as well as sources of increases and decreases in net interest income as derived from changes in volumes and rates. The following table presents average balance sheets for the most recent three years in a format that highlights the Corporation s earning assets and interest-bearing liabilities over such periods:

| | Years Ended December 31, | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2004 | | | 2003 | | | 2002 | | |
| (Dollars in Thousands) | Average Balance | Interest | Average Yield/ Rate | Average Balance | Interest | Average Yield/ Rate | Average Balance | Interest | Average Yield/ Rate |
| Earning Assets: | | | | | | | | | |
| Federal Funds Sold and Due From Time | $ 14,303 | $ 170 | 1.19% | $ 7,912 | $ 81 | 1.02% | $ 12,989 | $ 212 | 1.63% |
| Investment Securities (Taxable) | 200,383 | 7,409 | 3.70 | 179,539 | 7,106 | 3.96 | 150,704 | 7,046 | 4.68 |
| Investment Securities (Tax-exempt)(2) | 7,280 | 395 | 5.43 | 5,779 | 314 | 5.43 | 3,060 | 177 | 5.77 |
| Loans, Net of Unearned Discount(1) | 647,686 | 39,024 | 6.03 | 504,520 | 31,171 | 6.18 | 463,106 | 31,326 | 6.76 |
| Total Earning Assets | 869,652 | 46,998 | 5.40 | 697,750 | 38,672 | 5.54 | 629,859 | 38,761 | 6.15 |
| Other Assets: | | | | | | | | | |
| Cash and Due From Banks | 28,620 | | | 26,295 | | | 25,728 | | |
| Other Assets | 35,281 | | | 22,964 | | | 19,760 | | |
| Allowance for Loan Losses | (9,351) | | | (7,351) | | | (6,438) | | |
| Total Assets | $ 924,202 | | | $ 739,658 | | | $ 668,909 | | |
| Interest-Bearing Liabilities: | | | | | | | | | |
| Interest-Bearing Transaction Accounts | $ 232,155 | 2,518 | 1.08 | $ 193,841 | 2,108 | 1.09 | $ 180,060 | 2,378 | 1.32 |
| Savings | 149,510 | 1,832 | 1.23 | 119,851 | 1,581 | 1.32 | 112,977 | 1,909 | 1.69 |
| Certificates of Deposit under $100,000 and IRA s | 68,602 | 1,526 | 2.22 | 62,938 | 1,563 | 2.48 | 64,042 | 2,041 | 3.19 |
| Certificates of Deposit $100,000 or More | 73,097 | 1,793 | 2.19 | 59,072 | 1,551 | 2.63 | 48,286 | 1,542 | 3.19 |
| Other Time | 288 | 8 | 2.59 | 315 | 7 | 2.26 | 339 | 11 | 3.18 |
| Other Borrowings | 112,592 | 1,829 | 1.62 | 60,156 | 627 | 1.04 | 39,453 | 631 | 1.60 |
| Total Interest-Bearing Liabilities | 636,244 | 9,506 | 1.49 | 496,173 | 7,437 | 1.50 | 445,157 | 8,512 | 1.91 |
| Other Liabilities: | | | | | | | | | |
| Demand Deposits | 212,482 | | | 172,784 | | | 156,868 | | |
| Other Liabilities | 3,899 | | | 3,028 | | | 3,695 | | |
| Shareholders Equity | 71,577 | | | 67,673 | | | 63,189 | | |
| Total Liabilities and Shareholders Equity | $ 924,202 | | | $ 739,658 | | | $ 668,909 | | |

| | 2004 | | 2003 | | 2002 | |
|---|---|---|---|---|---|---|
| Net Interest Income and Margin (T/E Basis)(2) | $ 37,492 | 4.31% | $ 31,235 | 4.48% | $ 30,249 | 4.80% |

(1) Loan interest income includes fees and loan volumes include loans on non-accrual. The loan fees include loan origination fees which are considered adjustments to interest income. These fees aggregated $1,469,000, $1,248,000, and $1,097,000 for the years ended December 31, 2004, 2003, and 2002, respectively. Related loan origination costs are not separately allocated to loans, but are charged to non-interest expense. For the purpose of calculating loan yields, average loan balances include non-accrual loans with no related interest income.

(2) Presented on a tax equivalent basis ( T/E ) using a federal income tax rate of 34% in all three years.

Net interest margin was 4.31% for 2004, which represented a decrease of 17 basis points from 2003. This decrease in net interest margin in 2004 reflected a 14 basis point decrease in yield on earning assets from 2003 to 2004, which was offset by a 1 basis point decrease in rates paid on interest-bearing liabilities from 2003 to 2004. The decrease in net interest margin also reflected less earned income from the Corporation s investment in earning assets that are funded by its non-interest fundings (demand deposits and shareholders equity) in 2004 compared to 2003 due to the lower interest rate environment during this period.

Net interest margin was 4.48% for 2003, which represented a decrease of 32 basis points from 2002. This decrease in net interest margin in 2003 reflected a 61 basis point decrease in yield on earning assets from 2002 to 2003, which was offset by a 41 basis point decrease in rates paid on interest-bearing liabilities from 2002 to 2003. The decrease in net interest margin also reflected less earned income from the Corporation s investment in earning assets that are funded by its non-interest fundings (demand deposits and shareholders equity) in 2003 compared to 2002 due to the lower interest rate environment during this period.

If market rates increase during 2005, management expects that the net interest margin would increase from 2004 levels.

In the event that the Corporation s average loans continue to grow during 2005 and the Corporation is unable to fund any such growth through the generation of additional deposits, the Corporation may be required to obtain funding from secondary sources, such as the Federal Home Loan Bank, which could have a negative impact on its net interest margin as compared to funding from deposits.

The table below analyzes the increase in net interest income on a fully tax equivalent basis for each of the fiscal years ended December 31, 2002 to December 31, 2004. Non-accruing loans have been included in assets for these computations, thereby reducing yields on total loans. The changes in interest due to both rate and volume in the rate/volume analysis table below have been allocated to volume or rate change in proportion to the absolute amounts of the change in each.

| | 2004 vs. 2003 Increase (Decrease) Due to Changes in: | | | 2003 vs. 2002 Increase (Decrease) Due to Changes in: | | |
|---|---|---|---|---|---|---|
| **(Dollars in Thousands)** | **Volume** | **Rate** | **Total** | **Volume** | **Rate** | **Total** |
| Interest Earning Assets: | | | | | | |
| Federal Funds Sold and Due From Time | $ 65 | $ 24 | $ 89 | $ (83) | $ (48) | $ (131) |
| Investment Securities (Taxable) | 814 | (511) | 303 | 1,325 | (1,265) | 60 |
| Investment Securities (Tax-exempt) | 81 | -0- | 81 | 157 | (20) | 137 |
| Loans, Net of Unearned Discount | 8,845 | (992) | 7,853 | 2,801 | (2,956) | (155) |
| Total Interest Income | 9,805 | (1,479) | 8,326 | 4,200 | (4,289) | (89) |
| Interest-Bearing Liabilities: | | | | | | |
| Transaction Accounts & Savings | 794 | (133) | 661 | 261 | (859) | (598) |
| Certificates of Deposit and Other Time | 508 | (302) | 206 | 309 | (782) | (473) |
| Other Borrowings | 849 | 353 | 1,202 | 331 | (335) | (4) |
| Total Interest Expense | 2,151 | (82) | 2,069 | 901 | (1,976) | (1,075) |
| Changes in Net Interest Income | $ 7,654 | $ (1,397) | $ 6,257 | $ 3,299 | $ (2,313) | $ 986 |

Net interest income for 2004 increased $6.3 million, or 20.0%, compared to 2003. In this same period, total interest income increased 21.5% and total interest expense increased 27.8%, primarily due to significant increases in average loan and deposit volumes, partly attributable to ANB. The increase in net interest income in 2004 was achieved, despite the decline in the net interest margin, due to the 28.4% growth in average loans and the 20.9% growth in average deposits over 2003.

Net interest income for 2003 increased $1.0 million, or 3.3%, compared to 2002. In this same period, total interest income decreased 0.2% and total interest expense decreased 12.6%, primarily due to declines in market interest rates. The increase in net interest income in 2003 was achieved, despite the decline in market rates, due to the 8.9% growth in average loans and the 8.2% growth in average deposits over 2002.

**Non-interest Income**. Non-interest income is an important contributor to net income. The major component of the Corporation s non-interest income is various charges and fees earned by the Corporation on deposit accounts and related services. The following table summarizes the changes in non-interest income during the past three years (dollars in thousands):

| | Years Ended December 31, | | | | |
|---|---|---|---|---|---|
| | **2004** | | **2003** | | **2002** |
| | **Amount** | **% Change** | **Amount** | **% Change** | **Amount** |
| Service Charges on Deposit Accounts | $ 4,248 | 23.4% | $ 3,443 | 17.3% | $ 2,934 |
| Non-recurring Income | 204 | 100.0 | -0- | (100.0) | 51 |
| Gain on Sale of Investment Securities | 32 | (86.1) | 230 | 39.4 | 165 |

| | | | | | |
|---|---|---|---|---|---|
| Other Non-interest Income | 2,758 | 17.1 | 2,355 | 1.6 | 2,317 |
| Total Non-interest Income | $ 7,242 | 20.1% | $ 6,028 | 10.3% | $ 5,467 |

Non-interest income for 2004 was $7.2 million, which represented an increase of $1.2 million, or 20.1%, compared to 2003. $1.0 million of this increase was attributable to the additions of branches acquired from ANB. In addition, service charges on deposits from existing locations increased in 2004 primarily as a result of an increase in insufficient funds charges on deposit accounts. The non-recurring income in 2004 resulted from the gain of $167,000 on the sale of an asset previously carried in Other Assets and a gain of $37,000 on the partial sale of land carried in Premises and Equipment that was previously held for future branch expansion. The increase in other non-interest income in 2004 was primarily due to increases in income from debit card and ATM fees, printed check fees, trust fees, interest recovered on loans previously on non-accrual, gains on sales of student loans and insurance sales commissions. Insurance

sales commissions were derived from SIA and totaled $72,000 in 2004. The increase in printed check fees was due to a contractual rebate received from a new check provider. These increases were partially offset by declines in mortgage brokerage fees which declined during 2004 primarily as a result of a reduction in mortgage re-financings due to rising rates in the latter half of 2004 and a decline in letter of credit fees which were lower in 2004 due to the loss of a significant relationship during 2003. The Corporation derived $336,000 of revenues in 2004 from the sale of investment brokerage services which was less than that recorded in 2003 primarily due to revenue lost in 2004 due to the merger of several banks in Tarrant County involving banks that were previously investment services customers.

Non-interest income for 2003 was $6.0 million, which represented an increase of $0.6 million, or 10.3%, compared to 2002. Service charges on deposits increased in 2003 primarily as a result of an increase in insufficient funds charges on deposit accounts and an increase in account analysis income on commercial accounts due to the reduction in the earnings credit rate on those accounts. The increase in other non-interest income in 2003 was primarily due to an increase in income from ATM fees, mortgage brokerage fees and insurance sales commissions. Mortgage brokerage fees increased during 2003 primarily as a result of the low interest rate environment and its impact on new mortgage originations and mortgage re-financings. Insurance sales commissions were derived from SIA and totaled $35,000 in 2003. The Corporation derived $419,000 of revenues in 2003 from the sale of investment brokerage services.

**Non-interest Expense**. Non-interest expense includes all expenses of the Corporation other than interest expense, the provision for loan losses and income tax expense. The following table summarizes the changes in the non-interest expenses for the past three years (dollars in thousands):

| | Years Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2004 | | 2003 | | 2002 |
| | Amount | % Change | Amount | % Change | Amount |
| Salaries and Employee Benefits | $ 15,329 | 18.6% | $ 12,926 | 16.7% | $ 11,078 |
| Occupancy Expense - Net | 2,206 | 27.2 | 1,734 | 52.6 | 1,136 |
| Furniture and Equipment Expense | 2,261 | 20.5 | 1,877 | 19.0 | 1,577 |
| Other Real Estate Owned and Foreclosed Asset Expense - Net | 44 | | (4) | | 234 |
| Core Deposit Intangible Amortization | 219 | 100.0 | -0- | | -0- |
| Other Expenses: | | | | | |
| Business Development | 810 | 6.3 | 762 | (4.4) | 797 |
| Insurance - Other | 230 | (0.9) | 232 | 17.8 | 197 |
| Legal and Professional Fees | 1,267 | 84.2 | 688 | (11.1) | 774 |
| Item Processing | 895 | 33.2 | 672 | 130.1 | 292 |
| Taxes - Other | 51 | (20.3) | 64 | (22.9) | 83 |
| Postage and Courier | 443 | 20.4 | 368 | 2.8 | 358 |
| Printing and Supplies | 440 | 1.1 | 435 | 23.2 | 353 |
| Regulatory Fees and Assessments | 302 | 20.8 | 250 | 4.6 | 239 |
| Other Operating Expenses | 1,693 | 16.8 | 1,449 | 21.7 | 1,191 |
| Total Other Expenses | 6,131 | 24.6 | 4,920 | 14.8 | 4,284 |
| Total Non-interest Expense | $ 26,190 | 22.1% | $ 21,453 | 17.2% | $ 18,309 |

Total non-interest expense increased $4.7 million, or 22.1%, in 2004 over 2003 reflecting increases in salaries and benefits, occupancy and equipment expenses, legal and professional fees, item processing expenses and other miscellaneous expenses. Total non-interest expense increased $3.1 million, or 17.2%, in 2003 over 2002 reflecting increases in salaries and benefits, occupancy and equipment expenses, insurance expenses, supplies expenses and other miscellaneous expenses. As a percent of average assets, total non-interest expenses were 2.83%, 2.90% and 2.74% in 2004, 2003 and 2002, respectively.

The increase in salaries and employee benefits for both years of 2004 and 2003 were due to salary merit increases, additions to staff, employee bonus expenses and increases in the cost of employee insurance. In addition, $1.3 million of the increase in salaries and benefits for 2004 was attributable to the addition of the ANB staff. In 2004 and 2003, the bonus expense was $0.9 million and $0.8 million, respectively. The average number of full-time equivalent employees increased in 2004 and 2003 by 31.2 and 11.6, respectively, to an average full-time equivalent staff of 244.3 and 213.1, respectively. At year-end 2004, the full-time equivalent staff was 254 as compared to 225 at the same time of 2003. The

impact of the ANB acquisition on 2004 full-time equivalent staff represented an increase of 23.9 on the full year average and 31 to the year end total.

Occupancy expenses increased in 2004 due to the addition of the ANB locations, which added $0.3 million to this expense, the addition of the Euless branch facility and a full year of expenses related to the facility leased in May 2003 to house the Corporation s administrative, credit and data processing departments as well as the Hulen branch personnel. The increase in occupancy expense in 2003 was due to the addition of two new branch facilities and the relocation and centralization of the support groups previously mentioned into a new facility which was leased beginning in May 2003. Rental expense for the Corporation has increased each year from 2002 to 2004, increasing from nearly $0.6 million in 2002 to $1.0 million in 2003 and $1.1 million in 2004 due to the added facilities mentioned above.

The increase in equipment expense in 2004 was primarily related to an increase in depreciation expense due to a 11.0% increase in average furniture and equipment assets during 2004. The increase in 2004 was also attributable to the ANB acquisition which added $0.3 million to furniture and equipment assets plus the facility for the support functions mentioned above. The increase in equipment expense in 2003 was primarily related to an increase in depreciation expense due to a 62.7% increase in furniture and equipment assets during 2003. The increase in 2003 also included the full year impact of the investment in new hardware and software related to a core system data processing conversion made in October 2002, the cost of equipment added in new branches and the new facility for the support functions mentioned above and the cost of a new telephone system.

The increase in the amortization of core deposit intangibles during 2004 was related to the ANB acquisition. As discussed in Note 6 to the Consolidated Financial Statements, a premium of $10.7 million was paid in connection with the acquisition of ANB, $2.7 million of which was identified as core deposit intangible. The core deposit intangibles will be amortized over their estimated useful life of 8 years using a straight line method.

Legal and professional fees increased significantly in 2004 compared to the prior year as a result of compliance with the Sarbanes-Oxley Act of 2002 and other corporate governance functions plus the cost of consultants related to compensation and asset-liability management issues.

Item processing expenses increased in 2004 over 2003 due to the addition of ANB and the conversion to a new internet banking system. These expenses increased in 2003 compared to 2002 as a result of the full year impact of the October 2002 core data processing system conversion.

Insurance expense increased in 2003 primarily due to the additional cost of directors and officers liability insurance which increased $50,000 over the cost of this insurance in 2002.

The increase in supplies expense in 2003 was related to the initial starting cost of the Davis and Hulen branches and new forms required due to the centralization of departments to a new facility.

The increase in other miscellaneous expenses in 2004 was primarily due to ANB which added $188,000 of expense in this category (primarily ATM, loan collection and telephone expenses). The increase in other miscellaneous expense in 2003 was due to a $319,000 insurance settlement received during 2002 related to other foreclosed assets.

**Federal Income Tax Expense**. The Corporation has adopted Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes. See Note 13 of the Notes to Consolidated Financial Statements for details of tax expense. The Corporation expensed $5,851,000, $5,017,000 and $4,846,000 for federal income taxes for the years ending December 31, 2004, 2003 and 2002, respectively. These amounts resulted in an effective tax rate of 35.0% for 2004, 34.0% for 2003 and 34.2% for 2002.

**Investment Securities**. The following table presents the consolidated investment securities portfolio at amortized cost as of December 31, 2004, all of which are classified as Available-for-Sale (see Note 1 of the Notes to Consolidated Financial Statements for a discussion of this designation), by stated maturity and with the weighted average interest yield for each range of maturities. The yields on tax-exempt obligations are computed on a fully taxable equivalent basis using statutory rates for federal income taxes.

| | December 31, 2004 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Due 1 Year or Less | | Due 1 to 5 Years | | Due 5 to 10 Years | | Due After 10 Years | | |
| (Dollars in Thousands) | Amount | Yield | Amount | Yield | Amount | Yield | Amount | Yield | Total |
| U.S. Government Agencies and Corporations | $ 14,099 | 4.20% | $ 148,779 | 3.57% | $ 968 | 4.37% | $ -0- | % | $ 163,846 |
| U.S. Government Agency Mortgage Backed Securities | -0- | | 9,965 | 4.04 | 17,518 | 3.66 | 16,597 | 3.92 | 44,080 |
| Obligations of States and Political Subdivisions | 505 | 5.01 | 3,759 | 4.81 | 3,745 | 5.32 | -0- | | 8,009 |
| Other Securities | -0- | | -0- | | -0- | | 8,135 | 2.92 | 8,135 |

| | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Total | $ | 14,604 | 4.23% | $ | 162,503 | 3.63% | $ | 22,231 | 3.97% | $ | 24,732 | 3.59% | $ | 224,070 |

The yield on the investment securities portfolio of the Corporation at December 31, 2004 was 3.80% and the weighted average life of the portfolio on that date was approximately 3.0 years. At December 31, 2003, the yield of the portfolio was 3.98% and the weighted average life was approximately 3.7 years. The average life of the portfolio decreased during 2004 as a significant amount of mortgage backed securities were sold during the year due to the rise in market rates in the last half of the year and the related negative impact on the market values of these securities. Mortgage backed securities typically have a longer life than the other types of securities within the portfolio. As of December 31, 2004, there was a net unrealized loss of $719,000 in the portfolio, or (0.3)% of the amortized cost of those securities.

The following table summarizes the book and fair value of investment securities held by the Corporation as of December 31 for the past three years (dollars in thousands):

| | December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2004 | % of Total | 2003 | % of Total | 2002 | % of Total |
| U.S. Treasury Securities | $ -0- | % | $ -0- | % | $ 1,018 | 0.6% |
| U.S. Government Agencies and Corporations | 163,620 | 73.3 | 120,024 | 61.2 | 124,786 | 71.9 |
| U.S. Government Agency Mortgage Backed Securities | 43,482 | 19.5 | 61,243 | 31.3 | 38,157 | 22.0 |
| Obligations of States and Political Subdivisions | 8,123 | 3.6 | 7,068 | 3.6 | 4,899 | 2.8 |
| Other Securities | 8,126 | 3.6 | 7,624 | 3.9 | 4,652 | 2.7 |
| Total | $ 223,351 | 100.0% | $ 195,959 | 100.0% | $ 173,512 | 100.0% |

In 2004, approximately $23.2 million of investment securities were sold, resulting in $32,000 of gains from these sales. In 2003, approximately $125.6 million of investment securities were sold, resulting in $230,000 of gains from these sales.

**Loans**. The following schedule classifies loans according to type as of December 31 for the past five years (dollars in thousands):

| | December 31, | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2004 | % of Total | 2003 | % of Total | 2002 | % of Total | 2001 | % of Total | 2000 | % of Total |
| Commercial and Industrial | $ 261,571 | 37.2% | $ 219,805 | 39.7% | $ 195,120 | 41.6% | $ 184,716 | 42.9% | $ 167,818 | 44.2% |
| Real Estate-Commercial | 224,720 | 32.0 | 159,082 | 28.7 | 130,755 | 27.9 | 107,600 | 25.0 | 94,066 | 24.7 |
| Real Estate-Residential | 82,839 | 11.8 | 67,635 | 12.2 | 48,447 | 10.3 | 44,522 | 10.3 | 37,996 | 10.0 |
| Real Estate-Construction | 93,558 | 13.3 | 74,069 | 13.4 | 59,941 | 12.8 | 60,548 | 14.1 | 47,183 | 12.4 |
| Loans to Individuals, Net of Unearned Discount | 39,931 | 5.7 | 33,178 | 6.0 | 34,882 | 7.4 | 33,368 | 7.7 | 32,953 | 8.7 |
| Total Loans, Net of Unearned Income | $ 702,619 | 100.0% | $ 553,769 | 100.0% | $ 469,145 | 100.0% | $ 430,754 | 100.0% | $ 380,016 | 100.0% |

The preceding loan distribution table reflects that total loans increased $148.9 million, or 26.9%, from December 31, 2003 to December 31, 2004, and $84.6 million, or 18.0%, from December 31, 2002 to December 31, 2003. Although these dollar increases were significant, the Corporation is continuing to apply stringent credit criteria on all loan applications. At December 31, 2004, 2003 and 2002, loans represented 88.7%, 86.3% and 80.6%, respectively, of deposits, reflecting a somewhat slower growth in deposits compared to loans over these periods. For the years 2004, 2003 and 2002, average loans represented 88.0%, 82.9% and 82.3%, respectively, of average deposits.

The commercial loan customers of the Corporation are primarily small to medium-sized businesses and professionals and executives. The Corporation offers a variety of commercial loan products that include revolving lines of credit, letters of credit, working capital loans and loans to finance accounts receivable, inventory and equipment. Generally, these commercial loans have floating rates of interest with terms of maturity of three years or less.

A significant portion of the Corporation s commercial real estate mortgage portfolio in 2004 and 2003 represented loans to finance owner-occupied real estate. The growth in 2004 and 2003 was partially attributable to significant new customer relationships formed during those years. At December 31, 2004 and 2003, $145.4 million and $109.1 million of loans, respectively and approximately 64.7% and 68.6%, respectively, of the commercial real estate mortgage portfolio, had been made for this purpose. At both December 31, 2004 and 2003, approximately 52% of the loans in the commercial real estate mortgage portfolio have variable rates of interest with a significant portion of the

remaining portfolio having balloon terms of five to seven years and/or rate adjustment clauses.

Real estate construction loans are made primarily to finance construction of single family residences in the Corporation s market area of Tarrant County, Texas. Construction loans generally are secured by first liens on real estate and have floating interest rates. The Corporation s lending activities in this area are primarily with borrowers that have been in the building trade for many years and with which the Corporation has long standing relationships. The Corporation s lending officers meet quarterly with consultants that track the residential building activities within the market. The Corporation adjusts its construction lending activities based on the trends of housing starts and absorption rates in the market.

The Corporation also lends to consumers for purchases of various consumer goods, such as automobiles and boats, and for home improvements. The terms of these loans typically are five years or less and are well secured with liens on products purchased or other assets. These loans are primarily made to customers who have other relationships with the Corporation. The Corporation does not issue credit cards and does not have any credit card loans outstanding.

As of December 31, 2004 and 2003, the Corporation had no concentration, by Standard Industrial Classification Code, in any single industry that exceeded 10% of total loans at such dates.

The following table presents commercial loans and real estate construction loans at December 31, 2004, based on scheduled principal repayments and the total amount of loans due after one year classified according to sensitivity to changes in interest rates (in thousands):

| | One Year or Less | Over One Year Through Five Years | Over Five Years | Total |
|---|---|---|---|---|
| Commercial and Industrial | $ 221,232 | $ 33,408 | $ 6,931 | $ 261,571 |
| Real Estate - Construction | 83,534 | 5,279 | 4,745 | 93,558 |
| Totals | $ 304,766 | $ 38,687 | $ 11,676 | $ 355,129 |

Of the loans maturing after one year, all have fixed rates of interest, with many having rate adjustment clauses during the remaining term of the loan that allow for periodic adjustments to rates.

**Allowance for Loan Losses**. Each loan carried by the Corporation involves some degree of inherent risk. This risk is reflected in the consolidated financial statements through the provision for loan losses and the allowance for loan losses.

The allowance for loan losses represents the amount which, in management s judgment, will be adequate to absorb future charge-offs of existing loans that may become uncollectible. Loans, or portions thereof, are charged against the allowance when management believes that full collection of the principal and interest is unlikely, and subsequent recoveries, if any, are credited to the allowance when received. Adjustments to the allowance for loan losses are reported in the period during which such adjustments become known or are reasonably estimable.

The allowance for loan losses is established through charges to income in the form of a provision for loan losses when it is probable that all amounts due pursuant to the contractual terms of the loan will not be collected. The amount of the provision for loan losses is a reflection of management s judgment as to the adequacy of the allowance for loan losses and is based upon management s evaluation of a number of factors, including past loan loss experience, current and projected economic conditions, delinquency ratios and management s review of the value of discounted cash flows associated with impaired loans.

The Corporation has adopted Statement of Financial Accounting Standards No. 114, Accounting by Creditors for Impairment of a Loan as amended by Statement of Financial Accounting Standards No. 118, Accounting by Creditors for Impairment of a Loan Income Recognition and Disclosure. These standards specify how allowances for certain impaired loans should be determined and the accounting for in-substance foreclosures.

The following table presents average loans, net of unearned income, and an analysis of the allowance for loan losses (dollars in thousands):

| | Years Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2004 | 2003 | 2002 | 2001 | 2000 |
| Average Loans Outstanding | $ 647,686 | $ 504,520 | $ 463,106 | $ 402,763 | $ 373,997 |
| Analysis of Allowance for Loan Losses: | | | | | |
| Balance, Beginning of Year | $ 7,784 | $ 6,706 | $ 6,015 | $ 5,399 | $ 5,169 |
| Balance Acquired in Arlington National Bank Acquisition | 1,254 | -0- | -0- | -0- | -0- |
| Charge-Offs: | | | | | |
| Commercial and Industrial | 814 | 351 | 2,330 | 1,280 | 2,429 |
| Real Estate-Mortgage | 12 | 31 | 213 | 4 | -0- |
| Real Estate - Construction | -0- | -0- | 10 | -0- | -0- |
| Loans to Individuals | 215 | 157 | 268 | 123 | 171 |
| Total Charge-Offs | 1,041 | 539 | 2,821 | 1,407 | 2,600 |
| Recoveries: | | | | | |
| Commercial and Industrial | 258 | 595 | 296 | 80 | 140 |
| Real Estate-Mortgage | 85 | 79 | 22 | 164 | 10 |
| Real Estate - Construction | -0- | -0- | -0- | -0- | -0- |
| Loans to Individuals | 57 | 63 | 54 | 24 | 74 |
| Total Recoveries | 400 | 737 | 372 | 268 | 224 |
| Net Charge-Offs (Recoveries) | 641 | (198) | 2,449 | 1,139 | 2,376 |
| Provision Charged to Operating Expense | 1,790 | 880 | 3,140 | 1,755 | 2,606 |
| Balance, End of Year | $ 10,187 | $ 7,784 | $ 6,706 | $ 6,015 | $ 5,399 |
| Ratio of Net Charge-Offs (Recoveries) to Average Loans Outstanding | 0.10% | (0.04)% | 0.53% | 0.28% | 0.64% |

The increase in the allowance for loan losses in 2004 from 2003 resulted from the increase in provision for loan loss expense which primarily reflected the growth in total loans plus the increase in net charge-offs in 2004 from 2003. In addition, the allowance for loan losses acquired in the ANB acquisition contributed to the growth in the balance of the allowance as of December 31, 2004. Asset quality remained strong (in part due to the performance of the Chief Credit Officer who is responsible for monitoring loan quality by ensuring that the quality is sustained, that individual loans perform as agreed and that the Bank receives an appropriate return for the risk in the portfolio) and the local economy continued to improve.

The decrease in provision for loan losses in 2003 from 2002 primarily reflected a continued improvement in asset quality, improvement in the local economy and a higher loan charge-off rate in 2002 compared to 2003.

The following table reflects the allowance for loan losses compared to total loans at the end of each year (dollars in thousands):

| | December 31, | | | | |
|---|---|---|---|---|---|
| | 2004 | 2003 | 2002 | 2001 | 2000 |
| Total Loans | $ 702,619 | $ 553,769 | $ 469,145 | $ 430,754 | $ 380,016 |

| | | | | | |
|---|---|---|---|---|---|
| Allowance for Loan Losses | 10,187 | 7,784 | 6,706 | 6,015 | 5,399 |
| Allowance for Loan Losses as a Percent of Total Loans | 1.45% | 1.41% | 1.43% | 1.40% | 1.42% |
| Allowance for Loan Losses as a Percent of Non-Performing Loans | 394.0 | 331.0 | 314.0 | 146.0 | 247.0 |

The following table illustrates the allocation of the allowance for loan losses to the various loan categories (dollars in thousands); see the table on page 20 for the percent of specific types of loans to total loans:

| | December 31, | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2004 | | 2003 | | 2002 | | 2001 | | 2000 | |
| | Amount | % of Total | Amount | % of Total | Amount | % of Total | Amount | % of Total | Amount | % of Total |
| Allowance For Loan Losses: | | | | | | | | | | |
| Commercial and Industrial | $ 3,973 | 39.0% | $ 3,087 | 39.7% | $ 3,231 | 48.2% | $ 3,336 | 55.5% | $ 2,066 | 38.3% |
| Real Estate-Mortgage | 3,138 | 30.8 | 2,215 | 28.5 | 1,697 | 25.3 | 1,613 | 26.8 | 1,095 | 20.3 |
| Real Estate - Construction | 831 | 8.2 | 646 | 8.3 | 493 | 7.4 | 635 | 10.6 | 381 | 7.1 |
| Loans to Individuals | 544 | 5.3 | 387 | 5.0 | 411 | 6.1 | 365 | 6.0 | 374 | 6.9 |
| Unallocated Portion | 1,701 | 16.7 | 1,449 | 18.5 | 874 | 13.0 | 66 | 1.1 | 1,483 | 27.4 |
| Total | $ 10,187 | 100.0% | $ 7,784 | 100.0% | $ 6,706 | 100.0% | $ 6,015 | 100.0% | $ 5,399 | 100.0% |

The allocations are comprised of specific allocations that are determined by providing specific reserves against each loan that is criticized (as defined on page 30 under Critical Accounting Policies ) as being weak, plus a general allocation against the remaining balance of the portfolio based on experience factors. Management of the Corporation believes that the allowance for loan losses at December 31, 2004 is adequate to cover losses inherent in the portfolio. There can be no assurance that the Corporation will not sustain loan losses in future periods which could be substantial in relation to, or exceed, the size of the current allowance. The total allowance is available to absorb losses from any loan.

**Non-Performing Assets**. Non-performing assets consist of non-accrual loans, renegotiated loans, other real estate and other foreclosed assets. Non-accrual loans are those on which the accrual of interest has been suspended and on which the interest is recorded as earned when it is received. Loans are generally placed on non-accrual status when principal or interest is past due 90 days or more and the loan is not both well-secured and in the process of collection, or immediately, if in the opinion of management, full collection of principal or interest is doubtful. At the time a loan is placed on non-accrual status, interest previously recorded but not collected is reversed and charged against current interest income.

Renegotiated loans are loans on which the interest and/or the principal have been reduced due to a deterioration in the borrower s financial condition. Even though these loans are actually performing, they are included in non-performing assets because of the loss of revenue related to the reduction of interest and/or principal.

Other real estate is real estate acquired through foreclosure or through partial settlement of debts and which is awaiting sale and disposition. At the time of acquisition, other real estate is recorded at the lower of estimated fair value less estimated selling costs or the loan balance or settlement agreement with any write-down charged to the allowance for loan losses. Any further write-downs, expenses related to the property and any gain or loss resulting from the sale of the property are recorded in current operating expenses.

Other foreclosed assets are other types of collateral (such as autos, shares of stock and equipment) acquired through foreclosure or through partial settlement of debts which are awaiting sale and disposition. At the time of acquisition, other foreclosed assets are recorded at the lower of estimated fair value less estimated selling costs or the loan balance or settlement agreement with any write-down charged to the allowance for loan losses. Any further write-downs, expenses related to the asset and any gain or loss resulting from the sale of the asset are recorded in current operating expenses.

The Corporation is required, by regulatory authorities, to have other real estate and other foreclosed assets evaluated periodically. In the event the new evaluation value is less than the carrying value of the property, the excess is written off to expense. Some properties or foreclosed assets are written down below their evaluation values when management believes the economic value has declined below the evaluation value.

The following table summarizes the non-performing assets and loans 90 days past due and still accruing (dollars in thousands):

| | December 31, | | | | |
|---|---|---|---|---|---|
| | 2004 | 2003 | 2002 | 2001 | 2000 |
| Non-accrual Loans | $ 2,587 | $ 2,351 | $ 2,135 | $ 4,115 | $ 2,182 |
| Renegotiated Loans | -0- | -0- | -0- | -0- | -0- |
| Other Real Estate & Other Foreclosed Assets | -0- | -0- | 1,268 | 444 | 1,595 |
| Total Non-Performing Assets | $ 2,587 | $ 2,351 | $ 3,403 | $ 4,559 | $ 3,777 |
| As a Percent of: | | | | | |
| Total Assets | 0.26% | 0.30% | 0.49% | 0.72% | 0.61% |
| Total Loans and Other Real Estate & Other Foreclosed Assets | 0.37 | 0.42 | 0.72 | 1.06 | 0.99 |
| Loans Past Due 90 Days or More and Still Accruing | $ 18 | $ 55 | $ 16 | $ 16 | $ 10 |

Non-accrual loans at December 31, 2004, were comprised of $1,841,000 in commercial loans, $469,000 in real estate mortgages, $119,000 in interim construction loans and $158,000 in consumer loans. Of the total non-accrual loans at December 31, 2004 of $2,587,000, $1,190,000 was SBA guaranteed. There was no Other Real Estate and Other Foreclosed Assets as of December 31, 2004.

Non-accrual loans at December 31, 2003, were comprised of $1,763,000 in commercial loans, $388,000 in real estate mortgages, $65,000 in interim construction loans and $135,000 in consumer loans. Of the total non-accrual loans at December 31, 2003 of $2,351,000, $964,000 was SBA guaranteed. There was no Other Real Estate and Other Foreclosed Assets as of December 31, 2003.

The impact on interest income from the above referenced non-accrual loans and renegotiated loans for each of the past five years is provided below (in thousands):

| | Years Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2004 | 2003 | 2002 | 2001 | 2000 |
| Gross Amount of Interest That Would Have Been Recorded at Original Rate | $ 221 | $ 162 | $ 171 | $ 340 | $ 600 |
| Interest Included in Income | 72 | 75 | 99 | 195 | 206 |
| Interest Not Recorded in Income | $ 149 | $ 87 | $ 72 | $ 145 | $ 394 |

Loans are graded on a system similar to that used by the banking industry regulators (as described on page 30 under Critical Accounting Policies ). In addition to the above grading system, the Corporation maintains a separate watch list which further aids the Corporation in monitoring loan quality. Watch list loans show warning elements where the present status portrays one or more deficiencies that require attention in the short run or where pertinent ratios of the loan account have weakened to a point where more frequent monitoring is warranted.

Non-accrual loans normally include weaker Substandard loans and loans that are considered to be Doubtful (which are defined later in this section).

An independent third party loan review was completed in late 2004. In addition, a regulatory examination was completed in early 2004. Based on the findings of these reviews and exams, management considers the loan portfolio to be adequately reserved.

Criticized loans (loans classified as OAEM, Substandard or Doubtful as noted on page 30) have increased since 2000. A significant portion of this year-over-year increase is due to enhanced classification procedures and the performance of the Chief Credit Officer employed by the Corporation in the third quarter of 2001 to assist in monitoring loan quality. In addition, $3.4 million of the increase in criticized loans from 2003 to 2004 is attributable to criticized loans within the ANB portfolio. Our aggressiveness in recognizing any weakness in our borrowers is the primary reason for the increase in criticized loans year-over-year since 2000. The Corporation remains diligent in its efforts to identify any loan that might reflect weakness of the borrower as soon as possible. Management is not aware of any potential loan problems that have not been disclosed to which serious doubts exist as to the ability of the borrower to substantially comply with the present repayment terms and the

Corporation does not anticipate any significant losses from these downgraded credits.

The following table summarizes the relationship between non-performing loans, criticized loans and the allowance for loan losses (dollars in thousands):

| | December 31, | | | | |
|---|---|---|---|---|---|
| | 2004 | 2003 | 2002 | 2001 | 2000 |
| Non-Performing Loans | $ 2,587 | $ 2,351 | $ 2,135 | $ 4,115 | $ 2,182 |
| Criticized Loans | 35,375 | 27,737 | 23,067 | 24,879 | 11,536 |
| Allowance for Loan Losses | 10,187 | 7,784 | 6,706 | 6,015 | 5,399 |
| Allowance for Loan Losses as a Percent of: | | | | | |
| Non-Performing Loans | 394.0% | 331.0% | 314.0% | 146.0% | 247.0% |
| Criticized Loans | 29.0 | 28.0 | 29.0 | 24.0 | 47.0 |

**Deposits**. The primary source of the Corporation s funds is deposits. The majority of the Corporation s deposits are considered core deposits. Core deposits are those that are not subject to material changes due to customer withdrawal because of market rate changes. Average demand deposits increased $39.7 million, or 23.0%, from 2003 to 2004, and increased $15.9 million, or 10.1%, from 2002 to 2003. Demand deposits from the acquired ANB locations added $19.5 million to the 2004 average. Average demand deposits represented 28.9% and 28.4% of average total deposits during 2004 and 2003, respectively. Average interest-bearing deposits increased $87.6 million, or 20.1%, from 2003 to 2004, and increased $30.3 million, or 7.5%, from 2002 to 2003. Interest-bearing deposits from the ANB locations added $47.7 million to the 2004 average. The deposit types daily average balance and related average rates paid during each of the last three years are as follows (dollars in thousands):

| | 2004 | | 2003 | | 2002 | |
|---|---|---|---|---|---|---|
| | Amount | Rate Paid | Amount | Rate Paid | Amount | Rate Paid |
| Noninterest-Bearing Demand Deposits | $ 212,482 | | $ 172,784 | | $ 156,868 | |
| Interest-Bearing Deposits: | | | | | | |
| Interest-Bearing Transaction Accounts | 232,155 | 1.08% | 193,841 | 1.09% | 180,060 | 1.32% |
| Savings | 149,510 | 1.23 | 119,851 | 1.32 | 112,977 | 1.69 |
| Certificates of Deposit under $100,000 and IRA s | 68,602 | 2.22 | 62,938 | 2.48 | 64,042 | 3.19 |
| Certificates of Deposit of $100,000 or More | 73,097 | 2.45 | 59,072 | 2.63 | 48,286 | 3.19 |
| Other Time Deposits | 288 | 2.59 | 315 | 2.26 | 339 | 3.18 |
| Total Interest-Bearing Deposits | 523,652 | 1.47% | 436,017 | 1.56% | 405,704 | 1.94% |
| Total Deposits | $ 736,134 | | $ 608,801 | | $ 562,572 | |

The remaining maturity on certificates of deposit of $100,000 or more as of December 31, 2004, 2003 and 2002 is presented below (dollars in thousands):

| Maturity | 2004 | % of Total | 2003 | % of Total | 2002 | % of Total |
|---|---|---|---|---|---|---|
| 3 months or less | $ 18,387 | 23.1% | $ 10,598 | 16.8% | $ 12,076 | 23.2% |
| 3 to 6 months | 8,332 | 10.4 | 11,799 | 18.7 | 9,962 | 19.2 |
| 6 to 12 months | 9,827 | 12.3 | 13,583 | 21.5 | 14,808 | 28.4 |
| Over 12 months | 43,208 | 54.2 | 27,119 | 43.0 | 15,204 | 29.2 |

The shift, reflected in the above table, toward longer maturities from 2002 to 2004 is due to the Corporation paying a premium on certificates of deposit with three year maturities to offset some of the loan growth with similar maturities during this period.

**Borrowings.** Securities sold under repurchase agreements generally represent borrowings with maturities ranging from one to thirty days. These borrowings are with significant commercial customers of the Corporation that require short-term liquidity for their funds. Information relating to these borrowings for the last three years is summarized as follows (dollars in thousands):

| | December 31, | | |
|---|---|---|---|
| | 2004 | 2003 | 2002 |
| Securities Sold Under Repurchase Agreements: | | | |
| Average Balance | $ 33,068 | $ 26,850 | $ 20,141 |
| Year-End Balance | 43,972 | 32,234 | 22,955 |
| Maximum Month-End Balance During Year | 43,972 | 32,234 | 29,560 |
| Interest Rate: | | | |
| Average | 0.68% | 0.31% | 0.87% |
| Year-End | 1.64 | 0.44 | 0.59 |
| Federal Home Loan Bank Advances: | | | |
| Average Balance | $ 67,732 | $ 30,532 | $ 17,989 |
| Year-End Balance | 60,000 | 50,000 | 14,300 |
| Maximum Month-End Balance During Year | 100,000 | 50,000 | 25,000 |
| Interest Rate: | | | |
| Average | 1.65% | 1.65% | 2.37% |
| Year-End | 2.11 | 1.52 | 2.41 |
| Federal Funds Purchased: | | | |
| Average Balance | $ 1,878 | $ 2,774 | $ 1,178 |
| Year-End Balance | -0- | -0- | -0- |
| Maximum Month-End Balance During Year | 21,525 | 7,200 | 8,650 |
| Interest Rate: | | | |
| Average | 1.45% | 1.41% | 2.03% |
| Year-End | -0- | -0- | -0- |

Also, the Corporation has available a line of credit with the Federal Home Loan Bank of Dallas ( FHLB ), which allows it to borrow on a collateralized basis at a fixed term. The borrowings are collateralized by a blanket floating lien on all first mortgage loans (which totaled $183.4 million at December 31, 2004), the FHLB capital stock owned by the Corporation and any funds on deposit with the FHLB. At December 31, 2004, $60.0 million of borrowings were outstanding under the line of credit at an average rate of 2.11%, $40.0 million of which matures during 2005 and $20.0 million of which matures in April 2006. For the year ended December 31, 2004, the Corporation had average borrowings of $67.7 million under this line of credit with the FHLB. The increase in FHLB borrowings in 2004 coincided with the significant increase in loans during the year. At December 31, 2003, the Corporation had $50.0 million of borrowings outstanding under the line of credit at an average rate of 1.52%, $45.0 million of which matured during 2004 and $5.0 million of which matures in April 2005.

In addition, from time to time the Corporation purchases Federal Funds from correspondent banks to meet periodic liquidity needs.

**Notes Payable.** On September 15, 2004, the Corporation obtained a line of credit from a bank under which the Corporation may borrow $10.0 million at a floating rate (three month LIBOR plus a margin of 2.00%). The line of credit is secured by stock of the Bank and matures on September 15, 2005, whereupon, if balances are outstanding, the line converts to a term note having a five year term. The Corporation will not pay a fee for any unused portion of the line. At December 31, 2004, $1.75 million had been borrowed under this line. The rate on this line at December 31, 2004 was 4.02%. The purpose of the line was to provide an additional liquidity source and the current amount outstanding was used to help fund the acquisition of ANB.

**Junior Subordinated Deferrable Debentures.** On May 3, 2004, the Corporation formed SBI Trust and SBI Trust subsequently issued $12.0 million of floating rate (three month LIBOR plus a margin of 2.65%) Capital Securities (the Trust Capital Securities ). Concurrent with the issuance of the Trust Capital Securities, SBI Trust issued trust common securities to the Corporation in the aggregate liquidation value of $372,000. The proceeds of the issuance of the Trust Capital Securities and trust common securities were invested in the Corporation s Floating Rate Junior Subordinated Deferrable Debentures (the Deferrable Debentures ), which mature on July 7, 2034 and have a call feature that permits the Corporation to redeem any or all of the securities after July 7, 2009. The interest rate on the Deferrable Debentures at December 31, 2004 was 4.72%. The Deferrable Debentures, which are the only assets of SBI Trust, are subordinated and junior in right of payment to all present and future senior indebtedness (as defined in the Indenture dated May 3, 2004) of the Corporation.

**Off-Balance-Sheet Arrangements, Commitments, Guarantees and Contractual Obligations**. In the normal course of business, the Corporation enters into various transactions, which, in accordance with accounting principles generally accepted in the United States, are not included in its consolidated balance sheets. The Corporation enters into these transactions to meet the financing needs of its customers. These transactions include commitments to extend credit and standby letters of credit, which involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amounts recognized in the consolidated balance sheets.

The Corporation enters into contractual loan commitments to extend credit, normally with fixed expiration dates or termination clauses, at specified rates and for specific purposes. Substantially all of the Corporation s commitments to extend credit are contingent upon customers maintaining specific credit standards at the time of loan funding. The Corporation minimizes its exposure to loss under these commitments by subjecting them to credit approval and monitoring procedures. Management assesses the credit risk associated with certain commitments to extend credit in determining the level of the allowance for possible loan losses.

Standby letters of credit are written conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. In the event the customer does not perform in accordance with the terms of the agreement with the third party, the Corporation would be required to fund the commitment. The maximum potential amount of future payments the Corporation could be required to make is represented by the contractual amount of the commitment. If the commitment is funded, the Corporation would be entitled to seek recovery from the customer. The Corporation s policies generally require that standby letter of credit arrangements contain security and debt covenants similar to those contained in loan agreements.

The following table summarizes the Corporation s contractual obligations and other commitments to make future payments as of December 31, 2004 (dollars in thousands). Payments for borrowings do not include interest. Payments related to leases are based on actual payments specified in the underlying contracts. Loan commitments and standby letters of credit are presented at contractual amounts; however, since many of these commitments are expected to expire unused or only partially used, the total amounts of these commitments do not necessarily reflect future cash requirements.

| | Payments Due by Period | | | | |
|---|---|---|---|---|---|
| | **1 Year or Less** | **More Than 1 Year But Less Than 3 Years** | **3 Years or More But Less Than 5 Years** | **5 Years or More** | **Total** |
| Contractual Obligations: | | | | | |
| Federal Home Loan Bank Advances | $ 40,000 | $ 20,000 | $ -0- | $ -0- | $ 60,000 |
| Operating Leases | 1,201 | 2,320 | 2,018 | 2,280 | 7,819 |
| Deposits with Stated Maturity Dates | 75,764 | 73,556 | 3,410 | -0- | 152,730 |
| Total | 116,965 | 95,876 | 5,428 | 2,280 | 220,549 |
| Other Commitments: | | | | | |
| Loan Commitments | 130,348 | 15,946 | 2,352 | 26,428 | 175,074 |
| Standby Letters of Credit | 5,814 | 339 | 22 | -0- | 6,175 |
| Total | 136,162 | 16,285 | 2,374 | 26,428 | 181,249 |
| Total Contractual Obligations and Other Commitments | $ 253,127 | $ 112,161 | $ 7,802 | $ 28,708 | $ 401,798 |

**Interest Rate Sensitivity**. The objectives of monitoring and managing the interest rate risk of the balance sheet are to contribute to earnings by minimizing adverse changes in net interest income as a result of changes in the direction and level of interest rates and to provide liquidity to satisfy cash flow requirements to meet customers fluctuating demands.

Interest rate sensitivity is the relationship between changes in the market interest rates and changes in net interest income due to the repricing characteristics of assets and liabilities.

An asset-sensitive position in a given period will result in more assets than liabilities being subject to repricing; therefore, market interest-rate changes will be reflected more quickly in asset rates. If interest rates decline, such a position will have an adverse effect on net interest income. Conversely, in a liability-sensitive position, where liabilities reprice more quickly than assets in a given period, a decline in market rates will

benefit net interest income.

A mix of earning assets and interest-bearing liabilities in which relatively equal volumes reprice each period represents a matched interest sensitivity GAP position; any excess of these assets or liabilities results in an interest sensitive GAP.

The following table, commonly referred to as a static GAP report, indicates the interest rate sensitivity position at December 31, 2004 and may not be reflective of positions in subsequent periods (dollars in thousands):

| | Due in 30 Days Or Less | Due in 31-180 Days | Due in 181 Days to One Year | Total Rate Sensitive | Repriced After 1 Year or Non-Rate Sensitive | Total |
|---|---|---|---|---|---|---|
| Earning Assets: | | | | | | |
| Loans | $ 415,392 | $ 46,025 | $ 37,239 | $ 498,656 | $ 203,963 | $ 702,619 |
| Investment Securities | 10,311 | 12,734 | 11,943 | 34,988 | 188,363 | 223,351 |
| Federal Funds Sold & Due From Time | 5,020 | -0- | -0- | 5,020 | -0- | 5,020 |
| Total Earning Assets | 430,723 | 58,759 | 49,182 | 538,664 | 392,326 | 930,990 |
| Interest-Bearing Liabilities: | | | | | | |
| Interest-Bearing Transaction Accounts and Savings | 404,136 | -0- | -0- | 404,136 | -0- | 404,136 |
| Certificates of Deposit under $100,000 and IRA s | 3,799 | 21,512 | 13,857 | 39,168 | 33,657 | 72,825 |
| Certificates of Deposit of $100,000 or More | 4,487 | 22,232 | 9,827 | 36,546 | 43,208 | 79,754 |
| Other Time Deposits | 50 | -0- | -0- | 50 | 100 | 150 |
| Other Borrowings | 73,094 | 20,000 | 5,000 | 98,094 | 20,000 | 118,094 |
| Total Interest- Bearing Liabilities | 485,566 | 63,744 | 28,684 | 577,994 | 96,965 | 674,959 |
| Interest Sensitivity GAP | $ (54,843) | $ (4,985) | $ 20,498 | $ (39,330) | $ 295,361 | $ 256,031 |
| Cumulative GAP | $ (54,843) | $ (59,828) | $ (39,330) | | | |
| Periodic GAP To Total Assets | (5.55)% | (0.50)% | 2.07% | | | |
| Cumulative GAP To Total Assets | (5.55)% | (6.05)% | (3.98)% | | | |

In the preceding table under the Repriced after 1 Year or Non-Rate Sensitive category, $105.4 million in investment securities will reprice or mature within one to three years and another $73.0 million will reprice or mature within three to five years. The average maturity of the investment portfolio is approximately 3.0 years. Also, the above table reflects the call dates versus maturity dates and periodic principal amortization of investment securities.

The preceding static GAP report reflects a cumulative liability sensitive position during the one year horizon. An inherent weakness of this report is that it ignores the relative volatility any one category may have in relation to other categories or market rates in general. For instance, the rate paid on certain interest-bearing transaction accounts typically adjusts less quickly than the three month T-Bill. Management attempts to capture this relative volatility by utilizing a simulation model with a beta factor adjustment which estimates the volatility of rate sensitive assets and/or liabilities in relation to other market rates.

Beta factors are an estimation of the long term, multiple interest rate environment relation between an individual account and market rates in general. For instance, NOW, savings and money market accounts, which are repriceable within 30 days will have considerably lower beta factors than variable rate loans and most investment categories. Taking this into consideration, it is quite possible for a bank with a negative cumulative GAP to total asset ratio to have a positive beta adjusted GAP risk position. As a result of applying the beta factors established by the Corporation s management to the earning assets and interest-bearing liabilities in the static GAP report via a simulation model, the Corporation s cumulative GAP to total assets ratio at one year of (3.98%) was reversed to a positive 28.67% beta adjusted GAP position. Management feels that the beta adjusted GAP risk technique more accurately reflects the Corporation s GAP position.

In addition to GAP analysis, the Corporation uses an interest rate risk simulation model and shock analysis to test the interest rate sensitivity of net interest income and the balance sheet, respectively. Contractual maturities and repricing opportunities of loans are incorporated in the model as are prepayment assumptions, maturity data and call options within the investment portfolio. Assumptions based on past experience are incorporated into the model for non-maturity deposit accounts. Based on the December 31, 2004 simulation analysis, it is estimated that a 100

basis point rise in interest rates over the next 12 month period would have an impact of approximately a 7.0% increase on net interest income for the period, while a 100 basis point decline in interest rates over the same period would have an impact of approximately an (8.1%) decrease on net interest income for the period. These varying results are primarily a product of the manner in which interest rates on demand, money market and savings deposits change. The Corporation has found that historically, interest rates on these deposits change more slowly in a rising rate environment than in a declining rate environment. This assumption is incorporated into the simulation model and is generally not fully reflected in a GAP analysis. The analysis does not contemplate any actions that the Corporation might undertake in response to changes in market interest rates. Accordingly, this analysis is not intended to be and does not provide a forecast of the effect actual changes in market rates will have on the Corporation.

The following table reflects certain spreads and margins for the past three years:

| | 2004 | 2003 | 2002 |
|---|---|---|---|
| Yield on Earning Assets (T/E) | 5.40% | 5.54% | 6.15% |
| Cost of Funds | 1.49 | 1.50 | 1.91 |
| Net Interest Spread (T/E) | 3.91 | 4.04 | 4.24 |
| Net Interest Margin (T/E) | 4.31 | 4.48 | 4.80 |

T/E = Tax Equivalent

**Capital Resources**. At December 31, 2004, shareholders equity totaled $74.5 million, an increase of $5.8 million, or 8.5%, compared to 2003. This increase reflected an increase in retained earnings offset by the impact of dividends and repurchases of shares of Common Stock of the Corporation. In 2004, the Corporation repurchased 47,766 shares of Common Stock for an aggregate of $0.7 million. At December 31, 2003, shareholders equity totaled $68.7 million, an increase of $3.7 million, or 5.8%, compared to 2002. This increase reflected an increase in retained earnings offset by the impact of dividends and repurchases of shares of Common Stock of the Corporation. In 2003, the Corporation repurchased 86,276 shares of Common Stock for an aggregate of $1.0 million. The ability of the Corporation to repurchase shares of Common Stock is subject to various banking laws, regulations and policies as well as rules and regulations of the SEC.

The Corporation and the Bank are subject to capital adequacy guidelines established by the FRB and other regulatory authorities. See Business - The Corporation - Capital Adequacy Requirements, Business - The Bank - Capital Adequacy Requirements and Note 23 of the Notes to Consolidated Financial Statements for additional information regarding levels of required capital and risk weighted assets and other information relating to the capital adequacy guidelines. The table below illustrates the Corporation s and the Bank s compliance with the capital adequacy guidelines as of December 31, 2004 and 2003 (dollars in thousands):

| | December 31, 2004 | | December 31, 2003 | |
|---|---|---|---|---|
| | The Consolidated Corporation | Summit Bank, N.A. | The Consolidated Corporation | Summit Bank, N.A. |
| Total Assets | $ 989,117 | $ 988,710 | $ 795,478 | $ 795,468 |
| Risk Weighted Assets | 753,509 | 753,108 | 594,044 | 594,042 |
| Equity Capital (Tier 1) | $ 76,435 | $ 77,959 | $ 67,996 | $ 67,822 |
| Qualifying Allowance For Loan Losses | 9,428 | 9,423 | 7,430 | 7,430 |
| Total Capital | $ 85,863 | $ 87,382 | $ 75,426 | $ 75,252 |
| Leverage Ratio | 7.85% | 8.03% | 8.62% | 8.60% |
| Risk Capital Ratio: | | | | |
| Tier 1 Capital | 10.14% | 10.35% | 11.45% | 11.42% |
| Total Capital | 11.40 | 11.60 | 12.70 | 12.67 |

The Corporation had an unrealized loss on Available-for-Sale securities, net of deferred tax benefit, of $0.5 million at December 31, 2004 and an unrealized gain on Available-for-Sale securities, net of deferred taxes, of $0.7 million as of December 31, 2003. Under regulatory requirements, the unrealized gain or loss on Available-for-Sale securities is not included in the calculation of risk-based capital. The decline in the percentages between the years is primarily due to the growth in loans as a percent of assets during 2004. Loans are generally classified in the 100% risk category for the purpose of these calculations.

As of December 31, 2004 and 2003, the Corporation and the Bank exceeded the risk-based capital and leverage requirements set by regulatory authorities and satisfied the criteria for classification as a well capitalized institution under the rules of FDICIA. See Note 23 of the Notes to Consolidated Financial Statements for additional information regarding these classifications.

**Liquidity**. Liquidity is defined as the Corporation s ability to meet deposit withdrawals, provide for the legitimate credit needs of customers and take advantage of certain investment opportunities as they arise. While maintaining adequate liquid assets to fulfill these functions, it must also maintain compatible levels of maturity and rate concentrations between its sources of funds and earning assets. The liability structure of the Corporation is short-term in nature and the asset structure is likewise oriented towards short maturities.

The Corporation s primary internal sources of liquidity consist of the federal funds that it sells and its portfolio of marketable investment securities, particularly those with shorter maturities. Federal funds sold and investment securities maturing within 30 days represented $15.3 million, or 1.5%, of total assets as of December 31, 2004. Additionally, the Corporation s ability to sell loan participations, purchase federal funds and obtain advances from the FHLB serve as secondary sources of liquidity. The Bank has approved federal funds lines at other banks.

The Corporation has available a line of credit with the FHLB that allows it to borrow on a collateralized basis at a fixed term. At December 31, 2004, $60.0 million of borrowings were outstanding under this line of credit at an average rate of 2.11%, $40.0 million of which matures during 2005 and $20.0 million of which matures in April 2006. In addition, on September 15, 2004, the Corporation obtained a line of credit from a bank under which the Corporation may borrow $10.0 million at a floating rate. At December 31, 2004, $1.75 million had been borrowed under this line and the rate on this line was 4.02%.

On May 3, 2004, SBI Trust issued $12.0 million of Trust Capital Securities as well as trust common securities in the aggregate liquidation value of $372,000. The proceeds from the issuance of these securities were invested in the Deferrable Debentures of the Corporation, which mature on July 7, 2034 and have a call feature that permits the Corporation to redeem any or all of the Deferrable Debentures after July 7, 2009. At December 31, 2004, the interest rate on the Deferrable Debentures was 4.72%.

The liquidity of the Corporation is enhanced by the fact that 89.9% of its total deposits at December 31, 2004 were core deposits. For this purpose, core deposits are defined as total deposits less public funds and certificates of deposit greater than $100,000. Also, the Corporation s loan to deposit ratio averaged 88.0% for the year.

In the event that the Corporation s average loans continue to grow during 2005 and the Corporation is unable to fund such growth through the generation of additional deposits, the Corporation may be required to obtain funding from secondary sources, including purchasing federal funds, obtaining advances from the FHLB or other secondary sources. In such event, the Corporation s business, results of operations and financial condition could be negatively impacted.

The Corporation s income, which provides funds for the payment of dividends to shareholders and for other corporate purposes, is derived from its investment in the Bank.

**Impact of Inflation**. The effects of inflation on the local economy and on the Corporation s operating results have been relatively modest for the past several years. Since substantially all of the Corporation s assets and liabilities are monetary in nature, such as cash, investments, loans and deposits, their values are less sensitive to the effects of inflation than to changing interest rates, which do not necessarily change in accordance with inflation rates. The Corporation attempts to control the impact of interest rate fluctuations by managing the relationship between its interest rate sensitive assets and liabilities.

**Related Party Transactions.** The Bank has made transactions in the ordinary course of business with certain of its and the Corporation s officers, directors and their affiliates. All loans included in such transactions are made on substantially the same terms, including interest rate and collateral, as those prevailing at the time for comparable transactions with other persons and all loans are current as to principal and interest payments. Total loans outstanding to such parties amounted to approximately $8,537,000 at December 31, 2004 and $9,389,000 at December 31, 2003.

**Subsequent Events**. On December 31, 2004, the Corporation effected a two-for-one stock split payable in the form of a 100% stock dividend payable to shareholders of record at the close of business on December 20, 2004. On January 18, 2005, the Board of Directors of the Corporation declared a quarterly dividend of $0.07 per share to be paid on February 14, 2005 to shareholders of record on January 28, 2005.

**Critical Accounting Policies.** The Corporation s accounting policies are fundamental to understanding management s discussion and analysis of results of operations and financial condition. The Corporation has identified its policy with respect to allowance for loan losses as critical because it requires management to make particularly difficult, subjective or complex judgments about matters that are inherently uncertain and because of the likelihood that materially different amounts would be reported under different conditions or using different assumptions. The Corporation, in consultation with the Audit Committee of the Board of Directors, has reviewed and approved this critical accounting policy, which is further described under the caption Loans and Allowance for Loan Losses in Note 1 of the Notes to the Consolidated Financial Statements.

The amount maintained in the allowance reflects management s continuing assessment of the potential losses inherent in its loan portfolio based on evaluations of industry concentrations, specific credit risks, current loan portfolio quality, present and future economic, political and regulatory conditions and unidentified losses generally associated with bank lending inherent in its current loan portfolio. In making these evaluations, management and the Loan Committee of the Board of Directors take into account past loan loss experience, delinquency ratios and the analysis of third party loan review specialists.

The allocation of the allowance is determined by providing specific reserves against each loan that is criticized as being weak plus a general allocation against the remaining balance of the portfolio based on experience factors. The loans are graded on a system similar to that used by the banking industry regulators. The first level of criticized loans is Other Assets Especially Mentioned (OAEM). These loans are fundamentally sound but have potential weaknesses which may, if not corrected, weaken the asset or inadequately protect the bank s credit

position at some future date. The second level is Substandard, which are loans inadequately protected by current sound net worth, paying capacity or pledged collateral of the borrower. The last level of criticized loans, before they are charged-off, is Doubtful. Doubtful loans are considered to have inherent weaknesses because collection or liquidation in full is highly questionable. The general allocation is based upon the Corporation s loss experience over a period of years and is adjusted for subjective factors such as economic trends, performance trends and concentrations of credit. At December 31, 2004, the general allocation rate of the allowance was .93%.

These evaluations are inherently subjective because, even though they are based on objective data, it is management s interpretation of that data that determines the amount of the appropriate allowance. Therefore, from time to time (but at least quarterly), management reviews the actual performance and write-off history of the loan portfolio and compares that to previously determined allowance coverage percentages. In this manner, management evaluates the impact the previously mentioned variables may have had on the loan portfolio to determine which changes, if any, should be made to the assumptions and analyses. Recent analysis has indicated that projections of estimated losses inherent in the loan portfolio has approximated actual write-off experience during the current economic environment.

Actual results could differ materially from estimates as a result of changes in economic or market conditions and other factors. Changes in the Corporation s evaluations and the assumptions underlying these evaluations could result in a material change in the allowance. While the Corporation believes that the allowance for loan losses has been established and maintained at levels adequate to reflect the risks inherent in the loan portfolio, future increases may be necessary if economic or market conditions and other factors differ substantially from the conditions that existed at the time of the initial determinations.

**Factors That May Affect Future Results.** This Annual Report on Form 10-K contains forward-looking statements concerning the business, results of operations and financial condition of the Corporation and its subsidiaries. The forward-looking statements are based upon management s current expectations and assumptions about future events. Such expectations and assumptions have been expressed in good faith, and management believes that there is a reasonable basis for them.

A number of risks and uncertainties could cause the Corporation s actual results to differ materially from the forward-looking statements contained in this Annual Report on Form 10-K. These risks and uncertainties include, without limitation:

changes in, or the effects of, competition for the Corporation s products and services;

the Corporation s ability to effectively manage interest rate risk and other market, credit and operation risks;

the Corporation s ability to develop competitive new products and services in a timely manner and the acceptance of such products and services by the Corporation s customers and potential customers;

the costs and effects of litigation involving the Corporation and of unexpected or adverse outcomes in such litigation;

the Corporation s ability to successfully integrate, and to achieve anticipated cost savings and revenue enhancements with respect to, acquired businesses and operations;

the Corporation s ability to attract and retain key employees;

changes in general local, regional and international economic conditions;

changes in, or the effects of, trade, monetary and fiscal policies, laws and regulations, including interest rate policies, of the FRB and other regulatory authorities;

changes in consumer and business spending, borrowing and savings habits;

changes in laws, regulations and policies applicable to the Corporation; and

political instability and acts of war or terrorism.

**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

For information regarding the market risk of the Corporation s financial instruments, see Management s Discussion and Analysis of Financial Condition and Results of Operations - Interest Rate Sensitivity and Liquidity. The Corporation s principal market risk exposure is to interest rates.

**ITEM 8. CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.**

**Index to Financial Statements and Supplementary Data:**


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**INDEPENDENT AUDITOR S REPORT**

To the Board of Directors and Shareholders
of Summit Bancshares, Inc.
Fort Worth, Texas

We have audited the accompanying consolidated balance sheets of Summit Bancshares, Inc. (the Corporation ) as of December 31, 2004 and 2003, and the related statements of income, changes in shareholders equity and cash flows for each of the three years in the period ending December 31, 2004. These financial statements are the responsibility of the Corporation s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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 financial statements referred to above present fairly, in all material respects, the consolidated financial position of Summit Bancshares, Inc. at December 31, 2004 and 2003, and the consolidated results of its operations and its cash flows for each of the three years in the period ending December 31, 2004, in conformity with U.S. generally accepted accounting principles.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Summit Bancshares, Inc. s internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 4, 2005 expressed an unqualified opinion thereon.

/s/ STOVALL, GRANDEY, & WHATLEY, L.L.P.

STOVALL, GRANDEY, & WHATLEY, L.L.P.
Fort Worth, Texas
March 4, 2005

**Management s Responsibility for Financial Reporting**

The management of the Corporation is responsible for the preparation of the Corporation s consolidated financial statements, related financial data and other information in this Annual Report on Form 10-K. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and include amounts based on management s estimates and judgment where appropriate. Financial information appearing throughout this Annual Report on Form 10-K is consistent with the consolidated financial statements.

In meeting its responsibility both for the integrity and fairness of these financial statements and information, management depends on the accounting systems and related internal accounting controls that are designed to provide reasonable assurances that transactions are authorized and recorded in accordance with established procedures and that assets are safeguarded and that proper and reliable records are maintained.

The concept of reasonable assurance is based on the recognition that the cost of a system of internal controls should not exceed the related benefits. As an integral part of the system of internal controls, the Audit Committee of the Board of Directors of the Corporation and its subsidiaries retains independent auditors who monitor compliance with, and evaluate the effectiveness of, the Corporation s system of internal controls and coordinates audit coverage with the independent auditors.

The Audit Committee, which is composed entirely of directors independent of management of the Corporation, meets regularly with management, regulatory examiners, internal auditors, the loan review consultants and independent auditors to discuss financial reporting matters, internal controls, regulatory reports, internal auditing and the nature, scope and results of audit efforts. The banking regulators, internal auditors and independent auditors have direct access to the Audit Committee.

The consolidated financial statements have been audited by Stovall, Grandey, & Whatley, L.L.P., independent auditors, who render an independent opinion on the Corporation s consolidated financial statements. The appointment of Stovall, Grandey, & Whatley, L.L.P. has been approved by the Audit Committee. Stovall, Grandey, & Whatley, L.L.P. s audit provides an additional assessment of the degree to which the Corporation s management meets its responsibility for financial reporting. The opinion of Stovall, Grandey, & Whatley, L.L.P. on the Corporation s consolidated financial statements is based on auditing procedures, which include its consideration of the internal control structure and performance of selected tests of transactions and records, as it deems appropriate. These auditing procedures are designed to provide an additional reasonable level of assurance that the consolidated financial statements of the Corporation are fairly presented in accordance with generally accepted accounting principles in all material respects.

| /s/ Philip E. Norwood | /s/ Bob G. Scott |
|---|---|
| PHILIP E. NORWOOD<br>CHAIRMAN OF THE BOARD,<br>PRESIDENT AND CHIEF EXECUTIVE OFFICER | BOB G. SCOTT<br>EXECUTIVE VICE PRESIDENT<br>AND CHIEF OPERATING OFFICER |

SUMMIT BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

| | December 31, | |
|---|---|---|
| | **2004** | **2003** |
| | **(In Thousands)** | |
| ***ASSETS*** | | |
| CASH AND DUE FROM BANKS NOTE 1 | $ 27,219 | $ 28,620 |
| DUE FROM BANKS TIME | 370 | 336 |
| FEDERAL FUNDS SOLD | 4,650 | 1,000 |
| INVESTMENT SECURITIES NOTE 3 | | |
| Securities Available-for-Sale, at Fair Value | 223,351 | 195,959 |
| LOANS NOTES 4 AND 14 | | |
| Loans | 702,619 | 553,769 |
| Allowance for Loan Losses | (10,187) | (7,784) |
| LOANS, NET | 692,432 | 545,985 |
| PREMISES AND EQUIPMENT NOTE 5 | 15,749 | 12,920 |
| GOODWILL NOTE 6 | 8,042 | -0- |
| OTHER INTANGIBLE ASSETS, NET NOTE 6 | 2,478 | -0- |
| ACCRUED INCOME RECEIVABLE | 4,814 | 3,754 |
| OTHER REAL ESTATE NOTE 7 | -0- | -0- |
| OTHER ASSETS | 10,012 | 6,904 |
| TOTAL ASSETS | $ 989,117 | $ 795,478 |
| ***LIABILITIES AND SHAREHOLDERS EQUITY*** | | |
| DEPOSITS NOTE 8 | | |
| Noninterest-Bearing Demand | $ 235,399 | $ 192,877 |
| Interest-Bearing | 556,865 | 448,504 |
| TOTAL DEPOSITS | 792,264 | 641,381 |
| SHORT TERM BORROWINGS NOTE 9 | 103,972 | 82,234 |
| NOTES PAYABLE NOTE 10 | 1,750 | -0- |
| JUNIOR SUBORDINATED DEFERRABLE DEBENTURES NOTE 11 | 12,372 | -0- |
| ACCRUED INTEREST PAYABLE | 601 | 294 |
| OTHER LIABILITIES | 3,668 | 2,885 |
| TOTAL LIABILITIES | 914,627 | 726,794 |
| COMMITMENTS AND CONTINGENCIES NOTES 5, 10, 16, 18 AND 20 | | |
| SHAREHOLDERS EQUITY NOTES 15, 17, 18, 21 AND 22 | | |
| Common Stock - $1.25 Par Value; 20,000,000 shares authorized; 12,359,232 and 6,152,329 shares issued and outstanding at December 31, 2004 and 2003, respectively. | 15,449 | 7,690 |
| Capital Surplus | 7,705 | 7,421 |
| Retained Earnings | 51,810 | 52,988 |
| Accumulated Other Comprehensive Income Unrealized Gain (Loss) on Available-for-Sale Investment Securities, Net of Tax (Benefit) | (474) | 688 |
| Treasury Stock at Cost (3,700 shares at December 31, 2003) | -0- | (103) |
| TOTAL SHAREHOLDERS EQUITY | 74,490 | 68,684 |
| TOTAL LIABILITIES AND SHAREHOLDERS EQUITY | $ 989,117 | $ 795,478 |

The accompanying Notes should be read with these financial statements.

SUMMIT BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

| | For The Years Ended December 31, | | |
|---|---|---|---|
| | 2004 | 2003 | 2002 |
| | (In Thousands, Except Per Share Data) | | |
| INTEREST INCOME | | | |
| Interest and Fees on Loans | $ 39,018 | $ 31,134 | $ 31,283 |
| Interest and Dividends on Investment Securities: | | | |
| Taxable | 7,409 | 7,106 | 7,046 |
| Exempt from Federal Income Taxes | 260 | 206 | 116 |
| Interest on Federal Funds Sold and Due From Time | 170 | 81 | 212 |
| TOTAL INTEREST INCOME | 46,857 | 38,527 | 38,657 |
| INTEREST EXPENSE | | | |
| Interest on Deposits | 7,677 | 6,810 | 7,881 |
| Interest on Short Term Borrowings | 1,423 | 627 | 624 |
| Interest on Note Payable | 62 | -0- | 7 |
| Interest on Junior Subordinated Deferrable Debentures | 344 | -0- | -0- |
| TOTAL INTEREST EXPENSE | 9,506 | 7,437 | 8,512 |
| NET INTEREST INCOME | 37,351 | 31,090 | 30,145 |
| LESS: PROVISION FOR LOAN LOSSES NOTE 4 | 1,790 | 880 | 3,140 |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES | 35,561 | 30,210 | 27,005 |
| NON-INTEREST INCOME | | | |
| Service Charges and Fees on Deposits | 4,248 | 3,443 | 2,934 |
| Gain on Sale of Investment Securities | 32 | 230 | 165 |
| Other Income | 2,962 | 2,355 | 2,368 |
| TOTAL NON-INTEREST INCOME | 7,242 | 6,028 | 5,467 |
| NON-INTEREST EXPENSE | | | |
| Salaries and Employee Benefits NOTE 18 | 15,329 | 12,926 | 11,078 |
| Occupancy Expense - Net | 2,206 | 1,734 | 1,136 |
| Furniture and Equipment Expense | 2,261 | 1,877 | 1,577 |
| Other Real Estate Owned Expense - Net | 44 | (4) | 234 |
| Core Deposit Intangible Amortization | 219 | -0- | -0- |
| Other Expense NOTE 12 | 6,131 | 4,920 | 4,284 |
| TOTAL NON-INTEREST EXPENSE | 26,190 | 21,453 | 18,309 |
| INCOME BEFORE INCOME TAXES | 16,613 | 14,785 | 14,163 |
| APPLICABLE INCOME TAXES NOTE 13 | 5,851 | 5,017 | 4,846 |
| NET INCOME | $ 10,762 | $ 9,768 | $ 9,317 |
| NET INCOME PER SHARE NOTE 16 | | | |
| Basic | $ 0.87 | $ 0.79 | $ 0.75 |
| Diluted | 0.85 | 0.77 | 0.73 |

The accompanying Notes should be read with these financial statements.

SUMMIT BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002

| | **Common Stock** | | | | **Accumulated Other Comprehensive Income - Net Unrealized Gain (Loss) on Investment Securities** | | |
|---|---|---|---|---|---|---|---|
| | **Shares** | **Amount** | **Capital Surplus** | **Retained Earnings** | | **Treasury Stock** | **Total Share-Holders Equity** |
| | **(Dollars in Thousands, Except Per Share Data)** | | | | | | |
| BALANCE AT January 1, 2002 | 6,262,961 | $ 7,829 | $ 6,865 | $ 44,166 | $ 1,694 | $ (18) | $ 60,536 |
| Stock Options Exercised | 39,525 | 49 | 257 | | | | 306 |
| Purchases of Stock Held in Treasury | | | | | | (3,402) | (3,402) |
| Retirement of Stock Held in Treasury | (143,944) | (180) | | (2,837) | | 3,017 | -0- |
| Cash Dividend - $.24 Per Share | | | | (2,986) | | | (2,986) |
| Net Income for the Year Ended 2002 | | | | 9,317 | | | 9,317 |
| Securities Available-for-Sale Adjustment | | | | | 1,167 | | 1,167 |
| Total Comprehensive Income - NOTE 27 | | | | | | | 10,484 |
| BALANCE AT December 31, 2002 | 6,158,542 | 7,698 | 7,122 | 47,660 | 2,861 | (403) | 64,938 |
| Stock Options Exercised | 53,225 | 66 | 299 | | | | 365 |
| Purchases of Stock Held in Treasury | | | | | | (1,009) | (1,009) |
| Retirement of Stock Held in Treasury | (59,438) | (74) | | (1,235) | | 1,309 | -0- |
| Cash Dividend - $.26 Per Share | | | | (3,205) | | | (3,205) |
| Net Income for the Year Ended 2003 | | | | 9,768 | | | 9,768 |
| Securities Available- for-Sale Adjustment | | | | | (2,173) | | (2,173) |
| Total Comprehensive Income - NOTE 27 | | | | | | | 7,595 |
| BALANCE AT December 31, 2003 | 6,152,329 | 7,690 | 7,421 | 52,988 | 688 | (103) | 68,684 |
| Stock Options Exercised | 55,270 | 69 | 284 | | | | 353 |
| Purchases of Stock Held in Treasury | | | | | | (694) | (694) |
| Retirement of Stock Held in Treasury | (27,583) | (34) | | (763) | | 797 | -0- |
| Two-for-One Stock Split | 6,179,216 | 7,724 | | (7,724) | | | -0- |
| Cash Dividend - $.28 Per Share | | | | (3,453) | | | (3,453) |
| Net Income for the Year Ended 2004 | | | | 10,762 | | | 10,762 |
| Securities Available- for-Sale Adjustment | | | | | (1,162) | | (1,162) |
| Total Comprehensive Income - NOTE 27 | | | | | | | 9,600 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| BALANCE AT December 31, 2004 | 12,359,232 | $ 15,449 | $ 7,705 | $ 51,810 | $ (474) | $ -0- | $ 74,490 |

The accompanying Notes should be read with these financial statements.

SUMMIT BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

| | For The Years Ended December 31, | | |
|---|---|---|---|
| | **2004** | **2003** | **2002** |
| | | **(In Thousands)** | |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Net Income | $ 10,762 | $ 9,768 | $ 9,317 |
| Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities: | | | |
| Depreciation and Amortization | 1,669 | 1,370 | 1,094 |
| Net Premium Amortization of Investment Securities | 1,429 | 1,486 | 1,026 |
| Amortization of Core Deposit Intangible | 219 | -0- | -0- |
| Provision for Loan Losses | 1,790 | 880 | 3,140 |
| Deferred Income Tax (Benefit) Expense | (434) | 336 | (62) |
| Net Gain on Sale of Investment Securities | (32) | (230) | (165) |
| Net (Gain) Loss From Sale of Other Real Estate & Repossessed Assets | (70) | 10 | (358) |
| Net (Gain) Loss From Sale of Premises and Equipment | (37) | (46) | 1 |
| Net (Increase) Decrease in Accrued Income and Other Assets | (809) | (68) | 632 |
| Net Increase (Decrease) in Accrued Expenses and Other Liabilities | 397 | (352) | 340 |
| Total Adjustments | 4,122 | 3,386 | 5,648 |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | 14,884 | 13,154 | 14,965 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | |
| Net Decrease (Increase) in Federal Funds Sold | 19,738 | (1,074) | 2,022 |
| Proceeds from Matured and Prepaid Investment Securities | 120,254 | 101,354 | 51,818 |
| Proceeds from Sales of Investment Securities | 23,233 | 125,620 | 143,444 |
| Purchase of Investment Securities | (173,730) | (253,971) | (207,732) |
| Premium Paid for ANB Financial Corporation | (10,520) | -0- | -0- |
| Net Assets Acquired in the Purchase of ANB Financial Corporation (Net of Acquired Cash of $3,871) | (2,039) | -0- | -0- |
| Loans Originated and Principal Repayments, Net | (89,427) | (85,163) | (42,962) |
| Recoveries of Loans Previously Charged-Off | 400 | 737 | 372 |
| Proceeds from Sale of Premises and Equipment | 48 | 279 | 31 |
| Proceeds from Sale of Other Real Estate & Repossessed Assets | 892 | 1,257 | 1,293 |
| Purchases of Premises and Equipment | (4,509) | (3,038) | (4,479) |
| NET CASH USED BY INVESTING ACTIVITIES | (115,660) | (113,999) | (56,193) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | | |
| Net Increase in Demand Deposits, Savings Accounts and Interest-Bearing Transaction Accounts | 52,506 | 49,540 | 34,838 |
| Net Increase in Certificates of Deposit | 14,803 | 9,892 | 3,308 |
| Net Increase in Short-Term Borrowings | 21,738 | 44,979 | 8,889 |
| Proceeds from Note Payable | 1,750 | -0- | -0- |
| Proceeds from Issuance of Junior Subordinated Debentures | 12,372 | -0- | -0- |
| Payments of Cash Dividends | (3,453) | (3,205) | (2,986) |
| Proceeds from Stock Options Exercised | 353 | 365 | 306 |
| Purchase of Treasury Stock | (694) | (1,009) | (3,402) |
| NET CASH PROVIDED BY FINANCING ACTIVITIES | 99,375 | 100,562 | 40,953 |
| NET DECREASE IN CASH AND DUE FROM BANKS | (1,401) | (283) | (275) |

| | | | |
|---|---|---|---|
| CASH AND DUE FROM BANKS AT BEGINNING OF YEAR | 28,620 | 28,903 | 29,178 |
| CASH AND DUE FROM BANKS AT END OF YEAR | $ 27,219 | $ 28,620 | $ 28,903 |
| SUPPLEMENTAL SCHEDULE OF OPERATING AND INVESTING ACTIVITIES: | | | |
| Interest Paid | $ 9,199 | $ 7,497 | $ 8,763 |
| Income Taxes Paid | 6,377 | 4,296 | 4,762 |
| Other Real Estate Acquired and Other Assets Acquired in Settlement of Loans | 321 | -0- | 1,579 |

The accompanying Notes should be read with these financial statements.

SUMMIT BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 1 - Summary of Significant Accounting and Reporting Policies**

The accounting and reporting policies of Summit Bancshares, Inc. are in accordance with accounting principles generally accepted in the United States of America and the prevailing practices within the banking industry. A summary of the more significant policies follows:

**Basis of Presentation and Principles of Consolidation**
The consolidated financial statements of Summit Bancshares, Inc. (hereinafter, collectively with its subsidiaries, the Corporation ), include its accounts and its direct and indirect wholly-owned subsidiaries, Summit Delaware Financial Corporation, Summit Bank, National Association (the Bank ) and SIA Insurance Agency, Inc. ( SIA ). All significant intercompany balances and transactions have been eliminated in consolidation.

**Use of Estimates**
The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ materially from those estimates.

**Cash and Due From Banks**
The Bank is required to maintain certain non-interest-bearing cash balances at the Federal Reserve Bank based on its level of deposits. During 2004, the average cash balance maintained at the Federal Reserve Bank was approximately $2,218,000. Compensating balances held at correspondent banks, to minimize service charges, averaged approximately $21,880,000 during the same period.

**Investment Securities**
The Corporation has adopted Statement of Financial Accounting Standards No. 115, Accounting for Certain Investments in Debt and Equity Securities. At the date of purchase, the Corporation is required to classify debt and equity securities into one of three categories: held-to-maturity, trading or available-for-sale. At each reporting date, the appropriateness of the classification is reassessed. Investments in debt securities are classified as held-to-maturity and measured at amortized cost in the financial statements only if management has the positive intent and ability to hold those securities to maturity. Securities that are bought and held principally for the purpose of selling them in the near term are classified as trading and measured at fair value in the financial statements with unrealized gains and losses included in earnings. Investments not classified as either held-to-maturity or trading are classified as available-for-sale and measured at fair value in the financial statements with unrealized gains and losses reported, net of tax, in a separate component of shareholders equity until realized.

The Corporation has the ability and intent to hold to maturity its investment securities classified as held-to-maturity; accordingly, no adjustment has been made for the excess, if any, of amortized cost over market. In determining the investment category classifications at the time of purchase of securities, management considers its asset/liability strategy, changes in interest rates and prepayment risk, the need to increase capital and other factors. Under certain circumstances (including the deterioration of the issuer s creditworthiness, a change in tax law, or statutory or regulatory requirements), the Corporation may change the investment security classification. In the periods reported for 2004 and 2003, the Corporation held no securities that would have been classified as trading securities.

All investment securities are adjusted for amortization of premiums and accretion of discounts. Amortization of premiums and accretion of discounts are recorded to income over the contractual maturity or estimated life of the individual investment on the level yield method. Gain or loss on sale of investments is based upon the specific identification method and the gain or loss is recorded in non-interest income. Income earned on the Corporation s investments in state and political subdivisions is not taxable.

Declines in the fair value of individual held-to-maturity and available-for-sale securities below their cost that are other than temporary result in write-downs of the individual securities to their fair value. The related write-downs are included in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Corporation to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

**Loans and Allowance for Loan Losses**
Loans are stated at the principal amount outstanding less unearned discount, deferred fees and the allowance for loan losses. Unearned discount on installment loans is recognized as income over the terms of the loans by a method approximating the interest method. Interest income on all other loans is recognized based upon the principal amounts outstanding, the simple interest method. Loan origination fee income, net of direct

loan origination costs, is deferred and amortized over the life of the related loan. The accrual of interest on a loan is discontinued when, in the opinion of management, there is doubt about the ability of the borrower to pay interest or principal. Interest previously earned, but uncollected on such loans, is written off. After loans are placed on non-accrual, all payments received are applied to principal and no interest income is recorded until the loan is returned to accrual status or the principal has been reduced to zero.

The Corporation has adopted Statement of Financial Accounting Standards No. 114, Accounting by Creditors for Impairment of a Loan, as amended by Statement of Financial Accounting Standards No. 118, Accounting by Creditors for Impairment of a Loan - Income Recognition and Disclosure. Under this standard, the allowance for loan losses related to loans that are identified for evaluation in accordance with Statement No. 114 (impaired loans) is based on discounted cash flows using the loan s initial effective rate or the fair value of the collateral for certain collateral dependent loans.

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**NOTE 1 - Summary of Significant Accounting Policies (cont d.)**

The allowance for loan losses is comprised of amounts charged against income in the form of a provision for loan losses for certain loans when it is probable that all amounts due pursuant to the contractual terms of the loan will not be collected. In these situations, a reserve is recorded when the carrying amount of the loan exceeds the discounted cash flows using the loan s initial effective interest rate or the fair value of the collateral for certain collateral dependent loans. Income on impaired loans is recognized based on the collectibility of the principal amount. Adjustments to the allowance for loan losses will be reported in the period such adjustments become known or are reasonably estimable.

The amount maintained in the allowance reflects management s continuing assessment of the potential losses inherent in its loan portfolio based on its evaluation of a number of factors, including the Bank s loss experience in relation to outstanding loans and the existing level of the allowance, prevailing and prospective economic conditions, and management s continuing review of the discounted cash flow values of impaired loans and its evaluation of the quality of the loan portfolio. Loans are charged against the allowance for loan losses when management believes that the collectibility of the principal is unlikely.

The evaluation of the adequacy of loan collateral is often based upon estimates and appraisals. Because of changing economic conditions, the valuations determined from such estimates and appraisals may also change. Accordingly, the Corporation may ultimately incur losses which vary materially from management s current estimates.

**Premises and Equipment**

Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation expense is computed on the straight-line method based upon the estimated useful lives of the assets ranging from three to forty years. Maintenance and repairs are charged to non-interest expense. Renewals and betterments are added to the asset accounts and depreciated over the periods benefited. Depreciable assets sold or retired are removed from the asset and related accumulated depreciation accounts and any gain or loss is reflected in the income and expense accounts.

**Other Real Estate**

Other real estate is foreclosed property held pending disposition and is valued at the lower of its fair value or the recorded investment in the related loan. At foreclosure, if the fair value, less estimated costs to sell, of the real estate acquired is less than the Corporation s recorded investment in the related loan, a write-down is recognized through a charge to the allowance for loan losses. Any subsequent reduction in value is recognized by a charge to income. Operating expenses of such properties, net of related income, and gains and losses on their disposition are included in non-interest expense.

**Federal Income Taxes**

The Corporation joins with its subsidiaries in filing a consolidated federal income tax return. The subsidiaries pay to the parent a charge equivalent to their current federal income tax based on the separate taxable income of the subsidiaries.

The Corporation and the subsidiaries maintain their records for financial reporting and income tax reporting purposes on the accrual basis of accounting. Deferred income taxes are provided in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes. Deferred income taxes are provided for accumulated temporary differences due to basic differences for assets and liabilities for financial reporting and income tax purposes.

Realization of net deferred tax assets is dependent on generating sufficient future taxable income. Although realization is not assured, management believes it is more likely than not that all of the net deferred tax assets will be realized. The amount of the net deferred tax asset considered realizable, however, could be reduced in the near term if estimates of future taxable income are reduced.

**Cash and Cash Equivalents**

For the purpose of presentation in the Statements of Cash Flows, cash and cash equivalents include cash on hand, clearings and exchanges, and balances due from correspondent banks.

**Reclassification**

Certain reclassifications have been made to the 2003 and 2002 financial statements to conform to the 2004 presentation.

**Earnings Per Common and Common Equivalent Share**

Statement of Financial Accounting Standards No. 128 ( SFAS 128 ), Earnings Per Share, requires presentation of basic and diluted earnings per share. Basic earnings per share has been computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding for the reporting period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. Net income per common share for all periods presented

has been calculated in accordance with SFAS 128. Outstanding stock options issued by the Corporation represent the only dilutive effect reflected in diluted weighted average shares.

**Stock-Based Compensation**

The Corporation accounts for stock-based compensation in accordance with the intrinsic value based method recommended by Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees. Under the intrinsic value based method, compensation cost is the excess, if any, of the quoted market price of the stock at grant date over the amount an employee must pay to acquire the stock. The impact on the financial statements of using this method is disclosed below.

**NOTE 1 - Summary of Significant Accounting Policies (cont d.)**

Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation, as amended by Statement of Financial Accounting Standards No. 148 ( SFAS 123 ), requires pro forma disclosures of net income and earnings per share for companies not adopting its fair value accounting method for stock-based compensation. The pro forma disclosures presented below use the fair value method of SFAS 123 to measure compensation expense for stock-based compensation plans.

The Corporation accounts for its stock-based compensation plans under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, under which no compensation cost has been recognized for options granted. The following table illustrates the effect on net income and earnings per share if the Corporation had applied the fair value recognition provisions of SFAS No. 123 to stock-based compensation.

| | Years Ended December 31, | | |
|---|---|---|---|
| | **2004** | **2003** | **2002** |
| Net Income, as Reported | $ 10,762 | $ 9,768 | $ 9,317 |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | (171) | (135) | (124) |
| Pro Forma Net Income | $ 10,591 | $ 9,633 | $ 9,193 |
| Earnings Per Share: | | | |