BLACKHAWK BANCORP INC
Form 10QSB
August 13, 2003

FORM 10-QSB
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (D)
OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2003

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D)
OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM ---- TO ----

COMMISSION FILE NUMBER 0-18599

BLACKHAWK BANCORP, INC.
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

WISCONSIN	39-1659424
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	(I. R. S. EMPLOYER IDENTIFICATION NO.)

400 BROAD STREET
BELOIT, WISCONSIN 53511
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

(608) 364-8911
(REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE)

NOT APPLICABLE
(FORMER NAME, FORMER ADDRESS AND FORMER FISCAL YEAR, IF CHANGED SINCE LAST REPORT)

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, and (2) has been subject to such filing requirements for the past 90 days.

YES X NO

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class of Common Stock	Outstanding at August 5, 2003
$.01 par value	2,518,131 shares

INDEX

PART I - FINANCIAL INFORMATION

Page

BLACKHAWK BANCORP, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED BALANCE SHEETS

	JUNE 30, 2003
ASSETS	(Dollar
Cash and due from banks	$ 12,166
Federal funds sold and securities purchased under agreements to resell	--
Interest-bearing deposits in banks	1,922
Available-for-sale securities	102,013

Held to maturity securities, at amortized cost	19,399
Loans, less allowance for loan losses of $2,342 and $2,079 at June 30, 2003 and December 31, 2002, respectively	183,539
Office buildings and equipment, net	6,511
Intangible assets	4,388
Other assets	13,595
Total Assets	$343,533
LIABILITIES AND STOCKHOLDERS' EQUITY	
LIABILITIES:	
Deposits:	
Noninterest-bearing	$ 33,120
Interest-bearing	215,772
Total deposits	248,892
Short-term borrowings	11,990
Long-term borrowings	46,600
Company Obligated Mandatorily Redeemable Preferred Securities of subsidiary trust holding solely subordinated debentures	7,000
Other liabilities	2,909
Total Liabilities	317,391
STOCKHOLDERS' EQUITY:	
Preferred stock 1,000,000 shares, $.01 par value per share authorized, none issued or outstanding	--
Common stock 10,000,000 shares, $.01 par value per share authorized, shares issued and outstanding: 2,518,131 at June 30, 2003, 2,507,065 at December 31, 2002	25
Surplus	8,773
Retained earnings	16,062
Accumulated other comprehensive income	1,282
Total Stockholders' Equity	26,142
Total Liabilities and Stockholders' Equity	$343,533

See Notes to Unaudited Consolidated Financial Statements

BLACKHAWK BANCORP, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF INCOME

	THREE MONTHS ENDED JUNE	
	2003	200
INTEREST INCOME:	(Dollars in thousands, except per share data)	
Interest and fees on loans	$3,019	$3,
Interest and dividends on securities:		
Taxable	929	

Nontaxable	282	
Interest on fed funds sold and securities purchased under agreements to resell	7	
Interest on interest-bearing deposits in banks	8	
Total Interest Income	4,245	4,
INTEREST EXPENSE:		
Interest on deposits	1,230	1,
Interest on short-term borrowings	41	
Interest on long-term borrowings	530	
Interest on Company Obligated Mandatorily Redeemable Preferred Securities	82	
Total Interest Expense	1,883	2,
Net Interest Income	2,362	2,
Provision for loan losses	142	
Net Interest Income after Provision for Loan Losses	2,220	2,
NONINTEREST INCOME:		
Service charges on deposit accounts	363	
Gain on sale of loans	141	
Securities gains, net	95	
Other	281	
Total Noninterest Income	880	
NONINTEREST EXPENSES:		
Salaries and employee benefits	1,360	1,
Occupancy	179	
Equipment	231	
Data processing services	203	
Advertising and marketing	143	
Amortization of intangibles	79	
Professional fees	116	
Office supplies	55	
Telephone	79	
Transportation and postage	112	
Other	212	
Total Noninterest Expenses	2,769	2,
Income before Income Taxes	331	
Income Taxes	1	
Net Income	$ 330	$
Basic Earnings Per Share	$ 0.13	$ 0
Diluted Earnings per Share	$ 0.13	$ 0
Dividends Per Share	$ 0.09	$ 0

See Notes to Unaudited Consolidated Financial Statements

BLACKHAWK BANCORP, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF INCOME

	SIX MONTHS ENDED JUNE 3	
	2003	200
INTEREST INCOME:	(Dollars in thousands, except per share data)	
Interest and fees on loans	$6,267	$7,
Interest and dividends on securities:		
Taxable	1,857	1,
Nontaxable	535	
Interest on fed funds sold and securities purchased under agreements to resell	49	
Interest on interest-bearing deposits in banks	18	
Total Interest Income	8,726	9,
INTEREST EXPENSE:		
Interest on deposits	2,496	3,
Interest on short-term borrowings	76	
Interest on long-term borrowings	1,035	1,
Interest on Company Obligated Mandatorily Redeemable Preferred Securities	163	
Total Interest Expense	3,770	4,
Net Interest Income	4,956	5,
Provision for loan losses	365	
Net Interest Income after Provision for Loan Losses	4,591	5,
NONINTEREST INCOME:		
Service charges on deposit accounts	700	
Gain on sale of loans	301	
Securities gains, net	424	
Other	492	
Total Noninterest Income	1,917	1,
NONINTEREST EXPENSES:		
Salaries and employee benefits	2,818	2,
Occupancy	369	
Equipment	461	
Data processing services	399	
Advertising and marketing	207	
Amortization of intangibles	159	
Professional fees	302	
Office supplies	117	
Telephone	153	
Transportation and postage	212	
Other	523	

Total Noninterest Expenses	5,720	5,
Income before Income Taxes	788	1,
Income Taxes	61	
Net Income	$ 727	$
Basic Earnings Per Share	$ 0.29	$ 0
Diluted Earnings per Share	$ 0.29	$ 0
Dividends Per Share	$ 0.18	$ 0

See Notes to Unaudited Consolidated Financial Statements

BLACKHAWK BANCORP, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	SIX MONTHS ENDED JUNE 3	
	2003	200
	(Dollars in thousands)	
Common Stock:		
Balance at beginning of period	$ 25	$
Stock options exercised	--	
Balance at end of period	25	
Surplus:		
Balance at beginning of period	8,698	7,
Stock options exercised	75	1,
Sale of treasury stock	--	
Balance at end of period	8,773	8,
Retained Earnings:		
Balance at beginning of period	15,788	15,
Net income	727	
Dividends declared on common stock	(453)	(
Balance at end of period	16,062	15,
Treasury Stock, at cost:		
Balance at beginning of period	--	
Sale of treasury stock	--	
Balance at end of period	--	

Accumulated other comprehensive income:

Balance at beginning of period	1,287	
Other comprehensive income (loss), net of taxes:		
Fair market value of available for sale securities	(50)	
Fair value of interest rate SWAP contract	45	
Balance at end of period	1,282	
Total Stockholders' Equity	$26,142	$25,

See Notes to Unaudited Consolidated Financial Statements

BLACKHAWK BANCORP, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

	SIX MONTHS ENDED JUNE	
	2003	200
	(Dollars in thousand	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 727	$
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	648	
Provision for loan losses	365	
Gain on sale of loans	(301)	(
FHLB stock dividends	(126)	
Amortization of premiums on securities, net	397	
Securities gains, net	(424)	(
Decrease (increase) in accrued interest receivable	253	
Decrease in accrued interest payable	(55)	(
Decrease (increase) in other assets	(213)	
Increase (decrease) in other liabilities	(1,127)	
Net cash provided by operations before loan originations and sales	144	1,
Origination of loans for sale	(15,050)	(9,
Proceeds from sale of loans	16,708	12,
Net cash provided by operating activities	1,802	3,
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net decrease in interest-bearing deposits in banks	6,550	7,
Net decrease in federal funds sold and securities purchased under agreements to resell	13,120	10,
Proceeds from sales of available-for-sale securities	23,957	8,
Proceeds from maturities and calls of available-for-sale securities	20,824	6,
Proceeds from maturities and calls of held-to-maturity securities	3,574	2,
Purchase of available-for-sale securities	(62,948)	(40,
Purchase of held-to-maturity securities	--	(2,
Net decrease in loans	951	13,
Proceeds from the sale of office buildings, equipment, and other real estate owned	317	
Purchase of office buildings and equipment, net	(202)	(
Net cash provided by investing activities	6,143	5,

--------   -----

See Notes to Unaudited Consolidated Financial Statements.

BLACKHAWK BANCORP, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
(CONTINUED)

	SIX MONTHS ENDED J 2003
	(Dollars in thous
CASH FLOWS FROM FINANCING ACTIVITIES:	
Net decrease in deposits	$(14,192)
Dividends paid	(453)
Proceeds from other borrowings	8,000
Payments on other borrowings	(300)
Net increase (decrease) in short-term borrowings	(1,464)
Proceeds from exercise of stock options	58
Sale of treasury stock	--
Net cash used in financing activities	(8,351)
Net increase (decrease) in cash and due from banks	(406)
CASH AND DUE FROM BANKS:	
Beginning	12,572
Ending	$ 12,166
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:	
Cash paid (refunded) during the period for:	
Interest	$ 3,825
Income taxes	$ (163)
SUPPLEMENTAL SCHEDULES OF NON-CASH INVESTING ACTIVITIES:	
Change in accumulated other comprehensive income unrealized gains (losses) on available-for-sale securities, net	$ (50)
Other assets acquired in settlement of loans	$ 88

See Notes to Unaudited Consolidated Financial Statements.

BLACKHAWK BANCORP, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2003

Note 1. General:

The unaudited consolidated financial statements include the accounts of Blackhawk Bancorp, Inc. and its subsidiaries. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the financial position, results of operation and cash flows for the interim periods have been made. The results of operations for the six months ended June

30, 2003 are not necessarily indicative of the results to be expected for the entire fiscal year.

The unaudited interim financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and industry practice. Certain information in footnote disclosure normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America and industry practice has been condensed or omitted pursuant to rules and regulations of the Securities and Exchange Commission. The more significant policies used by the Company in preparing and presenting its financial statements are stated in the Corporation's Form 10-KSB. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's December 31, 2002 audited financial statements.

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 which affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements, as well as the reported amounts of income and expenses during the reported periods. Actual results could differ from those estimates.

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

Stock-Based Compensation Plan: At June 30, 2003, the Company had a stock-based director, key officer and employee compensation plan. The Company accounts for this plan under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. No stock-based employee compensation cost is reflected in income, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The table on the following page illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of Financial Accounting Standards Board (FASB) Statement No. 123, Accounting for Stock-Based Compensation, to stock-based employee compensation.

(Dollars in thousands, except per share data)	Three Months Ended June 30, 2003	Three Months Ended June 30, 2002
Net income, as reported	$330	$430
Deduct total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(21)	(19)
PRO FORMA NET INCOME	$309	$411
Earnings per share:		
Basic:		
As reported	$0.13	$0.17
Pro forma	0.12	0.17
Diluted:		

As reported	0.13	0.17
Pro forma	0.12	0.17

(Dollars in thousands, except per share data)	Six Months Ended June 30, 2003	2002
Net income, as reported	$727	$747
Deduct total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(42)	(37)
PRO FORMA NET INCOME	$685	$710
Earnings per share:		
Basic:		
As reported	$0.29	$0.31
Pro forma	0.27	0.29
Diluted:		
As reported	0.29	0.31
Pro forma	0.27	0.29

In determining compensation cost using the fair value method prescribed in Statement No. 123, the value of each grant is estimated at the grant date with the following weighted-average assumptions used for grants: dividend yield of 4 percent; expected price volatility of 25 percent; risk-free interest rates of 4 percent; and expected lives of 10 years.

Note 2.Allowance for Loan Losses

A summary of transactions in the allowance for loan losses is as follows:

	THREE MONTHS ENDED JUNE 30, (Dollars in thousands) 2003	2002
Balance at beginning of period	$2,197	$2,517
Provision charged to expense	142	122
Loans charged off	90	131
Recoveries	93	11
Balance at end of period	$2,342	$2,519

	Six Months Ended June 30, (Dollars in thousands) 2003	2002
Balance at beginning of period	$2,079	$2,404
Provision charged to expense	365	261

Loans charged off	247	182
Recoveries	145	36
Balance at end of period	$2,342	$2,519

Note 3.Earnings per Share

Presented below are the calculations for basic and diluted earnings per share:

	THREE MONTHS ENDED JUNE 30, 2003	2002	SIX 2003
Basic:			
Net income available to common stockholders	$ 330,000	$ 430,000	$ 727,
Weighted average shares outstanding	2,517,219	2,478,283	2,515,
Basic earnings per share	$ 0.13	$ 0.17	$ 0
Diluted:			
Net income available to common stockholders	$ 330,000	$ 430,000	$ 727,
Weighted average shares outstanding	2,517,219	2,478,283	2,515,
Effect of dilutive stock options outstanding	17,267	9,782	17,
Diluted weighted average shares outstanding	2,534,486	2,488,065	2,532,
Diluted earnings per share	$ 0.13	$ 0.17	$ 0

Note 4. Derivative Instrument

As of June 30, 2003, the Company has entered into an interest rate swap transaction, which resulted in the Company converting its $7,000,000 of variable rate Company Obligated Mandatorily Redeemable Preferred Securities into fixed rate debt. This swap transaction requires the payment of interest by the Company at a fixed rate equal to 2.47% using an actual/360 day basis. In turn the Company receives a variable rate interest payment based on the 90 day LIBOR rate adjusted quarterly.

Summary information about the interest rate swap at June 30 is as follows:

	2003	2002
	(Dollars in thousands)	
Notional amount	$7,000	--
Weighted average fixed rate	2.51%	--

Weighted average variable rate	1.02%	--
Weighted average maturity	4.5 years	--
Fair value	$69	--

Note 5. Recent Accounting Developments

The Financial Accounting Standards Board has issued Statement 149, "Amendment of Statement 133 on Derivative Instruments and Hedging". This Statement amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under Statement 133. The Statement is effective for contracts entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003. Implementation of the Statement is not expected to have a material impact on the company's financial statements.

The Financial Accounting Standards Board has issued Statement 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity". This Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity and requires that certain freestanding financial instruments be reported as liabilities in the balance sheet. Depending on the type of financial instrument, it is required to be accounted for at either fair value or the present value of future cash flows determined at each balance sheet date with the change in that value reported as interest expense in the income statement. Prior to the application of Statement No. 150, either those financial instruments were not required to be recognized, or if recognized were reported in the balance sheet as equity and changes in the value of those instruments were normally not recognized in net income. For the Company, the Statement is effective July 1, 2003 and implementation is not expected to have a material impact on the consolidated financial statements.

Note 6. Recent Regulatory Developments

On July 30, 2002, President Bush signed the Sarbanes-Oxley Act of 2002 (the "Act"). This legislation impacts corporate governance of public companies, affecting their officers and directors, their audit committees, their relationships with their accountants and the audit function itself. Certain provisions of the Act became effective on July 30, 2002. Other provisions will become effective as the SEC adopts appropriate rules.

The Act implements a broad range of corporate governance and accounting measures for public companies designed to promote honesty and transparency in corporate America and better protect investors from corporate wrongdoing. The Act includes the creation of an independent accounting oversight board to oversee the audit of public companies and their auditors, provisions restricting non-audit services performed by independent accountants for public companies and additional corporate governance and responsibility provisions.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

The purpose of Management's discussion and analysis is to provide relevant information regarding the Registrant's financial condition and its results of operations. The information included herein should be read in conjunction with the company's consolidated financial statements and footnotes thereto for the year ended December 31, 2002.

This report contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 with respect to the financial condition, results of operations, plans, objectives, future performance and business of Blackhawk Bancorp, Inc. Statements that are not historical facts, including statements about beliefs and expectations, are forward-looking statements. These statements are based upon beliefs and assumptions of Blackhawk's management and on information currently available to such management. The use of the words "believe", "expect", "anticipate", "plan", "estimate", "may", "will" or similar expressions are forward-looking statements.

Contemplated, projected, forecasted or estimated results in such forward-looking statements involve certain inherent risks and uncertainties. A number of factors - many of which are beyond the ability of the company to control or predict - could cause actual results to differ materially from those described in the forward-looking statements. Factors which could cause such a variance to occur include, but are not limited to: heightened competition; adverse state and federal regulation; failure to obtain new or retain existing customers; ability to attract and retain key executives and personnel; changes in interest rates; unanticipated changes in industry trends; unanticipated changes in credit quality and risk factors, including general economic conditions; success in gaining regulatory approvals when required; changes in the Federal Reserve Board monetary policies; unexpected outcomes of new and existing litigation in which Blackhawk or its subsidiaries, officers, directors or employees is named defendants; technological changes; changes in accounting principles generally accepted in the United States; changes in assumptions or conditions affecting the application of critical accounting policies; and the inability of second party vendors to perform critical services for the company or its customers.

The Company does not undertake, and specifically declines any obligation, to publicly release the results of any revisions which may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

RESULTS OF OPERATIONS

The company reported net income of $330,000 for the three months ended June 30, 2003, a decrease of $100,000 or 23.3% from the $430,000 reported for the same three month period in 2002. Net income for the six month period ended June 30, 2003 was $727,000, a decrease of $20,000, or 2.7% from the $747,000 reported for the same period in 2002.

Diluted earnings per share were $0.13 and $0.29 for the three and six months ended June 30, 2003, respectively, compared to $0.17 and $0.31 for the same periods in 2002. This represents a decrease of 23.5% and 6.5% for the three month and six month periods, respectively.

NET INTEREST INCOME

Net interest income, which is the sum of interest and certain fees generated by earning assets minus interest paid on deposits and other funding sources, is the primary source of the company's earnings. All discussions of interest income amounts and rates are on a tax-equivalent basis, which accounts for income earned on loans and securities that are not fully subject to income taxes as if they were fully subject to income taxes. The following table sets forth the company's consolidated average balances of assets, liabilities and stockholders' equity, interest income and expense on related items, and the company's average rate for the three and six month periods ended June 30, 2003 and 2002. The tax-equivalent yield calculations assume a Federal Tax Rate of 34%:

AVERAGE BALANCE SHEET WITH RESULTANT INTEREST AND RATES

(yields on a tax-equivalent basis)	Three Months ended June 30, 2003			Three Months ended J	
	Average Balance	Interest	Average Rate	Average Balance	Interes
INTEREST EARNING ASSETS:					
Interest-bearing deposits in banks	$ 1,409	$ 8	2.28%	$ 1,428	$
Federal funds sold & securities purchased under agreements to resell	1,640	7	1.71%	3,885	1
Investment securities:					
Taxable investment securities	98,069	929	3.80%	72,345	92
Tax-exempt investment securities	28,387	427	6.03%	19,598	31
Total investment securities	126,456	1,356	4.30%	91,943	1,24
Loans	182,962	3,019	6.62%	196,087	3,67
TOTAL EARNING ASSETS	$312,467	$4,390	5.64%	$293,343	$4,94
Allowance for loan losses	(2,278)			(2,518)	
Cash and due from banks	11,263			10,173	
Other assets	21,351			16,980	
TOTAL ASSETS	$342,803			$317,978	
INTEREST BEARING LIABILITIES:					
Interest bearing checking accounts	$ 39,047	$ 75	.77%	$ 33,172	$ 8
Savings deposits	54,466	102	.75%	53,730	15
Time deposits	124,229	1,053	3.40%	121,827	1,30
Total interest bearing deposits	217,742	1,230	2.27%	208,729	1,54
Short-term borrowings	13,463	41	1.22%	10,879	4
Long-term borrowings	44,029	530	4.83%	41,306	55
Trust preferred securities	7,000	82	4.75%	-0-	-0
TOTAL INTEREST-BEARING LIABILITIES	$282,234	$1,883	2.68%	$260,914	$2,15
NET INTEREST SPREAD			2.96%		
Noninterest bearing deposits	32,535			30,274	
Other liabilities	2,140			2,011	
Total liabilities	316,909			293,199	
Stockholders' equity	25,894			24,779	
TOTAL LIABILITIES AND					

STOCKHOLDERS' EQUITY	$342,803			$317,978	
NET INTEREST MARGIN		$2,507	3.22%		$2,79

AVERAGE BALANCE SHEET WITH RESULTANT INTEREST AND RATES

(yields on a tax-equivalent basis)	Six Months ended June 30, 2003			Six Months ended J	
	Average Balance	Interest	Average Rate	Average Balance	Interes
INTEREST EARNING ASSETS:					
Interest-bearing deposits in banks	$ 1,774	$ 18	2.05%	$ 3,842	$
Federal funds sold & securities purchased under agreements to resell	5,072	49	1.95%	6,154	
Investment securities:					
Taxable investment securities	91,393	1,857	4.10%	61,424	1,6
Tax-exempt investment securities	26,692	810	6.12%	19,453	6
Total investment securities	118,085	2,667	4.55%	80,876	2,2
Loans	182,960	6,268	6.91%	199,942	7,5
TOTAL EARNING ASSETS	$307,891	$9,002	5.90%	$290,815	$9,9
Allowance for loan losses	(2,212)			(2,518)	
Cash and due from banks	10,860			9,816	
Other assets	21,514			17,224	
TOTAL ASSETS	$338,053			$315,336	
INTEREST BEARING LIABILITIES:					
Interest bearing checking accounts	$ 38,513	$ 162	.85%	$ 32,150	$ 1
Savings deposits	53,527	212	.80%	53,779	3
Time deposits	123,518	2,122	3.46%	121,431	2,6
Total interest bearing deposits	215,559	2,496	2.34%	207,360	3,1
Short-term borrowings	12,958	76	1.18%	10,333	
Long-term borrowings	42,445	1,035	4.92%	41,844	1,1
Trust preferred securities	7,000	163	4.70%	-0-	-
TOTAL INTEREST-BEARING LIABILITIES	$277,962	$3,770	2.74%	$259,537	$4,3

NET INTEREST SPREAD			3.16%		
Noninterest bearing deposits	32,164			29,260	
Other liabilities	2,046			2,134	
Total liabilities	312,172			290,931	
Stockholders' equity	25,881			24,405	
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$338,053			$315,336	
NET INTEREST MARGIN		$5,232	3.43%		$5,5

Net interest income decreased by $283,000, or 10.1%, to $2,507,000 for the quarter ended June 30, 2003, compared to $2,790,000 for the comparable period in 2002. On a year to date basis net interest income decreased by $357,000, or 6.4%, to $5,232,000 compared to $5,589,000 for the first six months of 2002. The net interest margin, which is the tax equivalent net interest income divided by average interest earning assets was 3.22% and 3.43% for the three and six month periods ended June 30, 2003. The second quarter net interest margin represents a 59 basis point decrease compared to the 2002 second quarter net interest margin of 3.81%. The year to date net interest margin of 3.43% represents a 45 basis point increase compared to the 3.88% net interest margin realized for the same period in 2002.

For the three months ended June 30, 2003, total interest income decreased by $551,000, or 11.2%, to $4,390,000 compared to $4,941,000 for the same period in 2002. The decrease in interest income is due to a 112 basis point decrease in the yield on average earning assets to 5.64% for the second quarter of 2003, compared to 6.76% for the same period in 2002. The decrease in the yield on average earning assets for the second quarter of 2003 compared to the second quarter of 2002 is offset by a $19,124,000 increase in average earning assets. For the six months ended June 30, 2003, total interest income decreased by $909,000, or 9.2%, to $9,002,000 compared to $9,911,000 for the same period in 2002. The decrease in interest income is due to a 97 basis point decrease in the yield on average earning assets to 5.90% compared to 6.87% for the same period in 2002 partially offset by a 5.9% increase in average earning assets.

The decrease in the yield on average earning assets reflects a shift in the asset mix from loans to investment securities for the three and six month periods ended June 30, 2003 compared to the same periods in 2002. The decrease in the yield on average earning assets also reflects the difficulty of finding attractive investments due to the lower interest rate environment during the second quarter and first six months of 2003 compared to the same periods in 2002. Managed and long-term interest rates are at historical lows. If managed rates continue to decrease or even remain at current levels, interest income and the average rate on earning assets are expected to continue to decline as bank assets reprice.

Interest and fees on loans decreased 17.8% to $3,019,000 for the three months ended June 30, 2003 compared to $3,674,000 for the same period of 2002. This decrease was the result of a $13,125,000 or 6.7% decrease in average loans outstanding and a 90 basis point decrease in yield on the portfolio. Interest and fees on loans decreased 17.3% to $6,268,000 for the six months ended June

30, 2003 compared to $7,583,000 in same period of 2002. This decrease was the result of a $16,982,000 or 8.5% decrease in average loans outstanding and a 74 basis point decrease in yield on the portfolio. The decrease in average loans outstanding for the three and six month periods ended June 30, 2003 compared to the same periods in 2002 is largely attributable to the refinancing activity in the residential real estate market, weak commercial and consumer loan demand and competitive pricing pressure for quality credits. The decrease in the bank's residential real estate portfolio accounted for $16,431,000 of the overall year to date decrease and was partially offset by a $10,655,000 increase in commercial real estate loans. Year to date average commercial loans decreased by $5,469,000 or 16.9% to $26,901,000 and year to date average consumer loans decreased by $6,179,000 or 23.5% to $20,101,000.

Interest income on taxable securities increased by $3,000 or 0.3% in the second quarter of 2003 to $929,000 compared to $926,000 for the same period in 2002. Average balances of taxable investment securities increased 35.6% to $98,069,000 for the quarter ended June 30, 2003 compared to $72,345,000 for the same period in the prior year. However, the yield on average taxable investment securities decreased 133 basis points to 3.80% for the second quarter of 2003 compared to 5.13% for the second quarter of 2002. The decrease in the yield on taxable investments is due to accelerated pre-payment speeds on mortgaged backed securities and collateralized mortgage obligations and management's decision to keep portfolio duration short during this historically low rate environment. Tax exempt investment securities increased $8,789,000, or 44.8% to an average balance of $28,387,000 for the three months ended June 30, 2003 compared to $19,598,000 for the same period in 2002. Interest income on tax exempt securities increased $110,000 or 34.7% to $427,000 for the second quarter of 2003 compared to $317,000 for the second quarter of 2002.

Interest income on taxable securities increased by $244,000 or 15.1% in the first six months of 2003 to $1,857,000 from $1,613,000 for the same period in 2002. Average balances of taxable investment securities increased 48.8% to $91,393,000 for the six months ended June 30, 2003 compared to $61,424,000 for the same period in the prior year. The increase in average balances outstanding was offset by a decrease of 120 basis points in average yield to 4.10% for the first six months of 2003 compared to 5.30% for the first six months of 2002. The decrease in the yield on taxable investments is due to accelerated pre-payment speeds on mortgaged backed securities and collateralized mortgage obligations and management's decision to keep portfolio duration short during this historically low rate environment. Average tax exempt securities increased to $26,692,000 for the six months ended June 30, 2003 compared to $19,453,000 for the same period in 2002 and their average tax equivalent yield decreased from 6.54% for the six months ended June 30, 2002 to 6.12% for the same period in 2003.

Interest from fed funds sold and securities purchased under agreements to resell decreased to $7,000 and $49,000 for the three and six month periods ended June 30, 2003, respectively, compared to $17,000 and $50,000 during the same periods in 2002. The quarterly and year to date decreases in interest on fed funds sold and securities purchased under agreements to resell were due to lower average balances.

Total interest expense decreased by $268,000, or 12.4%, to $1,883,000 for the three months ended June 30, 2003 compared to $2,151,000 for the same period in 2002. For the six months ended June 30, 2003 total interest expense decreased by $552,000, or 12.8%, to $3,770,000 compared to $4,322,000 for the same period in 2002. The decrease in total interest expense is the result of the aforementioned lower interest rate environment.

While interest paid on deposits decreased $317,000, or 20.4% to $1,230,000 during the three months ended June 30, 2003 compared to $1,547,000 for the same period in 2002, average interest bearing deposits increased $9,013,000 quarter over quarter. Year to date interest paid on deposits decreased $612,000, or 19.7% to $2,496,000 compared to $3,108,000 for the same period in 2002 while average total interest bearing deposits increased by $8,199,000.

Interest on short-term borrowings decreased $8,000 to $41,000 for the three months ended June 30, 2003 compared to $49,000 for the same period in 2002. This decrease is the result of an increase of $3,943,000 in average fed funds purchased for the three months ended June 30, 2003 compared to the same period in 2002 offset by lower rates due to the decrease in managed interest rates. For the six months ended June 30, 2003 interest on short-term borrowings decreased $19,000 to $76,000 compared to $95,000 for the same period in 2002. This decrease is the net result of the decrease in managed interest rates as mentioned earlier and a $2,625,000, or 25.4% increase in average short-term borrowings to $12,958,000 for the six months ended June 30, 2003 compared to $10,333,000 for the same period in 2002.

Interest expense on long-term borrowings decreased $25,000 and $84,000 to $530,000 and $1,035,000 for the three and six month periods ended June 30, 2003 compared to $555,000 for the second quarter and $1,119,000 for the first six months of 2002. The decrease is primarily the result of additional Federal Home Loan Bank advances in 2003, at lower market interest rates, and the pay-off of the bank debt of Blackhawk Bancorp, Inc. during December, 2002 co-incident with the issuance of the company's Trust Preferred Securities.

PROVISION FOR LOAN LOSSES

The provision for loan losses (provision) is an amount added to the allowance for loan losses (allowance) to provide for the known and estimated amount of loans that will not be collected. Actual loan losses are charged against (reduce) the allowance when management believes that the collection of principal will not occur. Subsequent recoveries of amounts previously charged to the allowance, if any, are credited to (increase) the allowance. Management determines the appropriate provision based upon a number of criteria, including a detailed evaluation of certain credits, historical performance, economic conditions and overall quality of the loan portfolio.

The provision was $142,000 in the second quarter of 2003, an increase of $20,000 or 16.4% from the $122,000 in the second quarter of 2002. For the first six months of 2003, the provision was $365,000 compared to $261,000 during the same time period a year ago.

Activity in the allowance for loan losses is detailed in footnote 2 to the unaudited consolidated financial statements. Charge-offs, net of recoveries for the second quarter of 2003 decreased by $123,000 to net recoveries of $3,000 compared to net charge-offs of $120,000 for the second quarter of 2002. Year to date net charge-offs decreased $44,000 or 30.1% to $102,000 compared to $146,000 for the first six months of 2002.

The year to date increases in the provision combined with reduced net charge-offs and a decrease in the loan portfolio have resulted in an increase in the ratio of the allowance to total loans to 1.26% at June 30, 2003 compared to 1.10% at December 31, 2002.

NONINTEREST INCOME

Total noninterest income increased $10,000, or 1.1%, to $880,000 for the three months ended June 30, 2003 compared to $870,000 for the same period in 2002. Year to date total noninterest income increased $405,000, or 26.8%, to $1,917,000 compared to $1,512,000 for the same period in 2002.

Service charges on deposit accounts totaled $363,000 for the quarter ended June 30, 2003 compared to $396,000 for the second quarter of 2002. The decrease is primarily due to lower overdraft fees collected which decreased by $46,000 or 18.0% to $210,000 for the quarter ended June 30, 2003 compared to $256,000 for the second quarter of 2002. Year to date service charges on deposits decreased $45,000, or 6.0%, to $700,000 compared to $745,000 in the prior year primarily due to lower levels of overdraft fees collected for the six months ended June 30, 2003.

Gain on the sale of mortgage loans increased $87,000 or 161.1% to $141,000 for the second quarter of 2003 compared to the $54,000 of gains recognized during the second quarter of 2002. The increase was due to higher volumes and margins during the second quarter of 2003. In the second quarter of 2003, $7,719,000 of loans were sold to the secondary market compared to $3,917,000 for the same period in 2002. Year to date gain on sale of mortgage loans increased $174,000 or 137.0% to $301,000 compared to $127,000 for the same period in 2002. The increase is due to a higher volume of loans sold and better margins. The average gain in 2003 was 1.80% on $16,708,000 in loans sold to the secondary market compared to an average gain of 1.04% on the $12,226,000 of loans sold in the same period in 2002. The lower volume in 2002 is the result of turn-over in the company's mortgage banking management and origination staff.

The Company recognized $95,000 in securities gains in the second quarter of 2003 compared to $225,000 in the second quarter of 2002. Year to date the company has realized $424,000 in securities gains, a $195,000 or 85.2% increase over the $229,000 realized for the six months ended June 30, 2002.

Other noninterest income increased $86,000 or 44.1% to $281,000 for the quarter ended June 30, 2003 compared to $195,000 for the second quarter of 2002. The increase is primarily due to additional income on the bank's investment in bank owned life insurance. The increase in the cash surrender value of life insurance increased by $67,000 in the second quarter of 2003 compared to the second quarter of 2002. The bank invested $5,000,000 in bank owned life insurance on September 30, 2002. Year to date other noninterest income increased by $81,000 or 19.7% to $492,000 for the six months ended June 30, 2003 from $411,000 for the six months ended June 30, 2002. The year to date increase is due to an increase in cash surrender value of bank owned life insurance of $135,000 offset by the unamortized portion of mortgage servicing rights written off on early payoffs of loans serviced for others.

NONINTEREST EXPENSES

Total operating expenses decreased $70,000, or 2.5%, to $2,769,000 for the three months ended June 30, 2003 compared to $2,839,000 for the same period in 2002. The second quarter of 2002 included a $75,000 charge for closing the bank's Wal-Mart facility and a $50,000 employee severance charge. Excluding these non-recurring items, operating expenses increased by $55,000 for the quarter. The increase in operating expenses, net of the non-recurring items, is due to an increase in marketing and advertising expense. For the first six months of 2002 total operating expenses increased $100,000, or 1.8%, to $5,720,000 compared to $5,620,000 for the same period in 2002.

Salaries and employee benefits increased $22,000 or 1.6% to $1,360,000 for the quarter ended June 30, 2003 compared to $1,338,000 for the second quarter of 2002. For the first six months of 2002 total salaries and employee benefits increased $87,000 or 3.2% to $2,818,000 compared to $2,731,000 for the same period in 2002.

Occupancy expenses for 2002 included a $75,000 charge related to the Wal-Mart branch consolidation. Excluding this one time charge, occupancy expenses for the three months ended June 30, 2003 decreased to $179,000 from $186,000 for the second quarter of 2002. Occupancy expenses for the six months ended June 30, 2003 decreased to $369,000 compared to $374,000 for the same period in 2002.

Furniture and equipment expenses increased $23,000 or 11.1% to $231,000 for the quarter ended June 30, 2003 compared to $208,000 for the same quarter in 2002. For the first six months of 2002 furniture and equipment expense increased $33,000, or 7.7%, to $461,000 compared to $428,000 for the same period in 2002. The increase relates primarily to increased depreciation and maintenance on computer equipment purchased.

Data processing costs increased $15,000, or 8.0%, to $203,000 for the quarter ended June 30, 2003 and $12,000, or 3.1%, to $399,000 for the six months ended June 30, 2003. These increases reflect higher volumes of service utilized from our core processor.

Advertising and marketing costs increased $52,000, or 57.1% to $143,000 for the second quarter of 2003 compared to $91,000 for the same period in 2002. Year to date advertising and marketing costs increased $44,000, or 27.0% to 207,000 from $163,000. The increase is primarily due to the timing of expenses as a number of major marketing campaigns occurred during the second quarter of 2003.

Transportation and postage increased $20,000 or 21.7% to $112,000 for the second quarter of 2003 compared to $92,000 for the second quarter of 2002. For the first six months of 2003 transportation and postage increased $30,000 or 16.4% to $212,000 compared to $182,000 for the same period in 2002. The increase is primarily due to additional costs from an expansion of the bank's courier program in 2003.

Other noninterest expenses decreased $106,000 or 33.3% to $212,000 for the three months ended June 30, 2003 compared to $318,000 for the same period a year ago. For the first six months of 2003 other noninterest expenses decreased $31,000 or 5.6% to $523,000 compared to $554,000 for the same period in 2002. Other noninterest expenses in 2002 included $117,000 of charges to accrue severance payments for executive officers that left the company in 2002 partially offset by an $87,000 credit from adjustment of stale reconciling items. The company also incurred lower net loan expenses in 2003 compared to the same periods in 2002.

Income taxes decreased $159,000, or 99.4%, to $1,000 for the three months ended June 30, 2003 from $160,000 for the same period in 2002. For the six months ended June 30, 2003 income taxes decreased $195,000, or 76.2%, to $61,000 from $256,000 for the same period in 2002. The decrease reflects greater tax efficiency brought about by an increase in non-taxable interest from the municipal bond portfolio and the purchase of bank owned life insurance on September 30, 2002.

BALANCE SHEET ANALYSIS

OVERVIEW

Total assets decreased to $343,533,000 at June 30, 2003 compared to $352,377,000 at December 31, 2002, a decrease of 2.5%. The December 31, 2002 balance sheet included short-term year-end deposits of $18,600,000, which were invested in federal funds sold and interest bearing deposits in banks at December 31, 2002. Excluding these deposits, total assets increased 2.9% from December 31, 2002 to June 30, 2003. While total assets excluding the short-term year-end deposits increased by $9,756,000, there was a considerable shift in balances from short-term investments to investment securities. Securities increased by $14,513,000, while short investments decreased by $19,670,000.

LOANS

Gross loans decreased $2,498,000, or 1.3%, to $185,881,000 on June 30, 2003 compared to $188,379,000 on December 31, 2002. The composition of loans is shown in the following table:

	June 30, 2003	December 31, 2002	Change in Balance	As a % of Total Loans June 30, 2003	As a % of Total Loans December 31, 2002
	(Dollars in millions)				
Residential Real Estate	$77.0	$71.8	$5.2	41.4%	38.1%
Commercial Real Estate	$55.2	$59.0	($3.8)	29.7%	31.4%
Construction and Land Development	$7.7	$6.4	$1.3	4.1%	3.4%
Commercial	$26.4	$28.3	($1.9)	14.2%	15.0%
Consumer	$19.1	$22.3	($3.2)	10.3%	11.8%
Other	$0.5	$0.6	($0.1)	0.3%	0.3%

The historically low interest rate environment has led to substantial prepayments on the company's 1-4 family residential real estate loan portfolio. To offset this loan run-off, the bank has retained new adjustable and fixed rate mortgages with lives of 15 years or less. This has lead to an increase of $5,200,000 or 7.2% in residential real estate loans for the six months ended June 30, 2003. This increase has partially offset decreases of $5,700,000 in Commercial and Commercial Real Estate loans and $3,200,000 in Consumer loans over the same period. In addition, the company's focus on relationship banking has resulted in the subsidiary bank not pursuing certain "transactions" that may have resulted in increased loan balances, but offered no opportunity to form other relationships with the client.

NON-PERFORMING LOANS

Non-performing loans includes loans which have been categorized by management as non-accruing because collection of interest is not assured, and loans which are past-due ninety days or more as to interest and/or principal payments.

The following summarizes information concerning non-performing loans:

(DOLLARS IN THOUSANDS)	JUNE 30, 2003	DECEMBER 31, 2002
Non-accruing loans	$3,233	$2,560
Past due 90 days or more and still accruing	17	26
Total non-performing loans	$3,250	$2,586
Restructured loans performing in accordance with modified terms	$ 393	$ 418

ASSET QUALITY

The allowance for loan losses was $2,342,000 or 1.26% of total loans at June 30, 2003 compared to $2,079,000 or 1.10% of total loans at December 31, 2002. As of June 30, 2003, non-performing loans and restructured loans performing in accordance with modified terms totaled $3,643,000 compared to $3,004,000 at December 31, 2002. The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes that the collectibility of the principal is unlikely. The allowance for loan losses is adequate to cover probable credit losses relating to specifically identified loans, as well as probable credit losses inherent in the balance of the loan portfolio. In accordance with FASB Statements 5 and 114, the allowance is provided for losses that have been incurred as of the balance sheet date. The allowance is based on past events and current economic conditions, and does not include the effects of expected losses on specific loans or groups of loans that are related to future events or expected changes in economic conditions. Management reviews a calculation of the allowance for loan losses on a quarterly basis. While management uses the best information available to make its evaluation, future adjustments to the allowance may be necessary if there are significant changes in economic conditions.

In addition, various regulatory agencies periodically review the allowance for loan losses. These agencies may require the bank to make additions to the allowance for loan losses based on their judgments of collectibility based on information available to them at the time of their examination. The policy of the Company is to place a loan on non-accrual status if: (a) payment in full of interest and principal is not expected, or (b) principal or interest has been in default for a period of 90 days or more, unless the obligation is both in the process of collection and well secured. Well secured is defined as collateral with sufficient market value to repay principal and all accrued interest. A debt is in the process of collection if collection of the debt is proceeding in due course either through legal action, including judgement enforcement procedures, or in appropriate circumstances, through collection efforts not involving legal action which are reasonably expected to result in repayment of the debt or in its restoration to current status.

At June 30, 2003 the allowance for loan losses to total non-performing and impaired loans equaled 64.3% compared to 69.2% at December 31, 2002. Total nonperforming and impaired loans increased by $639,000 primarily as the result of two large loans. One is a commercial real estate loan and the other is a single family residence. Both loans are in foreclosure.

SHORT-TERM INVESTMENTS

Fed funds sold and securities purchased under agreements to resell decreased $13,120,000 to $0 at June 30, 2003 compared to $13,120,000 at December 31, 2002. The decrease primarily reflects the liquidation of short-term year-end investments on January 2, 2002 associated with the December 31, 2002 year-end deposits of $18,600,000.

INVESTMENT SECURITIES

Securities available for sale increased $18,116,000, or 21.6%, to $102,013,000 at June 30, 2003 compared to $83,897,000 at December 31, 2002. The increase in investments in securities available for sale resulted from the redeployment of short-term investments and cash flows from held to maturity securities. In addition, proceeds from the net decrease in loans have been invested in available for sale securities.

DEPOSITS

Total deposits decreased $14,193,000 to $248,892,000 at June 30, 2003 compared to $263,085,000 at December 31, 2002. As noted above, the Company's December 31, 2002 financial statements reflect short-term year-end interest-bearing deposits of $18,600,000. Excluding the short-term year-end deposits, total deposits increased 1.8% from December 31, 2002. Excluding the short-term year-end deposits, non-interest bearing deposits decreased by $2,154,000 and interest bearing deposits increased by $6,561,000 at June 30, 2003 compared to December 31, 2002.

BORROWINGS

Short-term borrowings decreased $1,464,000 to $11,990,000 at June 30, 2003 from $13,454,000 at year-end. The decrease is due to lower outstanding balances of repurchase agreements with commercial customers, offset by $2,560,000 in Fed funds purchased at June 30, 2003.

Long-term borrowings consist of term advances from the Federal Home Loan Bank ("FHLB") and were $46,600,000 at June 30, 2003 compared to $38,900,000 at December 31, 2002. The increase reflects an additional $8,000,000 in FHLB advances net of a $300,000 repayment invested into securities during 2003.

STOCKHOLDERS' EQUITY

Total stockholders' equity increased $344,000 to $26,142,000 at June 30, 2003 compared to $25,798,000 at December 31, 2002. During the first six months of 2003 additional paid in capital increased by $75,000 from stock options exercised. Accumulated other comprehensive income, which is composed of the adjustment of securities available for sale to market value, net of tax, and the fair value of Blackhawk Bancorp, Inc.'s interest rate SWAP contract, net of tax, was $1,282,000 at June 30, 2003 compared to $1,287,000 at December 31, 2002. In addition the company declared two quarterly dividends of $0.09 per share on its common stock, which totaled $453,000.

The Company is subject to certain regulatory capital requirements and continues to remain in compliance with the requirements. The following table shows the company's capital ratios and regulatory requirements.

	June 30, 2003	December 31, 2002	Regulatory Requirements
Total Capital (To Risk-Weighted Assets)	14.9%	13.9%	8.0%
Tier I Capital (To Risk-Weighted Assets)	13.7%	12.9%	4.0%
Tier I Capital (To Average Assets)	8.2%	8.3%	4.0%

The Company's subsidiary bank meets regulatory capital requirements to be considered well capitalized.

ASSET/LIABILITY MANAGEMENT

Asset/liability management is the process of identifying, measuring and managing the risk to the Company's earnings and capital resulting from the movements in interest rates. It is the Company's objective to protect earnings and capital while achieving liquidity, profitability and strategic goals.

The Company focuses its measure of interest rate risk on the effect a shift in interest rates would have on earnings rather than on the amount of assets and/or liabilities subject to repricing in a given time period. Since not all assets or liabilities move at the same rate and at the same time, a determination must be made as to how each interest earning asset and each interest bearing liability adjusts with each change in the base rate. The Company develops, evaluates and amends its assumptions on an ongoing basis and analyzes its earnings exposure quarterly.

In addition to the effect on earnings, a monthly evaluation is made to determine the change in the economic value of the equity with various changes in interest rates. This determination indicates how much the value of the assets and the value of the liabilities change with a specified change in interest rates. The net difference between the economic values of the assets and liabilities results in an economic value of equity.

During June 2003, the Company entered into an interest rate SWAP agreement related to the company obligated mandatorily redeemable preferred securities. This SWAP is utilized to manage variable interest rate exposure and is designated as a highly effective cash flow hedge. The differential to be paid or received on the SWAP agreement is accrued as interest rates change and is recognized over the life of the agreement in interest expense. The SWAP agreement expires in December 2007 and essentially fixes the rate to be paid at 5.72%. The notional amount is $7,000,000. Included in other comprehensive income is a gain of $69,000, less $24,000 of deferred income tax, relating to the fair market value of the SWAP agreement as of June 30, 2003. Risk management results for the six months ended June 30, 2003 related to the balance sheet hedging of the company obligated mandatorily redeemable preferred securities indicate that the hedge was 100% effective and that there was no component of the derivative instrument's gain or loss which was excluded from the assessment of hedge effectiveness.

LIQUIDITY

Liquidity, as it relates to the subsidiary bank, is a measure of its ability to fund loans and withdrawals of deposits in a cost-effective manner. The Bank's principal sources of funds are deposits, scheduled amortization and prepayment of loan principal, maturities of investment securities, short-term borrowings and income from operations. Additional sources include purchasing fed funds, sale of securities, sale of loans, borrowing from both the Federal Reserve Bank and Federal Home Loan Bank, and dividends paid by Nevahawk, a wholly owned subsidiary of the Bank.

The liquidity needs of the Company generally consist of payment of dividends to its Stockholders, payments of principal and interest on borrowed funds and subordinated debentures, and a limited amount of expenses. The sources of funds to provide this liquidity are issuance of capital stock and dividends from its subsidiary bank. Certain restrictions are imposed upon the Bank, which could limit its ability to pay dividends if it did not have net earnings or adequate capital in the future. The Company maintains adequate liquidity to pay its expenses.

The following table summarizes The Company's significant contractual obligations and other potential funding needs at June 30, 2003 (in thousands):

Year Ended June 30,	Time Deposits	Long-term debt(1)	Operating