ALPENA BANCSHARES INC
Form 10KSB
March 30, 2004

SECURITIES AND EXCHANGE COMMISSION
450 FIFTH STREET, N.W.
WASHINGTON, D.C. 20549

FORM 10-KSB

|X| Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the Fiscal Year Ended December 31, 2003

OR

| | 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: 000-31957

ALPENA BANCSHARES, INC.
(Exact name of registrant as specified in its charter)

UNITED STATES	38-3567362
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
100 S. SECOND AVENUE, ALPENA, MICHIGAN	49707
(Address of Principal Executive Offices)	Zip Code

(989) 356-9041
(Registrant's telephone number)

Securities Registered Pursuant to Section 12(b) of the Act: NONE

Securities Registered Pursuant to Section 12(g) of the Act: COMMON STOCK, PAR VALUE $1.00 PER SHARE
(Title of Class)

Check 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 past twelve months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

YES |X| NO | |

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. |X|

The Registrant's revenues for the year ended December 31, 2003 were $13.2 million.

As of March 8, 2004, there were issued and outstanding 1,658,780 shares of the Registrant's common stock.

The aggregate market value of the voting stock held by non-affiliates of the Registrant, computed by reference to the last sale price on March 8, 2004 was $17.1 million. This amount does not include shares held by the Registrant's Employee Stock Ownership Plan, by executive officers and directors, and by Alpena Bancshares, M.H.C.

Transitional Small Business Disclosure Format

YES | | NO |X|

DOCUMENTS INCORPORATED BY REFERENCE

1. Sections of the Annual Report to Stockholders for the year ended December 31, 2003 (Part II).

2. Portions of the Proxy Statement for the 2004 Annual Meeting of Stockholders (Part III).

PART I

ITEM 1. BUSINESS

GENERAL

Alpena Bancshares, Inc. (the "Company") is a federally chartered holding company that conducts business principally through its wholly owned subsidiary, First Federal of Northern Michigan, a federally chartered savings bank (the "Bank"). The Company was formed in November 2000 when the Bank reorganized into the holding company structure. In this reorganization, each outstanding share of the Bank's common stock was converted by operation of law into one share of the Company's common stock. The Company's assets consist primarily of shares of the Bank's common stock and cash it receives from the Bank in the form of capital distributions. The Company has substantially no independent operations separate from its role as holding company for the Bank. Accordingly, the operations of the Bank as described in this report effectively describe the operations of the Company. At December 31, 2003, the Company had total assets of $223.9 million, total deposits of $151.7 million, and stockholders' equity of $21.9 million. The Company's principal executive office is located at 100 South Second Avenue, Alpena, Michigan, and its telephone number at that address is (989) 354-7310.

The Bank is a federally chartered savings bank that conducts its operations from eight full-service facilities located in Cheboygan, Alpena, Iosco, Otsego, Montmorency and Oscoda Counties, Michigan. The Bank has operated in Alpena since its chartering in 1957. The Bank's deposits are insured by the Federal Deposit Insurance Corporation ("FDIC") under the Savings Association Insurance Fund. The Bank has been a member of the Federal Home Loan Bank System since 1957.

The Bank is a community-oriented savings institution that is primarily engaged in the business of attracting deposits from the general public in the Bank's market area, and investing such deposits in one- to four-family residential real estate mortgages, commercial real estate loans and consumer loans.

The Bank's principal executive office is located at 100 South Second Avenue, Alpena, Michigan, and its telephone number at that address is (989) 354-7310.

MARKET AREA AND COMPETITION

The Bank conducts operations through its main office in Alpena, Michigan, which is located in the northeastern lower peninsula of Michigan, and through its seven other branch offices in Michigan. The population of Alpena (city and township) is approximately 21,000, and the population of the Bank's primary market area, which includes Alpena County and seven surrounding counties, is approximately 154,000. Alpena is the largest city located in the northeastern lower peninsula of Michigan. This area has long been associated with agricultural, wood and concrete products. Tourism has also been a major industry in the Bank's primary market area. All of these industries tend to be seasonal and are strongly affected by state and national economic conditions. Therefore, unemployment rates in the Bank's primary market area are generally higher than state and national levels.

Major employers in the Bank's primary market area include various public schools and governmental agencies, Alpena General Hospital, Besser Company (a manufacturer of concrete products equipment), Lafarge Corporation (a limestone mining and cement producer), Treetops Sylvan Resort (an operator of resort properties), Garland Resort (an operator of resort properties), Otsego Memorial Hospital, Community Memorial Hospital, and various other small companies.

As of December 31, 2003, the Bank was the only thrift institution headquartered in the Bank's market area. The Bank encounters strong competition both in attracting deposits and in originating real estate and other loans. Its most direct competition for deposits has historically come from commercial banks, other savings institutions, and credit unions in its market area. Competition for loans comes from such financial institutions as well as mortgage banking companies. The Bank expects continued strong competition in the foreseeable future, including increased competition from "super-regional" banks entering the market by purchasing other savings institutions. Many such institutions have greater financial and marketing resources available to them than does the Bank. The Bank competes for savings deposits by offering depositors a high level of personal service and a wide range of competitively priced financial services. In recent years, additional strong competition has come from stock and bond dealers and brokers. The Bank competes for real estate loans primarily through the interest rates and loan fees it charges and through advertising. Competition for deposits and loans may limit the Bank's growth and adversely affect its profitability in the future.

LENDING ACTIVITIES

Loan Portfolio. The principal component of the Bank's loan portfolio is mortgage loans secured by one-to-four family residential real estate. A majority of the fixed-rate conventional mortgage loans with 15, 20 and 30 year terms secured by one-to four-family residential real estate originated by the Bank is sold to Freddie Mac. A majority of the servicing of these mortgages is retained by the Bank. To a lesser extent, the Bank also originates commercial loans, commercial real estate loans and consumer loans. At December 31, 2003, the Bank's net loans receivable totaled $163.5 million, of which $100.2 million, or 61.3%, were one-to four-family residential real estate mortgage loans, and $30.0 million, or 18.3%, were commercial real estate loans. Other loans, consisting primarily of consumer loans, totaled $34.3 million, or 21.0% of the Bank's net loan portfolio.

Analysis of Loan Portfolio. Set forth below is selected data relating to the composition of the Bank's loan portfolio by type of loan as of the dates indicated.

At Dec

	2003		2
	Amount	Percent	Amount
			(in t
Real estate loans:			
One-to four-family residential	$ 100,198	61.30%	$ 104,77
Construction	5,381	3.29%	2,94
Other real estate loans construction	525	0.32%	-
Other real estate loans	29,978	18.34%	20,36
Total real estate loans	136,082	83.25%	128,09
Other loans:			
Commerical loans	13,397	8.20%	7,52
Consumer loans	20,708	12.67%	19,23
Loans on savings deposits	215	0.13%	35
Total other loans	34,320	21.00%	27,11
Total loans receivable	170,402	104.25%	155,20
Less:			
Loans in process	(5,665)	-3.47%	(2,85
Deferred loan costs, net of fees and unearned loan discounts ..	(241)	-0.15%	(9
Allowance for loan losses	(1,036)	-0.63%	(92
Total loans receivable, net at end of period	$ 163,460	100.00%	$ 151,34

	At December 31,		
	2000		1999
	Amount	Percent	Amount
	(in thousands)		
Real estate loans:			
One-to four-family residential	$ 176,548	80.63%	$ 195,237
Construction	3,930	1.79%	--
Other real estate loans construction	--	0.00%	--
Other real estate loans	10,681	4.88%	8,969
Total real estate loans	191,159	87.30%	204,206
Other loans:			
Commerical loans	1,410	0.64%	--
Consumer loans	28,652	13.09%	21,160
Loans on savings deposits	137	0.06%	46
Total other loans	30,199	13.79%	21,206
Total loans receivable	221,358	101.10%	225,412
Less:			
Loans in process	(1,727)	-0.79%	(1,179)
Deferred loan costs, net of fees and unearned loan discounts	(25)	-0.01%	81
Allowance for loan losses	(649)	-0.30%	(448)

Total loans receivable, net at end of period	$ 218,957	100.00%	$ 223,866

Loan Maturity Schedule. The following table sets forth the maturity or period of repricing of the Bank's loan portfolio at December 31, 2003. Demand loans, loans having no stated schedule of repayments and no stated maturity, and overdrafts are reported as due in one year or less. Adjustable-and floating rate loans are included in the period in which interest rates are next scheduled to adjust rather than in which they contractually mature, and fixed rate loans are included in the period in which the final contractual repayment is due.

	Within One Year	One Year Through Three Years	Three Years Through Five Years
			(In thousands)
Real estate loans:			
One-to four-family residential	$ 9,671	$16,735	$23,940
Construction	5,266	115	--
Other real estate construction loans	525	--	--
Other real estate loans	12,260	5,581	12,694
Total real estate loans	27,722	22,431	36,634
Other loans:			
Commerical loans	10,103	--	85
Consumer loans	7,800	2,408	3,968
Total other loans	$17,903	$ 2,408	$ 4,053
Total loans receivable	45,625	24,839	40,687

Fixed- and Adjustable-Rate Loan Schedule. The following table sets forth at December 31, 2003, the dollar amount of all fixed rate and adjustable rate loans that have a scheduled maturity or period to repricing after December 31, 2004.

	Fixed Rate	Adjustable Rate	Total
		(In thousands)	
Real estate loans:			
One-to four-family residential	$ 84,199	$10,618	$ 94,817
Construction	5,381	--	5,381
Other real estate construction loans	525	--	525
Other real estate loans	32,662	--	32,662
Total real estate loans	122,767	10,618	133,385

Other loans:			
Commerical loans	886	9,302	10,188
Consumer loans	20,476	447	20,923
Total other loans	21,362	9,749	31,111
Total loans receivable	$144,129	$20,367	$164,496

One- to Four-Family Residential Real Estate Loans. The Bank's primary lending activity consists of the origination of one- to four-family owner-occupied residential mortgage loans, virtually all of which are collateralized by properties located in the Bank's market area. The Bank also originates one- to four-family loans that pay interest only during the initial construction period (which generally does not exceed twelve months) and then pay interest and principal

for the remainder of the loan term. The Bank generally sells all of its originated longer term (greater than 20 years) fixed-rate mortgages to the Federal Home Loan Mortgage Corporation ("Freddie Mac") and retains a majority of the loan servicing upon those sales. Most, but not all, of the loans originated by the Bank qualify for resale in the secondary mortgage market. One- to four-family loans are underwritten and originated according to policies and guidelines established by the secondary market agencies and approved by the Board of Directors. The Bank utilizes existing liquidity, savings deposit growth, loan repayments, and FHLB advances to meet demand for loans.

The Bank currently offers fixed rate one- to four-family residential mortgage loans with terms ranging from 5 to 30 years. One- to four-family residential real estate loans often remain outstanding for significantly shorter periods than their contractual terms because borrowers may refinance or prepay loans at their option. The average length of time that the Bank's one- to four-family residential mortgage loans remain outstanding varies significantly depending upon trends in market interest rates and other factors. In recent years, the average maturity of the Bank's mortgage loans has decreased significantly due to the unprecedented volume of refinancing activity. Accordingly, estimates of the average length of one- to four-family loans that remain outstanding cannot be made with any degree of certainty.

Originations of fixed rate mortgage loans are regularly monitored and are affected significantly by the level of market interest rates, the Bank's interest rate gap position, and loan products offered by the Bank's competitors. The Bank's fixed rate mortgage loans amortize on a monthly basis with principal and interest due each month. To make the Bank's loan portfolio less interest rate sensitive, loans originated with terms greater than fifteen years are generally underwritten to secondary market standards and sold; balloon mortgage loans with five year terms and adjustable rate mortgage loans are generally underwritten to secondary market standards, but will be retained in the Bank's loan portfolio.

The Bank originates some fixed-rate loans which are generally amortized over 15 years but which have "balloon payments" which are due upon the maturity of the loan in five years. Upon maturity, the balloon mortgage loans are either underwritten as fixed-rate loans and sold in the secondary market or renewed at current market rates for a consecutive five year term. While the majority of the Bank's balloon mortgage loans amortize over 15 years, some amortize over 10 or 30 years, and a limited number amortize over 5 years.

The Bank's one- to four-family residential mortgage loans customarily

include due-on-sale clauses, which are provisions giving the Bank the right to declare a loan immediately due and payable in the event, among other things, that the borrower sells or otherwise disposes of the underlying real property serving as security for the loan. Due-on-sale clauses are an important means of adjusting the rates on the Bank's fixed-rate mortgage loan portfolio, and the Bank has generally exercised its rights under these clauses.

Regulations limit the amount that a savings institution may lend relative to the appraised value of the real estate securing the loan, as determined by an appraisal at the time of loan origination. Such regulations permit a maximum loan-to-value ratio of 100% for residential property and 90% for all other real estate loans. The Bank's lending policies limit the maximum loan-to-value ratio on fixed-rate loans without private mortgage insurance to 90% of the lesser of the appraised value or the purchase price of the property to serve as collateral for the loan.

The Bank makes one- to four-family real estate loans with loan-to-value ratios of up to 90%; however, for one- to four-family real estate loans with loan-to-value ratios of between 80% and 90%, the Bank may require the first 20% of the loan amount to be covered by private mortgage insurance. The Bank requires fire and casualty insurance, flood insurance when applicable, as well as title insurance, on all properties securing real estate loans made by the Bank.

Other Real Estate Loans. At December 31, 2003, the Bank had a total of 187 loans secured primarily by commercial real estate properties, unimproved vacant land and, to a limited extent, multifamily properties. The Bank's commercial real estate loans are secured by income producing properties such as office buildings, retail buildings and motels. The Bank has originated commercial construction loans that are originated as permanent loans but are interest-only during the initial construction period which generally does not exceed nine months. At December 31, 2003, the Bank's commercial real estate loans totaled $30.0 million and had an average principal balance of $160,310 and the largest commercial real estate loan had a principal balance of $3.4 million. The terms of each loan are negotiated on a case-by-case basis, although such loans typically amortize over 15 years and have a three- or five-year balloon feature.

An origination fee of 0.5% to 1.0% is generally charged on commercial real estate loans. The Bank generally makes commercial real estate loans up to 75% of the appraised value of the property securing the loan.

Loans secured by commercial real estate generally involve a greater degree of credit risk than one- to four-family residential mortgage loans and carry larger loan balances. This increased credit risk is a result of several factors, including the concentration of principal in a limited number of loans and borrowers, the effects of general economic conditions on income producing properties, and the increased difficulty of evaluating and monitoring these types of loans. Furthermore, the repayment of loans secured by commercial real estate is typically dependent upon the successful operation of the business or the related real estate property. If the cash flow from the business operation is reduced, the borrower's ability to repay the loan may be impaired.

Other Loans. The Bank also originates other real estate and non-real estate related loans, including commercial loans, consumer installment loans, credit card advances, and loans secured by savings accounts, automobiles, mobile homes, boats, recreational vehicles, and other personal property. Such other loans are originated by the Bank in order to provide a full range of financial services to its customers. Commercial loans carry a greater level of credit risk due to their dependence on the successful operation and cash flow of the business, which is the primary source of repayment for the debt. Consumer loans entail greater credit risk than do residential mortgage loans, particularly in the case of consumer loans that are secured by assets that depreciate rapidly,

such as automobiles, mobile homes, boats, and recreational vehicles. At December 31, 2003, the Bank's non real estate commercial loan portfolio totaled $13.4 million, or 8.2% of net loans receivable. The Bank's other consumer loans totaled $20.7 million, or 12.7% of net loans receivable.

Loan Originations, Solicitation, Processing, and Commitments. Loan originations are derived from a number of sources such as real estate agent referrals, existing customers, borrowers, builders, attorneys, the Bank's directors and walk-in customers. Upon receiving a loan application, the Bank obtains a credit report and employment verification to verify specific information relating to the applicant's employment, income, and credit standing. In the case of a real estate loan, the Bank obtains a determination of value of the real estate intended to collateralize the proposed loan. Conventional one- to four-family residential loans up to $322,700 generally may be approved by loan officers if the loan will be sold on the secondary market. For loans held in portfolio, the lending limits vary by officer experience but range from $50,000 to $322,700. The loan committee must approve any loan from $322,701 up to $400,000, and any loan request over $400,000 must be approved by the Board of Directors. Consumer lending limits by officer range from $15,000 to $200,000. For secured commercial loans, the limit ranges from $150,000 to $400,000. After the loan is approved, a loan commitment letter is promptly issued to the applicant.

The commitment letter specifies the terms and conditions of the proposed loan including the amount of the loan, interest rate, amortization term, a brief description of the required collateral, and required insurance coverage. Commitments are typically issued for 30-day periods. The borrower must provide proof of fire and casualty insurance on the property serving as collateral, which insurance must be maintained during the full term of the loan. A title insurance policy is required on all real estate loans. At December 31, 2003, the Bank had outstanding loan commitments of $47.4 million, including unfunded commitments under lines of credit and commercial and standby letters of credit.

Origination, Purchase and Sale of Loans. The table below shows the Bank's loan originations, purchases, sales, and repayments of loans for the periods indicated.

	YEARS ENDED DECE	
	2003	2002
	(In Thousan	
Loans receivable at beginning of period	$ 152,263	$ 176,835
Originations:		
Real estate:		
Residential 1-4 family	132,146	97,487
Commercial and Multi-family	35,004	27,211
Consumer	18,176	8,340
Total originations	185,326	133,038
Loan purchases	--	--
Loan sales	(81,510)	(68,631
Transfer of mortgage loans to foreclosed real estate	(583)	(618

Repayments	(91,000)	(88,361
Total loans receivable at end of period	164,496	152,263

Loan Origination Fees and Other Income. In addition to interest earned on loans, the Bank generally receives fees in connection with loan originations. Such loan origination fees, net of costs to originate, are deferred and amortized using an interest method over the contractual life of the loan. Fees deferred are recognized into income immediately upon prepayment or subsequent sale of the related loan. At December 31, 2003, the Bank had $227,500 of net deferred loan origination fees. Such fees vary with the volume and type of loans and commitments made and purchased, principal repayments, and competitive conditions in the mortgage markets, which in turn respond to the demand and availability of money. In addition to loan origination fees, the Bank also generates other income through the sales and servicing of mortgage loans, late charges on loans, and fees and charges related to deposit accounts. The Bank recognized fees and service charges of $802,000, $818,000 and $740,000 for the years ended December 31, 2003, 2002, and 2001 respectively.

DELINQUENCIES AND CLASSIFIED ASSETS

Delinquencies. The Bank's general collection procedures provide that when a mortgage or consumer loan is 16 days past due (11 days for a commercial loan), a computer-generated late charge notice is sent to the borrower requesting payment. If delinquency continues, a second delinquent notice is mailed when the loan continues past due for 30 days. If a loan becomes 60 days past due, the loan becomes subject to possible legal action. Bank officials will generally send a "due and payable" letter upon a loan becoming 90 days delinquent. This letter grants the mortgagor 30 days to bring the account paid to date prior to start of any legal action. If not paid, foreclosure proceedings are initiated after this 30 day period. To the extent required by regulations of the Department of Housing and Urban Development ("HUD"), generally within 45 days of delinquency, a Section 160 HUD notice is given to the borrower which provides access to consumer counseling services. General collection procedures may vary with particular circumstances on a loan by loan basis. Also, collection procedures for Freddie Mac serviced loans follow the Freddie Mac guidelines which are different from the Bank's general procedures.

Non-performing Assets. Loans are reviewed on a regular basis and are placed on non-accrual status when, in the opinion of management, the collection of additional interest is doubtful or when extraordinary efforts are required to collect the debt. Interest accrued and unpaid at the time a loan is placed on non-accrual status is charged against interest income.

Real estate acquired by the Bank as a result of foreclosure or by deed in lieu of foreclosure is deemed real estate owned ("REO") until such time as it is sold. In general, the Bank considers collateral for a loan to be "in-substance" foreclosed if: (i) the borrower has little or no equity in the collateral; (ii) proceeds for repayment of the loan can be expected to come only from the operation or sale of the collateral; and (iii) the borrower has either formally or effectively abandoned control of the collateral to the Bank, or retained control of the collateral but is unlikely to be able to rebuild equity in the collateral or otherwise repay the loan in the foreseeable future. Cash flow attributable to in-substance foreclosures is used to reduce the carrying value of the collateral.

When collateral, other than real estate, securing commercial and consumer loans is acquired as a result of delinquency or other reasons, it is classified as Other Repossessed Assets ("ORA") and recorded at the lower of cost or fair market value until it is disposed of.

When collateral is acquired or otherwise deemed REO/ORA, it is recorded at the lower of the unpaid principal balance of the related loan or its estimated net realizable value. This write down is recorded against the allowance for loan losses. Periodic future valuations are performed by management, and any subsequent decline in fair value is charged to operations. At December 31, 2003, the Bank held $198,672 of REO/ORA.

Delinquent Loans and Nonperforming Assets. The following table sets forth information regarding loans delinquent 90 days or more and REO/ORA by the Bank at the dates indicated. As of the dates indicated, the Bank did not have any material restructured loans within the meaning of SFAS 15.

	AT DE	
	2003	2002
	(Dollars	
Total non-accrual loans delinquent 90 days or more	$1,291	$ 662
Accrual loans delinquent 90 days or more:		
One- to four-family residential	617	566
Construction	--	--
Other real estate loans	77	--
Commercial	--	152
Consumer	134	89
Total accrual loans delinquent 90 days or more	$ 828	$ 807
Total nonperforming loans (1)	2,119	1,469
Total real estate owned (2)	199	128
Total nonperforming assets	$2,318	$1,597
Total nonperforming loans to net loans receivable	1.30%	0.97%
Total nonperforming loans to total assets	0.95%	0.64%
Total nonperforming assets to total assets	1.04%	0.70%

(1) All the Bank's loans delinquent 90 days or more are classified as nonperforming.

(2) Represents the net book value of property acquired by the Bank through foreclosure or deed in lieu of foreclosure. Upon acquisition, this property is recorded at the lower of its fair market value or the principal balance of the related loan.

Delinquent Loans. The following table sets forth information with respect to loans past due by 60-89 days and 90 days or more in the Bank's portfolio at the dates indicated.

	2003	2002	AT (In
Loans delinquent 60-89 days:			
One- to four-family residential	$1,248	$1,411	
Construction	43	--	
Other real estate loans	--	--	
Commercial	221	123	
Consumer	90	1,090	
Total loans delinquent 60-89 days	1,602	2,624	
Total non-accrual loans delinquent 90 days or more	1,291	662	
Accrual loans delinquent 90 days or more:			
One- to four-family residential	617	566	
Construction	--	--	
Other real estate loans	77	--	
Commercial	--	152	
Consumer	134	89	
Total accrual loans delinquent 90 days or more	828	807	
Total loans past due 60 days or more	$3,721	$4,093	

Classification of Assets. Federal regulations provide for the classification of loans and other assets such as debt and equity securities considered by the OTS to be of lesser quality as "substandard," "doubtful," or "loss" assets. An asset is considered "substandard" if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. "Substandard" assets include those characterized by the "distinct possibility" that the savings institution will sustain "some loss" if the deficiencies are not corrected. Assets classified as "doubtful" have all of the weaknesses inherent in those classified "substandard," with the added characteristic that the weaknesses present make "collection or liquidation in full," on the basis of currently existing facts, conditions, and values, "highly questionable and improbable." Assets classified as "loss" are those considered "uncollectible" and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted. Assets that do not expose the savings institution to risk sufficient to warrant classification in one of the aforementioned categories, but which possess some weaknesses, are required to be designated "special mention" by management. Loans designated as special mention are generally loans that, while current in required payments, have exhibited some potential weaknesses that, if not corrected, could increase the level of risk in the future.

The Bank classifies its assets pursuant to criteria similar to the classification structure provided in the OTS regulations. The following table sets forth the aggregate amount of the Bank's internally classified assets at the dates indicated.

AT DECEMBER 31,

	2003	2002	2001	2000	1999
	(In Thousands)				
Substandard assets	$2,295	$1,263	$2,198	$3,182	$2,526
Doubtful assets	105	370	--	--	18
Loss assets	--	--	--	--	--
Total classified assets	$2,400	$1,633	$2,198	$3,182	$2,544

Substandard assets increased to $2.3 million at December 31, 2003 compared to $1.3 million at December 31, 2002. The Bank's investment in subsidiary of $500,000 at December 31, 2003 and $600,000 at December 31, 2002 is classified as substandard due to slower then expected sales of building lots and condominium units in the subsidiary's land development project. This project (Wyndham Garden Estates) is an upscale condominium community comprised of 25 single-family building lots and 18 planned building units. Management believes this is a viable project with development and sales ongoing. At December 31, 2003, the Bank had a recorded lower of cost or market value adjustment of $121,000 for this development. All 25 lots are developed, of which sixteen lots have been sold. There are 16 constructed building units all of which are sold.

Allowance for Loan Losses. Management's policy is to provide for estimated losses on the Bank's loan portfolio based on management's evaluation of the estimated losses that may be incurred. The Bank regularly reviews its loan portfolio, including problem loans, to determine whether any loans require classification or the establishment of appropriate reserves or allowances for losses. Such evaluation, which includes a review of all loans of which full collectability of interest and principal may not be reasonably assured, considers, among other matters, the estimated fair value of the underlying collateral. During the years ended December 31, 2003, 2002, 2001, 2000 and 1999 the Bank added $267,000, $415,000, $255,000, $280,000 and $120,000 respectively, to the allowance for loan losses. The Bank's allowance for loan losses totaled $1,036,000, $922,000, $689,000, $649,000 and $$448,000 at December 31, 2003, 2002, 2001, 2000 and 1999 respectively.

For the year ended December 31, 2003, net charge-offs totaled $153,000. Management believes that the allowances for losses on loans and investments in real estate are adequate with respect to quality of assets, as Bank loan losses have generally been minimal. However, as the mix of loans continues to change (commercial and consumer loans grow as a percentage of the total loan portfolio) management may increase the allowance for loan losses for the increased risk these types of loans bring to the loan portfolio. While management uses available information to recognize losses on loans and investments in real estate, future additions to the allowances may be necessary based on changes in economic conditions and the composition of the loan portfolio. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowances for losses on loans and investments in real estate. Such agencies may require the Bank to recognize additions to the allowances based on their judgments about information available to them at the time of their examination.

Analysis of the Allowance for Loan Losses. The following table sets forth the analysis of the allowance for loan losses for the periods indicated.

	FOR THE YEARS ENDED		
	2003	2002	2001

	(Dollars in tho		
Net loans outstanding	$ 163,460	$ 151,341	$ 176,14
Average loans outstanding	155,105	152,943	181,34
Allowance at beginning of period	$ 922	$ 689	$ 64
Provisions for loan losses	267	415	25
Recoveries	62	52	7
Charge-offs	(215)	(234)	(28
Allowance balances at end of period	$ 1,036	$ 922	$ 68
Allowance for loan losses as a percent of net loans receivable at end of period	0.63%	0.61%	0.3
Net Charge-offs as a percent of average loans outstanding	0.10%	0.12%	0.1
Ratio of allowance for loan loss to total non-performing loans at end of period	48.89%	62.76%	101.9
Ratio of allowance for loan losses to total non-performing loans and REO at the end of the period	44.69%	57.73%	78.9

INVESTMENT ACTIVITIES

The Bank's investment portfolio comprises investment securities, mortgage-backed securities, FHLB stock, and other investments. At December 31, 2003, the Bank had no investments in unrated securities. At December 31, 2003, $29.5 million, or 85.5% of the Bank's investment portfolio were scheduled to mature in less than five years, and $5.0 million, or 14.5%, were scheduled to mature in over five years. At December 31, 2003, $7.1 million, or 20.5% of the Bank's investment portfolio is scheduled to mature in less than one year.

The Bank's mortgage-backed securities portfolio consists of pass-through certificates. At December 31, 2003, mortgage-backed securities totaled $7.3 million, or 3.3% of total assets. At December 31, 2003, 89.0% of the Bank's mortgage-backed securities were secured by Balloon loans. All of the Bank's pass-through certificates are insured or guaranteed by Freddie Mac, the Government National Mortgage Association ("GNMA"), or the Federal National Mortgage Association ("FNMA"). The Bank's policy is to hold mortgage-backed securities as available for sale. The Bank invests in mortgage-backed securities to supplement local loan originations as well as to reduce interest rate risk exposure.

The Bank's has interest in pools of single-family mortgages in which the principal and interest payments are passed from the mortgage originators, through intermediaries (generally quasi-governmental agencies) that pool and repackage loans and sell the participation interest in the form of securities, to investors such as the Bank. These quasi-governmental agencies include Freddie Mac, the GNMA, or the FNMA. The underlying pool of mortgages can be composed of either fixed-rate mortgage loans or ARM loans. The interest rate risk characteristics of the underlying pool of mortgages, i.e., fixed-rate or adjustable rate, are shared by the investors in that pool.

The Bank is required under federal regulations to maintain a minimum amount of liquid assets that may be invested in specified short term securities

and certain other investments. The Bank generally has maintained a portfolio of liquid assets that exceeds regulatory requirements. Liquidity levels may be increased or decreased depending upon the

yields on investment alternatives and upon management's judgment as to the attractiveness of the yields then available in relation to other opportunities and its expectation of the level of yield that will be available in the future, as well as management's projections as to the short term demand for funds to be used in the Bank's loan origination and other activities.

Investment Portfolio. The following table sets forth certain information regarding the carrying and market values of the Bank's investment securities portfolio, mortgage-backed securities portfolio and its held-for-sale portfolio at the dates indicated.

	2003		2002
	CARRYING VALUE	MARKET VALUE	CARRYING VALUE
Investment securities available for sale:			
Equity investments (1)	$ 161	$ 161	$ 166
U.S.Government agency securities	17,067	17,067	31,981
Mortgage-backed securities	7,335	7,335	6,931
Corporate and municipal bonds	10,108	10,108	7,866
Total Investments	$34,670	$34,670	$46,944

(1) Includes Freddie Mac & MIMLIC Stocks

Investment Portfolio Maturities. The following table sets forth the scheduled maturities, carrying/market values, and weighted average yields for the Bank's investment portfolio at December 31, 2003.

	AT DECEMBER 31, 2003			
	One Year or Less		One to Five Years	
	Carrying / Market Value	Annualized Weighted Average Yield	Carrying / Market Value	Annualized Weighted Average Yield
			(Dollars in Thousands)	
Investment securities available for sale:				
U.S. Government agency securities	$ 3,068	4.32%	$13,999	4.66%
Mortgage-backed securities	--	0.00%	2,690	3.66%
Corporate and municipal bonds	3,990	5.95%	5,783	4.59%
Total securiy investments	$ 7,058		$22,472	

	AT DECEMBER 31, 2003			
	More than Ten Years		Equity Securities	Total
	Carrying / Market Value	Annualized Weighted Average Yield	Carrying / Market Value	Carrying / Market Value
	(Dollars in Thousands)			
Investment securities available for sale:				
U.S. Government agency securities	$ --	0.00%	$ --	$17,067
Mortgage-backed securities	583	4.75%	--	7,334
Corporate and municipal bonds	--	0.00%	--	10,108
Federal Home Loan Mortgage Corp. Stock	--	0.00%	161	161
Total securiy investments	$ 583			$34,670

SOURCES OF FUNDS

General. The Bank's deposit-gathering activities are currently conducted from the Bank's eight full-service offices in Alpena, Ossineke, Mio, Cheboygan, Oscoda, Lewiston and Gaylord. Deposits are the major source of the Bank's funds for lending and other investment purposes. In addition to deposits, the Bank derives funds from borrowings, proceeds from the settlement of loan sales, the amortization and prepayment of loans and mortgage-backed securities, the maturity of investment securities, and operations. Scheduled loan principal repayments are a relatively stable source of funds, while deposit inflows and outflows and loan prepayments are influenced significantly by general interest rates and market conditions. Borrowings are used on a short-term basis to compensate for reductions in the availability of funds from other sources or on a longer term basis for general business purposes. The Bank is currently managing liquidity levels and loan funding primarily through secondary market sales.

Deposits. Deposits are attracted principally from within the Bank's market area through the offering of a broad selection of deposit instruments including NOW accounts, regular savings, money market deposit, term certificate accounts and individual retirement accounts. Deposit account terms vary according to the minimum balance required, the

period of time during which the funds must remain on deposit, and the interest rate, among other factors. The maximum rate of interest which the Bank must pay is not established by regulatory authority. The asset / liability committee (ALCO) regularly evaluates its internal cost of funds, surveys rates offered by competing institutions, reviews the cash flow requirements for lending and liquidity, and executes rate changes when deemed appropriate. The Bank has sought to decrease the risk associated with changes in interest rates by offering competitive rates on some deposit accounts and by pricing certificates of deposit to provide customers with incentives to choose certificates of deposit with longer terms. The Bank also attracts non-interest bearing commercial deposit accounts from its commercial borrowers and offers a competitive sweep product that is not insured by the FDIC. The Bank periodically obtains funds through brokers or through a solicitation of funds outside its market area when rates for these deposits compare favorably to local market

rates. The Bank offers a limited amount of certificates of deposit in excess of $100,000 which may have negotiated rates. Future liquidity needs are expected to be satisfied through the use of FHLB borrowings as necessary. Management does not generally plan on paying above market rates on deposit products.

Savings Portfolio. Savings in the Bank as of December 31, 2003 were represented by the various types of deposit programs described below.

Weighted Average Rate	Original Term	Description	Minimum Opening Amount
		Checking and Savings	
NA%	N/A	Non-interest checking	$ --
0.35%	N/A	NOW accounts	100
0.30%	N/A	Statement savings	50
0.28%	N/A	IRA Statement Savings	100
0.73%	N/A	Investment sweep account	2,500
1.22%	N/A	Money market accounts	500
		Total checking and savings accounts	
		Certificates of Deposit	
0.80%	3 - 5 months	Fixed term, fixed rate	500
0.96%	6 -11 months	Fixed term, fixed rate	500
1.64%	12-17 months	Fixed term, fixed rate	500
2.03%	18-23 months	Fixed term, fixed rate	500
2.96%	24-35 months	Fixed term, fixed rate	500
3.99%	36-47 months	Fixed term, fixed rate	500
5.08%	48-59 months	Fixed term, fixed rate	500
4.80%	60+ months	Fixed term, fixed rate	500
0.80%	3 -5 months	IRA accounts fixed rate	250
0.95%	6 -11 months	IRA accounts fixed rate	250
1.33%	12-17 months	IRA accounts fixed rate	250
1.67%	18-23 months	IRA accounts fixed rate	500
2.98%	24-35 months	IRA accounts fixed rate	500
3.64%	36-47 months	IRA accounts fixed rate	500
3.62%	48-59 months	IRA accounts fixed rate	500
5.69%	60+ months	IRA accounts fixed rate	500
5.19%	1-12 moonths	Jumbo	100,000
6.23%	12+ months	Jumbo	100,000
5.60%		Brokered CDs	
		Total certificates of deposit	
		Total deposits	

The following table sets forth the change in dollar amount of savings deposits in the various types of savings accounts offered by the Bank between the dates indicated.

	At December 31,					
	2003			2002		
	Amount	Percent of Total (1)	Increase (Decrease) (2)	Amount	Percent of Total (1)	Increase (Decrease (2)
	(Dollars in thousands)			(Dollars in thousands)		
Non-interest-bearing	$ 7,282	4.80%	$ 1,864	$ 5,418	3.47%	$ 1,99
NOW accounts	13,596	8.96	(1,055)	14,651	9.39	26
Passbook	25,851	17.04	(3,408)	29,259	18.74	59
Investment sweep account .	2,987	1.97	139	2,848	1.82	59
Money market accounts	11,613	7.66	3,149	8,464	5.42	72
Time deposits that mature:						
Less than 12 months	41,943	27.65	(3,010)	44,953	28.80	27,99
Within 12-36 months	31,934	21.05	11,016	20,918	13.40	(15,56
Beyond 36 months	13,524	8.91	(7,909)	21,433	13.73	(21,13
Jumbo	2,972	1.96	(5,176)	8,148	5.22	(5,91
Total deposits	$151,702	100.00%	$ (4,390)	$156,092	100.00%	$(10,44

(1) Represents percentage of total deposits.

(2) Represents increase (decrease) in balance from end of prior period.

Time Deposit Rates. The following table sets forth the time deposits in the Bank classified by rates as of the dates indicated (see footnote number 8 in the 2003 Alpena Bancshares Inc. and Subsidiaries Annual Report for a more detailed breakdown by rate range):

	At December 31,		
Rate	2003	2002	2001
	(In Thousands)		
0% - 4.99%	$ 68,422	$ 55,894	$ 40,720
5.00% - 6.99%	18,768	34,394	62,037
7.00% - 8.99%	3,183	5,073	7,311
9.00% - 9.50%	--	--	--
	$ 90,373	$ 95,361	$110,068

Time Deposit Maturities. The following table sets forth the amount and maturities of time deposits at December 31, 2003.

Rate	Less Than One Year	1 -2 Years	2-3 Years	3-5 Years	Greater than 5 Years	Total

0% - 4.99%	$ 36,790	$ 9,007	$ 16,332	$ 5,768	$ 525	$ 68,422
5.00% - 6.99%	6,044	3,870	2,822	1,732	4,300	$ 18,768
7.00% - 8.99%	378	1,306	--	128	1,371	$ 3,183
	$ 43,212	$ 14,183	$ 19,154	$ 7,628	$ 6,196	$ 90,373

Large Certificates of Deposit Maturities. The following table indicates the amount of the Bank's certificates of deposit that are equal to or greater than $100,000 by time remaining until maturity at December 31, 2003. This amount does not include savings accounts with balances greater than $100,000 or more, which totaled approximately $4.4 million at December 31, 2003.

MATURITY PERIOD	CERTIFICATES OF DEPOSIT
	(IN THOUSANDS)
Three months or less	$ 1,317
Three through six months	1,162
Six through twelve months	6,311
Over twelve months	8,601
Total	$17,391

BORROWINGS

Deposits are the Bank's primary source of funds. The Bank also obtains funds from the FHLB. FHLB advances are required to be collateralized by selected assets of the Bank. Such advances are made pursuant to several different credit programs, each of which has its own interest rate and range of maturities. The maximum amount that the FHLB will advance to member institutions, including the Bank, for purposes other than meeting withdrawals, fluctuates from time to time in accordance with the policies of the OTS and the FHLB. The maximum amount of FHLB advances to a member institution generally is reduced by borrowings from any other source. During the year ended December 31, 2003, the Bank decreased its advances from the FHLB by $2.6 million, and such advances totaled $45.8 million at December 31, 2003. The other borrowing represents the note payable to the former owners of InsuranCenter of Alpena which was purchased in June of 2003. The amount of the note payable is $1,357,000.

The following table sets forth certain information regarding borrowings by the Bank for the periods indicated.

	Years Ended December 31,		
	2003	2002	2001
	(Dollars in Thousands)		
Weighted average rate paid on:			
FHLB advances	5.240%	5.810%	5.768%

Other borrowings	5.485%	0.000%	--%
FHLB advances: (1)			
Maximum balance at any month end	$51,414	$51,720	$70,435
Average balance	$47,973	$49,462	$60,461
Other borrowings: (2)			
Maximum balance	$ 1,357	$ --	$ --
Average balance	$ 747	$ --	$ --

(1) FHLB advances, various adjustable and fixed rate notes, with renewable one year to ten year maturities.

(2) Note Payable on the InsuranCenter of Alpena Purchase - June of 2003.

REGULATION AND SUPERVISION

As a federally chartered SAIF-insured savings bank, the Bank is subject to examination, supervision and extensive regulation by the OTS and the FDIC. This regulation and supervision establishes a comprehensive framework of activities in which an institution can engage and is intended primarily for the protection of the insurance fund and depositors. The Bank also is subject to regulation by the Board of Governors of the Federal Reserve System (the "Federal Reserve Board"). The Federal Reserve Board requires reserves to be maintained against deposits and certain other matters. The OTS examines the Bank and prepares reports for the consideration of the Bank's Board of Directors on any deficiencies that they may find in the Bank's operations. The FDIC also examines the Bank in its role as the administrator of the SAIF. The Bank's relationship with its depositors and borrowers also is regulated to a great extent by both federal and state laws especially in such matters as the ownership of savings accounts and the form and content of the Bank's mortgage documents. Any change in such regulation, whether by the FDIC, OTS, or Congress, could have a material adverse impact on the Company and the Bank and their operations. The description of statutory provisions and regulations applicable to savings institutions and their holding companies set forth herein does not purport to be a complete description of such statutes and regulations and their effect on the Bank and the Company.

On November 12, 1999, the Gramm-Leach-Bliley Financial Services Modernization Act of 1999 was signed into law. As a result of the legislation, bank holding companies are permitted to engage in a wider variety of financial activities than permitted under prior law, particularly with respect to insurance and securities activities. In addition, in a change from prior law, bank holding companies are in a position to be owned, controlled or acquired by any company engaged in financially-related activities. However, to the extent that it permits banks, securities firms and insurance companies to affiliate, the financial services industry may experience further consolidation. This additional consolidation could result in a growing number of larger financial institutions that offer a wider variety of financial services than the Bank might be able to offer. This could adversely impact the Bank's ability to retain and attract customers that prefer to obtain all of their financial services from one provider and, ultimately, the Bank's profitability.

FEDERAL REGULATION OF SAVINGS INSTITUTIONS

Business Activities. The activities of savings institutions are governed by federal law, which (1) restricts the solicitation of brokered deposits by savings institutions that are troubled or not well-capitalized, (2) prohibits the acquisition of any corporate debt security that is not rated in one of the four highest rating categories, (3) restricts the aggregate amount of loans secured by non-residential real estate property to 400% of capital, (4) permits

savings and loan holding companies to acquire up to 5% of the voting shares of non-subsidiary savings institutions or savings and loan holding companies without prior approval, and (5) permits bank holding companies to acquire healthy savings institutions.

Loans to One Borrower. Under federal law, savings institutions are generally subject to the national bank limits on loans to one borrower. Generally, savings institutions may not make a loan or extend credit to a single or related group of borrowers in excess of 15% of the Bank's unimpaired capital and surplus on an unsecured basis. An additional amount may be lent, equal to 10% of unimpaired capital and surplus, if such loan is secured by readily-marketable collateral, which is defined to include certain securities and bullion, but generally does not include real estate. The Bank's maximum loans-to-one-borrower limit was $2.6 million at December 31, 2003. As of December 31, 2003, the Bank was in compliance with its loans-to-one-borrower limitations.

Qualified Thrift Lender Test. Federal law requires savings institutions to meet a qualified thrift lender ("QTL") test. Under the QTL test, a savings institution is required to maintain at least 65% of its "portfolio assets" (total assets less (i) specified liquid assets up to 20% of total assets, (ii) intangibles, including goodwill, and (iii) the value of property used to conduct business) in certain "qualified thrift investments," primarily residential mortgages and related investments, including certain mortgage-backed and related securities on a monthly average basis in 9 out of every 12 months. A savings institution that fails the QTL test must either convert to a bank charter or operate under certain

restrictions. As of December 31, 2003, the Bank maintained 104.09% of its portfolio assets in qualified thrift investments and, therefore, met the QTL test.

Capital Distributions. OTS regulations govern capital distributions by federal savings institutions, which include cash dividends, stock repurchases and other transactions charged to the capital account of a savings institution. A savings institution must file an application for OTS approval of a capital distribution if either (1) the total capital distributions for the applicable calendar year exceed the sum of the savings institution's net income for that year to date plus the institution's retained net income for the preceding two years, (2) the savings institution would not be at least adequately capitalized following the distribution, (3) the distribution would violate any applicable statute, regulation, agreement or OTS-imposed condition, or (4) the savings institution is not eligible for expedited treatment of its filings. If an application is not required to be filed, savings institutions which are a subsidiary of a holding company, as well as certain other savings institution, must still file a notice with the OTS at least 30 days before the board of directors declares a dividend or approves a capital distribution.

Any additional capital distributions would require prior OTS approval. If the Bank's capital falls below its required levels or the OTS notifies it that it is in need of more than normal supervision, the Bank's ability to make capital distributions could be restricted. In addition, the OTS may prohibit a proposed capital distribution by any institution, which would otherwise be permitted by regulation, if the OTS determines that the distribution would constitute an unsafe or unsound practice.

Liquidity. Liquidity represents the amount of an institution's assets that can be quickly and easily converted into cash without significant loss. Liquid assets include cash, U.S. Government securities, U.S. Government agency guaranteed securities and certificates of deposit. The Bank is required to maintain sufficient levels of liquidity as defined by the OTS regulations. This requirement may be varied at the direction of the OTS. Regulations currently in

effect require that the Bank must maintain sufficient liquidity to ensure its safe and sound operations. The Bank's objective for liquidity is to be above 20%. Liquidity as of December 31, 2003 was $42.3 million, or 26.9%, compared to $47.0 million, or 24.4% at December 31, 2002. The levels of these assets are dependent on the Bank's operating, financing, lending and investing activities during any given period.

Community Reinvestment Act and Fair Lending Laws. Federal savings institutions have a responsibility under the Community Reinvestment Act and related regulations of the OTS to help meet the credit needs of their communities, including low- and moderate-income neighborhoods. In addition, the Equal Credit Opportunity Act and the Fair Housing Act prohibit lenders from discriminating in their lending practices on the basis of characteristics specified in those statutes. An institution's failure to comply with the provisions of the CRA could, at a minimum, result in regulatory restrictions on its activities, and failure to comply with the Equal Credit Opportunity Act and the Fair Housing Act could result in enforcement actions by the OTS, as well as other federal regulatory agencies and the Department of Justice. The Bank received a satisfactory CRA rating under the current CRA regulations in its most recent federal examination by the OTS.

Transactions with Related Parties. The Bank's authority to engage in transactions with related parties or "affiliates" or to make loans to specified insiders is limited by Sections 23A and 23B of the Federal Reserve Act. The term "affiliates" for these purposes generally means any company that controls or is under common control with an institution, including the Company and its non-savings institution subsidiaries. Section 23A limits the aggregate amount of certain "covered" transactions with any individual affiliate to 10% of the capital and surplus of the savings institution and also limits the aggregate amount of covered transactions with all affiliates to 20% of the savings institution's capital and surplus. Covered transactions with affiliates are required to be secured by collateral in an amount and of a type described in Section 23A. The purchase of low quality assets from affiliates is generally prohibited. Section 23B provides that covered transactions with affiliates, including loans and asset purchases, must be on terms and under circumstances, including credit standards, that are substantially the same or at least as favorable to the institution as those prevailing at the time for comparable transactions with non-affiliated companies. In addition, savings institutions are prohibited from lending to any affiliate that is engaged in activities that are not permissible for bank holding companies and no savings institution may purchase the securities of any affiliate other than a subsidiary.

The Bank's authority to extend credit to executive officers, directors and 10% stockholders, as well as entities controlled by these persons, is currently governed by Sections 22(g) and 22(h) of the Federal Reserve Act, and also by Regulation O. Among other things, these regulations generally require these loans to be made on terms substantially the same as those offered to unaffiliated individuals and do not involve more than the normal risk of repayment. However, recent regulations now permit executive officers and directors to receive the same terms through benefit or compensation plans that are widely available to other employees, as long as the director or executive officer is not given preferential treatment compared to other participating employees. Regulation O also places individual and aggregate limits on the amount of loans the Bank may make to these persons based, in part, on the Bank's capital position, and requires approval procedures to be followed. At December 31, 2003, the Bank was in compliance with these regulations.

Enforcement. The OTS has primary enforcement responsibility over savings institutions and has the authority to bring enforcement action against all "institution-related parties," including stockholders, and attorneys, appraisers and accountants who knowingly or recklessly participate in wrongful action likely to have an adverse effect on an insured institution. Formal enforcement

action may range from the issuance of a capital directive or cease and desist order to removal of officers and/or directors of the institutions, receivership, conservatorship or the termination of deposit insurance. Civil penalties cover a wide range of violations and actions, and range up to $25,000 per day, unless a finding of reckless disregard is made, in which case penalties may be as high as $1 million per day. The FDIC also has the authority to recommend to the Director of the OTS that enforcement action be taken with respect to a particular savings institution. If action is not taken by the Director, the FDIC has authority to take such action under specified circumstances.

Standards for Safety and Soundness. Federal law requires each federal banking agency to prescribe for all insured depository institutions standards relating to, among other things, internal controls, information systems and audit systems, loan documentation, credit underwriting, interest rate risk exposure, asset growth, compensation, and such other operational and managerial standards as the agency deems appropriate. The federal banking agencies adopted Interagency Guidelines Prescribing Standards for Safety and Soundness to implement the safety and soundness standards required under the Federal law. The guidelines set forth the safety and soundness standards that the federal banking agencies use to identify and address problems at insured depository institutions before capital becomes impaired. The guidelines address internal controls and information systems; internal audit systems; credit underwriting; loan documentation; interest rate risk exposure; asset growth; and compensation, fees and benefits. If the appropriate federal banking agency determines that an institution fails to meet any standard prescribed by the guidelines, the agency may require the institution to submit to the agency an acceptable plan to achieve compliance with the standard. If an institution fails to meet these standards, the appropriate federal banking agency may require the institution to submit a compliance plan.

Assessments. Savings institutions are required by OTS regulation to pay assessments to the OTS to fund the operations of the OTS. The general assessment, paid on a semi-annual basis, is computed upon the savings institution's consolidated total assets, as reported in the institution's latest quarterly thrift financial report. The Bank paid assessments of approximately $61,035 in 2003.

Capital Requirements. The OTS capital regulations require savings institutions to meet three capital standards: a 1.5% tangible capital standard, a 4.0% leverage ratio (or core capital ratio) and an 8.0% risk-based capital standard. Core capital is defined as common stockholders' equity (including retained earnings), certain non-cumulative perpetual preferred stock and related surplus, minority interests in equity accounts of consolidated subsidiaries less intangibles other than certain qualifying supervisory goodwill and certain purchased mortgage servicing rights ("PMSRs"). Tangible capital is defined as core capital less all intangible assets (including supervisory goodwill) plus a specified amount of PMSRs. The OTS regulations also require that, in meeting the tangible ratio, leverage and risk-based capital standards, institutions must deduct investments in and loans to subsidiaries engaged in activities not permissible for a national bank, and unrealized gains (losses) on certain available for sale securities.

The risk-based capital standard for savings institutions requires the maintenance of Tier 2 (core) and total capital (which is defined as core capital and supplementary capital) to risk weighted assets of 4.0% and 8.0%, respectively. In determining the amount of risk-weighted assets, all assets, including certain off-balance sheet assets, are multiplied by a risk-weight of 0% to 100%, as assigned by the OTS capital regulation based on the risks the OTS believes are inherent in

the type of asset. The components of Tier 1 (core) capital are equivalent to those discussed earlier under the 4.0% leverage ratio standard. The components

of supplementary capital currently include cumulative preferred stock, long-term perpetual preferred stock, mandatory convertible securities, subordinated debt and intermediate preferred stock and allowance for loan and lease losses. Allowance for loan and lease losses includable in supplementary capital is limited to a maximum of 1.25%. Overall, the amount of supplementary capital included as part of total capital cannot exceed 100% of core capital.

OTS regulatory capital rules also incorporate an interest rate risk component. Savings institutions with "above normal" interest rate risk exposure are subject to a deduction from total capital for purposes of calculating their risk-based capital requirements. A savings institution's interest rate risk is measured by the decline in the net portfolio value of its assets (i.e., the difference between incoming and outgoing discounted cash flows from assets, liabilities and off-balance sheet contracts) that would result from a hypothetical 200-basis point increase or decrease in market interest rates, divided by the estimated economic value of the institution's assets. In calculating its total capital under the risk-based rule, a savings institution whose measured interest rate risk exposure exceeds 2%, must deduct an interest rate component equal to one-half of the excess change. The OTS has deferred, for the present time, the date on which the interest rate component is to be deducted from total capital. The rule also provides that the Director of the OTS may waive or defer an institution's interest rate risk component on a case-by-case basis. Further specific information is available in the Management Discussion and Analysis section of the 2003 Alpena Bancshares Inc. Annual Report.

The following table sets forth the Bank's capital position at December 31, 2003, 2002 and 2001 as compared to the minimum capital requirements.

	AT DECEMBER 31,					
	2003		2002		2001	
	Amount	Percent of Assets	Amount	Percent of Assets	Amount	Pe of
			(Dollar in Thousands)			
Equity capital	21,951	9.81%	21,747	9.50%	20,597	
Tangible Capital Requirement:						
Tangible capital level ...	17,019	7.78%	18,149	8.08%	17,212	
Requirement	3,283	1.50%	3,370	1.50%	3,568	
Excess	13,736	6.28%	14,779	6.58%	13,644	
Core Capital Requirement:						
Core capital level	17,019	7.78%	18,150	8.08%	17,212	
Requirement	8,754	4.00%	8,986	4.00%	9,516	
Excess	8,265	3.78%	9,164	4.08%	7,696	
Risk-based Capital Requirement:						
Risk-based capital level .	18,119	11.96%	19,137	15.95%	17,974	
Requirement	12,116	8.00%	9,596	8.00%	10,972	
Excess	6,003	3.96%	9,541	7.95%	7,002	

PROMPT CORRECTIVE REGULATORY ACTION

Under the OTS Prompt Corrective Action regulations, the OTS is required to take certain supervisory actions against undercapitalized institutions, the severity of which depends upon the institution's degree of capitalization. Generally, a savings institution that has total risk-based capital of less than 8.0% or a leverage ratio or a Tier 1 core capital ratio that is less than 4.0% is considered to be undercapitalized. A savings institution that has the total risk-based capital less than 6.0%, a Tier 1 core risk-based capital ratio of less than 4.0% or a leverage ratio that is less than 4.0% is considered to be "significantly undercapitalized" and a savings institution that has a tangible capital to assets ratio equal to or less than 1.5% is deemed to be "critically undercapitalized." Subject to a narrow exception, the banking regulator is required to appoint a receiver or conservator for an institution that is "critically undercapitalized." The regulation also provides that a capital restoration plan must be filed with the OTS within 45 days of the date an institution receives notice that it is "undercapitalized," "significantly undercapitalized" or "critically undercapitalized." In addition, numerous mandatory supervisory actions become immediately applicable to the institution, including, but not limited to, restrictions on growth, investment activities, capital distributions, and affiliate transactions. The OTS could also take any one of a number of discretionary supervisory actions, including the issuance of a capital directive and the replacement of senior executive officers and directors.

FEDERAL HOME LOAN BANK SYSTEM

The Bank is a member of the FHLB of Indianapolis, which is one of the 12 regional Federal Home Loan Banks. As a member of the FHLB, the Bank is required to purchase and maintain stock in the FHLB of Indianapolis in an amount equal to the greater of 1% of its aggregate unpaid residential mortgage loans, home purchase contracts or similar obligations at the beginning of each year, or 1/20 (or such greater fraction as established by the FHLB) of outstanding FHLB advances. At December 31, 2003 the Bank held $4.5 million in FHLB stock, which was in compliance with this requirement. Certain provisions of FIRREA require all 12 Federal Home Loan Banks to provide financial assistance for the resolution of troubled financial institutions and to contribute to affordable housing programs through direct loans or interest subsidies on advances targeted for community investment and low- and moderate-income housing projects.

These contributions could cause rates on the FHLB advances to increase and could affect adversely the level of FHLB dividends paid and the value of FHLB stock in the future.

FEDERAL RESERVE SYSTEM

The Federal Reserve Board regulations require savings institutions to maintain non-interest-earning reserves against their transaction accounts (primarily NOW and regular checking accounts). The Bank is in compliance with these reserve requirements. The balances maintained to meet the reserve requirements imposed by the FRB may be used to satisfy liquidity requirements imposed by the OTS.

HOLDING COMPANY REGULATION

General. The Holding Company and the Company are non-diversified mutual savings and loan holding companies within the meaning of federal law. As such, the Holding Company and the Company are registered with the OTS and are subject to OTS regulations, examinations, supervision and reporting requirements. In addition, the OTS has enforcement authority over the Holding Company and the Company and any non-savings institution subsidiaries. Among other things, this authority permits the OTS to restrict or prohibit activities that are determined to be a serious risk to the subsidiary savings institution. As federal corporations, the Company and the Holding Company are generally not subject to

state business organizations law.

Permitted Activities. Pursuant to federal law and OTS regulations and policy, a mutual holding company and a federally chartered mid-tier holding company such as the Company may engage in the following activities: (i) investing in the stock of a savings institution; (ii) acquiring a mutual association through the merger of such association into a savings institution subsidiary of such holding company or an interim savings institution subsidiary of such holding company; (iii) merging with or acquiring another holding company, one of whose subsidiaries is a savings institution; (iv) investing in a corporation, the capital stock of which is available for purchase by a savings institution under federal law or under the law of any state where the subsidiary savings institution or institutions share their home offices; (v) furnishing or performing management services for a savings institution subsidiary of such company; (vi) holding, managing or liquidating assets owned or acquired from a savings subsidiary of such company; (vii) holding or managing properties used or occupied by a savings institution subsidiary of such company properties used or occupied by a savings institution subsidiary of such company; (viii) acting as trustee under deeds of trust; (ix) any other activity (A) that the Federal Reserve Board, by regulation, has determined to be permissible for bank holding companies under Section 4(c) of the Bank Holding Company Act of 1956, unless the Director, by regulation, prohibits or limits any such activity for savings and loan holding companies; or (B) in which multiple savings and loan holding companies were authorized (by regulation) to directly engage on March 5, 1987; and (x) purchasing, holding, or disposing of stock acquired in connection with a qualified stock issuance if the purchase of such stock by such savings and loan holding company is approved by the Director. If a mutual holding company acquires or merges with another holding company, the holding company acquired or the holding company resulting from such merger or acquisition may only invest in assets and engage in activities listed in (i) through (x) above, and has a period of two years to cease any nonconforming activities and divest of any nonconforming investments.

Federal law prohibits a savings and loan holding company, including the Company and the Holding Company, directly or indirectly, or through one or more subsidiaries, from acquiring another savings institution or holding company thereof, without prior written approval of the OTS. It also prohibits the acquisition or retention of, with certain exceptions, more than 5% of a non-subsidiary savings institution, a non-subsidiary holding company, or a non-subsidiary company engaged in activities other than those permitted by federal law; or acquiring or retaining control of an institution that is not federally insured. In evaluating applications by holding companies to acquire savings institutions, the OTS must consider the financial and managerial resources, future prospects of the company and institution involved, the effect of the acquisition on the risk to the insurance fund, the convenience and needs of the community and competitive factors.

The OTS is prohibited from approving any acquisition that would result in a multiple savings and loan holding company controlling savings institutions in more than one state, subject to two exceptions: (i) the approval of interstate supervisory acquisitions by savings and loan holding companies, and (ii) the acquisition of a savings institution in another

state if the laws of the state of the target savings institution specifically permit such acquisitions. The states vary in the extent to which they permit interstate savings and loan holding company acquisitions.

Waivers of Dividends by the Holding Company. OTS regulations require the Holding Company to notify the OTS of any proposed waiver of its right to receive dividends. The OTS reviews dividend waiver notices on a case-by-case basis, and, in general, does not object to any such waiver if: (i) the Holding Company's board of directors determines that such waiver is consistent with such

directors' fiduciary duties to the Holding Company's members; (ii) for as long as the savings institution subsidiary is controlled by the Holding Company, the dollar amount of dividends waived by the Holding Company are considered as a restriction to the retained earnings of the savings institution, which restriction, if material, is disclosed in the public financial statements of the savings institution as a note to the financial statements; (iii) the amount of any dividend waived by the Holding Company is available for declaration as a dividend solely to the Holding Company, and, in accordance with SFAS No. 5, where the savings institution determines that the payment of such dividend to the Holding Company is probable, an appropriate dollar amount is recorded as a liability; (iv) the amount of any waived dividend is considered as having been paid by the savings institution in evaluating any proposed dividend under OTS capital distribution regulations; and (v) in the event the Holding Company converts to stock form, the appraisal submitted to the OTS in connection with the conversion application takes into account the aggregate amount of the dividends waived by the Holding Company.

Conversion of the Holding Company to Stock Form. OTS regulations permit the Holding Company to undertake a conversion from mutual to stock form ("Conversion Transaction"). In a Conversion Transaction a new holding company would be formed as the successor to the Company (the "New Holding Company"), the Holding Company's corporate existence would end, and certain customers of the Bank would receive the right to subscribe for additional shares of the New Holding Company. In a Conversion Transaction, each share of Common Stock held by stockholders of the Company other than the Holding Company ("Minority Stockholders") would be automatically converted into a number of shares of common stock of the New Holding Company determined pursuant to an exchange ratio that ensures that after the Conversion Transaction, subject to any adjustment to reflect the receipt of cash in lieu of fractional shares, the percentage of the to-be outstanding shares of the New Holding Company issued to Minority Stockholders in exchange for their Common Stock would be equal to the percentage of the outstanding shares of Common Stock held by Minority Stockholders immediately prior to the Conversion Transaction. The total number of shares held by Minority Stockholders after the Conversion Transaction would also be affected by any purchases by such persons in the offering that would be conducted as part of the Conversion Transaction.

FEDERAL SECURITIES LAW

The Common Stock is registered with the SEC under the Securities Exchange Act of 1934 (the "Exchange Act"). The Company is subject to the information, proxy solicitation, insider trading restrictions and other requirements of the SEC under the Exchange Act. Common Stock held by persons who are affiliates (generally officers, directors and principal stockholders) of the Company may not be resold without registration or unless sold in accordance with certain resale restrictions. If the Company meets specified current public information requirements, each affiliate of the Company is able to sell in the public market, without registration, a limited number of shares in any three-month period.

INSURANCE OF ACCOUNTS AND REGULATION BY THE FDIC

The FDIC has adopted a risk-based deposit insurance assessment system. The FDIC assigns an institution to one of three capital categories, based on the institution's financial information, as of the reporting period ending seven months before the assessment period, and one of three supervisory subcategories within each capital group. The three capital categories are well capitalized, adequately capitalized and undercapitalized. The supervisory subgroup to which an institution is assigned is based on a supervisory evaluation provided to the FDIC by the institution's primary federal regulator and information which the FDIC determines to be relevant to the institution's financial condition and the risk posed to the deposit insurance funds. An institution's assessment rate

depends on the capital category and supervisory category to which it is assigned. The FDIC is authorized to raise the assessment rates. The FDIC has exercised this authority several times in the past and may raise insurance premiums in the future. If this type of action is taken by the FDIC, it could have an adverse effect on the earnings of the Bank.

THE USA PATRIOT ACT

In response to the events of September 11, 2001, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, or the USA PATRIOT Act, was signed into law on October 26, 2001. The USA PATRIOT Act gives the federal government new powers to address terrorist threats through enhanced domestic security measures, expanded surveillance powers, increased information sharing and broadened anti-money laundering requirements. By way of amendments to the Bank Secrecy Act, Title III of the USA PATRIOT Act takes measures intended to encourage information sharing among bank regulatory agencies and law enforcement bodies. Further, certain provisions of Title III impose affirmative obligations on a broad range of financial institutions, including banks, thrifts, brokers, dealers, credit unions, money transfer agents and parties registered under the Commodity Exchange Act.

Among other requirements, Title III of the USA PATRIOT Act imposes the following requirements with respect to financial institutions:

- Pursuant to Section 352, all financial institutions must establish anti-money laundering programs that include, at minimum: (i) internal policies, procedures, and controls; (ii) specific designation of an anti-money laundering compliance officer; (iii) ongoing employee training programs; and (iv) an independent audit function to test the anti-money laundering program.

- Section 326 authorizes the Secretary of the Department of Treasury, in conjunction with other bank regulators, to issue regulations by October 26, 2002 that provide for minimum standards with respect to customer identification at the time new accounts are opened.

- Section 312 requires financial institutions that establish, maintain, administer, or manage private banking accounts or correspondence accounts in the United States for non-United States persons or their representatives (including foreign individuals visiting the United States) to establish appropriate, specific, and, where necessary, enhanced due diligence policies, procedures, and controls designed to detect and report money laundering.

- Financial institutions are prohibited from establishing, maintaining, administering or managing correspondent accounts for foreign shell banks (foreign banks that do not have a physical presence in any country), and will be subject to certain record keeping obligations with respect to correspondent accounts of foreign banks.

- Bank regulators are directed to consider a holding company's effectiveness in combating money laundering when ruling on Federal Reserve Act and Bank Merger Act applications.

The federal banking agencies have begun to propose and implement regulations pursuant to the USA PATRIOT Act. These proposed and interim regulations would require financial institutions to adopt the policies and

procedures contemplated by the USA PATRIOT Act.

SARBANES-OXLEY ACT OF 2002

On July 30, 2002, the President signed into law the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley"), which implemented legislative reforms intended to address corporate and accounting fraud. In addition to the establishment of a new accounting oversight board that will enforce auditing, quality control and independence standards and will be funded by fees from all publicly traded companies, Sarbanes-Oxley places certain restrictions on the scope of services that may be provided by accounting firms to their public company audit clients. Any non-audit services being provided to a public company audit client will require preapproval by the company's audit committee. In addition, Sarbanes-Oxley makes certain changes to the requirements for audit partner rotation after a period of time. Sarbanes-Oxley requires chief executive officers and chief financial officers, or their equivalent, to certify to the accuracy of periodic reports filed with the Securities and Exchange Commission, subject to civil and criminal penalties if they knowingly or willingly violate this certification requirement. The Company's Chief Executive Officer and Chief Financial Officer have signed certifications to this Form 10-K as required by Sarbanes-Oxley. In addition, under Sarbanes-Oxley, counsel will be required to report evidence of a material violation of the securities laws or a breach of fiduciary duty by a company to its chief executive officer or its chief legal officer, and, if such officer does not appropriately respond, to report such evidence to the audit committee or other similar committee of the board of directors or the board itself.

Under Sarbanes-Oxley, longer prison terms will apply to corporate executives who violate federal securities laws; the period during which certain types of suits can be brought against a company or its officers is extended; and bonuses issued to top executives prior to restatement of a company's financial statements are now subject to disgorgement if such restatement was due to corporate misconduct. Executives are also prohibited from trading the company's securities during retirement plan "blackout" periods, and loans to company executives (other than loans by financial institutions permitted by federal rules and regulations) are restricted. In addition, a provision directs that civil penalties levied by the Securities and Exchange Commission as a result of any judicial or administrative action under Sarbanes-Oxley be deposited to a fund for the benefit of harmed investors. The Federal Accounts for Investor Restitution provision also requires the Securities and Exchange Commission to develop methods of improving collection rates. The legislation accelerates the time frame for disclosures by public companies, as they must immediately disclose any material changes in their financial condition or operations. Directors and executive officers must also provide information for most changes in ownership in a company's securities within two business days of the change.

Sarbanes-Oxley also increases the oversight of, and codifies certain requirements relating to audit committees of public companies and how they interact with the company's "registered public accounting firm." Audit committee members must be independent and are absolutely barred from accepting consulting, advisory or other compensatory fees from the issuer. In addition, companies must disclose whether at least one member of the committee is a "financial expert" (as such term is defined by the Securities and Exchange Commission) and if not, why not. Under Sarbanes-Oxley, a company's registered public accounting firm is prohibited from performing statutorily mandated audit services for a company if such company's chief executive officer, chief financial officer, comptroller, chief accounting officer or any person serving in equivalent positions had been employed by such firm and participated in the audit of such company during the one-year period preceding the audit initiation date. Sarbanes-Oxley also prohibits any officer or director of a company or any other person acting under their direction from taking any action to fraudulently influence, coerce, manipulate or mislead any independent accountant engaged in the audit of the company's financial statements for the purpose of rendering the financial statements materially misleading. Sarbanes-Oxley also requires the Securities

and Exchange Commission to prescribe rules requiring inclusion of any internal control report and assessment by management in the annual report to shareholders. Sarbanes-Oxley requires the company's registered public accounting firm that issues the audit report to attest to and report on management's assessment of the company's internal controls.

Although we anticipate that we will incur additional expense in complying with the provisions of the Sarbanes-Oxley Act and the resulting regulations, management does not expect that such compliance will have a material impact on our results of operations or financial condition.

FEDERAL AND STATE TAXATION

Federal Taxation. For federal income tax purposes, the Company files a consolidated federal income tax return on a calendar year basis. This return includes the Bank. The Holding Company also files a federal income tax return. Because the Holding Company has nominal income, it has had no material federal income tax liability.

The Company and the Holding Company are subject to the rules of federal income taxation generally applicable to corporations under the Internal Revenue Code of 1986, as amended (the "Code"). Most corporations are not permitted to make deductible additions to bad debt reserves under the Code. However, savings institutions and savings banks such as the Bank, which met certain tests prescribed by the Code, could for tax years beginning prior to January 1, 1996, benefit from favorable provisions regarding deductions from taxable income for annual additions to their bad debt reserve. For purposes of the bad debt reserve deduction, loans were separated into "qualifying real property loans," which generally are loans secured by interests in real property, and non-qualifying loans, which are all other loans. The bad debt reserve deduction with respect to non-qualifying loans was based on actual loss experience (the "experience method") or a percentage of taxable income determined without regard to such deduction (the "percentage of taxable income method").

The Bank has elected to use the method that resulted in the greatest deduction for federal income tax purposes, which historically had been the percentage of taxable income method. The amount of the bad debt deduction that a thrift institution may claim with respect to additions to its reserve for bad debts is subject to certain limitations. First, the full deduction was available only if at least 60% of the institution's assets fell within certain designated categories. Second, under the percentage of taxable income method, the bad debt deduction attributable to "qualifying real property loans" could not exceed the greater of (i) the amount deductible under the experience method or (ii) the amount which, when added to the bad debt deduction for non-qualifying loans, equaled the amount by which 12% of the sum of the total deposits and the advance payments by borrowers for taxes and insurance at the end of the taxable year exceeds the sum of the surplus, undivided profits, and reserves at the beginning of the taxable year. Third, the amount of the bad debt deduction attributable to qualifying real property loans computed using the percentage of taxable income method was permitted only to the extent that the institution's reserve for losses on qualifying real property loans at the close of the taxable year did not exceed 6% of such loans outstanding at such time.

The Small Business Job Protection Act of 1996 (the "Act") repealed the percentage of taxable income method for years beginning after December 31, 1995, and "large" institutions, i.e., the quarterly average of the institution's total assets or of the consolidated group of which it is a member, exceeds $500 million for the year, may no longer be entitled to use the experience method of computing additions to their bad debt reserve. A "large" institution must use the direct write-off method for deducting bad debts, under which charge-offs are deducted and recoveries are taken into taxable income as incurred. If the Bank is not a "large" institution, the Bank will continue to be permitted to use the

experience method. The Bank will be required to recapture (i.e., take into income) over a six-year period its applicable excess reserves, i.e., the balance of its reserves for losses on qualifying loans and non-qualifying loans, as of the close of the last tax year beginning before January 1, 1996, over the greater of (a) the balance of such reserves as of December 31, 1987 (pre-1988 reserves) or (b) in the case of a bank which is not a "large" institution, an amount that would have been the balance of such reserves as of the close of the last tax year beginning before January 1, 1996, had the bank always computed the additions to its reserves using the experience method. Postponement of the recapture is possible for a two-year period if an institution meets a minimum level of mortgage lending for 1996 and 1997.

The Bank currently is accounting for income taxes in accordance with SFAS No. 109. The liability method accounts for deferred income taxes by applying the enacted statutory rates in effect at the balance sheet date to differences between the book cost and the tax cost of assets and liabilities. The resulting deferred tax liabilities and assets are adjusted to reflect changes in tax laws. SFAS 109 was implemented by the Bank effective January 1, 1993.

The Bank is subject to the corporate alternative minimum tax which is imposed to the extent it exceeds the Bank's regular income tax for the year. The alternative minimum tax will be imposed at the rate of 20% of a specially computed tax base. Included in this base will be a number of preference items, including the following: (i) 100% of the excess of a thrift institution's bad debt deduction over the amount that would have been allowable on the basis of actual

experience; and (ii) interest on certain tax-exempt bonds issued after August 7, 1986. In addition, for purposes of the alternative minimum tax, the amount of alternative minimum taxable income that may be offset by net operating losses is limited to 90% of alternative minimum taxable income.

The Bank was last audited by the Internal Revenue Service in 1995, for tax years 1992 and 1993. The audit did not result in material adjustments to the Bank's tax returns.

Michigan State Taxation. During 1999, the State of Michigan passed legislation that resulted in elimination of the Michigan single business tax by gradually phasing it out over the next 23 years. Public Act 115 reduces the single business tax rate by 0.1% annually beginning January 1, 1999. The Bank files Michigan Single Business Tax (SBT) returns, and in 2003 was subject to tax at a rate equal to 1.9% of taxable income. For this purpose, "taxable income" generally means federal taxable income, subject to certain adjustments to arrive at an adjusted tax base. The Bank was audited by the State of Michigan in 2001 for the tax years 1997 - 2000. No material adjustments were found.

SUBSIDIARY ACTIVITY

The Bank has two subsidiaries; the first is Financial Services & Mortgage Corporation ("FSMC"). At December 31, 2003, the net book value of the Bank's investment in FSMC was $786,400. The Bank may make additional investments in FSMC in the future. FSMC invests in real estate which includes leasing, selling, developing and maintaining real estate properties. FSMC also holds MIMLIC stock. Because of the nature of FSMC's real estate development activities, 100% of the Bank's investment in FSMC has been deducted from the Bank's capital. FSMC had a net income of $37,905 for the year ended December 31, 2003.

The Bank also has a second subsidiary, the InsuranCenter of Alpena, (ICA), which was acquired during 2003 as means to help diversify income sources. The Bank acquired (ICA), a licensed insurance agency engaged in the business of property, casualty and health insurance, for $2.6 million. The former owners of ICA remain with the organization and are entitled to an "earn-out" payment of up

to $300,000 per year for three years if specific net sales levels are achieved. The earn out payment level for net sales was achieved for 2003 and was recorded at December 31, 2003. The $300,000 payment was made to the former owners in February 2004. This amount was added to the Goodwill associated with the purchase. ICA had a net income of $219,230 for the year ended December 31, 2003.

PERSONNEL

As of December 31, 2003, the Bank had 95 full-time and 9 part-time employees. None of the Bank's employees is represented by a collective bargaining group. The Bank believes its relationship with its employees to be good. The InsuranCenter of Alpena had 18 employees as of the same date. FSMC has no employees.

ITEM 2. PROPERTIES

(a) The Company conducts its business through the Bank's main office and seven full-service branch offices located in Alpena, Ossineke, Mio, Cheboygan, Lewiston, Oscoda and Gaylord, Michigan. The Lewiston branch is leased on short-term lease agreement. All of the remaining offices are owned by the Bank. The aggregate net book value of the Bank's premises and equipment was $5.8 million, net of $2.8 million of depreciation at December 31, 2003.

(b) INVESTMENT POLICIES. For a description of the Bank's policies (all of which may be changed without a vote of the Bank's security holders) and the limitations on the percentage of assets which may be invested in any one investment, or type of investment with respect to: (1) investments in real estate or interests in real estate; (2) investments in real estate mortgages; and (3) securities of or interests in persons primarily engaged in real estate activities, reference is made hereunder to the information presented above under "Item 1. Description of Business."

(c) DESCRIPTION OF REAL ESTATE AND OPERATING DATA. Not Applicable; the book value of each of the Company's properties is less than 10% of the Company's total consolidated assets at December 31, 2003.

ITEM 3. LEGAL PROCEEDINGS

The Company and the Bank are periodically involved in claims and lawsuits that are incident to their business. At December 31, 2003, neither the Company nor the Bank was involved in any claims or lawsuits material to their respective businesses.

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

No matters were submitted during the fourth quarter of the year ended December 31, 2003 to a vote of security holders.

PART II

ITEM 5. MARKET FOR COMPANY'S COMMON STOCK AND RELATED STOCKHOLDER MATTERS

For information concerning the market for the Company's common stock, the section captioned "Stockholder Information" of the Company's Annual Report to Stockholders for the Year Ended December 31, 2003 (the "Annual Report to Stockholders") is incorporated herein by reference.

Information concerning dividends paid by the Company in the last two years on its common stock follows:

Period	Dividend Declared	Payment Date	Dividend per share
1st Quarter 2002	3/12/2002	4/25/2002	$ 0.125
2nd Quarter 2002	6/11/2002	7/25/2002	$ 0.125
3rd Quarter 2002	9/10/2002	10/25/2002	$ 0.125
4th Quarter 2002	12/10/2002	1/24/2003	$ 0.125
1st Quarter 2003	3/18/2003	4/25/2003	$ 0.125
2nd Quarter 2003	6/17/2003	7/25/2003	$ 0.125
3rd Quarter 2003	9/16/2003	10/24/2003	$ 0.125
4th Quarter 2003	12/16/2003	1/23/2004	$ 0.125

As of March 8, 2004, there were approximately 367 holders of record of the Company's common stock.

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The "Management's Discussion and Analysis of Financial Condition and Results of Operations" section of the Company's Annual Report to Stockholders is incorporated herein by reference.

ITEM 7. FINANCIAL STATEMENTS

Pages 16 to 54 of the Company's Annual Report to Stockholders are incorporated herein by reference.

ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None

ITEM 8A. CONTROLS AND PROCEDURES

Under the supervision and with the participation of our management, including the Company's Chief Executive Officer and Chief Financial Officer, the Company evaluated the effectiveness of the design and operation of its disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were effective to ensure that information required to be disclosed in the reports the Company files or submits under the Securities Exchange Act of 1934, is recorded, processed, summarized and reported, within the time periods specified by the SEC's rules and forms AND in timely alerting them to material information relating to the Company (or its consolidated subsidiaries) required to be included in its periodic SEC filings.

There has been no change in the Company's internal control over the financial reporting during the Company's fourth quarter of fiscal year 2003 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART III

ITEM 9. DIRECTORS AND EXECUTIVE OFFICERS OF THE COMPANY

Information concerning directors and executive officers of the Company,

the Audit Committee, the Company's audit committee financial expert and the Company's Code of Ethics is incorporated herein by reference from the Company's definitive Proxy Statement dated March 15, 2004 (the "Proxy Statement"), specifically the section captioned "Proposal I--Election of Directors."

ITEM 10. EXECUTIVE COMPENSATION

Information concerning executive compensation is incorporated herein by reference from the Company's Proxy Statement, specifically the sections captioned "Proposal I--Election of Directors--Executive Compensation," "--Directors' Compensation," and "--Benefits."

ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Information concerning security ownership of certain owners and management is incorporated herein by reference from the Company's Proxy Statement (Section headed "Voting Securities, Principal Holders Thereof and Methods of Counting Votes"). Information concerning compensation plans previously approved by stockholders is set forth in the table on page 13 of the Proxy Statement and is incorporated herein by reference.

ITEM 12. CERTAIN TRANSACTIONS

Information concerning relationships and transactions is incorporated herein by reference from the Company's Proxy Statement (Section headed "Transactions with Certain Related Persons").

ITEM 13. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

The exhibits and financial statement schedules filed as a part of this Form 10-KSB are as follows:

(a)(1) Financial Statements

- Independent Auditors' Report
- Consolidated Statement of Financial Condition, December 31, 2003 and 2002
- Consolidated Statement of Income, Years Ended December 31, 2003, 2002 and 2001
- Consolidated Statement of Changes in Stockholder Equity, Years Ended December 31, 2003, 2002, and 2001
- Consolidated Statement of Cash Flows, Years Ended December 31, 2003 2002 and 2001
- Notes to Consolidated Financial Statements.

(a)(2) Financial Statement Schedules
No financial statement schedules are filed because the required information is not applicable or is included in the consolidated financial statements or related notes.

(a)(3) Exhibits

3.1 Federal Stock Charter of Alpena Bancshares, Inc. (Incorporated by reference to Exhibit 3.1 of the Company's Form 8-K as filed on November 15, 2000)

3.2 Bylaws of Alpena Bancshares, Inc. (Incorporated by reference to Exhibit 3.2 to Company's 8-K filed on November 15, 2000)

4 Common Stock Certificate Certificate of the Company (Incorporated by reference to Exhibit 4 of the Company's Form 8-K as filed on November 15, 2000)

10 Employment Contract with Ralph Stepaniak dated March 1, 2003.

13 2003 Annual Report to Stockholders

14 Code of Ethics for Senior Financial Officers adopted on March 12, 2004.

21 Subsidiaries of the Registrant

23 Consent of Accountants

31.1 Certification of Chief Executive Officer

31.2 Certification of Chief Financial Officer

32.1 Section 1350 Certification by Chief Executive Officer

32.2 Section 1350 Certification by Chief Financial Officer

(b) Reports on Form 8-K:

None

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Information concerning principal accountant fees and services is incorporated herein by reference from pages 14 and 15 of the Proxy Statement.

SIGNATURES

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

ALPENA BANCSHARES, INC.

By: /a/Martin A. Thomson

Martin A. Thomson
President and Chief Executive Officer

Date: March 30, 2004

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

By: /s/Martin A. Thomson

Martin A. Thomson, Director,
President and Chief Executive Officer
(Principal Executive Officer)

By: /s/Michael W. Mahler

Michael W. Mahler, Treasurer and Chief Financial Officer
(Principal Financial and Accounting Officer)

Date: March 30, 2004	Date: March 30, 2004
By: /s/James Rapin	By: /s/Keith Wallace
James Rapin, Chairman	Keith Wallace, Director
Date: March 26, 2004	Date: March 30, 2004
By: /s/GaryVanMassenhove	By: /s/Thomas R. Townsend
Gary VanMassenhove, Director	Thomas R. Townsend, Director
Date: March 29, 2004	Date: March 29, 2004

EXHBIT INDEX

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