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TAYLOR CALVIN B BANKSHARES INC

Form 10-Q

May 13, 2002

SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

FORM 10-Q

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

FOR THE QUARTER ENDED MARCH 31, 2002

Commission File Number: 0001003986

CALVIN B. TAYLOR BANKSHARES, INC.

I.R.S. Employer Identification No.: 52-1948274  
State of incorporation: Maryland

Address of principal executive offices: 24 North Main  
Street, Berlin, Maryland 21811  
Issuer's telephone number: (410) 641-1700

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

State the number of shares outstanding of each of the  
issuer's classes of common equity, as of the latest  
practicable date: The registrant had 3,240,000 shares of  
common stock (\$1.00 par) outstanding as of April 30, 2001.

Calvin B. Taylor Bankshares, Inc. and Subsidiaries  
Form 10-Q  
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Calvin B. Taylor Bankshares, Inc. and Subsidiaries  
Part I - Financial Information  
Consolidated Balance Sheets

	(unaudited)	
	March 2002	December 2001
<b>Assets</b>		
Cash and due from banks	14,773,266	18,397,266
Federal funds sold	54,432,446	54,389,656
Interest-bearing deposits	879,000	879,000
Investment securities available for sale	3,918,479	3,974,099
Investment securities held to maturity (approximate fair value of \$88,090,100 and \$85,604,080)	87,542,086	84,398,152
Loans, less allowance for loan losses of 2,188,547 and 2,195,922	167,612,114	166,501,512
Premises and equipment	6,040,735	5,895,275
Accrued interest income	1,714,032	1,753,816
Deferred income taxes	156,147	134,639
Other assets	458,586	501,152
	337,526,891	336,824,567
<b>Liabilities and Stockholders' Equity</b>		
<b>Deposits</b>		
Noninterest-bearing	61,571,649	60,508,663
Interest-bearing	213,505,480	213,640,518
	275,077,129	274,149,181
Securities sold under agreements to repurchase	4,546,882	4,555,323
Accrued interest payable	457,171	529,348
Note payable	211,599	215,702
Accrued income taxes	690,819	2,298
Other liabilities	(1,009)	130,145
	280,982,591	279,581,997
<b>Stockholders' equity</b>		
Common stock, par value \$1 per share authorized 10,000,000 shares, issued and outstanding 3,240,000 shares	3,240,000	3,240,000
Additional paid in capital	17,290,000	17,290,000
Retained earnings	35,610,015	36,274,102
	56,140,015	56,804,102
Net unrealized gain on securities available for sale	404,285	438,468
	56,544,300	57,242,570
	337,526,891	336,824,567

Calvin B. Taylor Bankshares, Inc. and Subsidiaries  
Consolidated Statements of Income (unaudited)

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For the three months ended March 31,  
2002                      2001

Interest and dividend revenue		
Loans, including fees	3,260,478	3,576,124
U.S. Treasury and Agency securities	874,386	896,411
State and municipal securities	61,038	94,413
Federal funds sold	220,517	261,284
Deposits with banks	10,522	11,972
Equity securities	15,158	14,703
Total interest and dividend revenue	4,442,099	4,854,907
Interest expense		
Deposit interest	1,160,399	1,513,256
Other	10,382	16,043
Total interest expense	1,170,781	1,529,299
Net interest income	3,271,318	3,325,608
Provision for loan losses	-	-
Net interest income after provision for loan losses	3,271,318	3,325,608
Other operating revenue		
Service charges on deposit accounts	218,719	202,387
Miscellaneous revenue	94,458	82,513
Total other operating revenue	313,177	284,900
Other expenses		
Salaries and employee benefits	864,189	842,147
Occupancy	119,316	128,032
Furniture and equipment	157,485	142,470
Other operating	472,392	412,570
Total other expenses	1,613,382	1,525,219
Income before income taxes	1,971,113	2,085,289
Income taxes	691,200	728,433
Net income	1,279,913	1,356,856
Basic earnings per share	0.40	0.42

Calvin B. Taylor Bankshares, Inc. and  
Subsidiaries  
Consolidated Statements of Cash Flows (unaudited)

For the three months ended March 31,  
2002                      2001

Cash flows from operating activities		
Interest received	4,454,002	5,087,621
Fees and commissions received	313,169	319,770
Interest paid	(1,242,958)	(1,522,212)
Cash paid to suppliers / employees	(1,556,159)	(1,522,349)
Income taxes paid	(2,679)	(103,593)
	1,965,375	2,259,237
Cash flows from investing activities		
Proceeds from maturities of investment securities	17,365,000	20,465,000
Purchase of investment securities		

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held to maturity	(20,481,124)	(4,014,548)
Certificates of deposit purchased, net of redemptions	-	-
Purchases of premises, equipment, and intangibles	(291,262)	(253,395)
Loans made, net of principal collected	(1,110,602)	(4,671,433)
Proceeds from sales of equipment	-	17,000
	(4,517,988)	11,542,624
Cash flows from financing activities		
Net change in time deposits	186,122,263	501,653
Net change in other deposits	(185,194,315)	(4,174,155)
Net change in repurchase agreements	(8,441)	(120,363)
Payment on mortgage obligation	(4,104)	(3,865)
Dividend paid	(1,944,000)	-
	(1,028,597)	(3,796,730)
Net increase (decrease) in cash	(3,581,210)	10,005,131
Cash and equivalents at beginning of period	72,786,922	31,499,806
Cash and equivalents at end of period	69,205,712	41,504,937
Reconciliation of net income to net cash provided from operating activities		
Net income	1,279,913	1,356,856
Adjustments		
Depreciation and amortization	153,964	116,872
Deferred income tax	-	-
Provision for loan losses	-	-
Security discount accretion, net of premium amortization	(27,881)	(33,419)
Loss on disposition of assets	8,343	-
Decrease in accrued interest receivable and other assets	65,844	261,748
Increase in accrued interest payable and other liabilities	485,192	557,180
	1,965,375	2,259,237

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

### 1. Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q. Accordingly, they do not include all the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation of financial position and results of operations have been made. These adjustments are of a normal recurring nature. Results of operations for the three months ended March 31, 2002 are not necessarily indicative of the results that may be expected for the year ending December 31, 2002. For

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further information, refer to the audited consolidated financial statements and related footnotes for the Registrant's fiscal period ended December 31, 2001.

Consolidation has resulted in the elimination of all significant intercompany accounts and transactions.

### Cash Flows

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks and overnight investments in federal funds sold.

### Per share data

Earnings per common share and dividends per common share are determined by dividing net income and dividends by the 3,240,000 shares outstanding, giving retroactive effect to the stock dividends distributed.

## 2. Comprehensive Income

Comprehensive income consists of:

	Three months ended March 31,	
	2002	2001
Net income	1,279,913	1,356,856
Unrealized gain (loss) on investment securities available for sale, net of income taxes	(34,183)	2,645
Comprehensive income	1,245,730	1,359,501

## Calvin B. Taylor Bankshares, Inc. and Subsidiaries

### Part I. Financial Information

#### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

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

### General

Calvin B. Taylor Bankshares, Inc. (the "Company") was incorporated as a Maryland corporation on October 31, 1995. The Company owns all of the stock of two banks. The Maryland bank is a commercial bank incorporated under the laws of the State of Maryland on December 17, 1907. This bank operates nine banking offices in Worcester County with the Bank's main office located in Berlin, Maryland. It is engaged in a general commercial and retail banking business serving individuals, businesses, and governmental units in Worcester County, Maryland and neighboring counties. The second bank was incorporated in Delaware in 1997 and opened late in the second quarter of 1998. This one-branch Delaware bank offers the same services as the Maryland bank. The Company

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currently engages in no business other than owning and managing the Banks.

### Financial Condition, Liquidity and Sources of Capital

Total assets of the Company increased \$702 thousand from December 31, 2001 to March 31, 2002. An increase in asset size is unusual for the banks during this quarter. Management attributes the increase to depositors' lack of confidence in the stock market and a resultant flight to the safety of insured deposits. During the first quarter of the year, the banks typically experience a decline in deposits since business customers are using their deposits to meet cash flow needs. Generally, this situation reverses late in the second quarter of the year as the banks receive loan repayments from seasonal business customers, and deposits from summer residents and tourists.

During the first quarter of 2002, the banks' loan portfolios increased \$1.1 million. Funding for these loans was provided primarily by growth in deposits.

The allowance for loan losses represents a reserve for potential losses in the loan portfolio. The adequacy of the allowance for loan losses is evaluated periodically based on a review of all significant loans, with a particular emphasis on non-accruing, past due, and other loans that management believes require attention. The determination of the reserve level relies on management's judgment about factors affecting loan quality and anticipated changes in the composition and size of the portfolio, as well as assumptions about the economy. Historically, the Company has low loan charge-offs.

The banks' target levels for their allowances as a percentage of gross loans range from approximately 1.00% to 1.35%. Based on review of the consolidated loan portfolio, the Company determined that an allowance of 1.29% of gross loans was adequate as of March 31, 2002. At December 31, 2001, the allowance was 1.30% of gross loans. At March 31, 2002, non-accruing loans totaled \$25,265 or .01% of the portfolio and loans delinquent ninety days or more, excluding non-accruing loans, totaled \$191,948 or .11% of the portfolio.

### Financial Condition, Liquidity and Sources of Capital (continued)

The company's major sources of liquidity are loan repayments, and maturities of short-term investments including federal funds sold, and increases in core deposits. Throughout the first quarter of the year, when the banks typically experience a decline in deposits, federal funds sold and investment securities are primary sources of liquidity. During the second quarter of the year, additional sources of liquidity become more readily available as business borrowers start repaying loans, and the banks receive seasonal deposits. Throughout the second and third quarters the banks maintain a high liquidity level. Funds

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from seasonal deposits are generally invested in short-term U.S. Treasury Bills and overnight federal funds. Average liquid assets (cash and amounts due from banks, interest bearing deposits in other banks, federal funds sold, and investment securities) compared to average deposits were 58.36% for the first quarter of 2002, compared to 46.21% for the first quarter of 2001.

At March 31, 2002, the Company's interest rate sensitivity, as measured by gap analysis, showed the Company was asset-sensitive with a one-year cumulative gap of 19.06%, as a percentage of interest-earning assets. Generally asset-sensitivity indicates that assets reprice more quickly than liabilities and in a rising rate environment net interest income typically increases. Conversely, if interest rates decrease, net interest income would decline. Both banks have classified their demand mortgage and commercial loans as immediately repriceable. Unlike loans tied to prime, these rates do not necessarily change as prime changes since the decision to call the loans and change the rates rests with management.

Tier one risk-based capital ratios of the Company as of March 31, 2002 and 2001 were 34.60% and 35.05%, respectively. Both are substantially in excess of regulatory minimum requirements.

### Results of Operations

The following discussion contains certain forward-looking statements within the meaning of and made pursuant to the safe harbor provisions of the Private Litigation Securities Reform Act of 1995.

Net income for the three months ended March 31, 2002, was \$1,279,913 or \$.40 per share, compared to \$1,356,856 or \$.42 per share for the first quarter of 2001. This represents a decrease of \$76,943. The primary reasons for the decrease in net income are lower net interest income and increased other operating costs. Net interest income decreased \$54,290 in the first quarter of 2002 as compared to the first quarter of 2001 due to lower interest rates on higher balances of both interest-earning assets and interest-bearing liabilities. The banks reduced loan and deposit rates in response to overall market conditions. Market rate reductions have also diminished rates of return on federal funds sold and investment securities.

### Results of Operations (continued)

Net interest income of the company is one of the most important factors in evaluating the financial performance of the Company. The Company uses interest sensitivity analysis to determine the effect of rate changes. Net interest income is projected over a one-year period to determine the effect of an increase or decrease in the prime rate of 100 basis points. If prime were to decrease one hundred basis points, and all assets and liabilities maturing within that period

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were fully adjusted for the rate change, the Company would experience a decrease of less than five percent in net interest income. The sensitivity analysis does not consider the likelihood of these rate changes nor whether management's reaction to this rate change would be to reprice its loans or deposits.

No provision for loan losses was made in the first quarters of 2002 or 2001. Loans charged-off during the first quarter of 2002 totaled \$7,775. There were no loans charged-off during the first three months of 2001.

The banks employed 97 full time equivalent employees as of March 31, 2002, a decrease of ten employees from March 31, 2001. The Maryland bank hires seasonal employees during the summer. The Company has no employees other than those hired by the banks.

During the fourth quarter of 2001, the Company replaced its core processing system. Related equipment depreciation, software amortization, and maintenance costs for both equipment and software increased with this replacement. Prior to the installation of the new processing system, upgrades to the company's data storage, networking and Internet banking systems were installed. These, too, caused an increase in related costs.

Other expense increased \$88 thousand in the first quarter of 2002 as compared to the first quarter of 2001. Significant components of this increase include a \$22 thousand increase in telephone costs due to network and Internet usage, and additional correspondent bank fees of \$29 thousand. Additionally, increased amortization and software maintenance costs related to recent upgrades and enhancements to the company's data processing capabilities are record in other operating expense.

### Plans of Operation

The banks conduct general commercial banking businesses in their service areas, of Worcester County, Maryland and Sussex County, Delaware, while also emphasizing the banking needs of individuals and small- to medium-sized businesses and professional concerns. The banks offer a full range of federally insured deposit services that are typically available in most banks and savings and loan associations, including checking accounts, NOW accounts, savings accounts and time deposits of various types ranging from daily money market accounts to longer-term certificates of deposit.

The Company, through its banks, offers a full range of short- to medium-term commercial and personal loans, and originates mortgage loans, including real estate construction and acquisition loans. The banks have the intent and the ability to hold loans that their portfolios.

Other bank services include cash management services, safe deposit boxes, travelers checks, direct deposit of payroll and social security checks, debit cards, and automatic drafts for various accounts. The Company is



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associated with the MAC network of automated teller machines that may be used by customers throughout Maryland, Delaware and other regions. The Company offers credit card services through a correspondent bank.

### Capital Resources and Adequacy

Total stockholders' equity decreased \$698,270 from December 31, 2001 to March 31, 2002. This change is attributable to the comprehensive income of \$1,245,730 recorded during the period, as detailed in Note 2 of the Notes to Financial Statements, reduced by the payment cash dividend of \$1,944,000.

Under the capital guidelines of the Federal Reserve Board and the FDIC, the Company and its banks are currently required to maintain a minimum risk-based total capital ratio of 8%, with at least 4% being Tier 1 capital. Tier 1 capital consists of common shareholders' equity, qualifying perpetual preferred stock, and minority interests in equity accounts of consolidated subsidiaries, less certain intangibles. In addition, the Company and the banks must maintain a minimum Tier 1 leverage ratio (Tier 1 capital to total assets) of at least 3%, but this minimum ratio is increased by 100 to 200 basis points for other than the highest-rated institutions.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company's principal market risk exposure relates to interest rates on interest-earning assets and interest-bearing liabilities. Unlike most industrial companies, the assets and liabilities of financial institutions such as the Company and the banks are primarily monetary in nature. Therefore, interest rates have a more significant effect on the Company's performance than do the effects of changes in the general rate of inflation and change in prices. In addition, interest rates do not necessarily move in the same direction or in the same magnitude as the prices of goods and services. As discussed previously, management monitors and seeks to manage the relationships between interest sensitive assets and liabilities in order to protect against wide interest rate fluctuations, including those resulting from inflation.

### Calvin B. Taylor Bankshares, Inc. and Subsidiaries Part II. Other Information

Item 1 Legal Proceedings  
Not applicable

Item 2 Changes in Securities and Use of Proceeds  
Not applicable

Item 3 Defaults Upon Senior Securities  
Not applicable

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Item 4 Submission of Matters to a Vote of Security  
Holders  
Not applicable

Item 5 Other information  
Not applicable.

Item 6 Exhibits and Reports on Form 8-K  
a) Exhibits  
2. Proxy Statement dated March 15, 2002, is  
incorporated by reference.  
  
b) Reports on Form 8-K  
There were no reports on Form 8-K filed for the  
quarter ended March 31, 2002.

SIGNATURES

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

Calvin B. Taylor Bankshares, Inc.

Date: By: /s/ Reese F. Cropper, Jr.  
Reese F. Cropper, Jr.  
President and  
Chief Executive Officer

Date: By: /s/ William H. Mitchell  
William H. Mitchell  
Senior Vice President and  
Chief Financial Officer