GUARANTY FINANCIAL CORP /VA/
Form 10QSB
August 14, 2001

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-QSB

Quarterly Report Under Section 13 or 15(d)
of the Securities Exchange Act of 1934

For Quarter Ended June 30, 2001 — Commission File No. 0-25905

GUARANTY FINANCIAL CORPORATION

Virginia	54-1786496
(State or other Jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1658 State Farm Blvd., Charlottesville, VA 22911
(Address of Principal Executive Offices)

(804) 970-1100
(Issuer's Telephone Number, Including Area Code)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 ___

As of August 1, 2001, 1,961,727 shares of Common Stock, par value $1.25 per share, were outstanding.

GUARANTY FINANCIAL CORPORATION

QUARTERLY REPORT ON FORM 10-QSB

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Part I. Financial Information

Item 1 Financial Statements

GUARANTY FINANCIAL CORPORATION
CONSOLIDATED BALANCE SHEETS
(In Thousands)

	June 30, 2001	December 31, 2000

ASSETS	(Unaudited)	
Cash and cash equivalents	$ 16,695	$ 15,550
Investment securities		
Held-to-maturity	1,113	1,200
Available for sale	30,617	17,931
Investment in FHLB stock	1,550	1,550
Loans receivable, net	189,981	201,617
Accrued interest receivable	1,736	2,079
Real estate owned	532	1,301
Office properties and equipment, net	9,630	9,877
Mortgage servicing rights	1,010	1,021
Other assets	1,966	1,897
Total assets	$ 254,830	$ 254,023
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Deposits:		
Interest bearing demand	$ 23,625	$ 23,585
Non-interest bearing demand	20,006	16,986
Money market accounts	21,526	18,894
Savings accounts	11,439	10,311
Certificates of deposit	150,376	146,952
	226,972	216,728
Bonds payable	749	792
Advances from Federal Home Loan Bank	4,000	14,000
Accrued interest payable	763	394
Payments by borrowers for taxes and insurance	240	264
Other liabilities	405	795
Total liabilities	233,129	232,973
Convertible preferred securities	6,012	6,012
STOCKHOLDERS' EQUITY		
Preferred stock, par value $1 per share, 500,000 shares authorized, none issued	-	-
Common stock, par value $1.25 per share, 4,000,000 shares authorized, 1,961,727 issued and outstanding	2,452	2,452
Additional paid-in capital	8,953	8,953
Accumulated comprehensive income (loss)	(742)	(1,218)
Retained earnings	5,026	4,851
Total stockholders' equity	15,689	15,038
Total liabilities and stockholders' equity	$ 254,830	$ 254,023

See accompanying notes to consolidated financialstatements.

GUARANTY FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(In Thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2001	2000	2001	2000
	(unaudited)		(unaudited)	
Interest income				
Loans	$ 3,959	$ 5,260	$ 8,557	$ 10,02
Investment securities	610	590	1,117	1,14
Total interest income	4,569	5,850	9,674	11,17
Interest expense				
Deposits	2,582	2,693	5,175	5,05
Borrowings	171	624	507	1,28
Total interest expense	2,753	3,317	5,682	6,33
Net interest income	1,816	2,533	3,992	4,84
Provision for loan losses	75	1,075	225	1,20
Net interest income after provision for loan losses	1,741	1,458	3,767	3,63
Other income				
Loan and deposit fees and servicing income	175	201	409	36
Gain on sale of loans and securities	295	183	470	11
Other	90	117	219	23
Total other income	560	501	1,098	71
Other expenses				
Personnel	1,150	1,051	2,411	2,09
Occupancy	423	226	762	44
Data processing	255	157	509	37
Marketing	89	126	117	14
Deposit insurance premiums	26	60	52	11
Other	347	463	749	92
Total other expenses	2,290	2,083	4,600	4,10
Income (loss) before income taxes	11	(124)	265	24
Provision (benefit) for income taxes	4	(42)	90	8
Net income (loss)	$ 7	$ (82)	$ 175	$ 16

Basic and diluted earnings (loss) per common share	$ 0.00	$ (0.04)	$ 0.09	$ 0.0

See accompanying notes to consolidated financial statements.

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GUARANTY FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In Thousands)

	Three Months Ended June 30,		
	2001	2000	
	(unaudited)		
Net Income (loss)	$ 7	($ 82)	$
Other comprehensive income:			
Unrealized gains (losses) on securities available for sale	81	(598)	
Other comprehensive income (loss), before tax	81	(598)	
Income tax (expense) benefit related to items of other comprehensive income	(28)	203	
Other comprehensive income (loss), net of tax	53	(395)	
Comprehensive Income (loss)	$ 60	($ 477)	$

See accompanying notes to consolidated financial statements.

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GUARANTY FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands)

	Six Mo
	2001

	(un
Operating Activities	
Net Income	$ 175
Adjustments to reconcile net income to net cash provided (absorbed) by operating activities:	
Provision for loan losses	225
Depreciation and amortization	719
Deferred loan fees	(75)
Net amortization of premiums and accretion of discounts	60
Gain on sale of loans	(586)
Originations of loans held for sale	(36,255)
Proceeds from sale of loans	36,841
Changes in:	
Accrued interest receivable	343
Other assets	(151)
Accrued interest payable	369
Prepayments by borrowers for taxes and insurance	(24)
Other liabilities	(390)
Net cash provided (absorbed) by operating activities	1,251
Investing activities	
Net (increase) decrease in loans	11,487
Mortgage-backed securities principal repayments	88
Purchase of securities available for sale	(12,000)
Purchase of FHLB stock	-
Proceeds from sale of real estate owned	757
Origination of servicing rights	(314)
Purchases of office properties and equipment	(312)
Net cash absorbed by investing activities	(294)
Financing activities	
Net increase in deposits	10,244
Proceeds from FHLB advances	31,000
Repayment of FHLB advances	(41,000)
Decrease in securities sold under agreement to repurchase	-
Repurchase of convertible preferred securities	-
Dividends paid on common stock	-
Principal payments on bonds payable, including unapplied payments	(56)
Net cash provided by financing activities	188
Increase in cash and cash equivalents	1,145
Cash and cash equivalents, beginning of period	15,550
Cash and cash equivalents, end of period	$ 16,695

See accompanying notes to consolidated financial statements.

GUARANTY FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the Three and Six Months Ended June 30, 2001 and 2000

Note 1 Principles of Presentation

The accompanying consolidated financial statements of Guaranty Financial Corporation (the "Company") have not been audited by independent accountants, except for the balance sheet at December 31, 2000. These financial statements have been prepared in accordance with the regulations of the Securities and Exchange Commission in regard to quarterly (interim) reporting. In the opinion of management, the financial information presented reflects all adjustments, comprised only of normal recurring accruals, that are necessary for a fair presentation of the results for the interim periods. Significant accounting policies and accounting principles have been consistently applied in both the interim and annual consolidated financial statements. Certain notes and the related information have been condensed or omitted from the interim financial statements presented in this Quarterly Report on Form 10-QSB. Therefore, these financial statements should be read in conjunction with the Company's Annual Report on Form 10-KSB for the year ended December 31, 2000. The results for the three months and six months ended June 30, 2001, are not necessarily indicative of future financial results.

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Guaranty Capital Trust I and Guaranty Bank, and Guaranty Bank's wholly-owned subsidiaries, GMSC, Inc., which was organized as a financing subsidiary, and Guaranty Investments Corp., which was organized to sell insurance annuities and other non-deposit investment products. All material intercompany accounts and transactions have been eliminated in consolidation.

Amounts in the year 2000 financial statements have been reclassified to conform to the year 2001 presentation. These reclassifications had no effect on previously reported net income.

Note 2 Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Note 3 Earnings Per Share

Basic earnings per share is based on net income divided by the weighted average number of common shares outstanding during the period. Diluted earnings per share shows the dilutive effect of additional common shares issuable under stock option plans. The basic and diluted earnings per share for the three and six months ended June 30, 2001 and 2000, have been determined by dividing net income by the weighted average number of shares of common stock outstanding during these periods, 1,961,727. All options outstanding were anti-dilutive for each period presented and, therefore, not included in the diluted earnings per share calculations.

Note 4 Loans

The loan portfolio is composed of the following:

	June 30, 2001	December 31, 2000
	(In thousands)	
Commercial business loans	$ 65,782	$ 62,976
Mortgage loans	51,471	59,613
Interim real estate loans	48,703	54,437
Consumer loans	26,603	26,987
Total loans	192,559	204,013
Less allowance for loan loss	(2,578)	(2,396)
	$ 189,981	$ 201,617

Note 5 Allowance for Loan Loss

The following is a summary of transactions in the allowance for loan loss:

	June 30, 2001	December 31, 2000
	(In thousands)	
Balance at January 1	$ 2,396	$ 1,303
Provision charged to operating expense	225	1,505
Recoveries added to the reserve	0	23
Loans charged off	(43)	(435)
Balance at the end of the period	$ 2,578	$ 2,396

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

Changes in Financial Condition

Total assets increased 0.3% to $254.8 million at June 30, 2001, from $254.0 million at December 31, 2000. Cash and cash equivalents increased $1.1 million or 7.4%, to $16.7 million at June 30, 2001, from $15.6 million at December 31, 2000. During this period, the Company's liability mix shifted as deposits increased by $10.3 million and FHLB borrowings decreased by $10.0 million. Deposits at June 30, 2001, totaled $227.0 million compared to $216.7 million at December 31, 2000. FHLB borrowings decreased to $4.0 million at June 30, 2001, compared to $14.0 million at December 31, 2000. In addition, the Company's asset mix shifted during the same period. Net loans decreased by $11.6 million while total investments increased by $12.6 million. These changes resulted from the Company's strategy to increase its liquidity and reduce its lending in the real estate development and construction sectors.

The investment portfolio was comprised of the following:

	June 30, 2001	December 31, 2000
Held to maturity:		
Mortgage-backed securities	$ 863	$ 950
U.S. Government obligations	250	250
Available for sale:		
Corporate Bonds	18,195	17,509
U.S. Government obligations	12,000	-
Other:		
Federal Reserve Bank & other stocks	422	422
Federal Home Loan Bank stock	1,550	1,550
	$ 33,280	$ 20,681

Net loans were $190.0 million at June 30, 2001, a decrease of $11.6 million, or 5.8%, from net loans of $201.6 million at December 31, 2000. The decrease in the loan portfolio was primarily due to the sale of $6.9 million of seasoned fixed rate mortgage loans and a reduction of $5.7 million in interim real estate loans. This decrease was partially offset by a $3.7 million increase in commercial business loans.

Real estate owned decreased to $532,000 at June 30, 2001, from $1.3 million at December 31, 2000. The decline was due to the sale of a commercial real estate property during the period. The remainder of real estate owned consists of developed lots located within a residential subdivision. Net proceeds are anticipated to approximate the carrying value at June 30, 2001. No material losses are anticipated on the ultimate sale of these properties.

Deposits were $227.0 million at June 30, 2001, an increase of $10.3 million, or 4.7%, from total deposits of $216.7 million at December 31, 2000. The deposit growth was evenly spread between growth in certificates of deposits and transaction accounts. New deposits at the Forest Lakes branch accounted for $2.4 million of the increase in deposits.

Results of Operations

Net Income

The Company reported net income of $7,000 for the three months ended June 30, 2001, compared with a net loss of $82,000 for the three months ended June 30, 2000. While net income in the current quarter was negatively impacted by a compression of the Company's net interest margin, net income was favorable to the same quarter of the prior year due to a lower provision for loan losses. Net income of $175,000 for the six months ended June 30, 2001, was slightly improved over the $162,000 reported for the same period a year ago.

Net Interest Income

Net interest income decreased to $1.8 million for the three months ended June 30, 2001, from the $2.5 million reported during the same period in 2000. For the six months ended June 30, 2001, net interest income decreased to $4.0 million from $4.8 million for the same period in 2000. The compression in the net interest margin was due to a decrease in the average amount of loans outstanding and the impact of six prime rate decreases during the first half of 2001. Because of the Company's reliance on fixed rate certificates of deposit, prime rate decreases lowered its yield on earning assets (especially those loans whose interest rates are indexed to prime) faster than its cost of interest bearing deposits fell. Certificates of deposits totaling $38.4 million with an average cost of 6.38% mature during the third quarter of 2001. During the fourth quarter of 2001, certificates of deposit totaling $33.7 million with an average cost of 6.24% mature. The net interest margin was 3.48% for the most recent quarter compared with 3.95% for the same period a year ago. The following table summarizes the factors determining net interest income ($ in thousands).

	Three Months Ended June 30, 2001	Three Months Ended June 30, 2000	Six Months Ended June 30, 200
Average Interest Earning Assets	$ 233,052	$ 257,163	$ 232,945
Average Yield	8.22%	9.12%	8.55%
Average Interest Bearing Liabilities	$ 216,690	$ 244,161	$ 217,938
Average Cost	5.10%	5.45%	5.26%
Interest Spread	3.12%	3.67%	3.29%
Interest Margin	3.48%	3.95%	3.64%

Provision for Loan Losses

The Company provides valuation allowances for anticipated losses on loans when its management determines that a significant decline in the value of the collateral has occurred, and if the value of the collateral is less than the amount of the unpaid principal of the related loan, plus estimated costs of acquisition and sale. In addition, the Company provides reserves based on the dollar amount and type of collateral securing its loans, in order to protect against unanticipated losses. A loss experience percentage is established for each loan type and is reviewed quarterly. Each quarter, the loss percentage is applied to the portfolio, by product type, to determine the minimum amount of reserves required. The Company recorded a provision of $75,000 and $1.1 million for the three months ended June 30, 2001 and 2000, respectively. The provision recorded in the prior year was to increase the allowance for loan losses to an amount that properly reflected the credit risk in the loan portfolio.

Net charge-offs for the three months ended June 30, 2001, were $9,000 compared to $379,000 for the same period a year ago. At June 30, 2001, the Company had $1.6 million of loans that were 90 days or more past due. Of this total, only $118,000 of loans were considered to be non-accrual. At June 30, 2001, the allowance for loan losses was $2.6 million or 1.34% of total loans. Management believes that the allowance for loan losses is adequate to cover loan losses inherent in the loan portfolio at June 30, 2001. Loans classified as special mention, substandard, doubtful and loss have been adequately reserved. Although management believes that it uses the best information available to make such determinations, future adjustments to the allowance for loan losses may be necessary, and net income could be significantly affected, if circumstances differ substantially from assumptions used in making the initial determinations.

Non-Interest Income

Non-interest income was $560,000 for the three months ended June 30, 2001, compared with $501,000 for the same period a year ago. Fees on deposit accounts increased by 11.6% to $204,400 for the most recent quarter as compared to $183,200 for the same period a year ago. A higher volume of loan payoffs accelerated the amortization of originated mortgage loan servicing rights and negatively impacted loan servicing income. Loan servicing revenue increased by 69.8% to $73,000 for the most recent quarter compared to $43,000 for the same period a year ago. However, the amortization of loan servicing rights increased to $155,000 in the most recent quarter from $25,000 for the same period of the prior year. The Company shifted its operating strategy in the past quarter to sell the majority of its mortgage loan production on a servicing released basis going forward. Net gains on the sale of mortgage loans and securities were $295,000 for the three months ended June 30, 2001, compared to $183,000 in the prior year. Non-interest income was $1.1 million for the six months ended June 30, 2001, compared with $715,000 for the same period a year ago.

Non-Interest Expense

Other expenses during the three months ended June 30, 2001, were $2.3 million, a $207,000 increase over those incurred during the same quarter of 2000. This increase is primarily attributable to the additional operating expenses of the Forest Lakes branch in Albemarle County. For the six months ended June 30, 2001, other expenses increased to $4.6 million compared to $4.1 million for the same period a year ago. This increase was also attributable to the additional operating expenses of the Forest Lakes branch, severance expense of $165,000 for former employees and a $51,000 loss on the sale of a foreclosed commercial property.

The Company currently operates eight full-service banking offices. A new branch opened in early February in northern Albemarle County. The Company consummated the sale of its retail branch in Henrico County to Central Virginia Bank on July 13, 2001. This transaction included the assumption of approximately $7.3 million of deposit accounts and the sale of consumer and commercial loans totaling approximately $4.4 million. A small gain on the sale will be recorded in the Company's third quarter results. There are no current plans to open or close any additional offices.

Income Tax Expense

The Company recognized income tax expense of $4,000 for the three months ended June 30, 2001, compared to an income tax benefit of $42,000 for the same period in 2000. The Company recognized income tax expense of $90,000 for the six months ended June 30, 2001, compared to $84,000 for the same period in 2000. Changes in tax expense between periods are primarily a result of changes in the level of taxable income.

Liquidity and Capital Resources

Liquidity is the ability to meet present and future financial obligations either through the sale of existing assets or through the acquisition of additional funds through asset and liability management. The Company's primary sources of funds are deposits, borrowings and amortization, prepayments and maturities of outstanding loans and securities. While scheduled payments from the amortization of loans and securities are relatively predictable sources of funds, deposit flows and loan prepayments are greatly influenced by general interest rates, economic conditions and competition. Excess funds are invested in overnight deposits to fund cash requirements experienced in the normal course of business. The Company has been able to generate sufficient cash through its deposits as well as through its borrowings.

The Company uses its sources of funds primarily to meet its on-going operating expenses, to pay deposit withdrawals and to fund loan commitments. At June 30, 2001, total approved loan commitments outstanding were approximately $7.0 million. At the same date, commitments under unused lines of credit were approximately $41.8 million. Certificates of deposit scheduled to mature in one year or less at June 30, 2001, were $126.7 million. Management believes that a significant portion of maturing deposits will remain with the Company. If these certificates of deposit do not remain with the Company, it will have to seek other sources of funding that may be at higher rates or reduce assets.

At June 30, 2001, regulatory capital was in excess of amounts required by Federal Reserve regulations to be considered well capitalized as shown in the following table:

	Actual Amount	Actual Percentage	Amount Required	Percent Required
Leverage Ratio	$ 21,808	8.62%	$ 10,134	4.00%
Tier 1 Risk Based Capital	21,808	10.59%	8,240	4.00%
Total Risk Based Capital	24,919	12.10%	16,640	8.00%

Regulatory Issues

In October 2000, the Company and it subsidiary, Guaranty Bank, entered into a written agreement with the Federal Reserve Bank of Richmond ("FRB") and the Bureau of Financial Institutions of the Commonwealth of Virginia ("BFI") with respect to various operating policies and procedures. Various bank operating policies including asset/liability management, liquidity, risk management, loan administration and capital adequacy have been rewritten and approved by bank regulators. The Company is restricted from paying future dividends or incurring any debt at the parent company level without prior regulatory approval. In addition, Guaranty Bank is prohibited from paying intercompany dividends to the Company without prior regulatory approval. Absent this intercompany dividend, the Company does not have sufficient resources to make the payments due on its outstanding subordinated debt securities.

The Company and Guaranty Bank have requested regulatory approval for an intercompany dividend in an amount sufficient to make the September 15, 2001, payment due on its subordinated debt securities. While the FRB and the BFI have approved all prior quarterly dividend payment requests since the written agreement was executed, no assurances can be given that this request will be approved.

Forward Looking Statements

Certain statements in this quarterly report on Form 10-QSB may include "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements are generally identified by the use of words such as "believe", "expect", "anticipate", "should", "planned", "estimated", and "potential". These statements are based on the Company's current expectations. A variety of factors could cause the Company's actual results to differ materially from the anticipated results or other expectations expressed in such forward-looking statements. The risks and uncertainties that may affect the operations, performance, development, and results of the Company's business include interest rate movements, competition from both financial and non-financial institutions, the timing and occurrence (or nonoccurrence) of transactions and events that may be subject to circumstances beyond the Company's control, and general economic conditions.

Part II. Other Information

Item 1 Legal Proceedings
Not Applicable

Item 2 Changes in Securities
Not Applicable

Item 3 Defaults Upon Senior Securities
Not Applicable

Item 4 Submission of Matters to a Vote of Security Holders

On May 24, 2001, the Company's Annual Meeting of Shareholders was held to elect two directors to serve on its Board of Directors for terms of three years each. The results of the votes were as follows:

For Terms Expiring in 2004	For	Withheld
Henry J. Browne	1,496,030	176,232
Oscar W. Smith, Jr.	1,496,030	176,232

Item 5 Other Information
Not Applicable

Item 6 Exhibits and Reports on 8-K

(a) Exhibits

10.1 Employment Agreement, dated as of May 10, 2001, by and between Guaranty Financial Corporation and William E. Doyle, Jr.

10.2 Severance and Release Agreement, dated as of March 19, 2001, by and between Guaranty Financial Corporation and Thomas P. Baker.

(b) Reports on Form 8-K - None

SIGNATURES

In accordance with the requirements of the Securities Exchange Act of 1934, as amended, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

GUARANTY FINANCIAL CORPORATION

Date: August 13, 2001

By: /s/ William E. Doyle, Jr.
William E. Doyle, Jr.
President and Chief Executive Officer

Date: August 13, 2001

By: /s/ Thomas F. Crump
Thomas F. Crump
Senior Vice President and
Chief Financial Officer

EXHIBIT INDEX

Exhibit No.	Document
10.1	Employment Agreement, dated as of May 10, 2001, by and between Guaranty Financial Corporation and William E. Doyle, Jr.
10.2	Severance and Release Agreement, dated as of March 19, 2001, by and between Guaranty Financial Corporation and Thomas P. Baker.