PREMIER BANCORP INC /PA/
Form 10-K
March 24, 2003

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

[X] ANNUAL REPORT UNDER SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2002

OR

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NUMBER 1-15513

PREMIER BANCORP, INC.
(Name of Registrant as Specified in Its Charter)

PENNSYLVANIA (State or Other Jurisdiction of incorporation or organization)	23-2921058 (I.R.S. Employer Identification No.)
379 NORTH MAIN STREET, DOYLESTOWN, PENNSYLVANIA (Address of Principal Executive Offices)	18901 (Zip Code)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (215) 345-5100

SECURITIES REGISTERED UNDER SECTION 12(b) OF THE EXCHANGE ACT:

TITLE OF EACH CLASS	NAME OF EACH EXCHANGE ON WHICH REGISTERED

Common Stock, $0.33 par value	American Stock Exchange
Series A Preferred Stock, no par value	American Stock Exchange

SECURITIES REGISTERED UNDER SECTION 12(g) OF THE EXCHANGE ACT:
NONE

(Title of Class)

Check whether the registrant: (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 [ ]

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-K contained in this form, and no disclosure will 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-K or any amendment to this Form 10-K   No [ ]

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes [ ]   No [X]

As of March 21, 2003, 3,417,515 shares of common stock of the registrant were outstanding. The aggregate market value of the voting and non-voting common stock of the registrant, held by non-affiliates was approximately $24,294,000 at June 28, 2002.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's proxy statement for the registrant's 2003 annual meeting of shareholders which is part of the proxy statement/prospectus on Form S-4 filed by Fulton Financial Corporation are incorporated by reference into Part III of this report.

PREMIER BANCORP, INC.

FORM 10-K

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PART I

ITEM 1 -- BUSINESS

PREMIER BANCORP, INC.

Premier Bancorp, Inc. (PBI) is a registered financial holding company. We were incorporated in the Commonwealth of Pennsylvania in July 1997 and reorganized on November 17, 1997 as the one-bank holding company of Premier Bank. Our primary business is the operation of our wholly-owned principal subsidiary, Premier Bank, which we manage as a single business segment and which is a state chartered Federal Reserve member commercial bank whose deposits are insured by the Federal Deposit Insurance Corporation's Bank Insurance Fund to the fullest extent provided by law. Premier Bank was organized in 1990 and began operations on April 24, 1992.

Our consolidated financial condition and results of operations consist almost entirely of those of Premier Bank. At December 31, 2002, we had total consolidated assets of $609,972,000, total deposits of $456,486,000 and total shareholders' equity of $38,436,000.

Other wholly owned subsidiaries include PBI Capital Trust, Premier Capital Trust II, Lenders Abstract, LLC and Premier Bank Insurance Services, LLC. PBI Capital Trust and Premier Capital Trust II are Delaware statutory business trusts established for the sole purpose of issuing $10,000,000 and $15,000,000, respectively, in trust preferred securities. PBI Capital Trust and Premier Capital Trust II were established in 1998 and 2002, respectively. Lenders Abstract, LLC is a Pennsylvania limited liability company organized in December 2000 to sell title insurance policies. Premier Bank Insurance Services, LLC is a Pennsylvania limited liability company organized in March 2002 principally to sell long-term health care insurance policies.

As of December 31, 2002, PBI did not own or lease any property and had no employees.

On January 16, 2003, PBI announced that it had entered into a definitive agreement to be acquired by Fulton Financial Corporation based in Lancaster, Pennsylvania. Under the terms of the agreement, Fulton Financial will acquire all of PBI's issued and outstanding shares of common stock. Each share of PBI common stock outstanding will be exchanged for 1.34 shares of Fulton Financial common stock, subject to adjustment. All outstanding shares of PBI preferred stock are expected to be redeemed as of or before the closing date of the transaction. This acquisition, which is subject to the approval of bank regulators and PBI shareholders, is expected to close by the third quarter of 2003.

PREMIER BANK

Premier Bank is a Pennsylvania chartered financial services provider whose business primarily consists of originating loans to small to mid-sized businesses and attracting retail deposits from the general public. The bank also invests in securities such as mortgage-backed securities, obligations of U.S. government agencies and government sponsored entities, corporate bonds and municipal bonds. The bank's revenues are primarily derived from net interest income. Over our eleven-year history, we have grown significantly through internal growth.

Our deposit products include checking, savings, and money market accounts, as well as certificates of deposit. We offer numerous credit products, but specialize in lending to small to mid-sized businesses and professionals. We offer a full array of lending products including loans secured by real estate and other assets, working capital lines and other commercial loans. We make a wide range of consumer loan products available such as residential mortgage loans, home equity loans and lines of credit, personal lines of credit and other consumer loans. We sell our residential mortgage loans immediately in the secondary market. We also offer other services such as internet banking, telephone banking, cash management services, automated teller services and safe deposit boxes. Further, through our subsidiary, Lenders Abstract, LLC, we sell title insurance. We also offer long-term health care insurance products through our subsidiary, Premier Bank Insurance Services, LLC.

Premier Bank conducts business from seven full-service Pennsylvania banking offices in Doylestown, Easton, Southampton, Floral Vale, Bethlehem, Montgomeryville, and Bensalem. In addition, the bank operates a limited service branch in the Heritage Towers Retirement Community in Doylestown. We plan to open our eighth full-service Pennsylvania banking office in Abington, Montgomery County during the second quarter of 2003.

At December 31, 2002, Premier Bank had 78 full-time and 36 part-time employees.

MARKET AREA

Our primary market area is Doylestown, Pennsylvania and the surrounding Bucks County and Greater Lehigh and Delaware Valley communities. These markets are, in our opinion, among the best in Pennsylvania. The bank has four Bucks County based offices and one office in Montgomery County. We also service parts of the Lehigh Valley from our Bethlehem and Easton, Northampton County, Pennsylvania offices. Though the vast majority of our deposit and lending business comes from these specific areas, we will from time to time do business in a wider geographic region including all of Eastern Pennsylvania and portions of New Jersey, including the New Jersey coastline.

LENDING ACTIVITIES

Premier Bank offers a variety of loan products to its customers, including loans secured by real estate, commercial and consumer loans. Our lending objectives are as follows:

- to establish a diversified commercial loan portfolio;

- to properly price loans to include the cost of funds, administrative costs, bad debts, local economic conditions, competition, customer relationships, the term of the loan, credit risk, collateral quality and a reasonable profit margin.

We manage credit risk through portfolio diversification, underwriting policies and procedures, and loan monitoring practices. Premier Bank generally secures its loans with real estate, with such collateral values dependent and subject to change based on real estate market conditions within the bank's market area. Premier Bank also has a significant number of borrowers engaged in medical, dental, legal and real estate professions, as well as restaurant and hotel businesses.

Gross loans totaled $361,495,000 at December 31, 2002 compared to $316,066,000 at December 31, 2001. The $45,429,000 or 14% increase is primarily due to the continued success of our lending staff in servicing the small to mid-sized business community. Gross loans represented approximately 59% and 70% of total assets at year-end 2002 and 2001, respectively. At December 31, 2002, $315,921,000 or 87% of loans were secured by real estate compared to $269,736,000 or 85% at December 31, 2001.

Loans secured by commercial properties include owner occupied commercial properties and investment income producing properties. Commercial mortgages totaled $253,357,000 and $208,412,000 at December 31, 2002 and 2001, respectively.

Loans secured by residential properties include both first and second mortgages on single family homes. Many of these loans were made to small business owners and professionals. Loans secured by residential property totaled $32,446,000 and $30,188,000 at December 31, 2002 and 2001, respectively.

Loans secured by apartments and other multi-family residential properties totaled $19,350,000 at December 31, 2002 and $15,011,000 at December 31, 2001.

Construction loans are secured by real estate primarily for the building of residential properties. Construction loans totaled $10,574,000 and $15,911,000 at December 31, 2002 and 2001, respectively.

Other loans not secured by real estate include commercial and consumer loans. Commercial loans are generally made to finance the acquisition of machinery and equipment and to provide working capital for local commercial, retail and professional companies. These loans are usually secured by business assets,

excluding real property, and guaranteed by the owners. Commercial loans totaled $44,387,000 and $45,238,000 at December 31, 2002 and 2001, respectively.

Consumer loans consist generally of automobile loans and personal loans. At December 31, 2002 and 2001, these loans totaled $1,187,000 and $1,092,000, respectively.

INVESTMENT ACTIVITIES

At December 31, 2002 and 2001, PBI's investment portfolio totaled $203,141,000 and $98,351,000, respectively. Investments consisted primarily of mortgage-backed securities, corporate bonds and municipal securities. At December 31, 2002, our corporate bond portfolio included intermediate term debt issued by investment grade companies, single issuer trust preferred capital securities issued by other banking companies and pooled debt securities secured by the trust preferred capital securities of various banking companies. At December 31, 2001, our corporate bond portfolio consisted primarily of single issuer trust preferred capital securities issued by other banking companies. Equity securities included stock in the Federal Home Loan Bank of Pittsburgh, the Federal Reserve Bank of Philadelphia and the Atlantic Central Bankers Bank, Premier Bank's principal correspondent bank. Investment securities available for sale are recorded at market value with the unrealized holding gain or loss, net of tax, included in shareholders' equity. Investment securities held to maturity are recorded at amortized cost.

The carrying value of the held to maturity portfolio was $500,000 at both December 31, 2002 and 2001, respectively. At December 31, 2002 and 2001, the carrying value of the available for sale portfolio was $202,641,000 and $97,851,000, respectively.

During 2002, we utilized excess liquidity to grow and restructure our investment portfolio. Our investment portfolio, exclusive of the SFAS 115 valuation allowance, grew $100,206,000 or 97% in 2002. Mortgage-backed securities and corporate bonds, exclusive of the SFAS 115 valuation allowance, grew $67,241,000 and $35,601,000, respectively, during 2002. The net unrealized gain on available for sale securities was $36,000 at December 31, 2002 compared to a net unrealized loss of $4,548,000 at December 31, 2001. The appreciation of the fair value of our AFS investments is due to lower interest rates and the restructuring of our portfolio.

Gross unrealized losses at December 31, 2002 and 2001 were concentrated in single issuer trust preferred securities. Unrealized losses on these securities were $1,802,000 and $3,848,000 at December 31, 2002 and 2001, respectively. In addition to changes in interest rates, valuations of single issuer trust preferred securities have been influenced by perceived credit risk in response to certain world events. Management believes that the credit quality of these securities is sound and that the unrealized loss is temporary.

Management views the investment portfolio as a source of earnings and liquidity. Decisions on maturity and type of investment are dictated by investment and balance sheet management policies as approved annually by the Board of Directors. The Chief Financial Officer makes the decision regarding the specific selection of investments for the portfolio. The Asset Liability Committee sets investment guidelines and strategy based on PBI's financial goals and interest rate sensitivity.

SOURCES OF FUNDS

Premier Bank primarily uses deposits and borrowings to finance lending and investment activities. Borrowing sources include advances from the Federal Home Loan Bank of Pittsburgh, reverse repurchase agreements with investment banks and overnight borrowings from Premier Bank's depositors and correspondent bank. All borrowings, except for the line of credit with Premier Bank's correspondent bank, require collateral in the form of loans or securities. Borrowings are, therefore, limited by collateral levels and the available lines of credit extended by the bank's creditors. As a result, deposits remain key to the future funding and growth of the business. Competition for deposits may require banks to increase deposit prices or expand their branch office networks (increasing costs) to adequately grow deposits in the future.

COMPETITION

Premier Bank actively competes with other financial services companies for deposit and loan business. Competitors include other commercial banks, savings banks, savings and loan associations, insurance companies, securities brokerage firms, credit unions, finance companies, mutual funds, and money market funds. Financial institutions compete primarily on the quality of services rendered, interest rates on loans and deposits, service charges, the convenience of banking facilities, location and hours of operation and, in the case of loans to larger commercial borrowers, relative lending limits.

Many competitors are significantly larger than Premier Bank and have significantly greater financial resources, personnel and locations from which to conduct business. In addition, the bank is subject to banking regulations while certain competitors may not be. Consequently, competition exists from both regulated and non-regulated entities. For more information, see the "Supervision and Regulation" section below.

The growth of mutual funds over the past decade has made it increasingly difficult for financial institutions to attract deposits. Much of the cash flow into mutual funds is from tax deferred investment vehicles such as 401(k) plans. In addition, insurance companies recently have become more significant competitors for deposits through their thrift subsidiaries.

SUPERVISION AND REGULATION

GENERAL

Bank holding companies and banks are extensively regulated under both federal and state laws. The regulation and supervision of PBI and Premier Bank are designed primarily for the protection of depositors, the FDIC and the monetary system, and not PBI or its shareholders. Enforcement actions may include the imposition of a conservator or receiver, cease-and-desist orders and written agreements, the termination of insurance on deposits, the imposition of civil money penalties and removal and prohibition orders. If any enforcement action is taken by a banking regulator, the value of an equity investment in PBI could be substantially reduced or eliminated.

HOLDING COMPANY REGULATION

As a registered financial holding company under the Bank Holding Company Act of 1956 and a Pennsylvania business corporation, PBI is regulated by the Federal Reserve Board and the provisions of Section 115 of the Pennsylvania Banking Code of 1965.

The Bank Holding Company Act requires PBI to file an annual report with the Federal Reserve Board regarding the financial holding company and its subsidiary bank. The Federal Reserve Board also makes examinations of the financial holding company and its subsidiary bank. The Federal Reserve Board possesses cease-and-desist powers over bank holding companies and their subsidiaries where their actions would constitute an unsafe or unsound practice or violation of law.

The Bank Holding Company Act restricts a bank holding company's ability to acquire control of additional banks. In addition, the Act restricts the activities in which bank holding companies may engage directly or through non-bank subsidiaries.

The Gramm-Leach-Bliley Financial Services Modernization Act of 1999 amended the Bank Holding Company Act of 1956 to create a new category of holding company -- the "financial holding company." To be designated as a financial holding company, a bank holding company must file an application with the

Federal Reserve Board. The holding company must be well capitalized and well managed, as determined by Federal Reserve Board regulations. When a bank holding company becomes a financial holding company, the holding company or its affiliates may engage in any financial activities that are "financial in nature or incidental to such activities." Furthermore, the Federal Reserve may approve a proposed activity if it is "complementary" to financial activities and does not threaten the safety and

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soundness of banking. The Act provides an initial list of activities that constitute activities that are financial in nature, including:

- lending and deposit activities;

- insurance activities, including underwriting, agency and brokerage;

- providing financial investment advisory services;

- underwriting in, and acting as a broker or dealer in, securities;

- merchant banking;

- insurance company portfolio investment;

- support services;

- making equity and debt investments in corporations or projects designed primarily to promote community welfare, and providing advisory services to these programs;

- subject to certain limitations, providing others financially oriented data processing or bookkeeping services;

- issuing and selling money orders, travelers' checks and United States savings bonds;

- providing consumer financial counseling that involves counseling, educational courses and distribution of instructional materials to individuals on consumer-oriented financial management matters, including debt consolidation, mortgage applications, bankruptcy, budget management, real estate tax shelters, tax planning, retirement and estate planning, insurance and general investment management, so long as this activity does not include the sale of specific products or investments; and

- providing tax planning and preparation advice.

In addition to permitting financial services providers to enter into new lines of business, the law allows companies the freedom to streamline existing operations and to potentially reduce costs. The Act may increase both opportunity as well as competition. Many community banks are less able to devote the capital and management resources needed to facilitate broad expansion of financial services including insurance and brokerage services.

In the fourth quarter of 2000, PBI became a registered financial holding company. Under this designation, PBI operates a title insurance agency through its subsidiary, Lenders Abstract, LLC and an insurance agency specializing in long-term health care insurance through its subsidiary, Premier Bank Insurance Services, LLC. PBI's ability to retain its ownership of these subsidiaries and its authority to expand into other activities permissible for financial holding companies but not permissible for bank holding companies that are not financial holding companies, is contingent on maintaining PBI as a well capitalized and well managed company in the view of the applicable regulatory authorities.

SARBANES-OXLEY ACT OF 2002

On July 30, 2002, President Bush signed into law the Sarbanes-Oxley Act of 2002. The stated goals of the Act are to increase corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies and to protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws.

The Act is the most far-reaching U.S. securities legislation enacted in decades. The Act generally applies to all companies, both U.S. and non-U.S., that file or are required to file periodic reports with the Securities and Exchange Commission under the Securities Exchange Act of 1934. Due to the SEC's extensive role in implementing rules relating to many of the Act's new requirements, the final scope of these requirements remains to be determined.

The Act includes very specific additional disclosure requirements and new corporate governance rules, requires the SEC and securities exchanges to adopt extensive additional disclosure, corporate governance and other related rules and mandates further studies of certain issues by the SEC. The Act represents significant federal involvement in matters traditionally left to state regulatory systems, such as the regulation of the accounting profession, and to state corporate law, such as the relationship between a board of directors and management and between a board of directors and its committees.

The Act addresses, among other matters:

- audit committees for all reporting companies;

- certification of financial statements by the chief executive officer and the chief financial officer;

- the forfeiture of bonuses or other incentive-based compensation and profits from the sale of an issuer's securities by directors and senior officers in the twelve month period following initial publication of any financial statements that later require restatement;

- a prohibition on insider trading during pension plan black out periods;

- disclosure of off-balance sheet transactions;

- a prohibition on personal loans to directors and officers; expedited filing requirements for Forms 4's;

- disclosure of a code of ethics and filing a Form 8-K for a change or waiver of such code;

- "real time" filing of periodic reports;

- the formation of a public accounting oversight board;

- auditor independence; and

- various increased criminal penalties for violations of securities laws.

The Act contains provisions that were effective upon enactment on July 30, 2002 and provisions that will be phased in for up to one year after enactment.

The SEC was delegated the task of enacting rules to implement various provisions with respect to, among other matters, disclosure in periodic filings pursuant to the Exchange Act.

BANK REGULATION

Premier Bank is subject to supervision, regulation and examination by the Pennsylvania Department of Banking, the FDIC and the Federal Reserve Board. In addition, the bank is subject to a variety of local, state and federal laws.

Banking regulations include, but are not limited to, permissible types and amounts of loans, investments and other activities, capital adequacy, branching, interest rates on loans and the safety and soundness of banking practices.

CAPITAL REQUIREMENTS

Under risk-based capital requirements for bank holding companies, PBI is required to maintain a minimum ratio of total capital to risk-weighted assets (including certain off-balance-sheet activities, such as standby letters of credit) of eight percent. At least half of the total capital ("tier 1 capital" together with "tier 2 capital") is to be composed of common equity, retained earnings and qualifying perpetual preferred stock, less goodwill. The remainder may consist of subordinated debt, non-qualifying preferred stock and a limited amount of the loan loss allowance ("tier 2 capital").

In addition, the Federal Reserve Board has established minimum leverage ratio requirements for bank holding companies. These requirements provide for a minimum leverage ratio of tier 1 capital to adjusted average quarterly assets ("leverage ratio") equal to three percent for bank holding companies that meet certain specified criteria, including having the highest regulatory rating. All other bank holding companies

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will generally be required to maintain a leverage ratio of at least four to five percent. The requirements also provide that bank holding companies experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels without significant reliance on intangible assets. Furthermore, the requirements indicate that the Federal Reserve Board will continue to consider a "tangible tier 1 leverage ratio" (deducting all intangibles) in evaluating proposals for expansion or new activity. The Federal Reserve Board has not advised PBI of any specific minimum tier 1 leverage ratio applicable to it.

Premier Bank is subject to similar capital requirements adopted by the Federal Reserve Board for state member banks. The Federal Reserve Board has not advised the bank of any specific minimum leverage ratios applicable to it.

The capital ratios of PBI and Premier Bank are described below in the "Management's Discussion and Analysis" section.

Banking regulators continue to indicate their desire to further develop capital requirements applicable to banking organizations. Changes to capital requirements could materially affect the profitability of PBI or the market value of PBI stock.

PROMPT CORRECTIVE ACTION

In addition to the required minimum capital levels described above, federal law establishes a system of "prompt corrective actions" which Federal banking agencies are required to take, and certain actions which they have discretion to take, based upon the capital category into which a federally regulated depository institution falls. Regulations set forth detailed procedures and criteria for implementing prompt corrective action in the case of any institution which is not adequately capitalized. Under the rules, an institution will be deemed to be "adequately capitalized" or better if it exceeds the minimum Federal regulatory capital requirements. However, it will be deemed "undercapitalized" if it fails to meet the minimum capital requirements, "significantly undercapitalized" if it has a total risk-based capital ratio that is less than 6.0 percent, a Tier 1 risk-based capital ratio that is less than 3.0 percent, or a leverage ratio that is less than 3.0 percent, and "critically undercapitalized" if the institution has a ratio of tangible equity to total assets that is equal to or less than 2.0 percent.

The prompt corrective action rules require an undercapitalized institution to file a written capital restoration plan, along with a performance guaranty by its holding company or a third party. In addition, an undercapitalized institution becomes subject to certain automatic restrictions including a prohibition on payment of dividends, a limitation on asset growth and expansion, in certain cases, a limitation on the payment of bonuses or raises to senior executive officers, and a prohibition on the payment of certain "management fees" to any "controlling person". Institutions that are classified as undercapitalized are also subject to certain additional supervisory actions, including increased reporting burdens and regulatory monitoring, a limitation on the institution's ability to make acquisitions, open new branch offices, or engage in new lines of business, obligations to raise additional capital, restrictions on transactions with affiliates, and restrictions on interest rates paid by the institution on deposits. In certain cases, bank regulatory agencies may require replacement of senior executive officers or directors, or sale of the institution to a willing purchaser. If an institution is deemed to be "critically undercapitalized" and continues in that category for four quarters, the statute requires, with certain narrowly limited exceptions, that the institution be placed in receivership.

DEPOSIT INSURANCE

Deposits of the bank are insured by the FDIC through the Bank Insurance Fund ("BIF"). Deposits of certain savings associations are insured by the FDIC through the Savings Association Insurance Fund ("SAIF"). The insurance assessments paid by an institution are based on the probability that the fund will incur a loss with respect to the institution. The FDIC has adopted deposit insurance regulations under which insured institutions are assigned to one of the following three capital groups based on their capital levels: "well-capitalized," "adequately capitalized" and "undercapitalized." Banks in each of these three

groups are further classified into three subgroups based upon the level of supervisory concern with respect to each bank. The resulting matrix creates nine assessment risk classifications to which are assigned deposit insurance premiums ranging from 0.00% for the best capitalized, healthiest institutions, to 0.27% for undercapitalized institutions with substantial supervisory concerns.

The FDIC sets deposit insurance assessment rates on a semiannual basis and will increase deposit insurance assessments whenever the ratio of reserves to insured deposits in a fund is less than 1.25. Under the current assessment matrix Premier Bank does not pay any assessments for deposit insurance.

Premier Bank is also subject to quarterly assessments relating to interest payments on Financing Corporation (FICO) bonds issued in connection with the resolution of the thrift industry crisis. The FICO assessment rate is adjusted quarterly to reflect changes in the assessment bases of the BIF and SAIF. The

FICO assessments on BIF-insured deposits are set at an annual rate of 1.72% of assessable deposits.

ENVIRONMENTAL LAWS

Management does not anticipate that compliance with environmental laws and regulations will have any material effect on PBI's capital, expenditures, earnings, or competitive position. However, environmentally related hazards have become a source of high risk and potentially unlimited liability for financial institutions.

In 1995, the Pennsylvania General Assembly enacted the Economic Development Agency, Fiduciary and Lender Environmental Liability Protection Act which, among other things, provides protection to lenders from environmental liability and remediation costs under the environmental laws for releases and contamination caused by others. A lender who engages in activities involved in the routine practices of commercial lending, including, but not limited to, the providing of financial services, holding of security interests, workout practices, foreclosure or the recovery of funds from the sale of property shall not be liable under the environmental acts or common law equivalents to the Pennsylvania Department of Environmental Resources or to any other person by virtue of the fact that the lender engages in such commercial lending practice. A lender, however, will be liable if it, its employees or agents, directly cause an immediate release or directly exacerbate a release of regulated substance on or from the property, or known and willfully compelled the borrower to commit an action which caused such release or violate an environmental act. The Economic Development Agency, Fiduciary and Lender Environmental Liability Protection Act, however, does not limit federal liability which still exists under certain circumstances.

FEDERAL RESERVE BOARD RESERVE REQUIREMENTS

Regulation D of the Federal Reserve Board requires all depository institutions to maintain reserves on transaction accounts. These reserves may be in the form of cash or non-interest-bearing deposits with the Federal Reserve Bank of Philadelphia. Under Regulation D, Premier Bank's reserve requirement was $14,183,000 and $3,002,000 at December 31, 2002 and 2001, respectively.

REGULATION W

Transactions between a bank and its "affiliates" are quantitatively and qualitatively restricted under the Federal Reserve Act. The Federal Deposit Insurance Act applies Sections 23A and 23B to insured nonmember banks in the same manner and to the same extent as if they were members of the Federal Reserve System. The Federal Reserve Board has also recently issued Regulation W, which codifies prior regulations under Sections 23A and 23B of the Federal Reserve Act and interpretative guidance with respect to affiliate transactions. Regulation W incorporates the exemption from the affiliate transaction rules but expands the exemption to cover the purchase of any type of loan or extension of credit from an affiliate. Affiliates of a bank include, among other entities, the bank's holding company and companies that are under common control with the bank. PBI is considered to be an affiliate of Premier Bank. In general,

subject to certain specified exemptions, a bank or its subsidiaries are limited in their ability to engage in "covered transactions" with affiliates:

- to an amount equal to 10% of the bank's capital and surplus, in the case of covered transactions with any one affiliate; and

- to an amount equal to 20% of the bank's capital and surplus, in the case of covered transactions with all affiliates.

In addition, a bank and its subsidiaries may engage in covered transactions and other specified transactions only on terms and under circumstances that are substantially the same, or at least as favorable to the bank or its subsidiary, as those prevailing at the time for comparable transactions with nonaffiliated companies. A "covered transaction" includes:

- a loan or extension of credit to an affiliate;

- a purchase of, or an investment in, securities issued by an affiliate;

- a purchase of assets from an affiliate, with some exceptions;

- the acceptance of securities issued by an affiliate as collateral for a loan or extension of credit to any party; and

- the issuance of a guarantee, acceptance or letter of credit on behalf of an affiliate.

In addition, under Regulation W:

- a bank and its subsidiaries may not purchase a low-quality asset from an affiliate;

- covered transactions and other specified transactions between a bank or its subsidiaries and an affiliate must be on terms and conditions that are consistent with safe and sound banking practices; and

- with some exceptions, each loan or extension of credit by a bank to an affiliate must be secured by collateral with a market value ranging from 100% to 130%, depending on the type of collateral, of the amount of the loan or extension of credit.

Regulation W generally excludes all non-bank and non-savings association subsidiaries of banks from treatment as affiliates, except to the extent that the Federal Reserve Board decides to treat these subsidiaries as affiliates.

Concurrently with the adoption of Regulation W, the Federal Reserve Board has proposed a regulation which would further limit the amount of loans that could be purchased by a bank from an affiliate to not more than 100% of the bank's capital and surplus.

RECENT DEVELOPMENTS

As described above, the Gramm-Leach-Bliley Act, adopted November 12, 1999, enacted significant changes to the bank holding company laws, providing significantly expanded opportunities for combinations of banking, insurance and securities activities. The law also establishes significant new consumer privacy protections, which went into effect in July, 2001, including stringent restrictions on the disclosure of non-public consumer financial information to third parties. The Gramm-Leach-Bliley Act is sweeping legislation that PBI believes will affect the financial services industry for years to come. Implementing regulations with respect to many areas are still being developed, and it remains too early to determine the effect the law will have on PBI or its business, operations and financial performance.

In the wake of the tragic events, of September 11th, on October 26, 2001, the President signed the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT) Act of 2001. Under the USA PATRIOT Act, financial institutions are subject to prohibitions against specified financial transactions and account relationships as well as enhanced due diligence and "know your customer" standards in their dealings with foreign financial institutions and

foreign customers. For example, the enhanced due diligence policies, procedures, and controls generally require financial institutions to take reasonable steps:

- to conduct enhanced scrutiny of account relationships to guard against money laundering and report any suspicious transaction;

- to ascertain the identity of the nominal and beneficial owners of, and the source of funds deposited into, each account as needed to guard against money laundering and report any suspicious transactions;

- to ascertain for any foreign bank, the shares of which are not publicly traded, the identity of the owners of the foreign bank, and the nature and extent of the ownership interest of each such owner; and

- to ascertain whether any foreign bank provides correspondent accounts to other foreign banks and, if so, the identity of those foreign banks and related due diligence information.

Under the USA PATRIOT Act, financial institutions had until April 25, 2002 to establish anti-money laundering programs. The USA PATRIOT Act sets forth minimum standards for these programs, including:

- the development of internal policies, procedures, end controls;

- the designation of a compliance officer;

- an ongoing employee training program; and

- an independent audit function, to test, the programs.

The Secretary of the Treasury has prescribed regulations that consider the extent to which these new requirements are commensurate with the size, location, and activities of financial institutions subject to the Act.

In addition, the USA PATRIOT Act authorized the Secretary of the Treasury to adopt rules increasing the cooperation and information sharing between financial institutions, regulators, and law enforcement authorities regarding individuals, entities and organizations engaged in, or reasonably suspected based on credible evidence of engaging in, terrorist acts or money laundering activities. Any financial institutions complying with these rules will not be deemed to have violated the privacy provisions of the Gramm-Leach-Bliley Act, as discussed above.

Premier Bank does not have any significant international banking relationships and does not anticipate that the USA PATRIOT Act will have a material effect on its business or operations.

INTERNATIONAL MONEY LAUNDERING ABATEMENT AND FINANCIAL ANTI-TERRORISM ACT OF 2001 (IMLAFATA)

As part of the USA PATRIOT Act, Congress adopted the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001. IMLAFATA amended the Bank Secrecy Act and adopted certain additional measures that increase the obligation of financial institutions, including Premier Bank, to identify their customers, watch for and report upon suspicious transactions, respond to requests for information by federal banking regulatory authorities and law enforcement agencies, and share information with other financial institutions. The Secretary of the Treasury has adopted several regulations to implement these provisions. Premier Bank is also barred from dealing with foreign "shell" banks. In addition, IMLAFATA expands the circumstances under which funds in a bank account may be forfeited. IMLAFATA also amended the BHC Act and the Bank Merger Act to require the federal banking regulatory authorities to consider the effectiveness of a financial institution's anti-money laundering activities when reviewing an application to expand operations. Premier Bank has in place a Bank Secrecy Act compliance program.

EFFECTS OF GOVERNMENT POLICY AND POTENTIAL CHANGES IN REGULATION

Changes in regulations applicable to PBI or Premier Bank, or shifts in monetary or other government policies, could have a material affect on their business. PBI's and the bank's business is also affected by the state of the financial services industry in general. As a result of legal and industry changes, management believes that the industry will continue to experience an increased rate of change as the financial services industry strives for greater product offerings, market share and economies of scale.

AVAILABLE INFORMATION

Our common and Series A preferred stock are registered under Section 12(b) of the Securities Exchange Act of 1934 and are traded on the American Stock Exchange under the trading symbols "PPA" and "PPA.Pr.A", respectively. We are subject to the informational requirements of the Exchange Act and, accordingly, file reports, proxy statements and other information with the Securities and Exchange Commission. The reports, proxy statements and other information filed with the SEC are available for inspection and copying at the SEC's Public Reference Room at Judiciary Plaza, 450 Fifth Street, N.W., Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. We are an electronic filer with the SEC. The SEC maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. The SEC's Internet site address is: http://www.sec.gov. Our Internet site is: http://www.premierbankonline.com.

You may also inspect materials and other information concerning us at the offices of the American Stock Exchange, Inc. at 86 Trinity Place, New York, New York 10006. The American Stock Exchange's Internet site address is: http://www.amex.com.

You may obtain copies of Premier Bancorp, Inc.'s annual reports on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K as filed with the SEC upon request and at no charge by writing to John C. Soffronoff, President and Chief Executive Officer, Premier Bancorp, Inc., 379 North Main Street, Doylestown, Pennsylvania 18091 or from Premier Bank's website within two business days of filing the report electronically with the SEC.

ITEM 2 -- PROPERTIES

Our main office is located at 379 North Main Street, Doylestown, Pennsylvania. Premier Bank currently conducts business from the main office and six other full service Pennsylvania retail offices located in Southampton, Bensalem and Lower Makefield Township, Bucks County; Bethlehem and Easton, Northampton County; and Montgomeryville, Montgomery County. We also have a limited service branch in the Heritage Towers Retirement Community in Doylestown. We plan to open our eighth full-service Pennsylvania banking office in Abington, Montgomery County during the second quarter of 2003. In January

2003 we signed a 10-year lease on the Abington branch.

The following table details the ownership of our properties at December 31, 2002.

1) Doylestown, PA	Main office and branch -- owned
2) Bensalem, PA	Branch -- leased requiring rental payments of $96,000 per year
3) Bethlehem, PA	Branch -- owned
4) Easton, PA	Branch -- owned
5) Lower Makefield Twp., PA	Branch -- owned
6) Montgomeryville, PA	Branch -- land leased requiring rental payments of $85,000 per year
7) Southampton, PA	Branch and operations center -- leased requiring rental payments of $40,000 per year for the branch and $2,000 per month for operations center. Operations center lease expires in February 2004.

Lenders Abstract, LLC operates from the Lower Makefield Township branch. Premier Bank Insurance Services, LLC operates from the Montgomeryville branch.

ITEM 3 -- LEGAL PROCEEDINGS

At December 31, 2002, there were no known material legal proceedings pending against PBI, its subsidiaries, or its property. In addition, no material proceedings are known to be contemplated by governmental authorities against PBI, its subsidiaries, or its property.

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

None.

PART II

ITEM 5 -- MARKET FOR COMMON STOCK AND RELATED SHAREHOLDER MATTERS

PBI's common stock was listed and began trading on the American Stock Exchange (AMEX) on December 30, 1999 under the trading symbol "PPA." At December 31, 2002, 30,000,000 shares of common stock were authorized and 3,342,215 shares were outstanding. We had 553 shareholders of record as of March 10, 2003. No other class of common stock is authorized or outstanding.

Shares of our common stock traded on AMEX in the range of $8.75 to $14.50 per share during 2002 and $6.25 to $10.21 per share during 2001. PBI's ability to pay dividends to shareholders is dependent upon its ability to obtain dividends from the bank. The bank's ability to pay dividends is subject to certain regulatory restrictions that are described in greater detail at Note 25 to the 2002 Consolidated Financial Statements.

On February 13, 2003 we declared a cash dividend of $0.05 per share payable on April 15, 2003 to common shareholders of record on March 21, 2003. This is the first cash dividend declared on our common stock.

	2002		2001	
	HIGH	LOW	HIGH	LOW
First Quarter	$ 9.74	$ 8.75	$ 7.00	$6.25
Second Quarter	12.25	9.15	8.80	7.15
Third Quarter	13.44	11.00	9.90	8.50
Fourth Quarter	14.50	12.30	10.21	9.35

The following table summarizes our equity compensation plan information as of December 31, 2002.

PLAN CATEGORY	NUMBER OF SHARES TO BE ISSUED UPON EXERCISE OF OUTSTANDING OPTIONS, WARRANTS AND RIGHTS	WEIGHTED-AVERAGE EXERCISE PRICE OF OUTSTANDING OPTIONS, WARRANTS AND RIGHTS	NUMBER OF SHARES AVAILABLE FOR FUTURE ISSUANCE UNDER EQUITY COMPENSATION PLANS
Equity compensation plans approved by PBI shareholders	303,748	$5.98	8,326

PBI has no equity compensation plans at December 31, 2002 which were not approved by its shareholders.

ITEM 6 -- SELECTED FINANCIAL DATA

	FOR THE YEAR ENDED DECEMBER 31,				
	2002	2001	2000	1999	199
	(DOLLARS IN THOUSANDS, EXCEPT PER SHARE DATA)				
SELECTED OPERATING DATA					
Interest income	$ 32,794	$ 29,651	$ 26,693	$ 21,929	$ 16
Interest expense	15,265	16,625	15,294	11,420	8
Net interest income	17,529	13,026	11,399	10,509	7
Provision for loan losses	870	818	528	719	
Non-interest income	937	594	319	124	
Non-interest expense	10,953	9,405	8,454	6,744	4
Income before income taxes	6,643	3,397	2,736	3,170	2
Income tax expense	1,929	863	675	765	
Net income	$ 4,714	$ 2,534	$ 2,061	$ 2,405	$ 1
Less: Preferred stock dividends	$ (468)	$ --	$ --	$ --	$
Net income applicable to common shareholders	$ 4,246	$ 2,534	$ 2,061	$ 2,405	$ 1

Earnings per common share -- basic...	$ 1.26	$ 0.79	$ 0.67	$ 0.80	$
Earnings per common share -- diluted..................	1.22	0.74	0.60	0.70	
Average common shares outstanding....	3,365,467	3,212,537	3,097,450	3,016,893	2,762
Average diluted common shares outstanding........................	3,493,716	3,442,369	3,422,832	3,423,430	3,148

	AT DECEMBER 31,				
	2002	2001	2000	1999	199
SELECTED BALANCE SHEET DATA			(IN THOUSANDS)		
Loans, net..........................	$ 355,598	$ 310,876	$ 235,552	$ 196,121	$ 138
Investment securities held to maturity..........................	500	500	6,026	6,881	5
Investment securities available for sale..............................	202,641	97,851	94,573	97,076	93
Other interest-earning assets........	15,016	15,221	56	3,845	
Total assets.........................	609,972	450,569	355,201	318,660	249
Deposits............................	456,486	358,282	303,293	237,481	191
Borrowings..........................	80,067	49,605	14,404	52,537	29
Subordinated debt...................	1,500	3,500	1,500	1,500	1
Capital securities..................	25,000	10,000	10,000	10,000	10
Shareholders' equity................	38,436	19,609	16,455	12,647	11

	AT OR FOR THE YEAR ENDED DECEMBER 31,				
SELECTED RATIOS AND OTHER DATA	2002	2001	2000	1999	199
Net interest margin(1)...............	3.58%	3.50%	3.57%	3.90%	
Return on average assets(2)..........	0.81%	0.63%	0.61%	0.83%	
Return on average common equity(3)...	18.74%	13.66%	15.26%	17.59%	1
Average shareholders' equity to average assets.....................	5.58%	4.65%	3.98%	4.70%	
Book value per common share(4).......	$ 7.81	$ 6.05	$ 5.30	$ 4.11	$
Number of full service banking offices...........................	7	7	7	5	

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(1) Calculated as net interest income on a tax equivalent basis divided by average interest-earning assets

(2) Calculated as net income applicable to common shareholders divided by average assets

(3) Calculated as net income applicable to common shareholders divided by average total equity less preferred stock

(4) Calculated as shareholders' equity less preferred stock divided by the number of common shares outstanding

ITEM 7 -- MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

GENERAL

Our revenues are derived principally from interest income on our loan and securities portfolios. Our primary sources of funds are deposits, repayments of loans and investment securities, and borrowed funds. Currently, we have seven full service Pennsylvania banking offices: Doylestown, Easton, Southampton, Bethlehem, Yardley-Floral Vale, Bensalem and Montgomeryville. We also operate a limited service branch in the Heritage Towers Retirement Community in Doylestown. We face significant competition from other financial services companies, many of which are larger organizations with more resources and locations.

Our consolidated results of operations are dependent primarily on net interest income, which is the difference between the interest income earned on interest-earning assets, such as loans and investment securities, and the interest expense paid on interest-bearing liabilities, such as deposits and borrowed money. We generate non-interest income such as service charges, gains from sales of residential mortgages, fees from sales of title insurance and other fees. Our non-interest expense primarily consists of employee compensation and benefits, occupancy expenses, marketing, data processing costs and other operating expenses. We are subject to losses from our loan and investment portfolios if borrowers/issuers fail to meet their obligations or if the market value of our securities declines. Our results of operations are also significantly affected by general economic and competitive conditions, particularly changes in market interest rates, government policies and actions of regulatory agencies.

On January 16, 2003, PBI announced that it had entered into a definitive agreement to be acquired by Fulton Financial Corporation based in Lancaster, Pennsylvania. Under the terms of the agreement, Fulton Financial will acquire all of PBI's issued and outstanding shares of common stock. Each share of PBI common stock outstanding will be exchanged for 1.34 shares of Fulton Financial common stock, subject to adjustment. All outstanding shares of PBI preferred stock are expected to be redeemed as of or before the closing date of the transaction. This acquisition, which is subject to the approval of bank regulators and PBI shareholders, is expected to close by the third quarter of 2003.

The following discussion focuses on the major components of our operations and presents an overview of the significant changes in the results of operations and financial condition for the last three fiscal years. This discussion section should be read in conjunction with the Consolidated Financial Statements and accompanying Notes. Current performance may not be indicative of future performance.

Management has made forward-looking statements in this Annual Report on Form 10-K. These forward-looking statements may be subject to risks and uncertainties. Forward-looking statements include the information concerning possible or assumed future results of operations of Premier Bancorp, Inc. and its subsidiaries, Premier Bank, PBI Capital Trust, Premier Capital Trust II, Lenders Abstract, LLC and

Premier Bank Insurance Services, LLC. When words such as "believes", "expects", "anticipates" or similar expressions occur in this Annual Report, management is making forward-looking statements.

Shareholders should note that many factors, some of which are discussed elsewhere in this Annual Report, could affect the future financial results of Premier Bancorp, Inc. and its subsidiaries, both individually and collectively, and could cause those results to differ materially from those expressed in the forward-looking statements contained in this Annual Report. These factors include, but are not limited to the following:

- operating, legal and regulatory risks, such as continued levels of loan quality and origination volumes, continued relationships with major customers, and technological changes;

- economic, political and competitive forces affecting our banking business, such as changes in economic conditions, especially in the bank's market area, interest rate fluctuations, competitive product and pricing pressures within the bank's market, personal and corporate bankruptcies, monetary policy and inflation; and

- the risk that management's analyses of these risks and forces could be incorrect and or that the strategies developed to address them could be unsuccessful.

Management cautions readers not to place undue reliance on these forward-looking statements that reflects its analysis only as of this date. Management is not obliged to publicly revise or update these forward-looking statements to reflect events or circumstances that arise after this date. Readers should carefully review the risk factors described in other documents we file from time to time with the Securities and Exchange Commission, including quarterly reports on Form 10-Q and any current reports on Form 8-K.

CRITICAL ACCOUNTING POLICIES

The following discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities at the date of the financial statements. Actual results may differ from these estimates under different assumptions and conditions.

In management's opinion, the most critical accounting policies impacting our consolidated financial statements are:

EVALUATION OF THE ALLOWANCE FOR LOAN LOSSES

The loan loss allowance policy involves significant judgments and assumptions by management that may have a material impact on the carrying value of net loans and, potentially, on the net income recognized from period to period. For a description of our accounting policies and estimation methodology related to the allowance for loan losses, see discussion entitled "Allowance for loan losses," below.

ACCRUAL AND RECOGNITION OF INTEREST ON LOANS

These policies involve significant judgments and assumptions by management, which may have a material impact on the interest income recognized from period to period. For a description of our accounting policies in connection with accrual and recognition of interest on loans, see Note 1 to our Consolidated

Financial Statements included herein.

REALIZATION OF DEFERRED INCOME TAX ITEMS

Estimates of deferred tax assets and deferred tax liabilities make up the asset category titled, "Deferred income taxes." These estimates involve significant judgments and assumptions by management,

which may have a material impact on the carrying value of deferred tax assets for financial reporting purposes. For a more detailed description of these items and estimates, see Note 13 to the Consolidated Financial Statements included herein.

UNREALIZED GAINS AND LOSSES ON DEBT SECURITIES AVAILABLE FOR SALE

We receive estimated fair values of debt securities from an independent valuation service and brokers. In developing these fair values, the valuation service and brokers use estimates of cash flows based on historical performance of similar instruments in similar rate environments. Based on experience, management is aware that estimated fair values of debt securities vary among brokers and other valuation services. Debt securities available for sale are mostly comprised of mortgage-backed securities and corporate bonds. For more detail on the estimated fair value of debt securities, see the discussion entitled "Investment securities."

The Notes to our Consolidated Financial Statements set forth herein identify other significant accounting policies used in the development and presentation of our financial statements. This discussion and analysis, the significant accounting policies and other financial statement disclosures identify and address key variables and other qualitative and quantitative factors that are necessary for an understanding and evaluation of our results of operations.

RESULTS OF OPERATIONS

We reported net income applicable to common shareholders of $4,246,000 or $1.22 earnings per common share on a diluted basis for the year ended December 31, 2002. This represents an increase of $1,712,000 or 68% from the net income of $2,534,000 or $.74 earnings per common share on a diluted basis reported in 2001. Net interest income was $4,503,000 or 35% higher in 2002 compared to 2001 due primarily to a $115,581,000 increase in average interest-earning assets and a 150 basis point decrease in the rate on average interest-bearing liabilities. Loans accounted for $76,289,000 of the growth in average interest-earning assets. The rate on average interest-bearing deposits decreased 163 basis points from 5.00% in 2001 to 3.37% in 2002 primarily due to the repricing of certificates of deposit in the lower rate environment and the shift in deposit mix toward interest-bearing checking accounts. Other income was $343,000 or 58% higher in 2002 due primarily to a $66,000 increase in service charges and other deposit related fees, a $90,000 increase in gains on sales of investment securities available for sale, and a $79,000 increase in gains on sales of residential mortgages held for sale. In addition, we recorded a $33,000 gain on the sale of other real estate owned in 2002 compared to a loss of $17,000 in 2001. Overhead expenses were $1,548,000 or 16% higher in 2002 compared to 2001. This increase is consistent with the overall growth of the company. Salaries and employee benefits increased $945,000 in 2002 as the number of full-time equivalent employees increased from 81 at December 31, 2001 to 94 at December 31, 2002.

We reported net income of $2,534,000 or $.74 earnings per common share on a diluted basis for the year ended December 31, 2001. This represents an increase of $473,000 or 23% from net income of $2,061,000 or $.60 earnings per common share on a diluted basis reported in 2000. Interest income grew $2,958,000 or 11% in 2001 compared to 2000 primarily due to loan growth. Loans grew $76,621,000 or 32% in 2001. However, growth in net interest income was slowed by eleven decreases in the prime lending rate and the Federal Reserve's targeted federal funds rate totaling 4.75% during 2001. These rate cuts lowered the rates on new loans and existing adjustable/variable rate loans. Other income was $275,000 or 86% higher in 2001 due primarily to $137,000 in fees generated from our title insurance business and a $50,000 non-recurring fee related to one loan pay-off. Overhead expenses were $1,134,000 or 14% higher in 2001 compared to 2000, exclusive of $183,000 in one-time charges in 2000 related to two discontinued Internet projects and a relocated branch site. Overhead expenses were higher in 2001 due primarily to the recognition of a full year of operating expenses associated with the opening of two new branches in October 2000 and the overall growth of the company.

Our net income for 2000 was $344,000 or 14% lower than the net income of $2,405,000 or $.72 earnings per common share on a diluted basis reported in 1999. Earnings were lower in 2000 due primarily

to an increase in overhead expenses related to branch expansion. In addition, our net interest margin compressed in 2000 due to the combination of generally higher interest rates and increased competition for loans and deposits.

Return on average assets and return on average common shareholders' equity were .81% and 18.74%, respectively, in 2002 compared to .63% and 13.66%, respectively, in 2001 and .61% and 15.26%, respectively, in 2000. Return on average common shareholders' equity, exclusive of the unrealized gain (loss) on investment securities available for sale, was 17.35%, 11.94% and 11.12% for 2002, 2001 and 2000, respectively.

The following tables and discussions related to net interest income, interest income and interest expense were prepared on a tax-equivalent basis.

NET INTEREST INCOME

Net interest income is the most significant component of our operating income. Net interest income depends upon the levels of interest-earning assets and interest-bearing liabilities and the difference or "spread" between the respective yields earned and rates paid. The interest rate spread is influenced by the overall interest rate environment, the composition and characteristics of interest-earning assets and interest-bearing liabilities, and by competition. The interest rate spread is also influenced by differences in the maturity and repricing of assets versus the liabilities that fund them.

Responding to generally weak economic conditions, the Federal Reserve cut the targeted federal funds rate by .50% in 2002 and 4.75% in 2001. As a result, the current interest rate environment is at a historically low level. The bank's interest-earning assets and interest-bearing liabilities continue to originate and reprice in this lower rate environment. The yields on our average interest-earning assets were 6.61%, 7.79% and 8.15% for the year ended December 31, 2002, 2001, and 2000, respectively. The rates on our average interest-bearing liabilities were 3.45%, 4.95%, and 5.33% for the year ended December 31, 2002, 2001, and 2000, respectively.

Net interest income on a tax-equivalent basis increased $4,424,000 or 33% for 2002 compared to 2001. This increase was primarily a function of asset growth and a lower rate on average interest-bearing liabilities. These positive factors were partially offset by a lower yield on average interest-earning assets and a lower ratio of average interest-earning assets to average interest-bearing liabilities. Average interest-earning assets grew $115,581,000 or 30% in 2002 while the yield on average interest-earning assets declined 118 basis points. Average loans grew $76,289,000 in 2002 with a decrease in the average yield on such loans of 94 basis points. Average investments grew $19,523,000 in 2002 with a decrease in the average yield on such investments of 117 basis points. The average rate on interest-bearing liabilities improved due mostly to the repricing of certificates of deposits in the lower rate environment, the change in deposit mix and new long-term borrowings at lower rates. The offering rates on our deposit products have been lowered in response to the interest rate environment. Despite this lower interest rate environment we had considerable success in raising non-maturity deposits that are generally less costly than time deposits. The average balance of non-maturity deposits grew $98,791,000 during 2002 and was concentrated in interest checking accounts. The net interest margin increased 8 basis points from 3.50% in 2001 to 3.58% in 2002. The ratio of average interest-earning assets to average interest-bearing liabilities decreased from 115.44% in 2001 to 113.74% in 2002. The net interest rate spread improved 32 basis points from 2.84% in 2001 to 3.16% in 2002.

Net interest income on a tax-equivalent basis increased $1,684,000 or 14% for 2001 compared to 2000. This increase was primarily a function of asset growth and a lower rate on average interest-bearing liabilities. These positive factors were partially offset by a lower yield on average interest-earning assets and a lower ratio of average interest-earning assets to average interest-bearing liabilities. Average interest-earning assets grew $54,394,000 or 16% in 2001 while the yield on average interest-earning assets declined 36 basis points. Average loans grew $53,776,000 in 2001 with a decrease in the average yield on such loans of 45 basis points. The average rate on interest-bearing liabilities decreased 38 basis points. The average rate on interest-bearing liabilities improved in part due to the maturity of higher rate certificates of deposit,

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which were retained or replaced at a lower rate. The offering rates on most deposit products were lowered in response to the reductions in the federal funds and prime lending rate. Short-term borrowings and subordinated debt also repriced lower in 2001. The ratio of average interest-earning assets to average interest-bearing liabilities decreased from 116.12% in 2000 to 115.44% in 2001. The net interest margin decreased 7 basis points from 3.57% in 2000 to 3.50% in 2001. The net interest rate spread improved 2 basis points from 2.82% in 2000 to 2.84% in 2001.

During 2002, we accelerated the deferred fee recognition on certain renegotiated loans in accordance with FASB Statement No. 91. Net interest income for 2002 included $172,000 of such fees. Excluding these fees the yield on average loans, the yield on average interest-earning assets, and the net interest margin would have been 7.34%, 6.57% and 3.54%, respectively.

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The following table presents certain key average balance sheet amounts and the corresponding earnings/expenses and rates.

AVERAGE BALANCES, RATES AND INTEREST INCOME AND EXPENSE SUMMARY

	FOR THE YEAR ENDED DECEMBER 31	
	2002	2001

	AVERAGE BALANCE	INTEREST	AVERAGE RATE	AVERAGE BALANCE	INTEREST	AVERAGE RATE
				(DOLLARS IN THOUSANDS)		
ASSETS:						
Short-term investments...........	$ 16,873	$ 291	1.72%	$ 10,535	$ 368	3.49%
Interest-bearing deposits........	14,572	217	1.49%	1,141	35	3.07%
Investment securities available for sale(1)						
Taxable........................	109,543	5,959	5.44%	82,713	5,550	6.71%
Tax-exempt(2)..................	15,411	1,167	7.57%	19,295	1,474	7.64%
Investment securities held to maturity......................	500	29	5.80%	3,923	257	6.55%
Total investment securities................	125,454	7,155	5.70%	105,931	7,281	6.87%
Loans, net of unearned income(3)(4)..................	346,489	25,605	7.39%	270,200	22,520	8.33%
Total interest-earning assets....................	503,388	33,268	6.61%	387,807	30,204	7.79%
Cash and due from banks..........	17,310			7,516		
Allowance for loan losses........	(4,179)			(3,342)		
Other assets(5)..................	10,514			9,794		
Total assets.....................	$527,033			$401,775		
LIABILITIES, MINORITY INTEREST IN SUBSIDIARIES AND SHAREHOLDERS' EQUITY:						
Interest checking................	$121,001	3,179	2.63%	$ 31,180	809	2.59%
Money market deposit accounts....	16,984	383	2.26%	18,313	624	3.41%
Savings accounts.................	50,117	1,104	2.20%	43,936	1,294	2.95%
Time deposits....................	191,503	8,132	4.25%	202,819	12,093	5.96%
Total interest-bearing deposits..................	379,605	12,798	3.37%	296,248	14,820	5.00%
Short-term borrowings............	19,553	134	0.69%	18,894	549	2.91%
Long-term borrowings.............	40,356	2,161	5.35%	19,288	1,144	5.93%
Total borrowings...........	59,909	2,295	3.83%	38,182	1,693	4.43%
Subordinated debt................	3,051	172	5.64%	1,505	112	7.44%
Total interest-bearing liabilities..............	442,565	15,265	3.45%	335,935	16,625	4.95%
Non-interest-bearing deposits....	30,679			26,561		
Other liabilities................	8,690			8,057		
Capital securities...............	13,986			10,000		
Shareholders' equity(6)..........	31,113			21,222		
Total liabilities, minority interest in subsidiaries and shareholders' equity............	$527,033			$401,775		
Net interest income/rate spread...		$18,003	3.16%		$13,579	2.84%
Net interest margin(7)............			3.58%			3.50%
Average interest-earning assets as a percentage of average						

interest-bearing liabilities.....	113.74%	115.44%

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(1) Excludes the SFAS 115 valuation allowance on investment securities available for sale.

(2) Interest income on tax-exempt investment securities was presented on a tax-equivalent basis. Tax exempt yields were adjusted to a tax equivalent basis using a 34% rate.

(3) Includes non-accrual loans of $5,332,000, $458,000, and $106,000 on average in 2002, 2001 and 2000, respectively.

(4) Includes tax-exempt loans of $2,882,000, $1,733,000, and $1,077,000 on average in 2002, 2001 and 2000, respectively. Tax exempt yields were adjusted to a tax equivalent basis using a 34% rate.

(5) Excludes the deferred tax asset related to the SFAS 115 valuation allowance on investment securities available for sale.

(6) Excludes the SFAS 115 valuation allowance on investment securities available for sale, net of tax.

(7) Net interest margin is calculated as net interest income divided by average interest-earning assets.

The following table sets forth certain information regarding changes in net interest income attributable to changes in the volumes of interest-earning assets and interest-bearing liabilities and changes in rates for the periods indicated. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to:

- changes in volume (change in volume multiplied by prior year rate);

- changes in rates (change in rate multiplied by prior year volume); and

- total change.

Changes due to the combination of rate and volume changes (changes in volume multiplied by changes in rate) were allocated proportionately between changes in rate and changes in volume.

Interest income foregone on non-accrual loans is presented as a change in rate.

RATE VOLUME ANALYSIS OF CHANGES IN NET INTEREST INCOME

	FOR THE YEAR ENDED DECEMBER 31,					
	2002 VS. 2001			2001 VS. 2000		
	VOLUME	RATE	TOTAL	VOLUME	RATE	TOTAL
	(IN THOUSANDS)					

INTEREST INCOME:						
Short-term investments.............	$ 161	$ (238)	$ (77)	$ 162	$ (254)	$ (92)
Interest-bearing deposits...........	209	(27)	182	23	(27)	(4)
Investment securities available for sale............................	1,426	(1,324)	102	(28)	(212)	(240)
Investment securities held to maturity.........................	(202)	(26)	(228)	(184)	9	(175)
Loans..............................	5,896	(2,811)	3,085	4,534	(1,008)	3,526
Total interest income................	7,490	(4,426)	3,064	4,507	(1,492)	3,015
INTEREST EXPENSE:						
Interest checking..................	2,360	10	2,370	236	13	249
Money market accounts..............	(43)	(198)	(241)	432	(137)	295
Savings accounts...................	166	(356)	(190)	(127)	(245)	(372)
Time deposits......................	(643)	(3,318)	(3,961)	1,894	(100)	1,794
Short-term borrowings..............	19	(434)	(415)	(869)	(893)	(1,762)
Long-term borrowings...............	1,138	(121)	1,017	1,144	--	1,144
Subordinated debt..................	92	(32)	60	--	(17)	(17)
Total interest expense...............	3,089	(4,449)	(1,360)	2,710	(1,379)	1,331
Net interest income..................	$4,401	$ 23	$ 4,424	$1,797	$ (113)	$ 1,684

INTEREST INCOME

Total interest income on a tax equivalent basis increased $3,064,000 or 10% for 2002 to $33,268,000 compared to $30,204,000 for 2001. Higher average loan and AFS investment balances added $5,896,000 and $1,426,000, respectively, to interest income. Lower yields on loans and AFS investments reduced interest income by $2,811,000 and $1,324,000, respectively. The yield on average interest-earning assets decreased 118 basis points as the decline in overall interest rates continued through 2002. The lower yield on average interest-earning assets reduced interest income by $4,426,000 in 2002.

Total interest income on a tax-equivalent basis increased $3,015,000 or 11% for 2001 to $30,204,000 compared to $27,189,000 for 2000. Higher average loan balances added $4,534,000 to interest income while lower average investment balances reduced interest income by $212,000 in 2001. The yield on

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average interest-earning assets decreased 36 basis points to 7.79% as overall interest rates moved lower in 2001. The lower yield on average interest-earning assets reduced interest income by $1,492,000 in 2001.

INTEREST EXPENSE

Total interest expense decreased $1,360,000 or 8% for 2002 to $15,265,000 compared to $16,625,000 for 2001. Lower rates on deposits and borrowings reduced interest expense by $3,862,000, and $555,000, respectively. The rate on average interest-bearing liabilities decreased 150 basis points during 2002 as we lowered the offering rates on our deposit products and short-term borrowings, shifted our deposit mix toward less costly interest checking accounts, and added long-term borrowings in the lower rate environment. Higher average interest checking account balances and long-term borrowings added $2,360,000 and $1,138,000 to interest expense in 2002. Average time deposits decreased in 2002 reducing interest expense by $643,000.

Total interest expense increased $1,331,000 or 9% for 2001 to $16,625,000 compared to $15,294,000 for 2000. Higher average deposit balances and higher average borrowings added $2,435,000 and $275,000, respectively, to total interest expense. The rate on average interest-bearing liabilities decreased 38 basis points to 4.95% as overall interest rates moved lower in 2001. The lower rate on average interest-bearing liabilities reduced interest expense by $1,379,000 in 2001.

INTEREST RATE SENSITIVITY

We are subject to the interest rate risk inherent in our lending, investing and financing activities. Fluctuations in interest rates will impact both the interest income and expense and market value of all interest-earning assets and interest-bearing liabilities, other than those with a short term to maturity.

The primary objective in managing interest rate risk is to minimize the adverse impact of changes in interest rates on our net interest income while creating an asset/liability structure that maximizes earnings. The Asset Liability Management Committee actively monitors and manages our interest rate exposure using gap analysis and simulation models. Simulation models require significant assumptions about future business trends and interest rates.

Gap analysis measures the difference between volumes of rate-sensitive assets and liabilities and quantifies these repricing differences for various time intervals. Static gap analysis depicts interest sensitivity at a point in time. However, it alone does not accurately measure the magnitude of changes in net interest income because changes in interest rates do not always impact assets and liabilities at the same time or in the same magnitude. Furthermore, gap analysis does not consider future growth, changes in asset and liability composition or market conditions.

A positive gap results when the amount of interest rate-sensitive assets exceeds interest rate-sensitive liabilities repricing within the relevant time period and, generally means that the institution will benefit during periods of rising interest rates. A negative gap results when the amount of interest rate-sensitive liabilities exceeds interest rate-sensitive assets repricing within the relevant time period and, generally means that the institution will benefit during periods of falling interest rates.

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As depicted in the table below, we have a cumulative positive gap within the one-year and after three-year time intervals. We have a cumulative negative gap in the over one year to three year time interval.

Our gap analysis at December 31, 2002 is as follows.

INTEREST RATE SENSITIVITY

	WITHIN 3 MONTHS	4 TO 6 MONTHS	7 MONTHS TO 1 YEAR	1 TO 3 YEARS	3 TO 5 YEARS	AFTER 5 YEARS
	(DOLLARS IN THOUSANDS)					
DECEMBER 31, 2002						
Assets:						
Short-term investments.....	$ 10,530	$ --	$ --	$ --	$ --	$ --
Interest-bearing						

deposits.................	4,486	--	--	--	--	--
Investment securities......	50,187	5,613	8,830	53,027	32,758	52,726
Loans, net of deferred fees.....................	58,183	14,882	24,949	101,698	153,223	6,892
Total interest rate-sensitive assets.....................	$123,386	$ 20,495	$ 33,779	$154,725	$185,981	$ 59,618
Total cumulative assets......	$123,386	$143,881	$177,660	$332,385	$518,366	$577,984
Liabilities:						
Interest checking, money market and savings accounts.................	$ 7,034	$ 7,035	$ 14,069	$135,999	$ 46,897	$ 23,450
Time deposits..............	27,795	31,535	27,963	64,360	37,462	--
Short-term borrowings......	20,067	--	--	--	--	--
Long-term borrowings.......	--	--	--	--	--	60,000
Subordinated debt..........	1,500	--	--	--	--	--
Total interest rate-sensitive liabilities................	$ 56,396	$ 38,570	$ 42,032	$200,359	$ 84,359	$ 83,450
Total cumulative liabilities................	$ 56,396	$ 94,966	$136,998	$337,357	$421,716	$505,166
Gap during period...........	$ 66,990	$(18,075)	$ (8,253)	$(45,634)	$101,622	$(23,832)
Cumulative gap..............	$ 66,990	$ 48,915	$ 40,662	$ (4,972)	$ 96,650	$ 72,818
Cumulative gap as a percentage of:						
Interest-earning assets......	11.59%	8.46%	7.04%	(0.86)%	16.72%	12.60%
Total assets.................	10.98%	8.02%	6.67%	(0.82)%	15.84%	11.94%

We use two different simulation models to measure and monitor interest rate risk. One model is a licensed software program that is run internally and incorporates management's assumptions including future growth. The other is a program developed by an outside consulting firm utilizing data we supply (the "consulting model"), and considers only the existing composition and characteristics of the balance sheet without giving effect to anticipated future growth and interest rate changes. Although management expects to continue to grow interest-sensitive assets and liabilities, its assumptions about future growth and interest rates are excluded from the consulting model. Management believes that this approach provides a more conservative measure of our interest rate risk because assumed growth at current market interest rates lessens the effects of rate changes in simulation models in the short-term.

Simulation models require assumptions about certain categories of assets and liabilities. The models schedule existing assets and liabilities by their contractual maturity, estimated likely call date, or earliest repricing opportunity. Mortgage-backed securities and amortizing loans are scheduled based on their anticipated cash flow including estimated prepayments. For investment securities, we use a third party service to provide cash flow estimates in the various rate environments. Savings accounts, including

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passbook, statement savings, money market, and interest checking accounts, do not have a stated maturity or repricing term and can be withdrawn or repriced at any time. This may impact the margin if more expensive alternative sources of deposits are required to fund loans or deposit runoff. Management projects the repricing characteristics of these accounts based on historical performance and assumptions that it believes reflect their rate sensitivity. The consulting model reinvests all maturities, repayments and prepayments for each type of asset or liability into the same product for a new like term. As a result, the mix of interest-earning assets and interest-bearing liabilities is held constant.

The table below summarizes estimated changes in net interest income over a twelve-month period beginning January 1, 2003, under alternate interest rate scenarios using the consulting model described above.

CHANGE IN INTEREST RATES	NET INTEREST INCOME	DOLLAR CHANGE	PERCENT CHANGE
	(DOLLARS IN THOUSANDS)		
+200 Basis Points	$19,266	$ 45	0.23%
+100 Basis Points	19,370	149	0.78%
Flat Rate	19,221	--	--
-100 Basis Points	18,753	(468)	(2.43)%
-200 Basis Points	18,479	(742)	(3.86)%

Actual results may differ from simulated results due to various factors including the time and magnitude of interest rate changes, changes in customer behavior, effects of competition, and other factors. These variables influence the interest-rate spread and product mix. The consulting model predicts a base net interest income amount that is larger than that earned in the past 12 months or last fiscal year. This is principally the result of an increase in earning assets over the past year, which created a larger starting point for the 12-month projection. Past experience drives many of the assumptions used in the models. Actual results could vary substantially if our future performance differs from past experience.

NON-INTEREST INCOME COMPARISON

	FOR THE YEAR ENDED DECEMBER 31,		
	2002	2001	2000
	(IN THOUSANDS)		
Service charges and other deposit related fees	$396	$330	$286
Gain, net, on sale of investment securities available for sale	103	13	3
Gain (loss) on sale of other real estate owned	33	(17)	--
Gain on sale of loans held for sale	131	52	29
Fees from sales of title insurance policies	150	137	1
Other fees	124	79	--
Total non-interest income	$937	$594	$319

Non-interest income consists primarily of service charges on deposits, fees from sales of title insurance policies and gains (losses) on the sale of investment securities available for sale and loans held for sale.

Non-interest income increased $343,000 for 2002 to $937,000 compared to $594,000 for 2001. Gains on sales of investment securities available for sale and loans held for sale were higher by $90,000 and $79,000, respectively. Gains on sales of loans held for sale were higher in 2002 due to an increase in residential mortgage originations and sales as a result of lower interest rates and the hiring of a seasoned mortgage lender in the third quarter of 2002. Service charges and other deposit related fees were $66,000 higher in 2002 due primarily to an increase in the number of deposit accounts and transactions. During 2002 we recorded a gain of $33,000 on the sale of other real estate owned compared to a $17,000 loss in 2001. Other income for 2002 included a $46,000 gain on the sale of a small business administration loan.

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Non-interest income increased $275,000 for 2001 to $594,000 compared to $319,000 for 2000. This increase is primarily due to $137,000 in fees from sales of title insurance policies and $50,000 in fees related to one loan pay-off. In addition, fees from ATM/debit card transactions increased $50,000 due to an increase in the number of cardholders and ATM locations. Gains on sales of loans held for sale were $23,000 higher in 2001 due to an increase in residential mortgage loan originations and sales as a result of lower interest rates.

NON-INTEREST EXPENSE COMPARISON

	FOR THE YEAR ENDED DECEMBER 31,		
	2002	2001	2000
	(IN THOUSANDS)		
Salaries and employee benefits	$ 5,282	$4,337	$3,873
Occupancy costs	819	767	641
Data processing	1,156	973	841
Professional services	311	323	377
Marketing	286	424	484
Minority interest in expense of subsidiaries	1,082	873	873
Other	2,017	1,708	1,365
Total non-interest expense	$10,953	$9,405	$8,454

Non-interest expense increased $1,548,000 or 16% for 2002 to $10,953,000 compared to $9,405,000 for 2001. Overhead expense increased principally due to increased staffing and other costs related to the continued growth of the company. Salaries and employee benefits were $945,000 or 22% higher due primarily to an increase in the number of employees and salary adjustments. The number of full-time equivalent employees grew from 81 at December 31, 2001 to 94 at December 31, 2002. Marketing expense was $138,000 lower because deposit growth exceeded expectations in 2002. The $209,000 increase in the minority interest in expense of subsidiaries related to the issuance of $15,000,000 in trust preferred securities in September 2002. Other expense consisted primarily of furniture and equipment expense, shareholder-related expenses, loan expenses, Pennsylvania shares tax expense, employee travel and entertainment, stationary/supplies, postage, and board of directors' fees. The $309,000 or 18% increase in other expense is principally attributed to the growth of the company and increases in loan collection costs, shareholder-related expenses and

Pennsylvania shares tax expense. Other expense included $224,000 in fair market value adjustments on derivatives related to our IPCD product. This adjustment, which was $66,000 higher than the amount recorded in 2001, was due to the continued decline in interest rates in 2002. These adjustments will reverse in future periods as IPCD's approach maturity or if interest rates increase.

Non-interest expense increased $951,000 or 11% for 2001 to $9,405,000 compared to $8,454,000 for 2000. Overhead expense in 2000 included one-time charges of $115,000 related to two discontinued Internet initiatives and $68,000 for a relocated branch site. Excluding these one-time charges, overhead increased $1,134,000 or 14% for 2001 principally due to the continued growth of the company, which included the opening of two new branches in October 2000. Salaries and employee benefits grew $464,000 or 12% for 2001 compared to 2000 due to an increase in the number of employees and salary adjustments. The number of full-time equivalent employees increased from 76 at December 31, 2000 to 81 at December 31, 2001. Occupancy costs grew $126,000 for 2001 primarily due to the additional rent, maintenance and utility costs for new branches. Data processing costs increased $132,000 principally due to the growth of the company and variable costs associated with item processing and account volumes. Professional services and marketing were lower in 2001 due in part to the one-time charges in 2000. Other expense in 2000 included $68,000 for the write-off of land improvements related to a relocated branch. Exclusive of this one-time charge, other expense increased $411,000 or 32% in 2001 due principally to the growth of the company and increases in loan collection costs, other real estate owned expenses, and

Pennsylvania shares tax. Other expense in 2001 included $158,000 in fair market value adjustments on derivatives related to our IPCD product. This adjustment was due to falling interest rates in 2001 and will reverse in future periods as IPCD's approach maturity or if interest rates increase in the future.

PROVISION FOR LOAN LOSSES

The provision for loan losses represents the amount necessary to be charged to operations to bring the allowance for loan losses to a level that represents management's best estimate for known and inherent losses in our loan portfolio. The amount of the allowance for loan losses is subject to ongoing analysis of the loan portfolio which considers current economic conditions, actual loss experience, the current risk profile of the portfolio, and composition of loan types within the portfolio. Net charge-offs were $458,000, $33,000 and $7,000 in 2002, 2001 and 2000, respectively. Our loan portfolio is relatively immature given our recent growth rates. Therefore, charge-off and non-performing trends may not be indicative of future performance.

The provision for loan losses increased from $818,000 in 2001 to $870,000 in 2002. This increase was primarily due to an increase in non-performing loans and higher net charge-offs. Non-performing loans totaled $4,849,000 at December 31, 2002 compared to $2,687,000 at December 31, 2001. The allowance for loan losses was $4,229,000 or 1.17% of total loans at December 31, 2002 compared to $3,817,000 or 1.21% at December 31, 2001.

The provision for loan losses increased from $528,000 for 2000 to $818,000 for 2001. This increase was primarily due to greater loan growth in 2001 compared to 2000. Total gross loans grew $76,621,000 or 32% in 2001 compared to $40,221,000 or 20% in 2000. The allowance for loan losses was $3,817,000 or 1.21% of total loans at December 31, 2001 compared to $3,032,000 or 1.27% at December 31, 2000.

INCOME TAXES

We recorded a $1,929,000 tax provision representing an effective tax rate of 29.0% for the year ended December 31, 2002 compared to an $863,000 tax provision and a 25.4% effective tax rate for 2001. The effective tax rate was higher in 2002 principally due to a lower ratio of tax-exempt interest to total pre-tax income.

We recorded an $863,000 tax provision representing an effective tax rate of 25.4% for the year ended December 31, 2001 compared to a $675,000 tax provision and a 24.7% effective tax rate for 2000. The effective tax rate was higher in 2001 principally due to a lower ratio of tax-exempt interest to total pre-tax income.

PREFERRED STOCK DIVIDENDS

We issued 552,000 shares of Series A 9.25% Non-Cumulative Perpetual Preferred Stock in June 2002. Dividends are payable quarterly, but only if declared by our board of directors. On July 31, 2002 and October 31, 2002 we paid dividends on our preferred stock in the amount of $149,000 and $319,000, respectively.

All outstanding shares of our preferred stock are expected to be redeemed in connection with our pending acquisition by Fulton Financial Corporation. This acquisition is expected to close by the third quarter of 2003.

FINANCIAL CONDITION

Consolidated assets grew $159,403,000 or 35% during 2002 to $609,972,000. Cash and cash equivalents and investments, exclusive of the SFAS 115 valuation allowance, grew $8,439,000 and $100,206,000, respectively, during 2002. Total gross loans grew $45,429,000 in 2002. During 2002 we raised $27,345,000 in new capital through the issuance of preferred stock and capital securities. This new capital, together with a $98,204,000 increase in deposits, mostly interest checking accounts, and a $30,000,000 increase in long-term FHLB advances, funded our asset growth. Shareholders' equity

increased $18,827,000 from $19,609,000 at December 31, 2001 to $38,436,000 at December 31, 2002. This increase was attributable to $4,246,000 in earnings after preferred stock dividends, a $3,025,000 improvement in the estimated fair value of investment securities available for sale, net of tax, $529,000 from the exercise of common stock options and $12,345,000 in net proceeds from the issuance of preferred stock. Shareholders' equity was reduced by $1,318,000 due to the repurchase of common stock.

Consolidated assets grew $95,368,000 or 27% during the year ended December 31, 2001 to $450,569,000. Total loans grew $76,621,000 or 32% while total investments, exclusive of the SFAS 115 valuation allowance, decreased $2,675,000 or 3% during 2001. We funded our asset growth in 2001 with a $54,989,000 or 18% increase in deposits and a $35,201,000 or 244% increase in borrowings. Shareholders' equity grew $3,154,000 or 19% to $19,609,000 at December 31, 2001. This increase was attributable to $2,534,000 in earnings, $338,000 in common stock option exercises and a $282,000 increase in the estimated fair value of investment securities available for sale, net of tax.

INVESTMENT SECURITIES

Investment policies and applicable legal restrictions dictate permissible investment categories, credit quality, maturity intervals and investment concentrations. Management is responsible for making specific investment purchases within these standards. The carrying value of investment securities at

December 31, 2002 totaled $203,141,000 or 33% of total assets. At December 31, 2002 approximately 55% of the investment portfolio was comprised of mortgage-backed securities which amortize and provide monthly cash flow to reinvest. Corporate bonds and municipal bonds comprised 35% and 6% of the investment portfolio, respectively. At December 31, 2002, approximately 66% of the investment portfolio was fixed rate compared to 82% at December 31, 2001.

Management buys and sells investment securities from time to time depending on market conditions, business trends, liquidity and capital levels. Investment purchases provide a way to add assets quickly and generate additional earnings. The bank generally earns a positive interest spread by assuming interest rate risk and using deposits and borrowings to purchase securities with longer maturities.

Management classifies investment securities at the time of purchase by one of three categories: trading, available for sale (AFS) or, held to maturity (HTM). To date, management has not purchased any securities for trading purposes. Management classifies most of its securities as AFS. The AFS designation affords management the flexibility to sell securities and adjust the balance sheet in response to capital levels, liquidity needs and/or changes in market conditions. AFS securities are marked to market in the Consolidated Balance Sheets with an adjustment to equity, net of tax, and presented in the caption "Accumulated other comprehensive income (loss)."

During 2002, we utilized excess liquidity to grow and restructure our investment portfolio. Our investment portfolio, exclusive of the SFAS 115 valuation allowance, grew $100,206,000 or 97% in 2002. The yield on our investment portfolio declined in 2002 as a result of significant investing in a low interest rate environment.

Mortgage backed securities, exclusive of the SFAS 115 valuation allowance, grew $67,241,000 in 2002. We purchased and sold approximately $94,694,000 and $36,119,000, respectively, of mortgage-backed securities in 2002. We also purchased $5,000,000 of a mutual fund that invests principally in adjustable rate mortgage-backed securities.

Corporate bonds, exclusive of the SFAS 115 valuation allowance, grew $35,601,000 in 2002. We purchased and sold approximately $56,460,000 and $20,731,000, respectively, of corporate bonds in 2002. We significantly reduced our holdings in single issuer fixed rate trust preferred securities issued by other banking companies. Prior to 2002, the corporate bond portfolio consisted primarily of single issuer trust preferred securities. We also grew and diversified our corporate bond portfolio in 2002 by purchasing pooled trust preferred securities issued by various financial companies and intermediate term corporate bonds issued by investment grade companies. The variable rate component of our corporate bond portfolio increased from $9,855,000 or 30% at December 31, 2001 to $35,764,000 or 51% at December 31, 2002.

At December 31, 2002 the AFS portfolio had an estimated market appreciation of $36,000 before tax and an equity adjustment of $24,000, net of tax. This represents a $3,025,000 improvement in the estimated fair value of AFS securities, net of tax, over the prior year end due to lower interest rates and the aforementioned restructuring of our portfolio. At December 31, 2001 the AFS portfolio had an estimated unrealized loss of $4,548,000, before tax, and an equity adjustment of $3,001,000, net of tax. This was a $282,000 or 9% improvement in the estimated fair value of AFS securities, net of tax, compared to December 31, 2000. At December 31, 2000 the AFS portfolio had an estimated unrealized loss of $4,975,000, before tax, and an equity adjustment of $3,283,000, net of tax.

At December 31, 2002, 2001, and 2000 gross unrealized losses on our single issuer trust preferred securities were $1,802,000, $3,848,000 and $3,808,000, respectively. Management evaluated the credit quality of single issuer trust preferred securities prior to purchasing them and monitors them on an ongoing basis. Management believes that the credit quality of these securities is sound and that the company will ultimately be repaid. Therefore, management views the unrealized loss in the market value of single issuer trust preferred securities temporary. If, at some future date, management believes that this loss is other than temporary or that the recovery of the unrealized loss on these securities is not probable, we will recognize the loss through earnings which will reduce regulatory capital.

The composition and maturity of our investment portfolio is as follows.

	DECEMBER 31, 2002			
	HELD TO MATURITY		AVAILABLE FOR SALE	
	AMORTIZED COST	ESTIMATED FAIR VALUE	AMORTIZED COST	ESTIMATED FAIR VALUE
	(IN THOUSANDS)			
Mortgage-backed securities	$ --	$ --	$110,527	$111,806
Municipal securities	--	--	11,214	11,368
Equity securities	--	--	3,969	3,969
Corporate bonds	--	--	71,785	70,388
Mutual funds	--	--	5,000	5,000
Other debt securities	500	500	110	110
Total	$500	$500	$202,605	$202,641

	DECEMBER 31, 2001			
	HELD TO MATURITY		AVAILABLE FOR SALE	
	AMORTIZED COST	ESTIMATED FAIR VALUE	AMORTIZED COST	ESTIMATED FAIR VALUE
	(IN THOUSANDS)			
Mortgage-backed securities	$ --	$ --	$ 43,286	$43,365
Municipal securities	--	--	20,796	20,031
Equity securities	--	--	2,023	2,023
Corporate bonds	--	--	36,184	32,322
Other debt securities	500	500	110	110
Total	$500	$500	$102,399	$97,851

INVESTMENT SECURITIES MATURITIES AND WEIGHTED AVERAGE YIELDS

	UNDER 1 YEAR	1-5 YEARS	5-10 YEARS	OVER 10 YEARS	TOTAL
	(DOLLARS IN THOUSANDS)				
DECEMBER 31, 2002					
INVESTMENT SECURITIES AVAILABLE FOR SALE:					
Mortgage-backed securities					
Amortized cost....................	$19,720	$42,845	$23,399	$24,563	$110,527
Weighted average yield............	4.57%	4.68%	4.72%	5.03%	4.75%
Municipal securities					
Amortized cost....................	--	--	--	11,214	11,214
Weighted average yield(1).........	--	--	--	7.40%	7.40%
Equity securities					
Amortized cost....................	--	--	--	3,969	3,969
Weighted average yield............	--	--	--	3.59%	3.59%
Corporate bonds					
Amortized cost....................	2,000	24,012	--	45,773	71,785
Weighted average yield............	6.05%	5.88%	--	4.59%	5.06%
Mutual funds					
Amortized cost....................	--	--	--	5,000	5,000
Weighted average yield............	--	--	--	2.52%	2.52%
Other debt securities					
Amortized cost....................	--	110	--	--	110
Weighted average yield............	--	7.09%	--	--	7.09%
TOTAL AMORTIZED COST................	$21,720	$66,967	$23,399	$90,519	$202,605
TOTAL FAIR VALUE....................	$22,441	$67,857	$23,546	$88,797	$202,641
WEIGHTED AVERAGE YIELD..............	4.71%	5.11%	4.72%	4.90%	4.93%
INVESTMENT SECURITIES HELD TO MATURITY:					
Other debt securities					
Amortized cost....................	$ --	$ --	$ 500	$ --	$ 500
Weighted average yield............	--	--	4.88%	--	4.88%
TOTAL AMORTIZED COST................	$ --	$ --	$ 500	$ --	$ 500
WEIGHTED AVERAGE YIELD..............	--	--	4.88%	--	4.88%

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(1) Tax exempt yields on municipal securities were adjusted to a tax equivalent basis using a 34% tax rate.

LOANS HELD FOR SALE

Residential mortgages held for sale are sold within 30 days of their settlement pursuant to pre-existing commitments. At December 31, 2002, loans held for sale totaled $1,928,000 compared to $127,000 at December 31, 2001 and $0 at December 31, 2000. The fluctuation in balances relates to the timing of the loan originations versus their sale. We sold $13,925,000, $8,575,000 and $4,727,000 of residential mortgages in 2002, 2001 and 2000, respectively. Residential mortgage originations and sales are significantly influenced by the interest rate environment.

LOANS

Gross loans increased $45,429,000 or 14% to $361,495,000 at December 31, 2002 and increased $76,621,000 or 32% to $316,066,000 at December 31, 2001 from $239,445,000 at December 31, 2000. The majority of the loan portfolio is collateralized, at least in part, by real estate in the greater Delaware and Lehigh Valleys of Pennsylvania, and New Jersey. Real estate values are subject to risks associated with the local economy. Loans secured by commercial properties increased $44,945,000 or 22% during 2002, $46,737,000 or 29% during 2001, and $33,790,000 or 26% during 2000.

Inherent within the lending function is the evaluation and acceptance of credit risk and interest rate risk. We manage credit risk through portfolio diversification, underwriting policies and procedures, and loan monitoring practices. We manage interest rate risk using various asset/liability modeling techniques and analyses. Most loans are adjustable rate that reset in intervals of five years or less. When possible, we also originate variable rate loans.

Our lending activity is focused on small to mid-sized businesses and professionals within our market area.

LOAN PORTFOLIO

	DECEMBER 31,				
	2002	2001	2000	1999	1998
	(IN THOUSANDS)				
Real estate -- farmland.........	$ 194	$ 214	$ 230	$ --	$ --
Real estate -- construction.....	10,574	15,911	4,395	3,850	2,161
Real estate -- residential......	32,446	30,188	25,401	30,330	30,770
Real estate -- multi-family.....	19,350	15,011	13,667	9,738	5,135
Real estate -- commercial.......	253,357	208,412	161,675	127,885	86,008
Commercial......................	44,387	45,238	32,295	25,260	14,434
Consumer........................	1,187	1,092	1,782	2,161	1,840
Total...........................	$361,495	$316,066	$239,445	$199,224	$140,348

LOAN MATURITIES AND INTEREST SENSITIVITY

	UNDER 1 YEAR	1-5 YEARS	OVER 5 YEARS	TOTAL
	(IN THOUSANDS)			
DECEMBER 31, 2002				
Real estate -- farmland.....................	$ 21	$ 173	$ --	$ 194
Real estate -- construction..................	5,194	5,380	--	10,574
Real estate -- residential...................	15,231	16,771	444	32,446
Real estate -- multi-family..................	2,134	17,163	53	19,350

Real estate -- commercial	41,819	205,780	5,758	253,357
Commercial	23,636	16,644	4,107	44,387
Consumer	355	832	--	1,187
Total	$88,390	$262,743	$10,362	$361,495

The following shows, at December 31, 2002, the amount of loans due after one year that have fixed, adjustable or variable interest rates:

Loans with fixed or predetermined interest rates	$ 30,289,000
Loans with adjustable or variable interest rates	$242,816,000

ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses reflects management's best estimate of losses, both known and inherent, in the existing loan portfolio. Management's judgment is based on the evaluation of individual loans, past experience, the assessment of current economic conditions, and other relevant factors. The provision for loan losses charged to operating expenses represents the amount necessary to maintain an appropriate allowance. Loan losses are charged directly against the allowance for loan losses when loans are deemed to be uncollectible. Recoveries on previously charged-off loans are added to the allowance when received.

Estimates are used to determine the allowance for loan losses. A variety of factors are considered in establishing these estimates including current economic conditions, diversification of the loan portfolio, delinquency statistics, borrowers' perceived financial and managerial strengths, the adequacy of underlying collateral, if collateral dependent, or present value of future cash flows, and other relevant factors. Each commercial loan is assigned a specific loan loss reserve using a scoring system. This scoring system tak