

SUMMIT BANCSHARES INC /TX/  
Form 10-Q  
August 09, 2004

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**SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, D.C. 20549

**FORM 10-Q**

Mark One

- Quarterly report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the quarterly period ended **June 30, 2004**; or
- Transition report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the transition period from to \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 0-11986

**SUMMIT BANCSHARES, INC.**

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(Exact name of registrant as specified in its charter)

Texas

75-1694807

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(State of Incorporation)

(I.R.S. Employer Identification No.)

3880 Hulen St., Fort Worth, Texas 76107

---

(Address of principal executive offices)

(817) 336-6817

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(Registrant's telephone number, including area code)

No Change

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(Former name, former address and former fiscal year if changed since last report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (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 No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act) .

Yes No

The number of shares of common stock, \$1.25 par value, outstanding at June 30, 2004 was 6,186,249 shares.

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## SUMMIT BANCSHARES, INC.

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| <p>The June 30, 2004 and 2003 and the December 31, 2003 financial statements included herein are unaudited; however, such information reflects all adjustments (consisting solely of normal recurring adjustments), which are, in the opinion of management of the registrant, necessary to a fair statement of the results for the interim periods. The financial statements for the year ended December 31, 2003 included herein are headed "unaudited". These financial statements were reported as "audited" in our Annual Report on Form 10-K for the year ended December 31, 2003 filed with the Securities and Exchange Commission but are required to be reflected herein as unaudited because of the absence of an independent auditor's report.</p> |                 |
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**PART I - FINANCIAL INFORMATION****Item 1 - Financial Statements**SUMMIT BANCSHARES, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS

|  | (Unaudited)<br>June 30, |                   | (Unaudited)<br>December 31, |
|--|-------------------------|-------------------|-----------------------------|
|  | 2004                    | 2003              | 2003                        |
| (In Thousands )  |                         |                   |                             |
| <b>ASSETS</b>  |                         |                   |                             |
| CASH AND DUE FROM BANKS NOTE 1   | \$ 32,899               | \$ 28,669         | \$ 28,620                   |
| FEDERAL FUNDS SOLD & DUE FROM TIME   | 17,551                  | 14,975            | 1,336                       |
| INVESTMENT SECURITIES NOTE 3   |                         |                   |                             |
| Securities Available-for-Sale, at fair value   | 214,991                 | 178,241           | 195,959                     |
| LOANS NOTES 4, 14 AND 20   |                         |                   |                             |
| Loans, Net of Unearned Discount  | 672,686                 | 500,040           | 553,769                     |
| Allowance for Loan Losses  | (9,844)                 | (7,412)           | (7,784)                     |
| LOANS, NET   | 662,842                 | 492,628           | 545,985                     |
| PREMISES AND EQUIPMENT NOTE 5  | 15,145                  | 13,391            | 12,920                      |
| GOODWILL NOTE 6  | 7,752                   | -0-               | -0-                         |
| OTHER INTANGIBLE ASSETS, NET NOTE 6  | 2,642                   | -0-               | -0-                         |
| ACCRUED INCOME RECEIVABLE  | 4,360                   | 3,888             | 3,754                       |
| OTHER REAL ESTATE NOTE 7   | 366                     | -0-               | -0-                         |
| OTHER ASSETS   | 11,160                  | 7,124             | 6,904                       |
| <b>TOTAL ASSETS</b>  | <b>\$ 969,708</b>       | <b>\$ 738,916</b> | <b>\$ 795,478</b>           |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>   |                         |                   |                             |
| DEPOSITS NOTE 8  |                         |                   |                             |
| Noninterest-Bearing Demand   | \$ 218,343              | \$ 176,603        | \$ 192,877                  |
| Interest-Bearing   | 557,347                 | 435,143           | 448,504                     |
| <b>TOTAL DEPOSITS</b>  | <b>775,690</b>          | <b>611,746</b>    | <b>641,381</b>              |
| SHORT TERM BORROWINGS NOTE 9   | 106,663                 | 55,627            | 82,234                      |
| NOTES PAYABLE NOTE 10  | 2,750                   | -0-               | -0-                         |
| JUNIOR SUBORDINATED DEFERRABLE DEBENTURES NOTE 11  | 12,372                  | -0-               | -0-                         |
| ACCRUED INTEREST PAYABLE   | 493                     | 358               | 294                         |
| OTHER LIABILITIES  | 3,041                   | 2,456             | 2,885                       |
| <b>TOTAL LIABILITIES</b>   | <b>901,009</b>          | <b>670,187</b>    | <b>726,794</b>              |
| COMMITMENTS AND CONTINGENCIES NOTES 15, 17, 19 AND 21  |                         |                   |                             |
| SHAREHOLDERS EQUITY NOTES 16, 18 AND 22  |                         |                   |                             |
| Common Stock - \$1.25 Par Value; 20,000,000 shares authorized; 6,186,249, 6,165,617 and 6,152,329 shares issued and outstanding at June 30, 2004 and 2003 and at December 31, 2003, respectively | 7,733                   | 7,707             | 7,690                       |
| Capital Surplus  | 7,563                   | 7,345             | 7,421                       |
| Retained Earnings  | 56,211                  | 50,358            | 52,988                      |
| Accumulated Other Comprehensive Income Unrealized (Loss) Gain on Available-for-Sale Investment Securities, Net of Tax  | (2,227)                 | 3,335             | 688                         |
|  | (581)                   | (16)              | (103)                       |

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Treasury Stock at Cost (20,500, 688 and 3,700 shares at June 30, 2004 and 2003 and at December 31, 2003, respectively)

|   |            |            |            |
|---|------------|------------|------------|
| TOTAL SHAREHOLDERS EQUITY                 | 68,699     | 68,729     | 68,684     |
| TOTAL LIABILITIES AND SHAREHOLDERS EQUITY | \$ 969,708 | \$ 738,916 | \$ 795,478 |

The accompanying Notes should be read with these financial statements.

SUMMIT BANCSHARES, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF INCOME

|  | (Unaudited)<br>For the Six Months Ended<br>June 30, |                 | (Unaudited)<br>Year Ended<br>December 31, |
|--|---|-----------------|---|
|  | 2004  | 2003            | 2003                                      |
| (In Thousands, Except Per Share Data )                         |   |                 |   |
| <b>INTEREST INCOME</b>   |   |                 |   |
| Interest and Fees on Loans                                     | \$ 17,800   | \$ 15,357       | \$ 31,134                                 |
| Interest and Dividends on Investment Securities:               |   |                 |   |
| Taxable  | 3,496   | 3,310           | 7,106                                     |
| Exempt from Federal Income Taxes                               | 117   | 94              | 206                                       |
| Interest on Federal Funds Sold and Due From Time               | 88  | 37              | 81  |
| <b>TOTAL INTEREST INCOME</b>                                   | <b>21,501</b>                                       | <b>18,798</b>   | <b>38,527</b>                             |
| <b>INTEREST EXPENSE</b>  |   |                 |   |
| Interest on Deposits   | 3,478   | 3,441           | 6,810                                     |
| Interest on Short Term Borrowings                              | 620   | 309             | 627                                       |
| Interest on Note Payable                                       | 16  | -0-             | -0-                                       |
| Interest on Junior Subordinated Deferrable Debentures          | 76  | -0-             | -0-                                       |
| <b>TOTAL INTEREST EXPENSE</b>                                  | <b>4,190</b>  | <b>3,750</b>    | <b>7,437</b>                              |
| <b>NET INTEREST INCOME</b>                                     | <b>17,311</b>                                       | <b>15,048</b>   | <b>31,090</b>                             |
| <b>LESS: PROVISION FOR LOAN LOSSES</b> NOTE 4                  | <b>1,005</b>  | <b>540</b>      | <b>880</b>                                |
| <b>NET INTEREST INCOME AFTER<br/>PROVISION FOR LOAN LOSSES</b> | <b>16,306</b>                                       | <b>14,508</b>   | <b>30,210</b>                             |
| <b>NON-INTEREST INCOME</b>                                     |   |                 |   |
| Service Charges and Fees on Deposits                           | 1,984   | 1,649           | 3,443                                     |
| Gain on Sale of Investment Securities                          | -0-   | 12              | 230                                       |
| Other Income   | 1,306   | 1,285           | 2,355                                     |
| <b>TOTAL NON-INTEREST INCOME</b>                               | <b>3,290</b>  | <b>2,946</b>    | <b>6,028</b>                              |
| <b>NON-INTEREST EXPENSE</b>                                    |   |                 |   |
| Salaries and Employee Benefits - NOTE 17                       | 7,140   | 5,995           | 12,926                                    |
| Occupancy Expense - Net  | 990   | 688             | 1,734                                     |
| Furniture and Equipment Expense                                | 1,060   | 876             | 1,877                                     |
| Core Deposit Intangible Amortization                           | 55  | -0-             | -0-                                       |
| Other Real Estate Owned and Foreclosed Asset Expense - Net     | 15  | (13)            | (4)                                       |
| Other Expense NOTE 12  | 2,620   | 2,497           | 4,920                                     |
| <b>TOTAL NON-INTEREST EXPENSE</b>                              | <b>11,880</b>                                       | <b>10,043</b>   | <b>21,453</b>                             |
| <b>INCOME BEFORE INCOME TAXES</b>                              | <b>7,716</b>  | <b>7,411</b>    | <b>14,785</b>                             |
| <b>APPLICABLE INCOME TAXES</b> NOTE 13                         | <b>2,669</b>  | <b>2,521</b>    | <b>5,017</b>                              |
| <b>NET INCOME</b>  | <b>\$ 5,047</b>                                     | <b>\$ 4,890</b> | <b>\$ 9,768</b>                           |

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| NET INCOME PER SHARE | NOTE 18 |    |      |    |      |    |      |
|----------------------|---------|----|------|----|------|----|------|
| Basic                |         | \$ | 0.82 | \$ | 0.79 | \$ | 1.59 |
| Diluted              |         |    | 0.80 |    | 0.78 |    | 1.55 |

The accompanying Notes should be read with these financial statements.

SUMMIT BANCSHARES, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF INCOME

|  | (Unaudited)<br>For the Three Months Ended<br>June 30, |                 |
|--|---|-----------------|
|  | 2004  | 2003            |
|  | (In Thousands, Except Per Share<br>Data)              |                 |
| <b>INTEREST INCOME</b>   |   |                 |
| Interest and Fees on Loans                                     | \$ 9,391  | \$ 7,868        |
| Interest and Dividends on Investment Securities:               |   |                 |
| Taxable  | 1,778   | 1,599           |
| Exempt from Federal Income Taxes                               | 58  | 47              |
| Interest on Federal Funds Sold and Due From Time               | 75  | 33              |
| <b>TOTAL INTEREST INCOME</b>                                   | <b>11,302</b>   | <b>9,547</b>    |
| <b>INTEREST EXPENSE</b>  |   |                 |
| Interest on Deposits   | 1,837   | 1,781           |
| Interest on Short Term Borrowings                              | 345   | 153             |
| Interest on Notes Payable                                      | 16  | -0-             |
| Interest on Junior Subordinated Deferrable Debentures          | 76  | -0-             |
| <b>TOTAL INTEREST EXPENSE</b>                                  | <b>2,274</b>  | <b>1,934</b>    |
| <b>NET INTEREST INCOME</b>                                     | <b>9,028</b>  | <b>7,613</b>    |
| LESS: PROVISION FOR LOAN LOSSES NOTE 4                         | 400   | 240             |
| <b>NET INTEREST INCOME AFTER<br/>PROVISION FOR LOAN LOSSES</b> | <b>8,628</b>  | <b>7,373</b>    |
| <b>NON-INTEREST INCOME</b>                                     |   |                 |
| Service Charges and Fees on Deposits                           | 1,078   | 890             |
| Gain on Sale of Investment Securities                          | -0-   | 12              |
| Other Income   | 645   | 696             |
| <b>TOTAL NON-INTEREST INCOME</b>                               | <b>1,723</b>  | <b>1,598</b>    |
| <b>NON-INTEREST EXPENSE</b>                                    |   |                 |
| Salaries and Employee Benefits - NOTE 17                       | 3,772   | 3,090           |
| Occupancy Expense - Net  | 552   | 395             |
| Furniture and Equipment Expense                                | 565   | 447             |
| Core Deposit Amortization                                      | 55  | -0-             |
| Other Real Estate Owned and Foreclosed Asset Expense - Net     | 15  | 2               |
| Other Expense NOTE 12  | 1,391   | 1,312           |
| <b>TOTAL NON-INTEREST EXPENSE</b>                              | <b>6,350</b>  | <b>5,246</b>    |
| <b>INCOME BEFORE INCOME TAXES</b>                              | <b>4,001</b>  | <b>3,725</b>    |
| APPLICABLE INCOME TAXES NOTE 13                                | 1,405   | 1,268           |
| <b>NET INCOME</b>  | <b>\$ 2,596</b>                                       | <b>\$ 2,457</b> |

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NET INCOME PER SHARE - NOTE 18

|         |    |      |    |      |
|---------|----|------|----|------|
| Basic   | \$ | 0.42 | \$ | 0.40 |
| Diluted |    | 0.41 |    | 0.39 |

The accompanying Notes should be read with these financial statements.



SUMMIT BANCSHARES, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY  
FOR THE SIX MONTHS ENDED JUNE 30, 2004 AND 2003  
AND FOR THE YEAR ENDED DECEMBER 31, 2003  
(Unaudited)

|   | <u>Common Stock</u> |               | <u>Capital<br/>Surplus</u> | <u>Retained<br/>Earnings</u> | <u>Accumulated<br/>Other<br/>Comprehensive<br/>Income Net<br/>Unrealized<br/>Gain<br/>(Loss) on<br/>Investment<br/>Securities</u> | <u>Treasury<br/>Stock</u> | <u>Total<br/>Share<br/>Holder's<br/>Equity</u> |
|---|---------------------|---------------|----------------------------|------------------------------|---|---------------------------|--|
|   | <u>Shares</u>       | <u>Amount</u> |                            |                              |   |                           |  |
| (Dollars in Thousands, Except Per Share Data)         |                     |               |                            |                              |   |                           |  |
| Balance at January 1, 2003                            | 6,158,542           | \$ 7,698      | \$ 7,122                   | \$ 47,660                    | \$ 2,861  | \$ (403)                  | \$ 64,938                                      |
| Stock Options Exercised                               | 45,575              | 57            | 223                        |                              |   |                           | 280  |
| Purchases of Stock Held in Treasury                   |                     |               |                            |                              |   | (372)                     | (372)  |
| Retirement of Stock Held in Treasury                  | (38,500)            | (48)          |                            | (711)                        |   | 759                       | -0-  |
| Cash Dividend - .24 Per Share                         |                     |               |                            | (1,481)                      |   |                           | (1,481)  |
| Net Income for the Six Months Ended June 30, 2003     |                     |               |                            | 4,890                        |   |                           | 4,890  |
| Securities Available-for-Sale Adjustment              |                     |               |                            |                              | 474   |                           | 474  |
| Total Comprehensive Income - NOTE 25                  |                     |               |                            |                              |   |                           | 5,364  |
| Balance at June 30, 2003                              | 6,165,617           | 7,707         | 7,345                      | 50,358                       | 3,335   | (16)                      | 68,729   |
| Stock Options Exercised                               | 7,650               | 9             | 76                         |                              |   |                           | 85   |
| Purchases of Stock Held in Treasury                   |                     |               |                            |                              |   | (637)                     | (637)  |
| Retirement of Stock Held in Treasury                  | (20,938)            | (26)          |                            | (524)                        |   | 550                       | -0-  |
| Cash Dividend - .28 Per Share                         |                     |               |                            | (1,724)                      |   |                           | (1,724)  |
| Net Income for the Six Months Ended December 31, 2003 |                     |               |                            | 4,878                        |   |                           | 4,878  |
| Securities Available-for-Sale Adjustment              |                     |               |                            |                              | (2,647)   |                           | (2,647)  |
| Total Comprehensive Income - NOTE 25                  |                     |               |                            |                              |   |                           | 2,231  |
| Balance at December 31, 2003                          | 6,152,329           | 7,690         | 7,421                      | 52,988                       | 688   | (103)                     | 68,684   |
| Stock Options Exercised                               | 37,620              | 48            | 142                        |                              |   |                           | 190  |
| Purchases of Stock Held in Treasury                   | (3,700)             | (5)           |                            | (98)                         |   | (581)                     | (581)  |
|   |                     | (5)           |                            | (98)                         |   | 103                       | -0-  |

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|   |           |          |          |           |            |          |         |  |         |
|---|-----------|----------|----------|-----------|------------|----------|---------|--|---------|
| Retirement of Stock Held in Treasury              |           |          |          |           |            |          |         |  |         |
| Cash Dividend - .28 Per Share                     |           |          |          | (1,726)   |            |          |         |  | (1,726) |
| Net Income for the Six Months Ended June 30, 2004 |           |          |          | 5,047     |            |          |         |  | 5,047   |
| Securities Available-for-Sale Adjustment          |           |          |          |           |            |          | (2,915) |  | (2,915) |
| Total Comprehensive Income - NOTE 25              |           |          |          |           |            |          |         |  | 2,132   |
| Balance at June 30, 2004                          | 6,186,249 | \$ 7,733 | \$ 7,563 | \$ 56,211 | \$ (2,227) | \$ (581) | \$      |  | 68,699  |

The accompanying Notes should be read with these financial statements.

SUMMIT BANCSHARES, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR THE SIX MONTHS ENDED JUNE 30, 2004 AND 2003  
AND FOR THE YEAR ENDED DECEMBER 31, 2003

|  | (Unaudited)              |                   | (Unaudited)<br>Year Ended<br>December 31,<br>2003 |
|--|--------------------------|-------------------|---|
|  | For the Six Months Ended |                   |   |
|  | June 30,                 |                   |   |
|  | 2004                     | 2003              |   |
| (In Thousands)   |                          |                   |   |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>   |                          |                   |   |
| Net Income   | \$ 5,047                 | \$ 4,890          | \$ 9,768  |
| Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:                  |                          |                   |   |
| Depreciation and Amortization  | 770                      | 617               | 1,370   |
| Net Premium Amortization of Investment Securities  | 638                      | 716               | 1,486   |
| Amortization of Core Deposit Intangible  | 55                       | -0-               | -0-   |
| Provision for Loan Losses  | 1,005                    | 540               | 880   |
| Deferred Income Taxes Expense (Benefit)  | (440)                    | (156)             | 336   |
| Net Gain on Sale of Investment Securities  | -0-                      | (12)              | (230)   |
| Net (Gain) Loss From Sale of Other Real Estate & Repossessed Assets                                | (69)                     | -0-               | 10  |
| Net Gain From Sale of Premises and Equipment   | (1)                      | (42)              | (46)  |
| Net Increase in Accrued Income and Other Assets  | (1,724)                  | (1,105)           | (68)  |
| Net Decrease in Accrued Expenses and Other Liabilities   | (544)                    | (781)             | (352)   |
|  | <u>          </u>        | <u>          </u> | <u>          </u>                                 |
| Total Adjustments  | (310)                    | (223)             | 3,386   |
|  | <u>          </u>        | <u>          </u> | <u>          </u>                                 |
| <b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>   | <b>4,737</b>             | <b>4,667</b>      | <b>13,154</b>                                     |
|  | <u>          </u>        | <u>          </u> | <u>          </u>                                 |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>   |                          |                   |   |
| Net Decrease (Increase) in Federal Funds Sold and Due From Time                                    | 7,207                    | (14,713)          | (1,074)   |
| Proceeds from Matured and Prepaid Investment Securities  | 27,621                   | 23,514            | 101,354   |
| Proceeds from Sales of Investment Securities   | 80,000                   | 42,041            | 125,620   |
| Purchase of Investment Securities  | (131,342)                | (70,271)          | (253,971)   |
| Premium Paid for ANB Financial Corporation   | (10,394)                 | -0-               | -0-   |
| Net Assets Acquired in the Purchase of ANB Financial Corporation (Net of Acquired Cash of \$3,871) | (2,039)                  | -0-               | -0-   |
| Loans Originated and Principal Repayments, Net   | (59,423)                 | (31,247)          | (85,163)  |
| Recoveries of Loans Previously Charged-Off   | 134                      | 518               | 737   |
| Proceeds from Sale of Premises and Equipment   | 12                       | 274               | 279   |
| Proceeds from Sale of Other Real Estate & Repossessed Assets                                       | 124                      | 1,142             | 1,257   |
| Purchases of Premises and Equipment  | (546)                    | (2,755)           | (3,038)   |
|  | <u>          </u>        | <u>          </u> | <u>          </u>                                 |
| <b>NET CASH USED BY INVESTING ACTIVITIES</b>   | <b>(88,646)</b>          | <b>(51,497)</b>   | <b>(113,999)</b>                                  |
|  | <u>          </u>        | <u>          </u> | <u>          </u>                                 |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>   |                          |                   |   |
| Net Increase in Demand Deposits, Savings Accounts and Interest Bearing Transaction Accounts        | 41,709                   | 20,059            | 49,540  |
| Net Increase in Certificates of Deposit  | 9,045                    | 9,738             | 9,892   |
| Net Increase in Short Term Borrowings  | 24,429                   | 18,372            | 44,979  |
| Proceeds from Notes Payable  | 2,750                    | -0-               | -0-   |
| Proceeds from Issuance of Junior Subordinated Debentures   | 12,372                   | -0-               | -0-   |
| Payments of Cash Dividends   | (1,726)                  | (1,481)           | (3,205)   |
| Proceeds from Stock Options Exercised  | 190                      | 280               | 365   |
| Purchase of Treasury Stock   | (581)                    | (372)             | (1,009)   |
|  | <u>          </u>        | <u>          </u> | <u>          </u>                                 |

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|  |           |           |           |
|--|-----------|-----------|-----------|
| NET CASH PROVIDED BY FINANCING ACTIVITIES                          | 88,188    | 46,596    | 100,562   |
| NET INCREASE (DECREASE) IN CASH AND DUE FROM BANKS                 | 4,279     | (234)     | (283)     |
| CASH AND DUE FROM BANKS AT BEGINNING OF PERIOD                     | 28,620    | 28,903    | 28,903    |
| CASH AND DUE FROM BANKS AT END OF PERIOD                           | \$ 32,899 | \$ 28,669 | \$ 28,620 |
| SUPPLEMENTAL SCHEDULE OF OPERATING AND INVESTING ACTIVITIES        |           |           |           |
| Interest Paid  | \$ 4,167  | \$ 3,746  | \$ 7,497  |
| Income Taxes Paid  | 3,240     | 2,373     | 4,296     |
| Other Real Estate and Other Assets Acquired in Settlement of Loans | 55        | -0-       | -0-       |

The accompanying Notes should be read with these financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
SUMMIT BANCSHARES, INC. AND SUBSIDIARIES  
FOR THE SIX MONTHS ENDED JUNE 30, 2004 AND 2003 (UNAUDITED)  
AND FOR THE YEAR ENDED DECEMBER 31, 2003 (UNAUDITED)

NOTE 1 - Summary of Significant Accounting Policies

The accounting and reporting policies of Summit Bancshares, Inc. are in accordance with accounting principles generally accepted in the United States of America and the prevailing practices within the banking industry. A summary of the more significant policies follows:

Basis of Presentation and Principles of Consolidation

The consolidated financial statements of Summit Bancshares, Inc. (hereinafter, collectively with its subsidiaries, the Corporation ), include its accounts and its direct and indirect wholly-owned subsidiaries, Summit Delaware Financial Corporation, Summit Bank, National Association (the Bank ), SIA Insurance Agency, Inc. ( SIA ) and Summit Bancshares, Inc. Statutory Trust I ( SBI Trust ). All significant intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

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

Cash and Due From Banks

The Bank is required to maintain certain noninterest-bearing cash balances at the Federal Reserve Bank based on its level of deposits. During the first six months of 2004, the average cash balance maintained at the Federal Reserve Bank was \$2,198,000. Compensating balances held at other correspondent banks, to minimize service charges, averaged approximately \$23,084,000 during the same period.

Investment Securities

The Corporation has adopted Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities* ( SFAS 115 ). At the date of purchase, the Corporation is required to classify debt and equity securities into one of three categories: held-to-maturity, trading or available-for-sale. At each reporting date, the appropriateness of the classification is reassessed. Investments in debt securities are classified as held-to-maturity and measured at amortized cost in the financial statements only if management has the positive intent and ability to hold those securities to maturity. Securities that are bought and held principally for the purpose of selling them in the near term are classified as trading and measured at fair value in the financial statements with unrealized gains and losses included in earnings. Investments not classified as either held-to-maturity or trading are classified as available-for-sale and measured at fair value in the financial statements with unrealized gains and losses reported, net of tax, in a separate component of shareholders' equity until realized.

The Corporation has the ability and intent to hold to maturity its investment securities classified as held-to-maturity; accordingly, no adjustment has been made for the excess, if any, of amortized cost over market. In determining the investment category classifications at the time of purchase of securities, management considers its asset/liability strategy, changes in interest rates and prepayment risk, the need to increase capital and other factors. Under certain circumstances (including the deterioration of the issuer's creditworthiness, a change in tax law, or statutory or regulatory requirements), the Corporation may change the investment security classification. In the periods reported for 2004 and 2003 the Corporation held no securities that would have been classified as trading securities.

All investment securities are adjusted for amortization of premiums and accretion of discounts. Amortization of premiums and accretion of discounts are recorded to income over the contractual maturity or estimated life of the individual investment on the level yield method. Gain or loss on sale of investments is based upon the specific identification method and the gain or loss is recorded in non-interest income. Income earned on the Corporation's investments in state and political subdivisions is not taxable.

Loans and Allowance for Loan Losses

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Loans are stated at the principal amount outstanding less unearned discount, deferred fees and the allowance for loan losses. Unearned discount on installment loans is recognized as income over the terms of the loans by a method approximating the interest method. Interest income on all other loans is recognized based upon the principal amounts outstanding, the simple interest method. Loan origination fee income, net of direct loan origination costs, is deferred and amortized over the life of the related loan. The accrual of interest on a loan is discontinued when, in the opinion of management, there is doubt about the ability of the borrower to pay interest or principal. Interest previously earned, but uncollected on such loans, is written off. After loans are placed on non-accrual all payments received are applied to principal and no interest income is recorded until the loan is returned to accrual status or the principal has been reduced to zero.

NOTE 1 - Summary of Significant Accounting Policies (cont d.)

The Corporation has adopted Statement of Financial Accounting Standards No. 114, Accounting by Creditors for Impairment of a Loan, as amended by Statement of Financial Accounting Standards No. 118, Accounting by Creditors for Impairment of a Loan - Income Recognition and Disclosure. Under this standard, the allowance for loan losses related to loans that are identified for evaluation in accordance with Statement No. 114 (impaired loans) is based on discounted cash flows using the loan's initial effective rate or the fair value of the collateral for certain collateral dependent loans.

The allowance for loan losses is comprised of amounts charged against income in the form of a provision for loan losses for certain loans when it is probable that all amounts due pursuant to the contractual terms of the loan will not be collected. In these situations, a reserve is recorded when the carrying amount of the loan exceeds the discounted cash flows using the loan's initial effective interest rate or the fair value of the collateral for certain collateral dependent loans. Income on impaired loans is recognized based on the collectibility of the principal amount. Adjustments to the allowance for loan losses will be reported in the period such adjustments become known or are reasonably estimable.

The amount maintained in the allowance reflects management's continuing assessment of the potential losses inherent in its loan portfolio based on its evaluation of a number of factors, including the Bank's loss experience in relation to outstanding loans and the existing level of the allowance, prevailing and prospective economic conditions, and management's continuing review of the discounted cash flow values of impaired loans and its evaluation of the quality of the loan portfolio. Loans are charged against the allowance for loan losses when management believes that the collectibility of the principal is unlikely.

The evaluation of the adequacy of loan collateral is often based upon estimates and appraisals. Because of changing economic conditions, the valuations determined from such estimates and appraisals may also change. Accordingly, the Corporation may ultimately incur losses which vary from management's current estimates.

Premises and Equipment

Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation expense is computed on the straight-line method based upon the estimated useful lives of the assets ranging from three to forty years. Maintenance and repairs are charged to non-interest expense. Renewals and betterments are added to the asset accounts and depreciated over the periods benefited. Depreciable assets sold or retired are removed from the asset and related accumulated depreciation accounts and any gain or loss is reflected in the income and expense accounts.

Goodwill

Goodwill represents the excess of the purchase price over the fair value of net assets acquired in business combinations under the purchase method of accounting. The Corporation has adopted Financial Accounting Standards Board Statement No. 142 (FAS 142), Goodwill and Other Intangible Assets. FAS 142 eliminates amortization of goodwill associated with business combinations completed after June 30, 2001. Goodwill is periodically assessed for impairment when events or changes in circumstances indicate that the carrying value of the asset may not be recoverable. The Corporation bases its evaluation on such impairment factors as the nature of the assets, the future economic benefit of the assets, any historical or future profitability measurements, as well as other external market conditions or factors that may be present.

Amortization of Core Deposit Intangibles

Core Deposit Intangibles ( CDI ) are amortized using a straight line amortization method over an estimated useful life of eight years.

Other Real Estate

Other real estate is foreclosed property held pending disposition and is valued at the lower of its fair value or the recorded investment in the related loan. At foreclosure, if the fair value, less estimated costs to sell, of the real estate acquired is less than the Corporation's recorded investment in the related loan, a write-down is recognized through a charge to the allowance for loan losses. Any subsequent reduction in value is recognized by a charge to income. Operating expenses of such properties, net of related income, and gains and losses on their disposition are included in non-interest expense.

Federal Income Taxes

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The Corporation joins with its subsidiaries in filing a consolidated federal income tax return. The subsidiaries pay to the parent a charge equivalent to their current federal income tax based on the separate taxable income of the subsidiaries.

The Corporation and the subsidiaries maintain their records for financial reporting and income tax reporting purposes on the accrual basis of accounting. Deferred income taxes are provided in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes. Deferred income taxes are provided for accumulated temporary differences due to basic differences for assets and liabilities for financial reporting and income tax purposes.

Realization of net deferred tax assets is dependent on generating sufficient future taxable income. Although realization is not assured, management believes it is more likely than not that all of the net deferred tax assets will be realized. The amount of the net deferred tax asset considered realizable, however, could be reduced in the near term if estimates of future taxable income are reduced.



## NOTE 1 Summary of Significant Accounting Policies (cont d.)

Cash and Cash Equivalents

For the purpose of presentation in the Statements of Cash Flows, cash and cash equivalents include cash on hand, clearings and exchanges, and balances due from correspondent banks.

Reclassification

Certain reclassifications have been made to the 2003 financial statements to conform to the 2004 presentation.

Earnings Per Common and Common Equivalent Shares

Statement of Financial Accounting Standards No. 128 ( SFAS 128 ), Earnings Per Share, requires presentation of basic and diluted earnings per share. Basic earnings per share has been computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding for the reporting period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. Net income per share for all periods presented has been calculated in accordance with SFAS 128. Outstanding stock options issued by the Corporation represent the only dilutive effect reflected in diluted weighted average shares.

Stock Based Compensation

The Corporation accounts for stock-based compensation in accordance with the intrinsic value based method recommended by Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees. Under the intrinsic value based method, compensation cost is the excess, if any, of the quoted market price of the stock at grant date over the amount an employee must pay to acquire the stock. The impact on the financial statements of using this method is disclosed in Note 16, Stock Option Plans to the financial statements.

Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation, as amended by Statements of Financial Accounting Standards No. 148 ( SFAS 123 ), requires pro forma disclosures of net income and earnings per share for companies not adopting its fair value accounting method for stock-based compensation. The pro forma disclosures presented below use the fair value method of SFAS 123 to measure compensation expense for stock-based compensation plans.

The Corporation accounts for the Plans under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, under which no compensation cost has been recognized for options granted. The following table illustrates the effect on net income and earnings per share if the Corporation had applied the fair value recognition provisions of SFAS No. 123 to stock-based compensation:

|  | <u>Six Months Ended</u><br><u>June 30, 2004</u> | <u>Year Ended</u><br><u>December 31, 2003</u> |
|--|---|---|
| Net Income, as Reported  | \$ 5,047  | \$ 9,768                                      |
| Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of related tax effects | (66)  | (135)   |
| <b>Pro Forma Net Income</b>  | <b>\$ 4,981</b>                                 | <b>\$ 9,633</b>                               |
| <b>Earnings Per Share:</b>   |   |   |
| Basic - as Reported  | \$ 0.82   | \$ 1.59                                       |
| Basic - Pro Forma  | 0.81  | 1.56  |
| Diluted - as Reported  | 0.80  | 1.55  |
| Diluted - Pro Forma  | 0.79  | 1.52  |
| <u>Comprehensive Income</u>  |   |   |

Comprehensive income includes all changes in shareholders' equity during a period, except those resulting from investments by and distributions to owners and treasury stock transactions. Besides net income, the other component of the Corporation's comprehensive income is the after tax effect of changes in the fair value of securities available for sale. Comprehensive income for the periods ended June 30, 2004 and

2003 and for the year ended December 31, 2003 is reported in Note 25, Comprehensive Income.

## NOTE 1 Summary of Significant Accounting Policies (cont d.)

Audited Financial Statements

The consolidated balance sheet as of December 31, 2003, and the consolidated statements of income, changes in shareholders' equity and cash flows for the year ended December 31, 2003 are headed "unaudited" in these financial statements. These statements were reported as "audited" in our Annual Report of Form 10-K for the year ended December 31, 2003 filed with the Securities and Exchange Commission but are required to be reflected in these statements as unaudited because of the absence of an independent auditor's report.

NOTE 2 Acquisitions

On May 1, 2004, the Corporation completed its merger with ANB Financial Corporation ( "ANBFC" ), and its wholly-owned subsidiary, Arlington National Bank of Arlington, Texas (collectively, "ANB" ). Under the terms of the merger agreement with ANB, the Corporation acquired ANB for approximately \$16.0 million in cash. ANB was privately held and operated four (4) banking offices in Arlington, Texas. On May 1, 2004, ANB had total assets of \$89.0 million, loans of \$59.4 million, deposits of \$83.6 million and shareholders' equity of \$3.1 million. This acquisition was partially funded through the formation of Summit Bancshares, Inc. Statutory Trust I and its subsequent issuance of \$12.0 million of its floating rate Capital Securities.

NOTE 3 - Investment Securities

A summary of amortized cost and estimated fair values of investment securities is as follows (in thousands):

|   | <b>June 30, 2004</b>      |                                       |  |                       |
|---|---------------------------|---------------------------------------|--|-----------------------|
|   | <b>Amortized<br/>Cost</b> | <b>Gross<br/>Unrealized<br/>Gains</b> | <b>Gross<br/>Unrealized<br/>Losses</b> | <b>Fair<br/>Value</b> |
| <b>Investment Securities - Available-for-Sale</b> |                           |                                       |  |                       |
| U.S. Government Agencies and Corporations         | \$ 146,369                | \$ 585                                | \$ (2,066)                             | \$ 144,888            |
| U.S. Government Agency Mortgage Backed Securities | 55,558                    | 57                                    | (1,881)                                | 53,734                |
| Obligations of States and Political Subdivisions  | 7,016                     | 62                                    | (80)                                   | 6,998                 |
| Community Reinvestment Act Investment Fund        | 3,000                     | -0-                                   | (51)                                   | 2,949                 |
| Federal Reserve and Federal Home Loan Bank Stock  | 6,244                     | -0-                                   | -0-                                    | 6,244                 |
| Other   | 178                       | -0-                                   | -0-                                    | 178                   |
| <b>Total Available-for-Sale Securities</b>        | <b>218,365</b>            | <b>704</b>                            | <b>(4,078)</b>                         | <b>214,991</b>        |
| <b>Total Investment Securities</b>                | <b>\$ 218,365</b>         | <b>\$ 704</b>                         | <b>\$ (4,078)</b>                      | <b>\$ 214,991</b>     |

All investment securities are carried on the consolidated balance sheet as of June 30, 2004 at fair value. The net unrealized loss of \$3,374,000 is included in the Available-for-Sale Investment Securities balance. The unrealized loss, net of tax benefit, is included in Shareholders' Equity.

Included in the Federal Reserve and Federal Home Loan Bank Stock category at June 30, 2004 is \$5,444,000 of Federal Home Loan Bank Stock and \$800,000 of Federal Reserve Stock which are classified as restricted investment securities, carried at cost, and evaluated for impairment. No impairment losses were recorded as of June 30, 2004. The Corporation was required at June 30, 2004 to have stock holdings of Federal Home Loan Bank Stock equal to .20% of the Corporation's total assets as of the previous year end plus 4.25% of its outstanding advancements from the Federal Home Loan Bank ( "FHLB" ). The Corporation is also required to have stock holdings of Federal Reserve Stock equal to 6% of its Capital Stock and Surplus.

**NOTE 3 - Investment Securities (cont d.)**

A summary of amortized cost and estimated fair values of investment securities is as follows (in thousands):

|   | June 30, 2003     |                              |                               |                   |
|---|-------------------|------------------------------|-------------------------------|-------------------|
|   | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value     |
| <b>Investment Securities - Available-for-Sale</b> |                   |                              |                               |                   |
| U.S. Government Agencies and Corporations         | \$ 126,114        | \$ 4,349                     | \$ -0-                        | \$ 130,463        |
| U.S. Government Agency Mortgage Backed Securities | 36,750            | 425                          | -0-                           | 37,175            |
| Obligations of States and Political Subdivisions  | 5,181             | 278                          | -0-                           | 5,459             |
| Community Reinvestment Act Investment Fund        | 3,000             | -0-                          | -0-                           | 3,000             |
| Federal Reserve and Federal Home Loan Bank Stock  | 2,144             | -0-                          | -0-                           | 2,144             |
| <b>Total Available-for-Sale Securities</b>        | <b>173,189</b>    | <b>5,052</b>                 | <b>-0-</b>                    | <b>178,241</b>    |
| <b>Total Investment Securities</b>                | <b>\$ 173,189</b> | <b>\$ 5,052</b>              | <b>\$ -0-</b>                 | <b>\$ 178,241</b> |

All investment securities are carried on the consolidated balance sheet as of June 30, 2003 at fair value. The net unrealized gain of \$5,052,000 is included in the Available-for-Sale Investment Securities balance. The unrealized gain, net of tax, is included in Shareholders Equity.

Included in the Federal Reserve and Federal Home Loan Bank Stock category at June 30, 2003 was \$1,824,000 of Federal Home Loan Bank Stock and \$320,000 of Federal Reserve Stock which are classified as restricted investment securities, carried at cost, and evaluated for impairment. No impairment losses were recorded as of June 30, 2003. The Corporation was required at June 30, 2003 to have stock holdings of Federal Home Loan Bank Stock equal to 5% of its outstanding advancements from the FHLB. The Corporation was also required to have stock holdings of Federal Reserve Stock equal to 6% of its Capital Stock and Surplus.

**NOTE 4 - Loans and Allowance for Loan Losses**

The book values of loans by major type are as follows (in thousands):

|                                    | June 30,          |                   | December 31,<br>2003 |
|------------------------------------|-------------------|-------------------|----------------------|
|                                    | 2004              | 2003              |                      |
| Commercial                         | \$ 249,230        | \$ 204,647        | \$ 219,805           |
| Real Estate Mortgage - Commercial  | 192,956           | 134,370           | 159,082              |
| Real Estate Mortgage - Residential | 83,398            | 54,594            | 67,635               |
| Real Estate Construction           | 104,237           | 72,422            | 74,069               |
| Loans to Individuals               | 42,865            | 34,007            | 33,178               |
|                                    | 672,686           | 500,040           | 553,769              |
| Allowance for Loan Losses          | (9,844)           | (7,412)           | (7,784)              |
| <b>Loans - Net</b>                 | <b>\$ 662,842</b> | <b>\$ 492,628</b> | <b>\$ 545,985</b>    |

Loans are net of unearned income of \$833,000 and \$545,000 at June 30, 2004 and 2003, respectively, and \$690,000 at December 31, 2003.

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**NOTE 4** - Loans and Allowance for Loan Losses (cont d)

Transactions in the allowance for loan losses are summarized as follows (in thousands):

|   | Six Months Ended<br>June 30, |                 | Year Ended<br>December 31,<br>2003 |
|---|------------------------------|-----------------|------------------------------------|
|   | 2004                         | 2003            |                                    |
| Balance, Beginning of Period                                | \$ 7,784                     | \$ 6,706        | \$ 6,706                           |
| Balance Acquired in the Arlington National Bank Acquisition | 1,254                        | -0-             | -0-                                |
| Provisions, Charged to Income                               | 1,005                        | 540             | 880                                |
| Loans Charged-Off   | (333)                        | (352)           | (539)                              |
| Recoveries of Loans Previously Charged-Off                  | 134                          | 518             | 737                                |
| <b>Net Loans (Charged-Off) Recovered</b>                    | <b>(199)</b>                 | <b>166</b>      | <b>198</b>                         |
| <b>Balance, End of Period</b>                               | <b>\$ 9,844</b>              | <b>\$ 7,412</b> | <b>\$ 7,784</b>                    |

The provisions for loan losses charged to operating expenses during the six months ended June 30, 2004 and June 30, 2003 of \$1,005,000 and \$540,000, respectively, were considered adequate to maintain the allowance in accordance with the policy discussed in Note 1, Summary of Significant Accounting Policies. For the year ended December 31, 2003, a provision of \$880,000 was recorded.

At June 30, 2004, the recorded investment in loans that are considered to be impaired under Statement of Financial Accounting Standards No. 114 was \$1,285,000 (of which \$1,285,000 were on non-accrual status). The related allowance for loan losses for these loans was \$261,000. The average recorded investment in impaired loans during the six months ended June 30, 2004 was approximately \$1,595,000. For this period the Corporation recognized no interest income on these impaired loans.

**NOTE 5** - Premises and Equipment

The investment in premises and equipment stated at cost and net of accumulated amortization and depreciation is as follows (in thousands):

|   | June 30,         |                  | December 31,<br>2003 |
|---|------------------|------------------|----------------------|
|   | 2004             | 2003             |                      |
| Land  | \$ 3,047         | \$ 2,212         | \$ 2,212             |
| Buildings and Improvements                      | 11,578           | 10,536           | 10,209               |
| Furniture & Equipment                           | 11,276           | 10,222           | 10,515               |
| <b>Total Cost</b>                               | <b>25,901</b>    | <b>22,970</b>    | <b>22,936</b>        |
| Less: Accumulated Amortization and Depreciation | 10,756           | 9,579            | 10,016               |
| <b>Net Book Value</b>                           | <b>\$ 15,145</b> | <b>\$ 13,391</b> | <b>\$ 12,920</b>     |

**NOTE 6** Goodwill and Other Intangible Assets

Goodwill represents the excess of the purchase price over the fair value of net assets acquired in business combinations under the purchase method of accounting. The Corporation has adopted Financial Accounting Standards Board Statement No. 142 (FAS 142), Goodwill and Other Intangible Assets. FAS 142 eliminates amortization of goodwill associated with business combinations completed after June 30, 2001. Goodwill is periodically assessed for impairment when events or changes in circumstances indicate that the carrying value of the asset may not be recoverable. The Corporation bases its evaluation on such impairment factors as the nature of the assets, the future economic benefit of the assets, any historical or future profitability measurements, as well as other external market conditions or factors that may be present. On May 1, 2004, the Corporation completed its acquisition of ANB Financial Corporation. A premium of \$10.4 million was paid in connection with the

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acquisition of ANB, \$2.6 million of which was identified as core deposit intangibles. The remaining \$7.8 million has been recorded as goodwill. In accordance with FAS 142, the goodwill will not be amortized. The core deposit intangibles are being amortized using a straight line method over their estimated useful life of 8 years. Amortization expense of \$55,000 has been recorded on the core deposit intangibles through June 30, 2004.

**NOTE 7 - Other Real Estate**

The carrying value of other real estate is as follows (in thousands):

|                   | June 30, |        | December 31,<br>2003 |
|-------------------|----------|--------|----------------------|
|                   | 2004     | 2003   |                      |
| Other Real Estate | \$ 366   | \$ -0- | \$ -0-               |

Included in Other Real Estate at June 30, 2004 was one residential property. There were no direct write-downs of other real estate charged to income for the six months ended June 30, 2004 or June 30, 2003. There were also no direct write-downs of other real estate charged to income for the year ended December 31, 2003.

Included in Other Assets at June 30, 2004 and June 30, 2003 were \$4,000 and \$125,000 of Other Foreclosed Assets. The 2004 and 2003 assets were comprised of motor vehicles. There were no direct write-downs of these assets as of June 30, 2004 or for any period during 2003.

**NOTE 8 - Deposits**

The book values of deposits by major type are as follows (in thousands):

|  | June 30,          |                   | December 31,<br>2003 |
|--|-------------------|-------------------|----------------------|
|  | 2004              | 2003              |                      |
| Noninterest-Bearing Demand Deposits                          | \$ 218,343        | \$ 176,603        | \$ 192,877           |
| Interest-Bearing Deposits:                                   |                   |                   |                      |
| Interest-Bearing Transaction Accounts and Money Market Funds | 263,039           | 197,130           | 195,184              |
| Savings  | 147,355           | 112,476           | 127,630              |
| Certificates of Deposits under \$100,000 and IRAs            | 71,550            | 64,283            | 62,275               |
| Certificates of Deposits \$100,000 or more                   | 75,087            | 60,938            | 63,099               |
| Other  | 316               | 316               | 316                  |
| <b>Total</b>   | <b>557,347</b>    | <b>435,143</b>    | <b>448,504</b>       |
| <b>Total Deposits</b>  | <b>\$ 775,690</b> | <b>\$ 611,746</b> | <b>\$ 641,381</b>    |

**NOTE 9 - Short Term Borrowings**

Securities sold under repurchase agreements generally represent borrowings with maturities ranging from one to thirty days. Information relating to these borrowings is summarized as follows (in thousands):

|  | Six Months Ended<br>June 30, |           | Year Ended<br>December 31,<br>2003 |
|--|------------------------------|-----------|------------------------------------|
|  | 2004                         | 2003      |                                    |
| Securities Sold Under Repurchase Agreements: |                              |           |                                    |
| Average Balance                              | \$ 30,995                    | \$ 20,695 | \$ 26,850                          |
| Period-End Balance                           | 36,663                       | 28,627    | 32,234                             |
| Maximum Month-End Balance During Period      | 36,663                       | 22,597    | 32,234                             |
| Interest Rate:                               |                              |           |                                    |
| Average                                      | 0.52%                        | 0.54%     | 0.31%                              |
| Period-End                                   | 0.63%                        | 0.46%     | 0.44%                              |
| Federal Home Loan Bank Advances:             |                              |           |                                    |

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|   |    |         |    |        |    |        |
|---|----|---------|----|--------|----|--------|
| Average Balance                         | \$ | 72,225  | \$ | 24,945 | \$ | 30,532 |
| Period-End Balance                      |    | 70,000  |    | 27,000 |    | 50,000 |
| Maximum Month-End Balance During Period |    | 100,000 |    | 34,300 |    | 50,000 |
| Interest Rate:                          |    |         |    |        |    |        |
| Average                                 |    | 1.45%   |    | 1.94%  |    | 1.65%  |
| Period-End                              |    | 1.68%   |    | 1.57%  |    | 1.52%  |
| Federal Funds Purchased:                |    |         |    |        |    |        |
| Average Balance                         | \$ | 3,051   | \$ | 2,802  | \$ | 2,774  |
| Period-End Balance                      |    | -0-     |    | -0-    |    | -0-    |
| Maximum Month-End Balance During Period |    | 21,525  |    | 1,350  |    | 7,200  |
| Interest Rate:                          |    |         |    |        |    |        |
| Average                                 |    | 1.28%   |    | 1.53%  |    | 1.41%  |
| Period-End                              |    | 0.00%   |    | 0.00%  |    | 0.00%  |



Note 9 Short Term Borrowings (cont d.)

The Corporation has available a line of credit with the FHLB of Dallas which allows it to borrow on a collateralized basis at a fixed term. The borrowings are collateralized by a blanket floating lien on all first mortgage loans, the FHLB capital stock owned by the Corporation and any funds on deposit with FHLB. At June 30, 2004, the Corporation had \$70.0 million of borrowings outstanding under the line of credit at a rate of 1.65%, \$30.0 million of which matures in 2004, \$30.0 million of which matures in 2005 and the last \$10.0 million of which matures in April 2006. Through June 30, 2004, the Corporation had average borrowings on this line of \$72.2 million. At June 30, 2003, the Corporation had \$27.0 million of borrowings outstanding under the line and the Corporation had another \$10.1 million borrowed under an arrangement to purchase an investment security which matured in July 2003.

NOTE 10 Notes Payable

On September 15, 2003, the Corporation obtained lines of credit from a bank under which the Corporation may borrow \$11,000,000 at a floating rate (three month LIBOR plus a margin of 2.00%). The lines of credit are secured by stock of the Bank and mature on September 15, 2004, whereupon, if balances are outstanding, the lines convert to term notes having five year terms. The Corporation will not pay a fee for any unused portion of the lines. At June 30, 2004, \$2,750,000 had been borrowed under these lines. The rate at June 30, 2004 was 3.11%.

NOTE 11 Junior Subordinated Deferrable Debentures

On May 3, 2004, the Corporation formed Summit Bancshares, Inc. Statutory Trust I ( SBI Trust ) and SBI Trust subsequently issued \$12.0 million of floating rate (three month LIBOR plus a margin of 2.65%) Capital Securities (the Trust Capital Securities ). Concurrent with the issuance of the Trust Capital Securities, SBI Trust issued trust common securities to the Corporation in the aggregate liquidation value of \$372,000. The proceeds of the issuance of the Trust Capital Securities and trust common securities were invested in the Corporation's Floating Rate Junior Subordinated Deferrable Debentures (the Deferrable Debentures ), which mature on July 7, 2034 and have a call feature that permits the Corporation to redeem any or all of the securities after July 7, 2009. The interest rate on the Deferrable Debentures at June 30, 2004 was 3.83%. The Deferrable Debentures, which are the only assets of SBI Trust, are subordinated and junior in right of payment to all present and future senior indebtedness (as defined in the Indenture dated May 3, 2004) of the Corporation.

NOTE 12 - Other Non-Interest Expense

The significant components of other non-interest expense are as follows (in thousands):

|                                 | Six Months Ended<br>June 30, |                 | Year Ended<br>December 31,<br>2003 |
|---------------------------------|------------------------------|-----------------|------------------------------------|
|                                 | 2004                         | 2003            |                                    |
| Business Development            | \$ 420                       | \$ 448          | \$ 762                             |
| Legal and Professional Fees     | 398                          | 330             | 688                                |
| Item Processing                 | 271                          | 357             | 672                                |
| Printing and Supplies           | 183                          | 205             | 435                                |
| Regulatory Fees and Assessments | 143                          | 124             | 250                                |
| Other                           | 1,205                        | 1,033           | 2,113                              |
| <b>Total</b>                    | <b>\$ 2,620</b>              | <b>\$ 2,497</b> | <b>\$ 4,920</b>                    |

NOTE 13 - Income Taxes

Federal income taxes included in the consolidated balance sheets are as follows (in thousands):

|                               | June 30, |       | December 31,<br>2003 |
|-------------------------------|----------|-------|----------------------|
|                               | 2004     | 2003  |                      |
| Current Tax Asset (Liability) | \$ 727   | \$ 59 | \$ (39)              |
| Net Deferred Tax Asset        | 4,155    | 788   | 1,677                |

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|                                |          |        |          |
|--------------------------------|----------|--------|----------|
| Total Included in Other Assets | \$ 4,882 | \$ 847 | \$ 1,638 |
|--------------------------------|----------|--------|----------|

The net deferred tax asset at June 30, 2004 of \$4,155,000 included \$1,147,000, a deferred tax asset related to unrealized losses on Available-for-Sale Securities.

**NOTE 13 - Income Taxes (cont d.)**

The components of income tax expense are as follows (in thousands):

|   | Six Months Ended<br>June 30, |                 | Year Ended<br>December 31,<br>2003 |
|---|------------------------------|-----------------|------------------------------------|
|   | 2004                         | 2003            |                                    |
| <b>Federal Income Tax Expense:</b>      |                              |                 |                                    |
| Current                                 | \$ 3,109                     | \$ 2,677        | \$ 4,681                           |
| Deferred (benefit)                      | (440)                        | (156)           | 336                                |
| <b>Total Federal Income Tax Expense</b> | <b>\$ 2,669</b>              | <b>\$ 2,521</b> | <b>\$ 5,017</b>                    |
| <b>Effective Tax Rates</b>              | <b>34.60%</b>                | <b>34.00%</b>   | <b>34.00%</b>                      |

The reasons for the difference between income tax expense and the amount computed by applying the statutory federal income tax rate to operating earnings are as follows (in thousands):

|   | Six Months Ended<br>June 30, |                 | Year Ended<br>December 31,<br>2003 |
|---|------------------------------|-----------------|------------------------------------|
|   | 2004                         | 2003            |                                    |
| Federal Income Taxes at Statutory Rate of 34.5% | \$ 2,662                     | \$ 2,542        | \$ 5,071                           |
| Effect of Tax Exempt Interest Income            | (42)                         | (45)            | (94)                               |
| Non-deductible Expenses                         | 66                           | 35              | 70                                 |
| Other   | (17)                         | (11)            | (30)                               |
| <b>Income Taxes Per Income Statement</b>        | <b>\$ 2,669</b>              | <b>\$ 2,521</b> | <b>\$ 5,017</b>                    |

Deferred income tax expense (benefit) results from differences between amounts of assets and liabilities as measured for income tax return and financial reporting purposes. The significant components of federal deferred tax assets and liabilities are in the following table (in thousands):

|  | Six Months Ended<br>June 30, |              | Year Ended<br>December 31,<br>2003 |
|--|------------------------------|--------------|------------------------------------|
|  | 2004                         | 2003         |                                    |
| <b>Federal Deferred Tax Assets:</b>                |                              |              |                                    |
| Allowance for Loan Losses                          | \$ 3,396                     | \$ 2,542     | \$ 2,667                           |
| Valuation Reserves - Other Real Estate             | 15                           | 2            | 2                                  |
| Interest on Non-accrual Loans                      | 148                          | 210          | 121                                |
| Unrealized Losses on Available-for-Sale Securities | 1,147                        | -0-          | -0-                                |
| Deferred Compensation                              | 594                          | 544          | 541                                |
| Other  | 183                          | 9            | -0-                                |
| <b>Gross Federal Deferred Tax Assets</b>           | <b>5,483</b>                 | <b>3,307</b> | <b>3,331</b>                       |
| <b>Federal Deferred Tax Liabilities:</b>           |                              |              |                                    |
| Depreciation and Amortization                      | 1,188                        | 563          | 1,087                              |
| Accretion  | 29                           | 196          | 135                                |
| Unrealized Gains on Available-for-Sale Securities  | -0-                          | 1,718        | 354                                |
| Other  | 111                          | 42           | 78                                 |

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|  |          |        |          |
|--|----------|--------|----------|
| Gross Federal Deferred Tax Liabilities | 1,328    | 2,519  | 1,654    |
| Net Deferred Tax Asset                 | \$ 4,155 | \$ 788 | \$ 1,677 |

NOTE 14 - Related Party Transactions

The Bank has made transactions in the ordinary course of business with certain of its and the Corporation's officers, directors and their affiliates. All loans included in such transactions are made on substantially the same terms, including interest rate and collateral, as those prevailing at the time for comparable transactions with other persons and all loans are current as to principal and interest payments. Total loans outstanding to such parties amounted to approximately \$8,775,000 at June 30, 2004, \$9,389,000 at December 31, 2003 and \$9,002,000 at June 30, 2003.

**NOTE 15 - Commitments and Contingent Liabilities**

In the normal course of business, there are various outstanding commitments and contingent liabilities, such as guarantees and commitments to extend credit, which are not reflected in the financial statements. No losses are anticipated as a result of these transactions. Commitments are most frequently extended for real estate, commercial and industrial loans.

At June 30, 2004, outstanding documentary and standby letters of credit totaled \$5,327,000 and commitments to extend credit totaled \$170,148,000.

In addition, the Corporation leases certain office facilities under operating leases. Rent expense for all operating leases totaled \$496,000 and \$383,000 for the six months ended June 30, 2004 and 2003, respectively, and \$981,000 for the year ended December 31, 2003. Included in the June 30, 2004 totals is \$27,000 of lease expense related to the ANB facilities.

**NOTE 16 - Stock Option Plans**

The Corporation has two Incentive Stock Option Plans, the 1993 Plan and the 1997 Plan, (each, a Plan, and, collectively, the Plans ). Each Plan has reserved 600,000 shares (adjusted for two-for-one stock splits in 1995 and 1997) of common stock for grants thereunder. The Plans provide for the granting to executive management and other key employees of the Corporation and its subsidiaries incentive stock options, as defined under the current tax law. The options under the Plans will be exercisable for ten years from the date of grant and generally vest ratably over a five year period. Options will be and have been granted at prices which will not be less than 100-110% of the fair market value of the underlying common stock at the date of grant.

The following is a summary of transactions during the periods presented:

|  | Shares Under Option               |                                 |
|--|-----------------------------------|---------------------------------|
|  | Six Months Ended<br>June 30, 2004 | Year Ended<br>December 31, 2003 |
| Outstanding, Beginning of Period             | 379,659                           | 418,934                         |
| Additional Options Granted During the Period | 30,000                            | 25,000                          |
| Forfeited During the Period                  | (14,000)                          | (11,050)                        |
| Exercised During the Period                  | (37,620)                          | (53,225)                        |
| Outstanding, End of Period                   | 358,039                           | 379,659                         |

Options outstanding at June 30, 2004 ranged in price from \$5.25 to \$31.76 per share with a weighted average exercise price of \$15.11 and 277,499 shares exercisable. At June 30, 2004, there remained 320,250 shares reserved for future grants of options under the 1997 Plan. See Note 1 Summary of Significant Accounting Policies under Stock Based Compensation for information regarding the dilutive impact of these stock options.

**NOTE 17 - Employee Benefit Plans****401(k) Plan**

The Corporation implemented a 401(k) plan in December 1997 covering substantially all employees. The Corporation made no contribution to this plan in 1999 or 1998. In 2000 through 2003, the Corporation made matching contributions, not to exceed 6% of the employee's annual compensation, to the participant's deferrals of compensation up to 100% of the employee contributions.

The amount expensed in support of the 401(k) plan was \$267,000 and \$208,000 during the first six months of 2004 and 2003, respectively, and \$411,000 for the year ended December 31, 2003.

**Supplemental Executive Retirement Plan**

In 2002, the Corporation established a Supplemental Executive Retirement Plan (the Retirement Plan ) to provide key employees with retirement, death or disability benefits. For currently employed employees, the Retirement Plan replaces the previous Management Security

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Plan. The current Retirement Plan is a defined contribution plan. The expense charged to earnings for such future obligations was \$85,000 and \$103,000 for the first six months of 2004 and 2003, respectively, and \$202,000 for the year ended December 31, 2003.

### Employment Contracts

The Chief Executive Officer of the Corporation has entered into a severance agreement providing for salary and fringe benefits in the event of termination, other than for cause, and under certain changes in control of the Corporation.

### Other Post Retirement Benefits

The Corporation provides certain health care benefits for certain retired employees who bear all costs of these benefits. These benefits are covered under the Consolidated Omnibus Budget Reconciliation Act (COBRA).

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**NOTE 18 - Earnings per Share**

The following data shows the amounts used in computing earnings per share and the weighted average number of shares of dilutive potential common stock (dollars in thousands):

|  | Six Months Ended<br>June 30, |           | Year Ended<br>December 31,<br>2003 |
|--|------------------------------|-----------|------------------------------------|
|  | 2004                         | 2003      |                                    |
| Net income   | \$ 5,047                     | \$ 4,890  | \$ 9,768                           |
| Weighted average number of common shares used in Basic EPS                               | 6,156,177                    | 6,163,981 | 6,160,780                          |
| Effect of dilutive stock options   | 176,132                      | 129,713   | 156,382                            |
| Weighted number of common shares and dilutive potential common stock used in Diluted EPS | 6,332,309                    | 6,293,694 | 6,317,162                          |

**NOTE 19 - Financial Instruments with Off-Balance Sheet Risk**

The Corporation is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include loan commitments, standby letters of credit and documentary letters of credit. The instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the financial statements.

The Corporation's exposure to credit loss in the event of non-performance by the other party of these loan commitments and standby letters of credit is represented by the contractual amount of those instruments. The Corporation uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

The total contractual amounts of financial instruments with off-balance sheet risk are as follows (in thousands):

|  | June 30,   |            |
|--|------------|------------|
|  | 2004       | 2003       |
| <b>Financial Instruments Whose Contract Amounts Represent Credit Risk:</b> |            |            |
| Loan Commitments Including Unfunded Lines of Credit                        | \$ 170,148 | \$ 136,408 |
| Standby Letters of Credit  | 5,327      | 5,438      |

Loan commitments are agreements to lend to a customer as long as there is no customer violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Standby letters of credit are conditional commitments by the Corporation to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

Since many of the loan commitments and letters of credit may expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements. The Corporation evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Corporation upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, owner occupied real estate and income-producing commercial properties.

**NOTE 20 - Concentrations of Credit Risk**

The Bank makes commercial, consumer and real estate loans in its direct market which is defined as Fort Worth and its surrounding area. The Board of Directors of the Bank monitors concentrations of credit by purpose, collateral and industry at least quarterly. Certain limitations for concentration are set by the Board of Directors of the Bank. Additional loans in excess of these limits must have prior approval of the Bank's directors' loan committee. Although the Bank has a diversified loan portfolio, a substantial portion of its debtors' abilities to honor their contracts is dependent upon the strength of the local and state economy.

NOTE 21 - Litigation

The Corporation is involved in legal actions arising in the ordinary course of business. It is the opinion of management, after reviewing such actions with outside legal counsel, that the settlement of these matters will not materially affect the Corporation's financial position.



**NOTE 22 - Stock Repurchase Plan**

On April 20, 2004, the Board of Directors of the Corporation approved a stock repurchase plan. The plan authorized management to purchase up to 307,680 shares of the Corporation's common stock over the next twelve months through the open market or in privately negotiated transactions in accordance with all applicable state and federal laws and regulations.

In the six months ended June 30, 2004, 20,500 shares were purchased by the Corporation pursuant to the stock repurchase plan through the open market.

**NOTE 23 - Subsequent Event**

On July 20, 2004, the Board of Directors of the Corporation approved a quarterly dividend of \$.14 per share to be paid on August 16, 2004 to shareholders of record on August 2, 2004.

**NOTE 24 - Fair Values of Financial Instruments**

The following methods and assumptions were used by the Corporation in estimating its fair value disclosures for financial instruments:

*Cash and cash equivalents:* The carrying amounts reported in the balance sheet for cash and due from banks and federal funds sold approximate those assets' fair values.

*Investment securities (including mortgage-backed securities):* Fair values for investment securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments.

*Loans:* For variable-rate loans, fair values are based on carrying values. The fair values for fixed rate loans such as mortgage loans (e.g., one-to-four family residential) and installment loans are estimated using discounted cash flow analysis. The carrying amount of accrued interest receivable approximates its fair value.

*Deposit liabilities:* The fair value disclosed for interest-bearing and noninterest-bearing demand deposits, passbook savings, and certain types of money market accounts are, by definition, equal to the amount payable on demand at the reporting date or their carrying amounts. Fair values for fixed rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

*Short-term borrowings:* The carrying amounts of borrowings under repurchase agreements approximate their fair values.

The estimated fair values of the Corporation's financial instruments are as follows (in thousands):

|  | June 30,           |               |                    |               |
|--|--------------------|---------------|--------------------|---------------|
|  | 2004               |               | 2003               |               |
|  | Carrying<br>Amount | Fair<br>Value | Carrying<br>Amount | Fair<br>Value |
| <b>Financial Assets</b>                        |                    |               |                    |               |
| Cash and due from banks                        | \$ 32,899          | \$ 32,899     | \$ 28,669          | \$ 28,669     |
| Federal funds sold and Due From Time           | 17,551             | 17,551        | 14,975             | 14,975        |
| Securities                                     | 214,991            | 214,991       | 178,241            | 178,241       |
| Loans  | 672,686            | 677,903       | 500,040            | 509,607       |
| Allowance for loan losses                      | (9,844)            | (9,844)       | (7,412)            | (7,412)       |
| <b>Financial Liabilities</b>                   |                    |               |                    |               |
| Deposits                                       | 775,690            | 777,158       | 611,746            | 609,555       |
| Short Term Borrowings                          | 121,785            | 122,019       | 55,627             | 55,867        |
| <b>Off-balance Sheet Financial Instruments</b> |                    |               |                    |               |
| Loan commitments                               |                    | 170,148       |                    | 136,408       |
| Letters of credit                              |                    | 5,327         |                    | 5,438         |

NOTE 25 - Comprehensive Income

The Corporation has adopted Statement of Financial Accounting Standards No. 130 Reporting Comprehensive Income. This standard requires an entity to report and display comprehensive income and its components. Comprehensive income is as follows (in thousands):

|   | <b>Six Months Ended<br/>June 30,</b> |                 | <b>Year Ended<br/>December 31,<br/>2003</b> |
|---|--------------------------------------|-----------------|---|
|   | <b>2004</b>                          | <b>2003</b>     |   |
| Net Income  | \$ 5,047                             | \$ 4,890        | \$ 9,768                                    |
| Other Comprehensive Income:   |                                      |                 |   |
| Unrealized (loss) gain on securities available-for-sale, net of tax | (2,915)                              | 474             | (2,173)                                     |
| <b>Comprehensive Income</b>   | <b>\$ 2,132</b>                      | <b>\$ 5,364</b> | <b>\$ 7,595</b>                             |

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

*The following discussion should be read in conjunction with the consolidated financial statements, accompanying notes and selected financial data appearing elsewhere in this Quarterly Report on Form 10-Q and in our Annual Report on Form 10-K for the year ended December 31, 2003 and may contain certain forward-looking statements that are based on current management expectations. Generally, verbs in the future tense and the words believe, expect, anticipate, estimate, intends, opinion, potential and similar expressions identify forward-looking statements. Examples of this forward-looking information include, but are not limited to, the discussion of allowance for loan losses, continued loan growth and loan growth rates and liquidity. Our actual results could differ materially from those management expectations. Further information concerning our business, including additional risk factors and uncertainties that could cause actual results to differ materially from the forward-looking statements contained in this Quarterly Report on Form 10-Q, are set forth below under the heading Factors That May Affect Future Results. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. The forward-looking statements contained herein speak only as of the date of this Quarterly Report on Form 10-Q and, except as may be required by applicable law and regulation, we do not undertake, and specifically disclaim any obligation to, publicly update or revise such statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events. Except as the context otherwise requires, references herein to the Corporation, we, or our refer to the business of Summit Bancshares, Inc. and its consolidated subsidiaries.*

Overview

Our business has been conducted primarily through our wholly-owned subsidiaries, Summit Bank, National Association, (the Bank), Summit Delaware Financial Corporation, SIA Insurance Agency, Inc. (SIA) and Summit Bancshares, Inc. Statutory Trust I (SBI Trust). The Bank currently operates its branch offices in twelve locations in Tarrant County.

Our results of operations are primarily dependent on net interest income, which is the difference between the income earned on our loans and investment portfolios and our cost of funds, consisting of the interest paid on deposits and borrowings. Results of operations are also affected by our allowance for loan losses, investment activities, loan servicing fees and other fees. Our non-interest expense principally consists of compensation and benefits, occupancy and equipment expense, advertising costs, data processing expense and other expenses.

Net income for the second quarter of 2004 was \$2,596,000, an increase of \$139,000, or 5.7%, compared to \$2,457,000 recorded for the second quarter of 2003. On a weighted average share basis, net income for the second quarter of 2004 was \$0.41 per diluted share as compared to \$0.39 per diluted share for the second quarter of 2003. Net income for the first six months of 2004 was \$5,047,000, an increase of \$157,000, or 3.2%, compared to net income of \$4,890,000 for the first six months of 2003. On a weighted average share basis, net income for the first six months of 2004 was \$.80 per diluted share compared to \$.78 per diluted share for the first six months of 2003. The increase in earnings during the second quarter of 2004 and for the first six months of 2004 was primarily due to an increase in net interest income (tax equivalent) of \$1,411,000 for the second quarter of 2004 over the second quarter of 2003 and \$2,261,000 for the first six months of 2004 over the first six months of 2003. The increase in net interest income was primarily due to the growth in average loans and the acquisition of ANB Financial Corporation and its wholly-owned subsidiary, Arlington National Bank (collectively ANB). Average loans for the second quarter of 2004, excluding the impact of the ANB acquisition, grew 20.6% compared to the second quarter of 2003. Including the ANB acquisition, average loans for the second quarter were 28.7% more than average loans for the second quarter of 2003. Average loans for the first six months ended June 30, 2004 were 24.7% higher than the average for loans for the first six months ended June 30, 2003.

Based in part on an improving economy in our market area, the hiring of additional commercial lending personnel and the ANB acquisition, total loans at June 30, 2004 were \$672.7 million, which represented an increase of \$118.9 million, or 21.5%, over total loans at December 31, 2003 and an increase of \$172.6 million, or 34.5% over total loans at June 30, 2003. Excluding the impact of the ANB acquisition, total loans increased \$112.4 million, or 22.5% over the prior year. Although we do not expect to see loan growth rates from quarter to quarter to be as high as they have been the past few quarters, we do expect double digit loan growth for the full year of 2004. Total deposits at June 30, 2004 of \$775.7 million increased \$134.3 million, or 20.9% from December 31, 2003 and increased \$164.0 million, or 26.8% from \$611.7 million at June 30, 2003. Excluding the impact of the ANB acquisition, total deposits at June 30, 2004 grew \$64.2 million, or 10.5% from the prior year period. We experienced growth in every category of deposits during the second quarter of 2004 with the largest growth coming in demand deposits and interest-bearing transaction accounts which increased \$41.7 million and \$65.9 million, respectively, compared to the second quarter of 2003. Shareholders' equity remained constant at \$68.7 million as of June 30, 2004 and June 30, 2003.

The following table shows selected performance ratios for the first six months of 2004 and 2003 that management believes to be key indicators of our performance:

|  | Six Months Ended<br>June 30, |       |
|--|------------------------------|-------|
|  | 2004                         | 2003  |
| Annualized Return on Average Assets (ROAA)               | 1.17%                        | 1.40% |
| Annualized Return on Average Shareholders' Equity (ROAE) | 14.43                        | 14.72 |
| Shareholders' Equity to Assets - Average                 | 8.11                         | 9.52  |
| Dividend Payout Ratio                                    | 34.20                        | 30.29 |
| Net Interest Margin (tax equivalent)                     | 4.27                         | 4.60  |
| Efficiency Ratio   | 57.48                        | 55.60 |

The return on average assets ratio is calculated by dividing net income by average total assets for the period. Management believes our return on average asset ratio of 1.17% for the first six months of 2004 is comparable to the return on average assets of other financial institutions in our peer group, which was 1.26% in the first six months of 2004. Our peer group is comprised of other publicly traded bank holding companies headquartered in Texas and was selected by our management.

The return on average shareholders' equity ratio is calculated by dividing net income by average shareholders' equity for the period. Management believes our return on average shareholders' equity ratio of 14.43% for the first six months of 2004 compares favorably to the return on average shareholders' equity ratio of other financial institutions in our peer group, which was 14.01% in the first six months of 2004.

The shareholders' equity to assets ratio is calculated by dividing average shareholders' equity by average total assets for the period. Management believes our average shareholders' equity to average assets ratio of 8.11% for the first six months of 2004 is comparable to the average shareholders' equity to average asset ratio of other financial institutions in our peer group, which was 8.97% in the first six months of 2004.

The dividend payout ratio is determined by dividing the total dividends paid by net income for the period. Our dividend payout ratio results in a yield-to-market price return equal to or greater than our peer group.

Net interest margin is calculated by dividing net interest income on a tax equivalent basis by average total earning assets. Management believes our net interest margin of 4.27% for the first six months of 2004 compares favorably to the net interest margin ratio of other financial institutions in our peer group, which was 4.07% in the first six months of 2004.

The efficiency ratio is calculated by dividing non-interest expenses by the sum of total non-interest income and net interest income for the period. The efficiency ratio provides a measure of the extent to which our revenues are absorbed by our non-interest expenses. Management believes our efficiency ratio of 57.48% for the first six months of 2004 compares favorably to the average efficiency ratio of other financial institutions in our peer group, which was 60.63% in the first six months of 2004.

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Summary of Earning Assets and Interest-Bearing Liabilities

The following schedule presents average balance sheets that highlight earning assets and interest-bearing liabilities and their related rates earned and paid for the second quarter of 2004 and 2003 (rates on tax equivalent basis):

**Three Months Ended June 30,**

|   | 2004              |               |                    | 2003              |              |                    |
|---|-------------------|---------------|--------------------|-------------------|--------------|--------------------|
|   | Average Balances  | Interest      | Average Yield/Rate | Average Balances  | Interest     | Average Yield/Rate |
| (Dollars in Thousands)  |                   |               |                    |                   |              |                    |
| <b>Earning Assets:</b>  |                   |               |                    |                   |              |                    |
| Federal Funds Sold & Due From Time                              | \$ 31,177         | \$ 75         | 0.96%              | \$ 11,689         | \$ 33        | 1.13%              |
| Investment Securities (Taxable)                                 | 190,212           | 1,778         | 3.76%              | 160,498           | 1,599        | 4.00%              |
| Investment Securities (Tax-exempt)                              | 6,760             | 88            | 5.26%              | 5,102             | 71           | 5.62%              |
| Loans, Net of Unearned Discount <sup>(1)</sup>                  | 642,935           | 9,391         | 5.87%              | 499,545           | 7,878        | 6.33%              |
| <b>Total Earning Assets</b>                                     | <b>871,084</b>    | <b>11,332</b> | <b>5.23%</b>       | <b>676,834</b>    | <b>9,581</b> | <b>5.68%</b>       |
| <b>Non-interest Earning Assets:</b>                             |                   |               |                    |                   |              |                    |
| Cash and Due From Banks   | 28,813            |               |                    | 27,970            |              |                    |
| Other Assets  | 35,256            |               |                    | 21,648            |              |                    |
| Allowance for Loan Losses                                       | (9,323)           |               |                    | (7,382)           |              |                    |
| <b>Total Assets</b>   | <b>\$ 925,830</b> |               |                    | <b>\$ 719,070</b> |              |                    |
| <b>Interest-Bearing Liabilities:</b>                            |                   |               |                    |                   |              |                    |
| Interest-Bearing Transaction Accounts and Money Market Funds    | \$ 238,697        | 637           | 1.07%              | \$ 192,773        | 570          | 1.19%              |
| Savings   | 143,322           | 408           | 1.15%              | 114,259           | 411          | 1.44%              |
| Certificates of Deposit under \$100,000 and IRAs                | 68,459            | 366           | 2.15%              | 63,000            | 401          | 2.55%              |
| Certificates of Deposit \$100,000 or more                       | 71,019            | 424           | 2.40%              | 59,072            | 397          | 2.70%              |
| Other Time  | 316               | 2             | 2.87%              | 316               | 2            | 2.20%              |
| Other Borrowings  | 121,193           | 437           | 1.45%              | 48,866            | 153          | 1.26%              |
| <b>Total Interest-Bearing Liabilities</b>                       | <b>643,006</b>    | <b>2,274</b>  | <b>1.42%</b>       | <b>478,286</b>    | <b>1,934</b> | <b>1.62%</b>       |
| <b>Non-interest Bearing Liabilities:</b>                        |                   |               |                    |                   |              |                    |
| Demand Deposits   | 207,815           |               |                    | 170,234           |              |                    |
| Other Liabilities   | 4,426             |               |                    | 2,811             |              |                    |
| Shareholders' Equity  | 70,583            |               |                    | 67,739            |              |                    |
| <b>Total Liabilities and Shareholders' Equity</b>               | <b>\$ 925,830</b> |               |                    | <b>\$ 719,070</b> |              |                    |
| <b>Net Interest Income and Margin (Tax-equivalent Basis)(2)</b> |                   |               |                    |                   |              |                    |
|   |                   | \$ 9,058      | 4.18%              |                   | \$ 7,647     | 4.53%              |

(1) Loan interest income includes various loan fees and loan volumes include loans on non-accrual. The loan fees include loan origination fees which are considered adjustments to interest income. These fees aggregated \$400,000 and \$331,000 for the quarter ended June 30, 2004 and 2003, respectively, and \$1,248,000 for the year ended December 31, 2003. Related loan origination costs are not separately allocated to loans, but are charged to non-interest expense. For the purpose of calculating loan yields, average loan balances include non-accrual loans with no related interest income.

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(2) Presented on tax equivalent basis ( T/E ) using a federal income tax rate of 34% both years.

The net interest margin was 4.18% for the second quarter of 2004, which represented a decrease of 35 basis points from the second quarter of 2003. This decrease in net interest margin reflected a 45 basis point decrease in yield on earning assets from the second quarter of 2003 to the second quarter of 2004, which was partially offset by a 20 basis point decrease in rates paid on interest-bearing liabilities from the second quarter of 2003 to the second quarter of 2004. The decrease in net interest margin also reflected less earned income from our investment in earning assets of our non-interest fundings, demand deposits and shareholders' equity, in the second quarter of 2004 compared to the second quarter of 2003 due to the lower interest rate environment during the second quarter of 2004. In addition, the net interest margin was negatively impacted by a higher level of liquidity in the quarter in anticipation of rising interest rates with short-term investments averaging \$31.2 for the quarter.

Summary of Earning Assets and Interest-Bearing Liabilities (cont. d.)

The following schedule presents average balance sheets that highlight earning assets and interest-bearing liabilities and their related rates earned and paid for the first six months of 2004 and 2003 (rates on tax equivalent basis):

|  | Six Months Ended June 30, |                  |                       |                     |                  |                       |
|--|---------------------------|------------------|-----------------------|---------------------|------------------|-----------------------|
|  | 2004                      |                  |                       | 2003                |                  |                       |
|  | Average<br>Balances       | Interest         | Average<br>Yield/Rate | Average<br>Balances | Interest         | Average<br>Yield/Rate |
| (Dollars in Thousands)   |                           |                  |                       |                     |                  |                       |
| <b>Earning Assets:</b>   |                           |                  |                       |                     |                  |                       |
| Federal Funds Sold & Due From Time   | \$ 18,300                 | \$ 88            | 0.96%                 | \$ 6,517            | \$ 37            | 1.14%                 |
| Investment Securities (Taxable)  | 185,701                   | 3,496            | 3.77%                 | 163,042             | 3,310            | 4.09%                 |
| Investment Securities (Tax-exempt)   | 6,779                     | 178              | 5.27%                 | 5,049               | 142              | 5.69%                 |
| Loans, Net of Unearned Discount(1)   | 608,398                   | 17,805           | 5.89%                 | 487,985             | 15,377           | 6.35%                 |
| <b>Total Earning Assets</b>  | <b>819,178</b>            | <b>21,567</b>    | <b>5.29%</b>          | <b>662,593</b>      | <b>18,866</b>    | <b>5.74%</b>          |
| <b>Non-interest Earning Assets:</b>  |                           |                  |                       |                     |                  |                       |
| Cash and Due From Banks  | 26,975                    |                  |                       | 26,810              |                  |                       |
| Other Assets   | 29,417                    |                  |                       | 21,667              |                  |                       |
| Allowance for Loan Losses  | (8,651)                   |                  |                       | (7,190)             |                  |                       |
| <b>Total Assets</b>  | <b>\$ 866,919</b>         |                  |                       | <b>\$ 703,880</b>   |                  |                       |
| <b>Interest-Bearing Liabilities:</b>                                       |                           |                  |                       |                     |                  |                       |
| Interest-Bearing Transaction Accounts and Money Market Funds               | \$ 217,810                | 1,155            | 1.07%                 | \$ 184,956          | 1,033            | 1.13%                 |
| Savings  | 137,301                   | 793              | 1.16%                 | 115,407             | 807              | 1.41%                 |
| Certificates of Deposit under \$100,000 and IRAs                           | 65,254                    | 711              | 2.19%                 | 63,013              | 827              | 2.65%                 |
| Certificates of Deposit \$100,000 or more                                  | 67,402                    | 815              | 2.43%                 | 56,724              | 770              | 2.74%                 |
| Other Time   | 316                       | 4                | 2.84%                 | 316                 | 4                | 2.22%                 |
| Other Borrowings   | 111,271                   | 712              | 1.29%                 | 48,442              | 309              | 1.29%                 |
| <b>Total Interest-Bearing Liabilities</b>                                  | <b>599,354</b>            | <b>4,190</b>     | <b>1.41%</b>          | <b>468,858</b>      | <b>3,750</b>     | <b>1.61%</b>          |
| <b>Non-interest Bearing Liabilities:</b>                                   |                           |                  |                       |                     |                  |                       |
| Demand Deposits  | 193,605                   |                  |                       | 165,151             |                  |                       |
| Other Liabilities  | 3,610                     |                  |                       | 2,871               |                  |                       |
| Shareholders' Equity   | 70,350                    |                  |                       | 67,000              |                  |                       |
| <b>Total Liabilities and Shareholders' Equity</b>                          | <b>\$ 866,919</b>         |                  |                       | <b>\$ 703,880</b>   |                  |                       |
| <b>Net Interest Income and Margin (Tax-equivalent Basis)<sup>(2)</sup></b> |                           | <b>\$ 17,377</b> | <b>4.27%</b>          |                     | <b>\$ 15,116</b> | <b>4.60%</b>          |

(1) Loan interest income includes various loan fees and loan volumes include loans on non-accrual. The loan fees include loan origination fees which are considered adjustments to interest income. These fees aggregated \$734,000 and \$593,000 through June 30, 2004 and 2003, respectively, and \$1,248,000 for the year ended December 31, 2003. Related loan origination costs are not separately allocated to loans, but are charged to non-interest expense. For the purpose of calculating loan yields, average loan balances include non-accrual loans with no related interest income.

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(2) Presented on tax equivalent basis ( T/E ) using a federal income tax rate of 34% both years.

The net interest margin for the six months ended June 30, 2004 was 4.27%, which represented a decrease of 33 basis points from the 4.60% net interest margin earned for the six months ended June 30, 2003. This decrease in net interest margin for the six months ended June 30, 2004 reflected a 45 basis point decrease in yield on earning assets, which was partially offset by a 20 basis point decrease in rates paid on interest-bearing liabilities from the prior year period. The decrease in net interest margin also reflected less earned income from our investment in earning assets funded by our non-interest fundings, demand deposits and shareholders' equity.

In the event that our average loans continue to grow during the second half of 2004 and we are unable to fund any such growth solely through the generation of additional deposits, we may be required to obtain funding from secondary sources, such as the Federal Home Loan Bank, which could have a negative impact on our net interest margin. Therefore, we may experience a slightly lower net interest margin during the second half of 2004 as a result of any such borrowings and as our investment portfolio and maturing fixed rate loans reprice at lower rates. Because of the composition of our balance sheet and our emphasis on commercial lending, we are market interest rate sensitive and expect to benefit from any market interest rate increases, such as the increase that occurred in late June 2004.



Net Interest Income

Net interest income (tax equivalent) for the second quarter of 2004 was \$9,058,000 which represented an increase of \$1,411,000 or 18.5%, over the second quarter of 2003. In this same period, tax equivalent interest income increased \$1,751,000, or 18.3%, while interest expense increased \$340,000, or 17.6%, compared to the second quarter of 2003. The net increases in net interest income resulted from a 28.7% growth in average earning assets for the second quarter of 2004 compared to the second quarter of 2003, which offset a decline in market interest rates (as measured by average market rates published in the Wall Street Journal) from the first of January 2003 through June 2004.

Net interest income (tax equivalent) for the first six months of 2004 was \$17,377,000 which represented an increase of \$2,261,000, or 15.0%, over the first six months of 2003. In this same period, tax equivalent interest income increased \$2,700,000 or 14.3%, while interest expense increased \$439,000, or 11.7%, compared to the first six months of 2003. The net increases in net interest income resulted from a 23.6% growth in average earning assets for the first six months of 2004 compared to the first six months of 2003, which offset a decline in market interest rates (as measured by average market rates published in the Wall Street Journal) from the first of January 2003 through June 2004.

The following table summarizes the effects of changes in interest rates, average volumes of earning assets and interest bearing liabilities on net interest income (tax equivalent) for the periods ended June 30, 2004 and 2003:

ANALYSIS OF CHANGES IN NET INTEREST INCOME  
(Dollars in Thousands)

|                                      | 2nd Qtr. 2004 vs. 2nd Qtr. 2003<br>Increase (Decrease)<br>Due to Changes in: |                 |                 | Six Months 2004 vs. Six Months 2003<br>Increase (Decrease)<br>Due to Changes in: |                   |                 |
|--------------------------------------|--|-----------------|-----------------|--|-------------------|-----------------|
|                                      | Volume   | Rate            | Total           | Volume   | Rate              | Total           |
| <b>Interest Earning Assets:</b>      |  |                 |                 |  |                   |                 |
| Federal Funds Sold                   | \$ 55  | \$ (13)         | \$ 42           | \$ 67  | \$ (16)           | \$ 51           |
| Investment Securities (Taxable)      | 294  | (114)           | 180             | 453  | (267)             | 186             |
| Investment Securities (Tax-exempt)   | 23   | (6)             | 17              | 48   | (13)              | 35              |
| Loans, Net of Unearned Discount      | 2,255  | (743)           | 1,512           | 3,805  | (1,377)           | 2,428           |
| <b>Total Interest Income</b>         | <b>2,627</b>   | <b>(876)</b>    | <b>1,751</b>    | <b>4,373</b>   | <b>(1,673)</b>    | <b>2,700</b>    |
| <b>Interest-Bearing Liabilities:</b> |  |                 |                 |  |                   |                 |
| Deposits                             | 350  | (294)           | 56              | 505  | (468)             | 37              |
| Other Borrowings                     | 287  | (3)             | 284             | 462  | (60)              | 402             |
| <b>Total Interest Expense</b>        | <b>637</b>   | <b>(297)</b>    | <b>340</b>      | <b>967</b>   | <b>(528)</b>      | <b>439</b>      |
| <b>Net Interest Income</b>           | <b>\$ 1,990</b>  | <b>\$ (579)</b> | <b>\$ 1,411</b> | <b>\$ 3,406</b>  | <b>\$ (1,145)</b> | <b>\$ 2,261</b> |

Non-Interest Income

The major component of non-interest income is service charges on deposits. Other service fees are the majority of other non-interest income. The following table reflects the changes in non-interest income during the periods presented (dollars in thousands):

|                                     | Three Months Ended<br>June 30, |        |          | Six Months Ended<br>June 30, |          |          |
|-------------------------------------|--------------------------------|--------|----------|------------------------------|----------|----------|
|                                     | 2004                           | 2003   | % Change | 2004                         | 2003     | % Change |
| Service Charges on Deposit Accounts | \$ 1,078                       | \$ 890 | 21.1%    | \$ 1,984                     | \$ 1,649 | 20.3%    |
| Gain on Sale of Securities          | -0-                            | 12     | (100.0)  | -0-                          | 12       | (100.0)  |
| Non-recurring Income                | -0-                            | 42     | (100.0)  | 167                          | 42       | 297.6    |
| Other Non-interest Income           | 645                            | 654    | (1.4)    | 1,139                        | 1,243    | (8.4)    |

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|                           |          |          |      |          |          |       |
|---------------------------|----------|----------|------|----------|----------|-------|
| Total Non-interest Income | \$ 1,723 | \$ 1,598 | 7.8% | \$ 3,290 | \$ 2,946 | 11.7% |
|---------------------------|----------|----------|------|----------|----------|-------|

The increase in service charges on deposit accounts is primarily from growth in insufficient funds charges which have increased 31.7% from the prior year. This is due to a growing number of free checking accounts which offer overdraft protection and a pricing change that occurred during the second quarter. Included in the total deposit charges through June 30, 2004 was \$120,000 added from Arlington National Bank.

The non-recurring income in 2004 came from the sale of an asset previously carried in Other Assets during the first quarter.

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The decrease in other non-interest income for the second quarter of 2004 and the first six months of 2004 as compared to the same periods last year is primarily due to decreases in mortgage brokerage/origination fees, investment services fees, letter of credit fees and exchange fees partially offset by insurance sales and trust income. Mortgage brokerage/origination fees declined during the second quarter of 2004 and the first six months of 2004 due to a slowdown in mortgage re-financings compared to the previous year. Insurance sales, which began in the third quarter of 2003 through the formation of SIA, totaled \$26,000 through June 30, 2004. Revenues from trust services, a product offered by ANB and now by the Corporation, totaled \$35,000 in the second quarter of 2004.

Non-interest Expense

Non-interest expenses include all expenses other than interest expense, the provision for loan losses and income tax expense. The following table summarizes the changes in non-interest expense during the periods presented (dollars in thousands):

|   | Three Months Ended<br>June 30, |                 |              | Six Months Ended<br>June 30, |                  |              |
|---|--------------------------------|-----------------|--------------|------------------------------|------------------|--------------|
|   | 2004                           | 2003            | % Change     | 2004                         | 2003             | % Change     |
| Salaries & Employee Benefits                            | \$ 3,772                       | \$ 3,090        | 22.1%        | \$ 7,140                     | \$ 5,995         | 19.1%        |
| Occupancy Expense - Net                                 | 552                            | 395             | 39.7         | 990                          | 688              | 43.9         |
| Furniture and Equipment Expense                         | 565                            | 447             | 26.4         | 1,060                        | 876              | 21.0         |
| Other Real Estate and Foreclosed<br>Asset Expense - Net | 15                             | 2               | 650.0        | 15                           | (13)             |              |
| Core Deposit Amortization                               | 55                             | -0-             | 100.0        | 55                           | -0-              | 100.0        |
| Other Expenses:   |                                |                 |              |                              |                  |              |
| Business Development                                    | 227                            | 275             | (17.5)       | 420                          | 448              | (6.3)        |
| Insurance - Other                                       | 71                             | 64              | 10.9         | 134                          | 124              | 8.1          |
| Legal & Professional Fees                               | 219                            | 162             | 35.2         | 398                          | 330              | 20.6         |
| Item Processing   | 124                            | 187             | (33.4)       | 271                          | 357              | (24.1)       |
| Taxes - Other   | 15                             | 16              | (6.3)        | 33                           | 27               | 22.2         |
| Postage & Courier                                       | 116                            | 93              | 24.7         | 217                          | 179              | 21.2         |
| Printing & Supplies                                     | 88                             | 99              | (11.1)       | 183                          | 205              | (10.7)       |
| Regulatory Fees & Assessments                           | 76                             | 62              | 22.6         | 143                          | 124              | 15.3         |
| Other Operating Expenses                                | 455                            | 354             | 28.5         | 821                          | 703              | 16.8         |
| <b>Total Other Expenses</b>                             | <b>1,391</b>                   | <b>1,312</b>    | <b>6.0</b>   | <b>2,620</b>                 | <b>2,497</b>     | <b>4.9</b>   |
| <b>Total Non-interest Expense</b>                       | <b>\$ 6,350</b>                | <b>\$ 5,246</b> | <b>21.0%</b> | <b>\$ 11,880</b>             | <b>\$ 10,043</b> | <b>18.3%</b> |

Total non-interest expense increased 21.0% in the second quarter of 2004 over 2003, reflecting increases in salaries and benefits, occupancy and equipment, legal and professional and postage expenses. As a percent of average assets, non-interest expenses were 2.76% in the second quarter of 2004 (annualized) and 2.93% in the same period of 2003. The efficiency ratio (non-interest expenses divided by total non-interest income plus net interest income) was 58.90% for the second quarter of 2004 compared to 56.74% for the second quarter of 2003. The efficiency ratio is higher compared to the Corporation's historical percentages due to relatively lower net interest income due as a result of rate compression caused by the lower interest rate environment, the cost of new facilities and costs associated with two months operating expenses of ANB.

The increase in salaries and benefits during the second quarter of 2004 compared to the prior year is due to salary merit raises, additions to staff, the cost of employee insurance, training expenses and costs associated with ANB personnel. The additions included the addition of several lending officers who were previously employed by a competing community bank that had been acquired by a large regional bank. The increase in personnel expenses in the quarter excluding ANB personnel was 10%.

The increase in occupancy expense, equipment expense and postage expense are primarily associated with the openings of two new branch facilities since the middle of the second quarter of 2003, the move into a new facility in May 2003 to consolidate several back office functions including operations, credit and administration and costs associated with ANB facilities. Costs associated with ANB facilities created nearly half of the increase in occupancy and equipment expenses when comparing the second quarter of 2004 to 2003 and created virtually all of the increase in postage expense between the second quarters of the two years.

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Legal and professional expenses increased in the second quarter of 2004 compared to 2003 due to expenses incurred in relation to the ANB acquisition, costs associated with the issuance by Summit Bancshares, Inc. Statutory Trust I of \$12.0 million of its floating rate Capital Securities and expenses related to miscellaneous consultant fees.

### Allowance for Loan Losses and Non-Performing Assets

The Corporation's allowance for loan losses was \$9,844,000, or 1.46% of total loans, as of June 30, 2004 compared to \$7,412,000, or 1.48% of total loans, as of June 30, 2003. For the six months ended June 30, 2004 and 2003, net charge-offs (recoveries) were .03% and (.03)% of total loans, respectively, not annualized.

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Transactions in the provision for loan losses are summarized as follows (in thousands):

|   | Three Months Ended<br>June 30, |          | Six Months Ended<br>June 30, |          |
|---|--------------------------------|----------|------------------------------|----------|
|   | 2004                           | 2003     | 2004                         | 2003     |
| Balance, Beginning of Period                                | \$ 8,320                       | \$ 7,365 | \$ 7,784                     | \$ 6,706 |
| Balance Acquired in the Arlington National Bank Acquisition | 1,254                          | -0-      | 1,254                        | -0-      |
| Provisions, Charged to Income                               | 400                            | 240      | 1,005                        | 540      |
| Loans Charged-Off   | (196)                          | (272)    | (333)                        | (352)    |
| Recoveries of Loans Previously Charged-Off                  | 66                             | 79       | 134                          | 518      |
| Net Loans (Charged-Off) Recovered                           | (130)                          | (193)    | (199)                        | 166      |
| Balance, End of Period                                      | \$ 9,844                       | \$ 7,412 | \$ 9,844                     | \$ 7,412 |

The following table summarizes the non-performing assets as of the end of the last five quarters (in thousands):

|   | June 30,<br>2004 | March 31,<br>2004 | December 31,<br>2003 | September 30,<br>2003 | June 30,<br>2003 |
|---|------------------|-------------------|----------------------|-----------------------|------------------|
| Non-Accrual Loans                                   | \$ 2,832         | \$ 2,405          | \$ 2,351             | \$ 1,514              | \$ 1,458         |
| Renegotiated Loans                                  | -0-              | -0-               | -0-                  | -0-                   | -0-              |
| Other Real Estate Owned and Other Foreclosed Assets | 369              | 7                 | -0-                  | -0-                   | 125              |
| Total Non-Performing Assets                         | \$ 3,201         | \$ 2,412          | \$ 2,351             | \$ 1,514              | \$ 1,583         |

As a Percent of:

|   |        |        |       |        |       |
|---|--------|--------|-------|--------|-------|
| Total Assets  | 0.33%  | 0.28%  | 0.30% | 0.19%  | 0.21% |
| Total Loans and Other Real Estate/Foreclosed Assets | 0.48%  | 0.41%  | 0.42% | 0.29%  | 0.32% |
| Loans Past Due 90 days or More and Still Accruing   | \$ 111 | \$ -0- | \$ 55 | \$ -0- | \$ 14 |

At June 30, 2004, the ratio of non-accrual loans to total loans was .42% and non-performing assets represented .48% of loans and other real estate owned/foreclosed assets at the same date.

As of June 30, 2004, non-accrual loans were comprised of \$1,667,000 in commercial loans, \$876,000 in real estate mortgage loans, \$65,000 in interim construction loans and \$224,000 in consumer loans.

As of June 30, 2004, Other Real Estate included one residential property. In addition, the Corporation has \$4,000 in Other Foreclosed Assets, reported in Other Assets on the Balance Sheet, which represents a motor vehicle. These assets are in process of liquidation, however the process could take several months. The cost of liquidation will be recorded as a current period expense.

The following table summarizes the relationship between non-performing loans, criticized loans and the allowance for loan losses (dollars in thousands):

|  | June 30,<br>2004 | March 31,<br>2004 | December 31,<br>2003 | September 30,<br>2003 | June 30,<br>2003 |
|--|------------------|-------------------|----------------------|-----------------------|------------------|
| Non-Performing Loans                       | \$ 2,832         | \$ 2,405          | \$ 2,351             | \$ 1,514              | \$ 1,458         |
| Criticized Loans                           | 34,218           | 26,888            | 27,737               | 31,933                | 26,917           |
| Allowance for Loan Losses                  | 9,844            | 8,320             | 7,784                | 7,483                 | 7,412            |
| Allowance for Loan Losses as a Percent of: |                  |                   |                      |                       |                  |
| Non-Performing Loans                       | 348%             | 346%              | 331%                 | 494%                  | 508%             |
| Criticized Loans                           | 29%              | 31%               | 28%                  | 23%                   | 28%              |



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Loans are graded on a system similar to that used by the banking industry regulators. The first level of criticized loans is Other Assets Especially Mentioned (OAEM). These loans are fundamentally sound but have potential weaknesses which may, if not corrected, weaken the asset or inadequately protect the Bank's credit position at some future date. The second level is Substandard, which are loans inadequately protected by current sound net worth, paying capacity or pledged collateral of the borrower. The last level of criticized loans, before they are charged off, is Doubtful. Doubtful loans are considered to have inherent weaknesses because collection or liquidation in full is highly questionable. In addition to the above grading system, the Corporation maintains a separate watch list which further aids the Corporation in monitoring loan quality. Watch list loans show warning elements where the present status portrays one or more deficiencies that require attention in the short run or where pertinent ratios of the account have weakened to a point where more frequent monitoring is warranted.

Criticized loans at June 30, 2004, loans classified as OAEM, Substandard or Doubtful as noted above, have increased when compared to March 31, 2004 and to June 30, 2003. The majority of the increase from March 31, 2004 can be attributed to criticized loans within the ANB portfolio. The remainder of the increase is due to enhanced classification procedures and the employment of a Chief Credit Officer in the third quarter of 2001 who is responsible for monitoring loan quality by ensuring that the quality is sustained, that individual loans perform as agreed and that the Bank receives an appropriate return for the risk in the portfolio. The Corporation remains diligent in its efforts to identify any loan that might reflect weakness of the borrower as soon as possible. Management is not aware of any potential loan problems that have not been disclosed, to which serious doubts exist as to the ability of the borrower to substantially comply with the present repayment terms.

Interest Rate Sensitivity

Interest rate sensitivity is the relationship between changes in market interest rates and net interest income due to the repricing characteristics of assets and liabilities.

The following table, commonly referred to as a static GAP report, indicates the interest rate sensitivity position at June 30, 2004 and may not be reflective of positions in subsequent periods (dollars in thousands):

|   | Matures or Reprices within: |                    |                    | Total<br>Rate<br>Sensitive<br>One Year<br>or Less | Repriced<br>After<br>1 Year or<br>Non-interest<br>Sensitive | Total             |
|---|-----------------------------|--------------------|--------------------|---|---|-------------------|
|   | 30 Days<br>or Less          | 31-180<br>Days     | 181 to<br>One Year |   |   |                   |
| <b>Earning Assets:</b>                            |                             |                    |                    |   |   |                   |
| Loans   | \$ 347,695                  | \$ 41,664          | \$ 58,082          | \$ 447,441  | \$ 225,245  | \$ 672,686        |
| Investment Securities                             | 11,656                      | 15,853             | 14,747             | 42,256  | 172,735   | 214,991           |
| Federal Funds Sold and Due From Time              | 17,551                      | -0-                | -0-                | 17,551  | -0-   | 17,551            |
| <b>Total Earning Assets</b>                       | <b>376,902</b>              | <b>57,517</b>      | <b>72,829</b>      | <b>507,248</b>                                    | <b>397,980</b>  | <b>905,228</b>    |
| <b>Interest Bearing Liabilities:</b>              |                             |                    |                    |   |   |                   |
| Interest-Bearing Transaction Accounts and Savings | 410,394                     | -0-                | -0-                | 410,394   | -0-   | 410,394           |
| Certificate of Deposits under \$100,000 and IRAs  | 4,563                       | 20,225             | 18,465             | 43,253  | 28,297  | 71,550            |
| Certificate of Deposits \$100,000 or more         | 6,947                       | 21,339             | 13,103             | 41,389  | 34,014  | 75,403            |
| Other Borrowings                                  | 51,663                      | 15,000             | 30,000             | 96,663  | 25,122  | 121,785           |
| <b>Total Interest Bearing Liabilities</b>         | <b>473,567</b>              | <b>56,564</b>      | <b>61,568</b>      | <b>591,699</b>                                    | <b>87,433</b>   | <b>679,132</b>    |
| <b>Interest Sensitivity GAP</b>                   | <b>\$ (96,665)</b>          | <b>\$ 953</b>      | <b>\$ 11,261</b>   | <b>\$ (84,451)</b>                                | <b>\$ 310,547</b>   | <b>\$ 226,096</b> |
| <b>Cumulative GAP</b>                             | <b>\$ (96,665)</b>          | <b>\$ (95,712)</b> | <b>\$ (84,451)</b> |   |   |                   |
| Cumulative GAP to Total Earning Assets            | (10.68)%                    | (10.57)%           | (9.33)%            |   |   |                   |
| Cumulative GAP to Total Assets                    | (9.97)%                     | (9.87)%            | (8.71)%            |   |   |                   |

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The preceding static GAP report reflects a cumulative liability sensitive position during the one year horizon. An inherent weakness of this report is that it ignores the relative volatility any one category may have in relation to other categories or market rates in general. For instance, the rate paid on NOW accounts typically moves slower than the three month T-Bill. Management attempts to capture this relative volatility by utilizing a simulation model with a beta factor adjustment which estimates the volatility of rate sensitive assets and/or liabilities in relation to other market rates.



Beta factors are an estimation of the long term, multiple interest rate environment relation between an individual account and market rates in general. For instance, NOW, savings and money market accounts, which are repriced within 30 days will have considerably lower beta factors than variable rate loans and most investment categories. Taking this into consideration, it is quite possible for a bank with a negative cumulative GAP to total asset ratio to have a positive beta adjusted GAP risk position. As a result of applying the beta factors established by management to the earning assets and interest bearing liabilities in the static GAP report via a simulation model, the negative cumulative GAP to total assets ratio at one year of (8.71%) was reversed to a positive 22.11% beta adjusted GAP position. Management feels that the beta adjusted GAP risk technique more accurately reflects the Corporation's GAP position.

### Capital

At June 30, 2004, shareholders' equity totaled \$68.7 million, which remained unchanged from shareholders' equity at December 31, 2003 and at June 30, 2003. This reflected an increase in retained earnings less the change in unrealized gain/loss on available for sale securities, the payment of dividends and the impact of the purchase of treasury stock. During the second quarter of 2004, we purchased 20,500 shares of treasury stock. Our ability to repurchase shares of Common Stock is subject to various banking laws, regulations and policies as well as rules and regulations of the Securities and Exchange Commission. Our board of directors has authorized the repurchase of up to 5% of our outstanding Common Stock.

The Corporation and the Bank are subject to capital adequacy guidelines established by the Federal Reserve Board and other regulatory authorities. The table below illustrates the Bank's and our compliance with the capital adequacy guidelines as of June 30, 2004 and 2003 (dollars in thousands):

|                                      | June 30, 2004                |                   | June 30, 2003                |                   |
|--------------------------------------|------------------------------|-------------------|------------------------------|-------------------|
|                                      | The Consolidated Corporation | Summit Bank, N.A. | The Consolidated Corporation | Summit Bank, N.A. |
| Total Assets                         | \$ 969,708                   | \$ 969,280        | \$ 738,916                   | \$ 738,884        |
| Risk Weighted Assets                 | 723,022                      | 722,596           | 538,361                      | 538,340           |
| Equity Capital (Tier 1)              | 72,430                       | 74,512            | 65,394                       | 64,871            |
| Qualifying Allowance for Loan Losses | 9,048                        | 9,042             | 6,738                        | 6,741             |
| Total Capital                        | 81,478                       | 83,554            | 72,132                       | 71,612            |
| Leverage Ratio                       | 7.91%                        | 8.17%             | 9.09%                        | 9.03%             |
| Risk Capital Ratio:                  |                              |                   |                              |                   |
| Tier I Capital                       | 10.02%                       | 10.31%            | 12.15%                       | 12.05%            |
| Total Capital                        | 11.27                        | 11.56             | 13.40                        | 13.30             |

As of June 30, 2004, the Bank exceeded the risk-based capital and leverage requirements set by regulatory authorities and satisfied the criteria for classification as a well capitalized institution under the rules of the Federal Deposit Insurance Corporation Improvement Act of 1991.

### Liquidity

Our primary internal sources of liquidity consist of the federal funds that we sell and our portfolio of marketable investment securities, particularly those with shorter maturities. Federal funds sold and investment securities maturing within 30 days represented \$29.2 million, or 3.0%, of total assets as of June 30, 2004. Additionally, our ability to sell loan participations, purchase federal funds and obtain advances from the Federal Home Loan Bank serve as secondary sources of liquidity. The Bank has approved federal funds lines at other banks.

Our liquidity is enhanced by the fact that 90.3% of our total deposits at June 30, 2004 were core deposits. For this purpose, core deposits are defined as total deposits less public funds and certificates of deposit greater than \$100,000. Our loan to deposit ratio averaged 88.1% for the three month period ended June 30, 2004.

In the event that our average loans continue to grow during 2004 and we are unable to fund any such growth solely through the generation of additional deposits, we may be required to obtain funding from secondary sources, including purchasing federal funds, obtaining advances from the Federal Home Loan Bank or other secondary sources. In such event, our business, results of operations and financial condition could be somewhat negatively impacted.

Our income, which provides funds for the payment of dividends to our shareholders and for other corporate purposes, is derived from our investment in the Bank.

On May 3, 2004, the Corporation formed SBI Trust and SBI Trust subsequently issued \$12.0 million of floating rate (three month LIBOR plus a margin of 2.65%) Capital Securities (the Trust Capital Securities). Concurrent with the issuance of the Trust Capital Securities, SBI Trust issued trust common securities to the Corporation in the aggregate liquidation value of \$372,000. The proceeds of the issuance of the Trust Capital Securities and trust common securities were invested in the Corporation's Floating Rate Junior Subordinated Deferrable Debentures (the Deferrable Debentures), which mature on July 7, 2034 and have a call feature that permits the Corporation to redeem any or all of the securities after July 7, 2009. The interest rate on the Deferrable Debentures at June 30, 2004 was 3.83%. The Deferrable Debentures, which are the only asset of SBI Trust, are subordinated and junior in right of payment to all present and future senior indebtedness (as defined in the Indenture date May 3, 2004) of the Corporation.

#### Off-Balance-Sheet Arrangements, Commitments, Guaranteed and Contractual Obligations

Except as set forth herein, there have been no material changes in our contractual obligations as set forth in Item 7: Management's Discussion and Analysis of Financial Condition and Results of Operations Off-Balance-Sheet Arrangements, Commitments, Guarantees and Contractual Obligations in our Annual Report on Form 10-K for the year ended December 31, 2003.

The Corporation has available a line of credit with the FHLB of Dallas which allows it to borrow on a collateralized basis at a fixed term. The borrowings are collateralized by a blanket floating lien on all first mortgage loans, the FHLB capital stock owned by the Corporation and any funds on deposit with FHLB. At June 30, 2004, the Corporation had \$70.0 million of borrowings outstanding under the line of credit at a rate of 1.65%, \$30.0 million of which matures in 2004, \$30.0 million of which matures in 2005 and the last \$10.0 million of which matures in April 2006. Through June 30, 2004, the Corporation had average borrowings on this line of \$72.2 million. Borrowings at December 31, 2003 totaled \$50.0 million. The increase in borrowings was required to fund earnings asset growth.

At June 30, 2004, outstanding documentary and standby letters of credit totaled \$5,327,000 and commitments to extend credit totaled \$170,148,000. Documentary and standby letters of credit and commitments to extend credit totaled \$6,234,000 and \$145,777,000 at December 31, 2003. The commitments have increased in conjunction with the overall loan growth of the Corporation plus due to the addition of ANB.

#### Related Party Transactions

The Bank has made transactions in the ordinary course of business with certain of its and the Corporation's officers, directors and their affiliates. All loans included in such transactions are made on substantially the same terms, including interest rate and collateral, as those prevailing at the time for comparable transactions with other persons and all loans are current as to principal and interest payments. Total loans outstanding to such parties amounted to approximately \$8,775,000 at June 30, 2004, \$9,389,000 at December 31, 2003 and \$9,002,000 at June 30, 2003.

#### Subsequent Events

On July 20, 2004, the Board of Directors of the Corporation approved a quarterly dividend of \$.14 per share to be paid on August 16, 2004 to shareholders of record on August 2, 2004.

#### Critical Accounting Policies

Our accounting policies are fundamental to understanding management's discussion and analysis of results of operations and financial condition. We have identified our policy with respect to allowance for loan losses as critical because it requires management to make particularly difficult, subjective or complex judgments about matters that are inherently uncertain and because of the likelihood that materially different amounts would be reported under different conditions or using different assumptions. There have been no material changes in our application of accounting policies since December 31, 2003. We, in consultation with our Audit Committee of the Board of Directors, have reviewed and approved this critical accounting policy, which is further described under the captions Loan and Allowance for Loan Losses in Note 1 (Summary of Significant Accounting Policies) to the Financial Statements.

These evaluations are inherently subjective because, even though they are based on objective data, it is management's interpretation of that data that determines the amount of the appropriate allowance. Therefore, from time to time (but at least quarterly), management reviews the actual performance and write-off history of the loan portfolio and compares that to previously determined allowance coverage percentages. In this manner, management evaluates the impact the previously mentioned variables may have had on the loan portfolio to determine which changes, if any, should be made to the assumptions and analyses. Recent analysis has indicated that projections of estimated losses inherent in the loan portfolio has approximated actual write-off experience during the current economic environment.

Actual results could differ materially from estimates as a result of changes in economic or market conditions and other factors. Changes in our evaluations and the assumptions underlying these evaluations could result in a material change in the allowance. While we believe that the allowance for loan losses has been established and maintained at levels adequate to reflect the risks inherent in the loan portfolio, future increases may be necessary if economic or market conditions and other factors differ substantially from the conditions that existed at the time of the initial determination.

Factors That May Affect Future Results

This Quarterly Report on Form 10-Q contains forward-looking statements concerning the business, results of operations and financial condition of us and our subsidiaries. The forward-looking statements are based upon management's current expectations and assumptions about future events. Such expectations and assumptions have been expressed in good faith, and management believes that there is a reasonable basis for them.

A number of risks and uncertainties could cause our actual results to differ materially from the forward-looking statements contained in this Quarterly Report on Form 10-Q. These risks and uncertainties include, without limitation:

- Changes in, or the effects of, competition for our products and services;
- Our ability to effectively manage interest rate risk and other market, credit and operation risks;
- Our ability to develop competitive new products and services in a timely manner and the acceptance of such products and services by our customers and potential customers;
- The costs and effects of litigation involving us and of unexpected or adverse outcomes in such litigation;
- Our ability to successfully integrate, and to achieve anticipated cost savings and revenue enhancements with respect to, the ANB acquisition and any other businesses and operations that we may acquire in the future;
- Our ability to attract and retain key employees;
- Changes in general local, regional and international economic conditions;
- Changes in, or the effects of, trade, monetary and fiscal policies, laws and regulations, including interest rate policies, of the Federal Reserve Board and other regulatory authorities;
- Changes in consumer and business spending, borrowing and saving habits;
- Changes in laws, regulations and policies applicable to us; and
- Political instability and acts of war or terrorism.

Item 3 Quantitative and Qualitative Disclosure about Market Risk

There have been no material changes in market risks faced by the Corporation since December 31, 2003. For more information regarding quantitative and qualitative disclosures about market risk, please refer to the Corporation's Annual Report on Form 10-K as of and for the year ended December 31, 2003, and in particular, Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Interest Rate Sensitivity and Liquidity.

Item 4 Controls and Procedures

The Corporation's management, including the Corporation's principal executive officer and principal financial officer, has evaluated the effectiveness of the Corporation's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the Corporation's fiscal quarter ended June 30, 2004. Based on that evaluation, the Corporation's principal executive officer and principal financial officer have concluded that the Corporation's disclosure controls and procedures were effective as of the end of the Corporation's fiscal quarter ended June 30, 2004.

There were no changes in the Corporation's internal control over financial reporting that occurred during the Corporation's fiscal quarter ended June 30, 2004 that have materially affected, or are likely to materially affect, the Corporation's internal control over financial reporting.

**PART II - OTHER INFORMATION****Item 1. Legal Proceedings**

Not applicable

**Item 2. Change in Securities, Use of Proceeds and Issuer Purchases of Equity Securities**

On April 15, 2003, the Board of Directors of the Corporation approved a stock repurchase plan (the 2003 Repurchase Plan) authorizing the Corporation to purchase up to 308,900 shares of its common stock over the twelve-month period beginning April 15, 2003 through open market purchases or in privately negotiated transactions in accordance with all applicable state and federal laws and regulations. The 2003 Repurchase Plan expired in accordance with its terms on April 19, 2004, and the Corporation did not purchase any shares of its common stock pursuant to the 2003 Repurchase Plan during the second quarter of 2004.

On April 20, 2004, the Board of Directors of the Corporation approved a stock repurchase plan (the 2004 Repurchase Plan) authorizing the Corporation to purchase up to 307,680 shares of its common stock over the twelve-month period beginning April 20, 2004 through open market purchases or in privately negotiated transaction in accordance with all applicable state and federal laws and regulations. The following table provides information regarding purchases by the Corporation of its common stock during each calendar month of the second quarter of 2004 pursuant to the 2004 Repurchase Plan.

| Period           | Total<br>Number of<br>Shares<br>Purchased | Average Price<br>Paid Per<br>Share | Total<br>Number of<br>Shares<br>Purchased as<br>Part of<br>Publicly<br>Announced<br>Plans or<br>Programs | Maximum<br>Number of<br>Shares that<br>May Yet Be<br>Purchased<br>Under the<br>Plans or<br>Programs |
|------------------|---|------------------------------------|--|---|
|                  |   |                                    |  |   |
| 4/1/04 - 4/30/04 | 20,500                                    | \$ 28.36                           | 20,500   | 287,180   |
| 5/1/04 - 5/31/04 | -0-                                       | -0-                                | -0-  | 287,180   |
| 6/1/04 - 6/30/04 | -0-                                       | -0-                                | -0-  | 287,180   |
| <b>Total</b>     | <b>20,500</b>                             | <b>28.36</b>                       | <b>20,500</b>  | <b>287,180</b>  |

**Item 3. Defaults Upon Senior Securities**

Not applicable

**Item 4. Submission of Matters to a Vote of Security Holders**

At the Corporation's 2004 Annual Meeting of Shareholders held on April 20, 2004, the shareholders of the Corporation elected the following directors, constituting the entire Board of Directors of the Corporation, to serve terms expiring at the Corporation's 2005 Annual Meeting of Shareholders:

|                    | For       | Against   | Abstain |
|--------------------|-----------|-----------|---------|
| Elliott S. Garsek  | 4,729,856 | 192,654   | 8,500   |
| Ronald J. Goldman  | 4,921,110 | 1,400     | 8,500   |
| F.S. Gunn          | 4,205,105 | 717,405   | 8,500   |
| Robert L. Herchert | 4,887,193 | 35,317    | 8,500   |
| Jay J. Lesok       | 4,900,237 | 22,273    | 8,500   |
| William W. Meadows | 3,834,525 | 1,087,985 | 8,500   |

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|                   |           |           |       |
|-------------------|-----------|-----------|-------|
| James L. Murray   | 4,229,730 | 697,780   | 8,500 |
| Philip E. Norwood | 4,396,632 | 525,878   | 8,500 |
| Byron B. Searcy   | 4,262,856 | 659,654   | 8,500 |
| Roderick D. Stepp | 3,918,150 | 1,004,360 | 8,500 |

**Item 5. Other Information**

Not applicable

**Item 6. Exhibits and Reports on Form 8-K**

(a) Exhibits

- 11 Computation of Earnings Per Common Share
- 31.1 Certification of Principal Executive Officer of Summit Bancshares, Inc. pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.
- 31.2 Certification of Principal Financial Officer of Summit Bancshares, Inc. pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.
- 32.1 Certification of Principal Executive Officer of Summit Bancshares, Inc. pursuant to Section 1350, Chapter 63 of Title 18 of the United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Principal Financial Officer of Summit Bancshares, Inc. pursuant to Section 1350, Chapter 63 of Title 18 of the United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Current Reports of Form 8-K:

The Corporation furnished a Current Report on Form 8-K under Items 9 and 12 on July 12, 2004 relating to its issuance of a press release announcing its earnings for the second quarter of 2004.



**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**SUMMIT BANCSHARES, INC.**  
Registrant

Date: 07-25-04

By: /s/ PHILIP E. NORWOOD

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**Philip E. Norwood, Chairman & President  
and Chief Executive Officer**

Date: 07-25-04

By: /s/ BOB G. SCOTT

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**Bob G. Scott, Executive Vice President  
and Chief Operating Officer  
(Chief Financial Officer)**

**EXHIBIT INDEX**

| <b>Exhibit</b> | <b>Description</b>   |
|----------------|--|
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