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FORM 10−K

METROCORP BANCSHARES INC − MCBI

Filed: March 17, 2004 (period: December 31, 2003)

Annual report which provides a comprehensive overview of the company for the past year

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10−K

☑ **ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d)**
OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2003

or

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d)**
OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number: 0−25141

MetroCorp Bancshares, Inc.

(Exact name of registrant as specified in its charter)

Texas	**76−0579161**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

9600 Bellaire Boulevard, Suite 252

Houston, Texas 77036
(Address of principal executive offices including zip code)

(713) 776−3876

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, par value $1.00 per share
(Title of class)

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 Act). Yes ☐ No ☑

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S−K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10−K or any amendment to this Form 10−K. ☐

As of March 5, 2004, the number of outstanding shares of Common Stock was 7,162,990.

The aggregate market value of the shares of Common Stock held by non−affiliates, based on the closing price of the Common Stock on the Nasdaq National Market System on June 30, 2003, the last business day of the registrant's most recently completed second quarter, of $12.15 per share, was approximately $60.0 million.

DOCUMENTS INCORPORATED BY REFERENCE:

Portions of the Company's Proxy Statement for the 2004 Annual Meeting of Shareholders, which will be filed within 120 days after December 31, 2003, are incorporated by reference into Part III, Items 10−14 of this Form 10−K.

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PART I

Special Cautionary Notice Regarding Forward−Looking Statements

Statements and financial discussion and analysis contained in this Annual Report on Form 10−K and documents incorporated herein by reference that are not historical facts are forward−looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward−looking statements describe the Company's future plans, strategies and expectations, are based on assumptions and involve a number of risks and uncertainties, many of which are beyond the Company's control. The important factors that could cause actual results to differ materially from the results, performance or achievements expressed or implied by the forward−looking statements include, without limitation:

- changes in interest rates and market prices, which could reduce the Company's net interest margins, asset valuations and expense expectations;
- changes in the levels of loan prepayments and the resulting effects on the value of the Company's loan portfolio;
- changes in local economic and business conditions which adversely affect the ability of the Company's customers to transact profitable business with the Company, including the ability of borrowers to repay their loans according to their terms or a change in the value of the related collateral;
- increased competition for deposits and loans adversely affecting rates and terms;
- the Company's ability to identify suitable acquisition candidates;
- the timing, impact and other uncertainties of the Company's ability to enter new markets successfully and capitalize on growth opportunities;
- increased credit risk in the Company's assets and increased operating risk caused by a material change in commercial, consumer and/or real estate loans as a percentage of the total loan portfolio;
- the failure of assumptions underlying the establishment of and provisions made to the allowance for loan losses;
- changes in the availability of funds resulting in increased costs or reduced liquidity;
- increased asset levels and changes in the composition of assets and the resulting impact on capital levels and regulatory capital ratios;
- the Company's ability to acquire, operate and maintain cost effective and efficient systems without incurring unexpectedly difficult or expensive but necessary technological changes;
- the loss of senior management or operating personnel and the potential inability to hire qualified personnel at reasonable compensation levels; and
- changes in statutes and government regulations or their interpretations applicable to bank holding companies and present and future banking and other subsidiaries, including changes in tax requirements and tax rates.

All written or oral forward−looking statements attributable to the Company are expressly qualified in their entirety by these cautionary statements. The Company undertakes no obligation to publicly update or otherwise revise any forward−looking statements, whether as a result of new information, future events or otherwise, unless the securities laws require it to do so.

Item 1. *Business*

General

MetroCorp Bancshares, Inc. (the "Company") was incorporated as a business corporation under the laws of the State of Texas in 1998 to serve as a holding company for MetroBank, National Association (the

"Bank"). The Company's headquarters are located at 9600 Bellaire Boulevard, Suite 252, Houston, Texas 77036, and its telephone number is (713) 776−3876. The Company's internet website address is www.metrobank−na.com. The Company makes available, free of charge, on or through its website its annual report on Form 10−K, quarterly reports on Form 10−Q, current reports on Form 8−K and all amendments to those reports as soon as reasonably practicable after such material is filed with or furnished to the Securities and Exchange Commission. The information found on the Company's website is not a part of this or any other report.

The Company's mission is to enhance shareholder value by maximizing profitability and operating as the premier commercial bank in each community that it serves. The Company operates branches in niche markets by providing personalize service to the communities in Houston and Dallas. In the past, the Company has strategically opened each of its 14 banking offices in an area with large multicultural concentrations and intends to pursue branch opportunities in multicultural markets with significant small and medium−sized business activity.

The Bank was organized in 1987 by Don J. Wang, the Company's current Chairman of the Board, and five other Asian−American small business owners, four of whom currently serve as directors of the Company and the Bank. The organizers perceived that the financial needs of various ethnic groups in Houston were not being adequately served and sought to provide modern banking products and services that accommodated the cultures of the businesses operating in these communities. In 1989, the Company expanded its service philosophy to Houston's Hispanic community by acquiring from the Federal Deposit Insurance Corporation (the "FDIC") the assets and liabilities of a community bank located in a primarily Hispanic section of Houston. This acquisition broadened the Company's market and increased its assets from approximately $30.0 million to approximately $100.0 million. Other than this acquisition, the Company has accomplished its growth internally through the establishment of de novo branches in various market areas. Since the Bank's formation in 1987, it has established 11 branches in the greater Houston metropolitan area. In 1996, the Bank expanded into the Dallas metropolitan area, and with the success of the first Dallas area branch, opened two additional branch offices in 1998 and 1999, respectively.

Business

Management believes that quality products and services, cross−selling initiatives, relationship building, and outstanding customer service are all key elements to a successful retail banking endeavor. The Company intends to focus more attention on its retail banking initiatives in 2004. To achieve its goals, the Company has recently added an experienced senior officer to its management team to implement strategies throughout the 14−branch network. Specific goals include but are not limited to: (1) building solid customer relationships through cross−selling products and services, (2) targeting new mainstream markets to diversify the customer base, (3) ensuring that delivery systems for the Bank's products and services are effective and will produce the desired results, (4) reviewing the Bank's product mix to ensure that customer needs and demands are being met with existing products, and (5) studying the effectiveness of the Bank's customer service activities and implement enhancements, where applicable, to make certain that customer inquiries are being addressed timely and effectively.

In connection with the Company's approach to community banking, the Company offers products designed to appeal to its customers and further enhance profitability. The Company believes that it has developed a reputation as the premier provider of financial products and services to small and medium−sized businesses and consumers located in the communities that it serves. Each of its product lines is an outgrowth of the Company's expertise in meeting the particular needs of its customers. The Company's principal lines of business are the following:

Commercial and Industrial Loans. The primary lending focus of the Company is to small and medium−sized businesses in a variety of industries. Its commercial lending emphasis includes loans to wholesalers, manufacturers and business service companies. The Company makes available to businesses a broad range of short and medium−term commercial lending products for working capital (including inventory and accounts receivable), purchases of equipment and machinery, and business expansion

(including acquisitions of real estate and improvements). As of December 31, 2003, the Company's commercial and industrial loan portfolio totaled $332.5 million or 59.4% of the gross loan portfolio. At that date, the Company had a concentration of loans in the hotel and motel industry of $66.1 million. Hotel and motel lending was originally targeted by the Company because of management's particular expertise in this industry and a perception that it was an under−served market. More recently, the Company has broadened its lending strategy in efforts to further diversify its portfolio to other industries.

Commercial Mortgage Loans. The Company originates commercial mortgage loans to finance the purchase of real property, which generally consists of developed real estate. The Company's commercial mortgage loans are collateralized by first liens on real estate, typically have variable rates and amortize over a 15 to 20 year period, with balloon payments due at the end of five to seven years. As of December 31, 2003, the Company had a commercial mortgage portfolio of $178.3 million or 31.8% of the gross loan portfolio.

Construction Loans. The Company originates loans to finance the construction of residential and non−residential properties. The majority of the Company's residential construction loans are for single−family dwellings, which are under earnest money contracts. The Company also originates loans to finance the construction of commercial properties such as multi−family, office, industrial, warehouse and retail centers. As of December 31, 2003, the Company had a real estate construction portfolio of $24.6 million or 4.4% of the gross loan portfolio, of which, $12.7 million was residential and $11.9 million was commercial.

Residential Mortgage Brokerage and Lending. The Company uses its existing branch network to offer a complete line of single−family residential mortgage products. The Company solicits and receives a fee to process residential mortgage loans, which are underwritten and pre−sold to third party mortgage companies. The Company does not fund or service the loans underwritten by third party mortgage companies. The Company also originates five to seven year balloon residential mortgage loans with a 15−year amortization to its existing customers on a select basis, which loans are retained in the Company's portfolio. As of December 31, 2003, the residential mortgage portfolio totaled $14.3 million or 2.6% of the gross loan portfolio.

Government Guaranteed Small Business Lending. The Company has developed an expertise in several government guaranteed lending programs in order to provide credit enhancement to its commercial and industrial and mortgage portfolios. As a Preferred Lender under the United States Small Business Administration (the "SBA") federally guaranteed lending program, the Company's pre−approved status allows it to quickly respond to customers' needs. Depending upon prevailing market conditions, the Company may sell the guaranteed portion of these loans into the secondary market, yet retain servicing of these loans. The Company specializes in SBA loans to minority−owned businesses. As of December 31, 2003, the Company had $92.0 million in the retained portion of its SBA loans, approximately $59.4 million of which was guaranteed by the SBA. For the SBA's fiscal year ended September 30, 2003, the Company was ranked as the third largest SBA loan originator in the 32−county Houston SBA District in terms of dollar volume produced. Another source of government guaranteed lending provided by the Company is Business and Industrial loans ("B&I Loans") which are collateralized by the U.S. Department of Agriculture (the "USDA") and are available to borrowers in areas with a population of less than 50,000. As of December 31, 2003, the Company's USDA portfolio totaled $2.9 million. The Company also offers guaranteed loans through the Overseas Chinese Credit Guaranty Fund ("OCCGF"), which is sponsored by the government of Taiwan. These loans are for people of Chinese descent or origin, who are not mainland Chinese by birth and who reside "overseas." As of December 31, 2003, the Company's OCCGF portfolio totaled $4.1 million.

Trade Finance. Since its inception in 1987, the Company has originated trade finance loans and letters of credit to facilitate export and import transactions for small and medium−sized businesses. In this capacity, the Company has worked with the Export Import Bank of the United States (the "Ex−Im Bank"), an agency of the U.S. Government which provides guarantees for trade finance loans. At

December 31, 2003, the Company's aggregate trade finance portfolio commitments totaled approximately $7.3 million.

The Company offers a variety of loan and deposit products and services to retail customers through its branch network in Houston and Dallas. Loans to retail customers include residential mortgage loans, residential construction loans, automobile loans, lines of credit and other personal loans. Retail deposit products and services include checking and savings accounts, money market accounts, time deposits, ATM cards, debit cards and online banking.

On December 20, 2001, in collaboration with the Mexican Consulate of Houston, the Company introduced the Matricula Checking account as a service to the Hispanic community in the greater Houston metropolitan area. Using an official Matricula card issued by the consulate as identification, a Mexican national can open this account. Matricula Checking was the first account of this type in the Houston area. It addresses a significant social issue: Immigrants are typically unable to obtain acceptable identification and lack basic banking services. With this account, customers have a safe and secure place to keep their money, eliminating the need to carry or hide large sums of cash. The account allows the holder to write checks, execute transactions and make affordable wire transfers. Account holders can also designate individuals in Mexico to have limited ATM access to their account. As of December 31, 2003, the Company's aggregate Matricula Checking portfolio totaled approximately $1.8 million.

Competition

The banking business is highly competitive, and the profitability of the Company depends principally on the Company's ability to compete in the market areas in which its banking operations are located. The Company competes with other commercial banks, savings banks, savings and loan associations, credit unions, finance companies, mutual funds, insurance companies, brokerage and investment banking firms, asset−based non−bank lenders and certain other non−financial entities, including retail stores which may maintain their own credit programs and certain governmental organizations which may offer more favorable financing. The Company has been able to compete effectively with other financial institutions by emphasizing customer service, technology and responsive decision−making. Additionally, management believes the Company remains competitive by establishing long−term customer relationships, building customer loyalty and providing a broad line of products and services designed to address the specific needs of its customers.

In addition, the enactment of the Gramm−Leach−Bliley Act, which breaks down the barriers between financial institutions, securities firms and insurance companies, may significantly change the competitive environment in which the Company and the Bank conduct business. See "— Supervision and Regulation — The Company — Financial Modernization".

Employees

As of December 31, 2003, the Company had 299 full−time equivalent employees, 45 of whom were officers of the Bank classified as Vice President or above. The Company considers its relations with employees to be satisfactory.

Supervision and Regulation

The supervision and regulation of bank holding companies and their subsidiaries is intended primarily for the protection of depositors, the deposit insurance funds of the FDIC and the banking system as a whole, and not for the protection of the bank holding company shareholders or creditors. The banking agencies have broad enforcement power over bank holding companies and banks including the power to impose substantial fines and other penalties for violations of laws and regulations.

The following description summarizes some of the laws to which the Company and the Bank are subject. References herein to applicable statutes and regulations are brief summaries thereof, do not purport to be complete, and are qualified in their entirety by reference to such statutes and regulations.

The Company

The Company is a bank holding company registered under the Bank Holding Company Act, as amended, (the "BHCA"), and it is subject to supervision, regulation and examination by the Board of Governors of the Federal Reserve System ("Federal Reserve Board"). The BHCA and other federal laws subject bank holding companies to particular restrictions on the types of activities in which they may engage, and to a range of supervisory requirements and activities, including regulatory enforcement actions for violations of laws and regulations.

Regulatory Restrictions on Dividends; Source of Strength. It is the policy of the Federal Reserve Board that bank holding companies should pay cash dividends on common stock only out of income available over the past year and only if prospective earnings retention is consistent with the organization's expected future needs and financial condition. The policy provides that bank holding companies should not maintain a level of cash dividends that undermines the bank holding company's ability to serve as a source of strength to its banking subsidiaries.

Under Federal Reserve Board policy, a bank holding company is expected to act as a source of financial strength to each of its banking subsidiaries and commit resources to their support. Such support may be required at times when, absent this Federal Reserve Board policy, a holding company may not be inclined to provide it. As discussed below, a bank holding company in certain circumstances could be required to guarantee the capital plan of an undercapitalized banking subsidiary.

In the event of a bank holding company's bankruptcy under Chapter 11 of the U.S. Bankruptcy Code, the trustee will be deemed to have assumed and is required to cure immediately any deficit under any commitment by the debtor holding company to any of the federal banking agencies to maintain the capital of an insured depository institution, and any claim for breach of such obligation will generally have priority over most other uncollateralized claims.

Scope of Permissible Activities. Except as provided below, the Company is prohibited from acquiring a direct or indirect interest in or control of more than 5% of the voting shares of any company which is not a bank or bank holding company and from engaging directly or indirectly in activities other than those of banking, managing or controlling banks or furnishing services to its subsidiary banks, except the Company may engage in and may own shares of companies engaged in certain activities found by the Federal Reserve to be so closely related to banking or managing and controlling banks as to be a proper incident thereto. These activities include, among others, operating a mortgage, finance, credit card or factoring company; performing certain data processing operations; providing investment and financial advice; acting as an insurance agent for certain types of credit−related insurance; leasing personal property on a full−payout, non−operating basis; and providing certain stock brokerage and investment advisory services. In approving acquisitions or the addition of activities, the Federal Reserve considers whether the acquisition or the additional activities can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh such possible adverse effects as undue concentration of resources, decreased or unfair competition, conflicts of interest or unsound banking practices.

However, the Gramm−Leach−Bliley Act, effective in 2001, amended the BHC Act and granted certain expanded powers to bank holding companies. The Gramm−Leach−Bliley Act permits bank holding companies to become financial holding companies and thereby affiliate with securities firms and insurance companies and engage in other activities that are financial in nature. The Gramm−Leach−Bliley Act defines "financial in nature" to include securities underwriting, dealing and market making; sponsoring mutual funds and investment companies; insurance underwriting and agency; merchant banking activities; and activities that the Federal Reserve has determined to be closely related to banking. No regulatory approval will be required for a financial holding company to acquire a company, other than a bank or savings association, engaged in activities that are financial in nature or incidental to activities that are financial in nature, as determined by the Federal Reserve

Under the Gramm−Leach−Bliley Act, a bank holding company may become a financial holding company if each of its subsidiary banks is well capitalized under the Federal Deposit Insurance Corporation

Improvement Act ("FDICIA") prompt corrective action provisions, is well managed, and has at least a satisfactory rating under the Community Reinvestment Act of 1977 ("CRA") by filing a declaration that the bank holding company wishes to become a financial holding company. The Gramm−Leach−Bliley Act defines "financial in nature" to include securities underwriting, dealing and market making; sponsoring mutual funds and investment companies; insurance underwriting and agency; merchant banking activities; and activities that the Federal Reserve Board has determined to be closely related to banking. Subsidiary banks of a financial holding company must remain well capitalized and well managed in order to continue to engage in activities that are financial in nature without regulatory actions or restrictions, which could include divestiture of the financial in nature subsidiary or subsidiaries. In addition, a financial holding company may not acquire a company that is engaged in activities that are financial in nature unless each of its subsidiary banks has a CRA rating of satisfactory or better. Presently, the Company has no plans to become a financial holding company.

While the Federal Reserve Board will serve as the "umbrella" regulator for financial holding companies and has the power to examine banking organizations engaged in new activities, regulation and supervision of activities which are financial in nature or determined to be incidental to such financial activities will be handled along functional lines. Accordingly, activities of subsidiaries of a financial holding company will be regulated by the agency or authorities with the most experience regulating that activity as it is conducted in a financial holding company.

Safe and Sound Banking Practices. Bank holding companies are not permitted to engage in unsafe and unsound banking practices. The Federal Reserve Board's Regulation Y, for example, generally requires a holding company to give the Federal Reserve Board prior notice of any redemption or repurchase of its own equity securities, if the consideration to be paid, together with the consideration paid for any repurchases or redemptions in the preceding year, is equal to 10% or more of the company's consolidated net worth. The Federal Reserve Board may oppose the transaction if it believes that the transaction would constitute an unsafe or unsound practice or would violate any law or regulation. Prior approval of the Federal Reserve Board would not be required for the redemption or purchase of equity securities for a bank holding company that would be well capitalized both before and after such transaction, well−managed and not subject to unresolved supervisory issues.

The Federal Reserve Board has broad authority to prohibit activities of bank holding companies and their non−banking subsidiaries which represent unsafe and unsound banking practices or which constitute violations of laws or regulations, and can assess civil money penalties for certain activities conducted on a knowing and reckless basis, if those activities caused a substantial loss to a depository institution. The penalties can be as high as $1.0 million for each day the activity continues.

Anti−Tying Restrictions. Bank holding companies and their affiliates are prohibited from tying the provision of certain services, such as extensions of credit, to other services offered by a holding company or its affiliates.

Capital Adequacy Requirements. The Federal Reserve Board has adopted a system using risk−based capital guidelines to evaluate the capital adequacy of bank holding companies. Under the guidelines, specific categories of assets are assigned different risk weights, based generally on the perceived credit risk of the asset. These risk weights are multiplied by corresponding asset balances to determine a "risk−weighted" asset base. The guidelines require a minimum total risk−based capital ratio of 8.0% (of which at least 4.0% is required to consist of Tier 1 capital elements). Total capital is the sum of Tier 1 and Tier 2 capital. As of December 31, 2003, the Company's ratio of Tier 1 capital to total risk−weighted assets was 12.42% and its ratio of total capital to total risk−weighted assets was 13.67%.

In addition to the risk−based capital guidelines, the Federal Reserve Board uses a leverage ratio as an additional tool to evaluate the capital adequacy of bank holding companies. The leverage ratio is a company's Tier 1 capital divided by its average total consolidated assets. Certain highly rated bank holding companies may maintain a minimum leverage ratio of 3.0%, but other bank holding companies may be required to maintain a leverage ratio of at least 4.0%. As of December 31, 2003, the Company's leverage ratio was 8.84%.

The federal banking agencies' risk−based and leverage ratios are minimum supervisory ratios generally applicable to banking organizations that meet certain specified criteria. The federal bank regulatory agencies may set capital requirements for a particular banking organization that are higher than the minimum ratios when circumstances warrant. Federal Reserve Board guidelines also provide that banking organizations experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels, without significant reliance on intangible assets.

Imposition of Liability for Undercapitalized Subsidiaries. Bank regulators are required to take "prompt corrective action" to resolve problems associated with insured depository institutions whose capital declines below certain levels. In the event an institution becomes "undercapitalized," it must submit a capital restoration plan. The capital restoration plan will not be accepted by the regulators unless each company having control of the undercapitalized institution guarantees the subsidiary's compliance with the capital restoration plan up to a certain specified amount. Any such guarantee from a depository institution's holding company is entitled to a priority of payment in bankruptcy.

The aggregate liability of the holding company of an undercapitalized bank is limited to the lesser of 5% of the institution's assets at the time it became undercapitalized or the amount necessary to cause the institution to be "adequately capitalized." The bank regulators have greater power in situations where an institution becomes "significantly" or "critically" undercapitalized or fails to submit a capital restoration plan. For example, a bank holding company controlling such an institution can be required to obtain prior Federal Reserve Board approval of proposed dividends, or might be required to consent to a consolidation or to divest the troubled institution or other affiliates.

Acquisitions by Bank Holding Companies. The BHCA requires every bank holding company to obtain the prior approval of the Federal Reserve Board before it may acquire all or substantially all of the assets of any bank, or ownership or control of any voting shares of any bank, if after such acquisition it would own or control, directly or indirectly, more than 5% of the voting shares of such bank. In approving bank acquisitions by bank holding companies, the Federal Reserve Board is required to consider the financial and managerial resources and future prospects of the bank holding company and the banks concerned, the convenience and needs of the communities to be served, and various competitive factors.

Control Acquisitions. The Change in Bank Control Act prohibits a person or group of persons from acquiring "control" of a bank holding company unless the Federal Reserve Board has been notified and has not objected to the transaction. Under a rebuttable presumption established by the Federal Reserve Board, the acquisition of 10% of more of a class of voting stock of a bank holding company with a class of securities registered under Section 12 of the Exchange Act, such as the Company, would, under the circumstances set forth in the presumption, constitute acquisition of control of the Company.

In addition, any entity is required to obtain the approval of the Federal Reserve Board under the BHCA before acquiring 25% (5% in the case of an acquirer that is a bank holding company) or more of the outstanding Common Stock of the Company, or otherwise obtaining control or a "controlling influence" over the Company.

The Bank

The Bank is a nationally chartered banking association, the deposits of which are insured by the Bank Insurance Fund ("BIF") of the FDIC. The Bank's primary regulator is the Office of the Comptroller of the Currency (the "OCC"). By virtue of the insurance of its deposits, however, the Bank is also subject to supervision and regulation by the FDIC. Such supervision and regulation subjects the Bank to special restrictions, requirements, potential enforcement actions, and periodic examination by the OCC. Because the Federal Reserve Board regulates the bank holding company parent of the Bank, the Federal Reserve Board also has supervisory authority, which directly affects the Bank.

Financial Modernization. Under the Gramm−Leach−Bliley Act, a national bank may establish a financial subsidiary and engage, subject to limitations on investment, in activities that are financial in nature, other than insurance underwriting, insurance company portfolio investment, real estate development, real

estate investment, annuity issuance and merchant banking activities. To do so, a bank must be well capitalized, well managed and have a CRA rating of satisfactory or better. National banks with financial subsidiaries must remain well capitalized and well managed in order to continue to engage in activities that are financial in nature without regulatory actions or restrictions, which could include divestiture of the financial in nature subsidiary or subsidiaries. In addition, a bank may not acquire a company that is engaged in activities that are financial in nature unless the bank has a CRA rating of satisfactory or better.

Branching. The establishment of a branch must be approved by the OCC, which considers a number of factors, including financial history, capital adequacy, earnings prospects, character of management, needs of the community and consistency with corporate powers.

Restrictions on Transactions with Affiliates and Insiders. Transactions between the Bank and its non−banking affiliates, including the Company, are subject to Section 23A of the Federal Reserve Act. An affiliate of a bank is any company or entity that controls, is controlled by, or is under common control with the bank. In general, Section 23A imposes limits on the amount of such transactions, and also requires certain levels of collateral for loans to affiliated parties. It also limits the amount of advances to third parties which are collateralized by the securities or obligations of the Company or its non−banking subsidiaries.

Affiliate transactions are also subject to Section 23B of the Federal Reserve Act which generally requires that certain transactions between the Bank and its affiliates be on terms substantially the same, or at least as favorable to the Bank, as those prevailing at the time for comparable transactions with or involving other nonaffiliated persons. The Federal Reserve has also issued Regulation W which codifies prior regulations under Sections 23A and 23B of the Federal Reserve Act and interpretive guidance with respect to affiliate transactions.

The restrictions on loans to directors, executive officers, principal shareholders and their related interests (collectively referred to herein as “insiders”) contained in the Federal Reserve Act and Regulation O apply to all insured depository institutions and their subsidiaries. These restrictions include limits on loans to one borrower and conditions that must be met before such a loan can be made. There is also an aggregate limitation on all loans to insiders and their related interests. These loans cannot exceed the institution’s total unimpaired capital and surplus, and the OCC may determine that a lesser amount is appropriate. Insiders are subject to enforcement actions for knowingly accepting loans in violation of applicable restrictions.

Restrictions on Distribution of Subsidiary Bank Dividends and Assets. Dividends paid by the Bank have provided a substantial part of the Company’s operating funds and for the foreseeable future it is anticipated that dividends paid by the Bank to the Company will continue to be the Company’s principal source of operating funds. Capital adequacy requirements serve to limit the amount of dividends that may be paid by the Bank. Until capital surplus equals or exceeds capital stock, a national bank must transfer to surplus 10% of its net income for the preceding four quarters in the case of an annual dividend or 10% of its net income for the preceding two quarters in the case of a quarterly or semiannual dividend. At December 31, 2003, the Bank’s capital surplus exceeded its capital stock. Without prior approval, a national bank may not declare a dividend if the total amount of all dividends, declared by the bank in any calendar year exceeds the total of the bank’s retained net income for the current year and retained net income for the preceding two years. Under federal law, the Bank cannot pay a dividend if, after paying the dividend, the Bank will be “undercapitalized.” The OCC may declare a dividend payment to be unsafe and unsound even though the Bank would continue to meet its capital requirements after the dividend.

Because the Company is a legal entity separate and distinct from its subsidiaries, its right to participate in the distribution of assets of any subsidiary upon the subsidiary’s liquidation or reorganization will be subject to the prior claims of the subsidiary’s creditors. In the event of a liquidation or other resolution of an insured depository institution, the claims of depositors and other general or subordinated creditors are entitled to a priority of payment over the claims of holders of any obligation of the institution to its shareholders, arising as a result of their status as shareholders, including any depository institution holding company (such as the Company) or any shareholder or creditor thereof.

Examinations. The OCC periodically examines and evaluates insured banks. Based upon such an evaluation, the OCC may revalue the assets of the institution and require that it establish specific reserves to compensate for the difference between the OCC−determined value and the book value of such assets.

Audit Reports. Insured institutions with total assets of $500 million or more must submit annual audit reports prepared by independent auditors to federal regulators. In some instances, the audit report of the institution's holding company can be used to satisfy this requirement. Auditors must receive examination reports, supervisory agreements, and reports of enforcement actions. In addition, financial statements prepared in accordance with accounting principles generally accepted in the U.S., management's certifications concerning responsibility for the financial statements, internal controls and compliance with legal requirements designated by the OCC, and an attestation by the auditor regarding the statements of management relating to the internal controls must be submitted. For institutions with total assets of more than $3 billion, independent auditors may be required to review quarterly financial statements. The Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") requires that independent audit committees be formed, consisting of outside directors only. The committees of such institutions must include members with experience in banking or financial management, must have access to outside counsel, and must not include representatives of large customers.

Capital Adequacy Requirements. Similar to the Federal Reserve Board's requirements for bank holding companies, the OCC has adopted regulations establishing minimum requirements for the capital adequacy of national banks. The OCC may establish higher minimum requirements if, for example, a bank has previously received special attention or has a high susceptibility to interest rate risk.

The OCC's risk−based capital guidelines generally require national banks to have a minimum ratio of Tier 1 capital to total risk−weighted assets of 4.0% and a ratio of total capital to total risk−weighted assets of 8.0%. As of December 31, 2003, the Bank's ratio of Tier 1 capital to total risk−weighted assets was 11.66% and its ratio of total capital to total risk−weighted assets was 12.92%.

The OCC's leverage guidelines require national banks to maintain Tier 1 capital of no less than 4.0% of average total assets, except in the case of certain highly rated banks for which the requirement is 3.0% of average total assets unless a higher leverage capital ratio is warranted by the particular circumstances or risk profile of the depository institution. As of December 31, 2003, the Bank's ratio of Tier 1 capital to average total assets (leverage ratio) was 8.30%.

Corrective Measures for Capital Deficiencies. The federal banking regulators are required to take "prompt corrective action" with respect to capital−deficient institutions. Agency regulations define, for each capital category, the levels at which institutions are "well capitalized," "adequately capitalized," "under capitalized," "significantly under capitalized" and "critically under capitalized." A "well capitalized" bank has a total risk−based capital ratio of 10.0% or higher; a Tier 1 risk−based capital ratio of 6.0% or higher; a leverage ratio of 5.0% or higher; and is not subject to any written agreement, order or directive requiring it to maintain a specific capital level for any capital measure. An "adequately capitalized" bank has a total risk−based capital ratio of 8.0% or higher; a Tier 1 risk−based capital ratio of 4.0% or higher; a leverage ratio of 4.0% or higher (3.0% or higher if the bank was rated a composite 1 in its most recent examination report and is not experiencing significant growth); and does not meet the criteria for a well capitalized bank. A bank is "under capitalized" if it fails to meet any one of the ratios required to be adequately capitalized.

In addition to requiring undercapitalized institutions to submit a capital restoration plan, agency regulations authorize broad restrictions on certain activities of undercapitalized institutions including asset growth, acquisitions, branch establishment, and expansion into new lines of business. With certain exceptions, an insured depository institution is prohibited from making capital distributions, including dividends, and is prohibited from paying management fees to control persons if the institution would be undercapitalized after any such distribution or payment.

As an institution's capital decreases, the OCC's enforcement powers become more severe. A significantly undercapitalized institution is subject to mandated capital raising activities, restrictions on interest rates paid and transactions with affiliates, removal of management, and other restrictions. The OCC has only very

limited discretion in dealing with a critically undercapitalized institution and is virtually required to appoint a receiver or conservator.

Banks with risk−based capital and leverage ratios below the required minimums may also be subject to certain administrative actions, including the termination of deposit insurance upon notice and hearing, or a temporary suspension of insurance without a hearing in the event the institution has no tangible capital.

Deposit Insurance Assessments. The Bank must pay assessments to the FDIC for federal deposit insurance protection. The FDIC has adopted a risk−based assessment system as required by FDICIA. Under this system, FDIC−insured depository institutions pay insurance premiums at rates based on their risk classification. Institutions assigned to higher−risk classifications (that is, institutions that pose a greater risk of loss to their respective deposit insurance funds) pay assessments at higher rates than institutions that pose a lower risk. An institution's risk classification is assigned based on its capital levels and the level of supervisory concern the institution poses to the regulators. In addition, the FDIC can impose special assessments in certain instances.

The FDIC established a process for raising or lowering all rates for insured institutions semi−annually if conditions warrant a change. Under this new system, the FDIC has the flexibility to adjust the assessment rate schedule twice a year without seeking prior public comment, but only within a range of five cents per $100 above or below the assessment schedule adopted. Changes in the rate schedule outside the five−cent range above or below the current schedule can be made by the FDIC only after a full rulemaking with opportunity for public comment.

On September 30, 1996, President Clinton signed into law an act that contained a comprehensive approach to recapitalizing the Savings Association Insurance Fund ("SAIF") and to assure the payment of the Financing Corporation's ("FICO") bond obligations. Under this act, banks insured under the BIF are required to pay a portion of the interest due on bonds that were issued by FICO to help shore up the ailing Federal Savings and Loan Insurance Corporation in 1987. The BIF rate was required to equal one−fifth of the SAIF rate through year−end 1999, or until the insurance funds were merged, whichever occurred first. Thereafter, BIF and SAIF payers will be assessed pro rata for the FICO bond obligations. With regard to the assessment for the FICO obligation, for the first quarter of 2004, the BIF and SAIF rates were .00154% of deposits.

Enforcement Powers. The FDIC and the other federal banking agencies have broad enforcement powers, including the power to terminate deposit insurance, impose substantial fines and other civil and criminal penalties, and appoint a conservator or receiver. Failure to comply with applicable laws, regulations and supervisory agreements could subject the Company or its banking subsidiaries, as well as officers, directors and other institution−affiliated parties of these organizations, to administrative sanctions and potentially substantial civil money penalties. The appropriate federal banking agency may appoint the FDIC as conservator or receiver for a banking institution (or the FDIC may appoint itself, under certain circumstances) if any one or more of a number of circumstances exist, including, without limitation, the fact that the banking institution is undercapitalized and has no reasonable prospect of becoming adequately capitalized; fails to become adequately capitalized when required to do so; fails to submit a timely and acceptable capital restoration plan; or materially fails to implement an accepted capital restoration plan.

Brokered Deposit Restrictions. Adequately capitalized institutions (as defined for purposes of the prompt corrective action rules described above) cannot accept, renew or roll over brokered deposits except with a waiver from the FDIC, and are subject to restrictions on the interest rates that can be paid on such deposits. Undercapitalized institutions may not accept, renew, or roll over brokered deposits.

Cross−Guarantee Provisions. The Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA") contains a "cross−guarantee" provision which generally makes commonly controlled insured depository institutions liable to the FDIC for any losses incurred in connection with the failure of a commonly controlled depository institution.

Community Reinvestment Act. The CRA and the regulations issued thereunder are intended to encourage banks to help meet the credit needs of their service area, including low and moderate−income

neighborhoods, consistent with the safe and sound operations of the banks. These regulations also provide for regulatory assessment of a bank's record in meeting the needs of its service area when considering applications to establish branches, merger applications and applications to acquire the assets and assume the liabilities of another bank. FIRREA requires federal banking agencies to make public a rating of a bank's performance under the CRA. In the case of a bank holding company, the CRA performance record of the banks involved in the transaction are reviewed in connection with the filing of an application to acquire ownership or control of shares or assets of a bank or to merge with any other bank holding company. An unsatisfactory record can substantially delay or block the transaction.

Consumer Laws and Regulations. In addition to the laws and regulations discussed herein, the Bank is also subject to certain consumer laws and regulations that are designed to protect consumers in transactions with banks. While the list set forth herein is not exhaustive, these laws and regulations include the Truth in Lending Act, the Truth in Savings Act, the Electronic Funds Transfer Act, the Expedited Funds Availability Act, the Equal Credit Opportunity Act, and the Fair Housing Act, among others. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must deal with customers when taking deposits or making loans to such customers. The Bank must comply with the applicable provisions of these consumer protection laws and regulations as part of their ongoing customer relations.

Privacy. In addition to expanding the activities in which banks and bank holding companies may engage, the Gramm−Leach−Bliley Act imposes new requirements on financial institutions with respect to customer privacy. The Gramm−Leach−Bliley Act generally prohibits disclosure of customer information to non−affiliated third parties unless the customer has been given the opportunity to object and has not objected to such disclosure. Financial institutions are further required to disclose their privacy policies to customers annually. Financial institutions, however, will be required to comply with state law if it is more protective of customer privacy than the Gramm−Leach−Bliley Act. The privacy provisions became effective on July 1, 2002. The Gramm−Leach−Bliley Act contains a variety of other provisions including a prohibition against ATM surcharges unless the customer has first been provided notice of the imposition and amount of the fee.

USA Patriot Act of 2002. The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA Patriot) Act of 2002 was enacted in October 2002. The USA Patriot Act is intended to strengthen the ability of U.S. law enforcement and the intelligence communities to work cohesively to combat terrorism on a variety of fronts. The potential impact of the USA Patriot Act on financial institutions of all kinds is significant and wide ranging. The USA Patriot Act contains a broad range of anti−money laundering and financial transparency laws and requires various regulations, including: (i) due diligence requirements for financial institutions that administer, maintain, or manage private bank accounts or correspondent accounts for non−U.S. persons; (ii) standards for verifying customer identification at account opening; (iii) rules to promote cooperation among financial institutions, regulators and law enforcement entities in identifying parties that may be involved in terrorism or money laundering; (iv) reports by nonfinancial trades and business filed with the Treasury Department's Financial Crimes Enforcement Network for transactions exceeding $10,000; and (v) filing of suspicious activities reports involving securities by brokers and dealers if they believe a customer may be violating U.S. laws and regulations.

Instability of Regulatory Structure

Various legislation and proposals to overhaul the bank regulatory system and limit the investments that a depository institution may make with insured funds, is from time to time introduced in Congress. Such legislation may change banking statutes and the operating environment of the Company and its banking subsidiaries in substantial and unpredictable ways. The Company cannot determine the ultimate effect that potential legislation, if enacted, or implementing regulations with respect thereto, would have upon the financial condition or results of operations of the Company or its subsidiaries.

Expanding Enforcement Authority

One of the major additional burdens imposed on the banking industry by FDICIA is the increased ability of banking regulators to monitor the activities of banks and their holding companies. In addition, the Federal Reserve Board and OCC possess extensive authority to police unsafe or unsound practices and violations of applicable laws and regulations by depository institutions and their holding companies. For example, the FDIC may terminate the deposit insurance of any institution which it determines has engaged in an unsafe or unsound practice. The agencies can also assess civil money penalties, issue cease and desist or removal orders, seek injunctions, and publicly disclose such actions. FDICIA, FIRREA and other laws have expanded the agencies' authority in recent years, and the agencies have not yet fully tested the limits of their powers.

Effect of Monetary Policy

The policies of regulatory authorities, including the monetary policy of the Federal Reserve Board, have a significant effect on the operating results of bank holding companies and their subsidiaries. Among the means available to the Federal Reserve Board to affect the money supply are open market operations in U.S. Government securities, changes in the discount rate or federal funds rate on member bank borrowings, and changes in reserve requirements against member bank deposits. These means are used in varying combinations to influence overall growth and distribution of bank loans, investments and deposits, and their use may affect interest rates charged on loans or paid for deposits.

Federal Reserve Board monetary policies have materially affected the operating results of commercial banks in the past and are expected to continue to do so in the future. The nature of future monetary policies and the effect of such policies on the business and earnings of the Company and its subsidiaries cannot be predicted.

Item 2. ***Properties***

Facilities

The Company conducts business at 15 locations, 10 of which are leased. Included are 14 full−service banking locations and the Company's corporate offices. The following table sets forth specific information on each location. The Company's headquarters are located at 9600 Bellaire Boulevard, Suite 252, Houston, Texas. The lease for the Company's corporate headquarters will expire in December 2008.

Location	Owned/ Leased	Sq. Ft.	Deposits at December 31, 2003
			(In thousands)
Houston Area:			
Corporate Offices 9600 Bellaire Boulevard, Suite 252	Leased	36,298	$ N/A
Bellaire Boulevard 9600 Bellaire Boulevard, Suite 100	Leased	7,002	320,210
East 6730 Capitol at Wayside	Owned	16,400	81,598
Chinatown 1005 Saint Emanuel	Leased	2,500	30,790
Sugar Land 15144 Southwest Freeway	Owned	5,665	38,459
Harwin 10000 Harwin Drive	Leased	2,463	31,086
Clear Lake 2424 Bay Area Boulevard	Owned	1,986	29,985
Veterans Memorial 13480 Veterans Memorial Boulevard	Owned	5,571	30,540
Milam 2808 Milam Street	Leased	2,546	14,474
Boone Road 11205 Bellaire Boulevard, Suite B−9	Leased	905	9,972
Dulles 4635 Highway 6	Owned	479	18,906
Long Point 1426 Blalock	Leased	3,000	23,257
Dallas Area:			
Richardson 275 West Campbell Road	Leased	4,948	62,065
Dallas (Harry Hines) 2527 Royal Lane	Leased	6,000	24,498
Garland 3500 West Walnut Street	Leased	2,400	9,101

Item 3. ***Legal Proceedings***

Legal Proceedings

In September 2003, Advantage Finance Corporation ("AFC"), a subsidiary of the Company that is no longer active, was served in connection with a lawsuit based on alleged "malicious prosecution" and "conspiracy". Also included in the lawsuit are BDO Seidman LLP and the CIT Group/ Commercial Services, Inc. The plaintiff has filed his case in both Federal and State courts. In December 2003, the case was

dismissed from Federal court and a request for dismissal from State court is anticipated. An appeal is expected, however none has been filed to date. Management is unable to determine whether the outcome will have a material impact on the Company's financial statements. The lawsuit does not seek a specified amount.

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

No matters were submitted to a vote of security holders during the fourth quarter of 2003.

PART II

Item 5. ***Market for Registrant's Common Equity and Related Shareholder Matters***

The Company's Common Stock is listed on the Nasdaq National Market System ("Nasdaq NMS") under the symbol "MCBI." As of March 5, 2004, there were 7,162,990 shares outstanding and approximately 175 shareholders of record. The number of beneficial owners is unknown to the Company at this time.

The following table presents the high and low sales prices for the Common Stock reported on the Nasdaq NMS during the two years ended December 31, 2003:

	High	Low
2003		
Fourth quarter	$15.15	$12.50
Third quarter	13.08	12.10
Second quarter	14.30	11.94
First quarter	13.00	11.60
2002		
Fourth quarter	$12.13	$11.40
Third quarter	12.40	11.00
Second quarter	13.50	11.65
First quarter	11.81	10.50

Dividends

Holders of Common Stock are entitled to receive dividends when, and if, declared by the Company's Board of Directors, out of funds legally available. While the Company has declared and paid quarterly dividends since the fourth quarter 1998, there is no assurance that the Company will pay dividends in the future.

The cash dividends paid per share by quarter for the Company's last two fiscal years were as follows:

	2003	2002
Fourth quarter	$0.06	$0.06
Third quarter	0.06	0.06
Second quarter	0.06	0.06
First quarter	0.06	0.06

The principal source of cash revenues to the Company is dividends paid by the Bank with respect to the Bank's capital stock. There are certain restrictions on the payment of such dividends imposed by federal banking laws, regulations and authorities. Until capital surplus equals or exceeds capital, a national bank must transfer to surplus 10% of its net income for the preceding four quarters in the case of an annual dividend or 10% of its net income for the preceding two quarters in the case of a quarterly or semiannual dividend. As of December 31, 2003, the Bank's capital surplus exceeded its capital stock. Without prior approval, a national

bank may not declare a dividend if the total amount of all dividends, declared by the bank in any calendar year exceeds the total of the bank's retained net income for the current year and retained net income for the preceding two years. As of December 31, 2003, an aggregate of approximately $15.0 million was available for payment of dividends by the Bank to the Company under applicable restrictions, without regulatory approval. Regulatory authorities could impose administratively stricter limitations on the ability of the Bank to pay dividends to the Company if such limits were deemed appropriate to preserve certain capital adequacy requirements.

In the future, the declaration and payment of dividends on the Common Stock will depend upon the earnings and financial condition of the Company, liquidity and capital requirements, the general economic and regulatory climate, the Company's ability to service any equity or debt obligations senior to the Common Stock and other factors deemed relevant by the Company's Board of Directors.

Securities Authorized for Issuance Under Equity Compensation Plans

The Company currently has stock options outstanding. The following table provides information as of December 31, 2003 regarding the Company's equity compensation plans under which the Company's equity securities are authorized for issuance:

EQUITY COMPENSATION PLAN INFORMATION

Plan Category	(a) Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	(b) Weighted Average Exercise Price of Outstanding Options	(c) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	212,000	$ 11.10	477,500
Equity compensation plans not approved by security holders	—	—	—
Total	212,000	$ 11.10	477,500

Item 6. ***Selected Consolidated Financial Data***

The following Selected Consolidated Financial Data of the Company should be read in conjunction with the consolidated financial statements of the Company, and the accompanying notes, appearing elsewhere in this Annual Report on Form 10−K, and the information contained in "Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations." The selected historical consolidated financial data as of and for each of the five years ended December 31, 2003 is derived from the Company's Consolidated Financial Statements which have been audited by independent accountants. Certain prior year amounts have been reclassified to conform with the 2003 presentation.

	Years Ended December 31,				
	2003	2002	2001	2000	1999
	(Dollars in thousands, except per share data)				
Income Statement Data:					
Interest income	$ 43,838	$ 48,711	$ 55,451	$ 63,466	$ 53,668
Interest expense	12,134	14,628	23,799	27,276	21,026
Net interest income	31,704	34,083	31,652	36,190	32,642
Provision for loan losses	5,690	3,853	3,799	7,508	5,550
Net interest income after provision for loan losses	26,014	30,230	27,853	28,682	27,092
Noninterest income	8,927	8,967	8,660	7,032	6,088
Noninterest expense	29,704	26,058	25,383	27,230	22,412
Income before provision for income taxes	5,237	13,139	11,130	8,484	10,768
Provision for income taxes	1,529	4,350	3,553	3,001	3,638
Net income	$ 3,708	$ 8,789	$ 7,577	$ 5,483	$ 7,130
Per Share Data:					
Net income:					
Basic	$ 0.52	$ 1.25	$ 1.08	$ 0.79	$ 1.00
Diluted	0.51	1.23	1.07	0.79	1.00
Book value	10.65	10.59	9.32	8.42	7.38
Tangible book value	10.65	10.59	9.32	8.42	7.38
Cash dividends	0.24	0.24	0.24	0.24	0.24
Weighted average shares outstanding (in thousands):					
Basic	7,089	7,024	6,998	6,972	7,114
Diluted	7,213	7,154	7,059	6,973	7,114
Balance Sheet Data (Period End):					
Total assets	$864,773	$840,065	$742,174	$736,757	$660,589
Securities	262,264	264,418	176,230	143,759	110,065
Total loans	553,783	527,759	493,145	483,738	495,669
Allowance for loan losses	10,448	10,150	8,903	9,271	7,537
Total deposits	724,941	691,361	642,751	625,906	544,436
Other borrowings	54,173	65,774	25,195	25,573	55,636
Total shareholders' equity	76,210	74,463	65,229	58,701	52,580

	Years Ended December 31,				
	2003	2002	2001	2000	1999
	(Dollars in thousands, except per share data)				
Balance Sheet Data (Average):					
Total assets	$851,960	$790,752	$727,841	$698,209	$620,646
Securities	251,828	222,752	159,416	127,865	119,952
Total loans	549,610	505,495	474,986	486,549	456,653
Allowance for loan losses	10,595	9,238	9,315	8,589	6,720
Total deposits	708,575	656,824	626,970	590,217	501,808
Other borrowings	60,309	53,056	25,570	42,757	58,037
Total shareholders' equity	75,306	70,607	63,539	53,462	53,010
Performance Ratios:					
Return on average assets	0.44%	1.11%	1.04%	0.79%	1.15%
Return on average equity	4.92	12.45	11.92	10.26	13.52
Net interest margin	3.89	4.54	4.64	5.57	5.55
Efficiency ratio(1)	73.11	60.53	62.97	62.98	57.92
Asset Quality Ratios:					
Nonperforming assets to total loans and other real estate	5.08%	3.55%	1.13%	0.62%	1.42%
Nonperforming assets to total assets	3.27	2.24	0.75	0.40	1.07
Net loan charge−offs to total loans	0.97	0.49	0.84	1.19	0.90
Allowance for loan losses to total loans	1.89	1.92	1.81	1.92	1.52
Allowance for loan losses to nonperforming loans(2)	40.64	57.71	250.86	416.67	115.03
Capital Ratios:					
Leverage ratio(3)	8.84%	8.58%	8.91%	8.39%	8.80%
Average shareholders' equity to average total assets	8.84	8.93	8.73	7.66	8.54
Tier−1 risk−based capital ratio — period end	12.42	12.71	12.50	11.74	11.41
Total risk−based capital ratio — period end	13.67	13.97	13.76	13.00	12.66

(1) Calculated by dividing total noninterest expense by net interest income plus noninterest income.
(2) Nonperforming loans consist of nonaccrual loans, loans contractually past due 90 days or more and restructured loans.
(3) The leverage ratio is calculated by dividing Tier 1 capital by average assets at period end.

Item 7. ***Management's Discussion and Analysis of Financial Condition and Results of Operations***

Management's Discussion and Analysis of Financial Condition and Results of Operations of the Company analyzes the major elements of the Company's balance sheets and statements of operations. This section should be read in conjunction with the Company's Consolidated Financial Statements and accompanying notes and other detailed information appearing elsewhere in this document.

For the Years Ended December 31, 2003, 2002 and 2001

Overview

The Company, primarily through the Bank, generates earnings from several sources. First, the Bank attracts customer deposits through its fourteen branches located in Houston and Dallas. The types of deposits vary from noninterest−bearing demand deposit transaction accounts to interest−bearing NOW and money market transaction accounts, savings accounts, and various termed time deposits such as certificates of deposit ("CD's") and individual retirement accounts ("IRA's"). With the funds attracted from the communities surrounding the branches, the Bank originates loans to individuals and small businesses to finance business operations, purchases of real estate, or other business opportunities. The Bank's net interest income represents the difference between the interest income earned on loans and securities and the interest expense paid on customer deposits and other borrowed funds. Interest rate fluctuations, as well as changes in the amount and type of earning assets and liabilities, combine to affect net interest income. This represents the primary source of income generated by the Bank during each fiscal year and can be found on the Statement of Income under "net interest income".

To compliment the foregoing earnings, the Bank also earns fee income from both deposits and loans through service fees and charges collected from customers. Generally, the Bank receives the greater portion of its fees from its deposit customers in the form of service fees, nonsufficient funds ("NSF") fees, and other fees for services provided to the customer. Loan fees are generally earned from late charges, administrative document and processing fees, and other loan−related type fees. The fees collected by the Bank may be found on the Statement of Income under "noninterest income".

The Bank may also generate earnings through the sale of loans and securities which are categorized on the Balance Sheet as "held−for−sale" or "available−for−sale". While it is not uncommon to see such gains, they are generally not consistent throughout the year. This inconsistency is directly related to the availability and/or the market for these types of assets that the bank might want to sell.

Offsetting these earnings are operating expenses referred to as "noninterest expense". Because banking is a very people intensive industry, the largest of the Bank's operating expenses is salaries and benefits.

Total assets at December 31, 2003 were $864.8 million, an increase of $24.7 million or 2.9% compared to $840.1 million at December 31, 2002. Total loans at December 31, 2003 were $553.8 million, an increase of $26.0 million or 4.9% compared to $527.8 million at December 31, 2002. Investment securities at December 31, 2003 were $262.3 million, down $2.1 million or 0.8% from $264.4 million at December 31, 2002. Total deposits at December 31, 2003 were $724.9 million, an increase of $33.5 million or 4.9% compared to $691.4 million at December 31, 2002. Other borrowings at December 31, 2003 were $54.2 million, down $11.6 million or 17.6% compared to $65.8 million at December 31, 2002.

Total assets at December 31, 2002 were $840.1 million, an increase of $97.9 million or 13.2% compared to $742.2 million at December 31, 2001. Growth in loans and investment securities accounted for the majority of the Company's asset growth during this period, increasing to $527.8 million and $264.4 million, respectively, at December 31, 2002 from $493.1 million and $176.2 million, respectively, at December 31, 2001. Supporting this growth was an increase in deposits and other borrowings to $691.4 million and $65.8 million, respectively, at December 31, 2002 from $642.8 million and $25.2 million, respectively, at December 31, 2001, an increase of $48.6 million and $40.6 million, respectively. Shareholders' equity at December 31, 2002 was $74.5 million, an increase of $9.3 million or 14.2% compared with $65.2 million at December 31, 2001.

Net income for the years ended December 31, 2003, 2002, and 2001 was $3.7 million, $8.8 million, and $7.6 million, respectively. Diluted earnings per common share for the years ended December 31, 2003, 2002, and 2001 were $0.51, $1.23, and $1.07, respectively. The Company's returns on average assets for the years ended December 31, 2003, 2002, and 2001 were 0.44%, 1.11%, and 1.04, respectively. The Company's returns on average equity for the same periods were 4.92%, 12.45%, and 11.92%, respectively. The 2003 decreases in net income, diluted earnings per share, return on average assets, and return on average equity was primarily

the result of lower net interest income, a higher provision for loan losses, and lower of cost or market adjustments on loans held−for−sale.

The 2003 provision for loan losses was $5.7 million, up $1.8 million or 46.2% compared to $3.9 million in 2002. In 2003, management determined an additional provision was needed primarily due to the results of continued asset quality risk assessment procedures and a 4.9% increase in the loan portfolio. The loan review process involves the grading of each loan by its respective loan officer. Depending on the grade, a loan will be aggregated with other loans of similar grade and a loss factor is applied to the total loans in each group to establish the required level of allowance for loan losses.

In June 2003 the Company transferred the status of approximately $13.1 million in hospitality−related loans to held−for−sale. While the Company has not historically made such transfers, the high concentration of these loans was deemed necessary to reduce the Company's exposure to credit risk. In August 2003, an additional $3.9 million in hospitality−related loans was transferred to held−for−sale.

Results of Operations

Net Interest Income

Net interest income represents the amount by which interest income on interest−earning assets, including securities and loans, exceeds interest expense incurred on interest−bearing liabilities, including deposits and other borrowed funds.

Interest income in 2003, was 10.0% lower than interest income in 2002, and interest expense in 2003 was 17.0% lower than interest expense in 2002. Net interest income for 2003 was 7.0% lower than net interest income in 2002 primarily due to a decrease in the yield on earning assets of 112 basis points that was partially offset by a decrease in the cost of interest−bearing liabilities of 57 basis points. The lower net interest income in 2003, compared to 2002, primarily reflects the current low interest rate environment, refinancing activity on existing loans, and lower yields on new earning assets (both loans and investments). The Federal Reserve's interest rate reductions in November 2002 and June 2003 contributed to the lower yields. However, the effect of interest rate floors on approximately 64.7% of the loan portfolio helped to soften the decline in yield on earning assets. The loans with interest rate floors had a weighted average yield of approximately 5.88% at December 31, 2003 compared to approximately 61.3% of the loan portfolio with interest rate floors that had a weighted average yield of approximately 6.58% at December 31, 2002.

2003 versus 2002. Net interest income in 2003 was $31.7 million compared with $34.1 million in 2002, a decrease of $2.4 million or 7.0%. The decrease in net interest income for 2003 was primarily due to a decrease of $4.9 million in interest income that was partially offset by a decrease of $2.5 million in interest expense. The net interest spread is the difference between the yield on earning assets and the cost of interest−bearing liabilities. The net interest spread in 2003 decreased 55 basis points to 3.41% compared to 3.96% in 2002. The decrease in the net interest spread reflects a decrease of 112 basis points in the average yield on earning assets that was partially offset by a decrease of 57 basis points in the average rate paid for interest−bearing liabilities. The net interest margin is the difference between the yield on earning assets and the cost of earning assets. The cost of earning assets is annualized interest expense divided by average earning assets. The net interest margin in 2003 decreased 65 basis points to 3.89% compared to 4.54% in 2002 and primarily reflects the 112 basis point decline in earning asset yield that was partially offset by a decline in the cost of earning assets of 47 basis points.

Interest income in 2003 was $43.8 million compared with $48.7 million in 2002, a decrease of $4.9 million or 10.0%. The decrease in interest income for 2003 was primarily due to the lower interest rate economy, a lower yield on loans as a result of refinancing, increased nonaccrual loan balances, and lower yields on the investment portfolio. Approximately 85.1% of the loans in the loan portfolio have variable interest rates tied to the prime rate and are, therefore, sensitive to interest rate movement. However, at December 31, 2003 approximately 64.7% of the loans in the loan portfolio had interest rate floors with a weighted average yield of 5.88%. This was down 70 basis points from 6.58% at December 31, 2002, primarily as a result of new loans with floors at lower interest rates in addition to refinanced floor rates on pre−existing loans. These floor rates

helped to partially offset the decline in loan interest rate yield. The average yield on the total loan portfolio for 2003 was 6.41%, down 110 basis points compared to 7.51% in 2002. The average yield on the investment portfolio for 2003 was 3.23%, down 115 basis points compared to 4.38% in 2002. The yield on average earning assets for 2003 was 5.37%, down 112 basis points compared to 6.49% in 2002.

Interest expense in 2003 was $12.1 million compared to $14.6 million in 2002, a decrease of $2.5 million or 17.0%. The decrease in interest expense for 2003 was also primarily the result of lower interest rates paid for interest−bearing liabilities in 2003. The average cost of interest−bearing liabilities for 2003 was 1.96%, down 57 basis points compared to 2.53% in 2002.

2002 versus 2001. Net interest income in 2002 was $34.1 million compared with $31.7 million in 2001, an increase of $2.4 million or 7.7%. The increase in net interest income for 2002 was primarily due to a decrease of $9.1 million in interest expense partially offset by a decrease of $6.7 million in interest income. The net interest spread in 2002 improved 20 basis points to 3.96% compared to 3.76% in 2001. The increase in the net interest spread reflects a decrease of 185 basis points in the average rate paid on interest−bearing liabilities that was partially offset by a decrease of 165 basis points in the average yield on interest−earning assets. Interest rate floors on approximately 61.3% of the loan portfolio helped curtail the decrease in the average yield on total loans. The net interest margin in 2002 decreased 10 basis points to 4.54% compared to 4.64% in 2001 and was primarily due to the refinancing of existing loans and the origination of new loans both at lower interest rates. The Federal Reserve's 50 basis point interest rate reduction in November 2002 partially contributed to this decrease.

Interest income in 2002 was $48.7 million compared with $55.5 million in 2001, a decrease of $6.7 million or 12.2%. The decrease in interest income in 2002 was primarily due to the lower interest rate economy, a lower yield on loans as a result of refinancing, increased nonaccrual loan balances, and lower yields on the investment portfolio. Approximately 84.0% of the loans in the loan portfolio had variable interest rates tied to the prime rate and were, therefore, sensitive to interest rate movement. However, at December 31, 2002 approximately 61.3% of the loans in the loan portfolio had interest rate floors with a weighted average yield of 6.58%. This was down 117 basis points from 7.75% at December 31, 2001, primarily as a result of new loans with floors at lower interest rates in addition to refinanced floor rates on pre−existing loans. These floor rates helped to partially offset the decline in interest rate yield and therefore, curtail the decline in interest income. The average yield on the total loan portfolio for 2002 was 7.51%, down 174 basis points compared to 9.25% in 2001. The average yield on the investment portfolio for 2002 was 4.38%, down 120 basis points compared to 5.58% in 2001. The yield on average earning assets for 2002 was 6.49%, down 165 basis points compared to 8.14% in 2001.

Interest expense in 2002 was $14.6 million compared to $23.8 million in 2001, a decrease of $9.2 million or 38.5%. The decrease in interest expense for 2002 was also primarily the result of lower interest rates paid for deposits in 2002. The average cost of interest−bearing liabilities for 2002 was 2.53%, down 185 basis points compared to 4.38% in 2001.

The following table presents for the periods indicated the total dollar amount of interest income from average interest−earning assets and the resulting yields, as well as the interest expense on average interest−bearing liabilities, expressed both in dollars and rates. No tax−equivalent adjustments were made and all average balances are average daily balances. Nonaccrual loans have been included in the tables as loans carrying a zero yield with income, if any, recognized at the end of the loan term.

	Years Ended December 31,								
	2003			2002			2001		
	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate
	(Dollars in thousands)								
Assets									
Interest−earning assets:									
Total loans	$549,610	$35,242	6.41%	$505,495	$37,987	7.51%	$474,986	$43,926	9.25%
Taxable securities	227,054	7,321	3.22	195,649	9,080	4.64	132,366	8,356	6.31
Tax−exempt securities	20,095	997	4.96	23,362	1,160	4.97	23,491	1,177	5.01
Federal funds sold and other temporary investments	18,854	278	1.47	25,843	484	1.87	50,715	1,992	3.93
Total interest−earning assets	815,613	43,838	5.37%	750,349	48,711	6.49%	681,558	55,451	8.14%
Less allowance for loan losses	(10,595)			(9,238)			(9,315)		
Total interest−earning assets, net of allowance for loan losses	805,018			741,111			672,243		
Noninterest−earning assets	46,942			49,641			55,598		
Total assets	$851,960			$790,752			$727,841		
Liabilities and shareholders' equity									
Interest−bearing liabilities:									
Interest−bearing demand deposits	$ 73,987	$ 460	0.62%	$ 71,059	$ 837	1.18%	$ 54,694	$ 1,209	2.21%
Saving and money market accounts	111,867	885	0.79	110,372	1,378	1.25	102,268	2,322	2.27
Time deposits	371,500	8,942	2.41	342,707	10,595	3.09	360,370	19,003	5.27
Federal funds purchased	55	1	1.82	162	4	2.47	1	—	—
Other borrowings	60,255	1,846	3.06	52,894	1,814	3.43	25,570	1,265	4.95
Total interest−bearing liabilities	617,664	12,134	1.96%	577,194	14,628	2.53%	542,903	23,799	4.38%
Noninterest−bearing liabilities:									
Noninterest−bearing demand deposits	151,221			132,686			109,638		
Other liabilities	7,769			10,265			11,761		
Total liabilities	776,654			720,145			664,302		
Shareholders' equity	75,306			70,607			63,539		
Total liabilities and shareholders' equity	$851,960			$790,752			$727,841		
Net interest income		$31,704			$34,083			$31,652	
Net interest spread			3.41%			3.96%			3.76%
Net interest margin			3.89%			4.54%			4.64%

The following table presents the dollar amount of changes in interest income and interest expense for the major components of interest−earning assets and interest−bearing liabilities and distinguishes between changes in outstanding balances and changes in interest rates. For purposes of this table, changes attributable to both rate and volume have been allocated to each accordingly.

	Years Ended December 31,					
	2003 vs. 2002			2002 vs. 2001		
	Increase (Decrease) Due to			Increase (Decrease) Due to		
	Volume	Rate	Total	Volume	Rate	Total
	(Dollars in thousands)					
Interest−earning assets:						
Loans	$3,315	$(6,060)	$(2,745)	$2,821	$ (8,760)	$(5,939)
Securities	1,295	(3,217)	(1,922)	3,989	(3,282)	707
Federal funds sold and other temporary investments	(131)	(75)	(206)	(977)	(531)	(1,508)
Total increase (decrease) in interest income	4,479	(9,352)	(4,873)	5,833	(12,573)	(6,740)
Interest−bearing liabilities:						
Interest−bearing demand deposits	34	(411)	(377)	362	(734)	(372)
Saving and money market accounts	19	(512)	(493)	184	(1,128)	(944)
Time deposits	890	(2,543)	(1,653)	(931)	(7,477)	(8,408)
Federal funds purchased	(3)	—	(3)	—	4	4
Other borrowings	252	(220)	32	1,352	(803)	549
Total increase (decrease) in interest expense	1,192	(3,686)	(2,494)	967	(10,138)	(9,171)
Increase (decrease) in net interest income	$3,287	$(5,666)	$(2,379)	$4,866	$ (2,435)	$ 2,431

Provision for Loan Losses

Provisions for loan losses are charged to income to bring the Company's allowance for loan losses to a target level based on the factors discussed under "— Financial Condition — Allowance for Loan Losses."

The 2003 provision for loan losses was $5.7 million, up by $1.8 million or 46.2% compared to $3.9 million in 2002. In 2003, management determined an additional provision was needed primarily due to the results of continued asset quality risk assessment procedures and a 4.9% increase in the loan portfolio. The loan review process involves the grading of each loan by its respective loan officer. Depending on the grade, a loan will be aggregated with other loans of similar grade and a loss factor is applied to the total loans in each group to establish the required level of allowance for loan losses. Grades of 1−10 are applied to each loan where grades of 7−10 require the most allowance for loan losses. Factors utilized in the grading process include but are not limited to historical performance, current status, collateral value, and financial strength of the borrower. Oversight of the loan grades is vested with the Loan Review/ Compliance Officer. Differences of opinion are resolved among the loan officer, loan review officer, and the chief credit officer.

The ratio of the allowance for loan losses to total loans at December 31, 2003 was 1.89% compared with 1.92% and 1.81% at December 31, 2002 and 2001, respectively. The Company strives to maintain its allowance for loan losses at target levels commensurate with probable losses inherent in the loan portfolio. Management conducts ongoing risk assessments that may, from time to time, necessitate varying levels of allowance for loan losses based on these risk assessments.

Noninterest Income

For the years ended December 31, 2003, 2002 and 2001, noninterest income was $8.9 million, $9.0 million, and $8.7 million, respectively, reflecting a decrease of approximately $40,000 in 2003 compared to 2002, and an increase of $307,000 or 3.5% in 2002 compared to 2001. The service fees category of noninterest income includes monthly account service charge assessments, non−sufficient funds charges, and all other traditional non−lending bank service fees. Service fees for 2003 were $6.5 million, down $126,000 primarily due to less NSF related activity. Other loan−related fees for 2003 were $1.0 million, down $74,000 compared to $1.1 million in 2002 primarily due to a decrease in mortgage brokerage fees of $187,000 that was partially offset by increases in late charges and SBA servicing fees of $48,000 and $36,000, respectively. The gain on sale of SBA loans in 2003 was approximately $460,000, and increase of $139,000 over 2002.

The following table presents the major categories of noninterest income:

	Years Ended December 31,		
	2003	2002	2001
	(Dollars in thousands)		
Service fees	$6,544	$6,670	$6,360
Other loan−related fees	1,009	1,083	936
Letters of credit commissions and fees	516	610	655
Gain on sale of investment securities, net	165	34	189
Gain on sale of loans	600	322	127
Other noninterest income	93	248	393
Total noninterest income	$8,927	$8,967	$8,660

Noninterest Expense

For the years ended December 31, 2003, 2002 and 2001, noninterest expense was $29.7 million, $26.1 million, and $25.4 million, respectively, reflecting an increase of approximately $3.6 million or 14.0% in 2003 compared to 2002, and an increase of $675,000 or 2.7% in 2002 compared to 2001.

The increase in total noninterest expense in 2003 compared to 2002 was primarily due to $437,000 in higher employee salaries and benefits expense as a result of annual salary adjustments and $2.1 million in lower of cost or market adjustments on loans held−for−sale. Legal and professional fees in 2003, compared to 2002, increased approximately $987,000 as a result of increased costs related to matters concerning problem assets. Occupancy and equipment expense in 2003, compared to 2002, increased approximately $272,000 and was primarily the result of additional leased space in the corporate offices. All other categories of noninterest expense in 2003, compared to 2002, decreased approximately $199,000.

The increase in total noninterest expense in 2002 compared to 2001 was primarily due to higher employee salaries and benefits expense as a result of increased staffing levels in lending operations and compliance functions in addition to the full−year effect of executive level additions made during the third and fourth quarters of 2001. With the exception of losses incurred on net foreclosed assets, generally, all other categories of noninterest expense decreased in 2002 compared to 2001.

In June 2003, the Company transferred the status of approximately $13.1 million in hospitality−related loans to held−for−sale. While the Company has not historically made such transfers, the high concentration of these loans was deemed necessary to reduce the Company's exposure to credit risk. In August 2003, an additional $3.9 million composed of two restaurant loans totaling $2.6 million and an office building loan of $1.3 million, was transferred to held−for−sale. Approximately $11.0 million of the loans−held−for−sale were sold during 2003 and a gain of approximately $139,000 was recognized. The remaining $6.0 million were held−for−sale at December 31, 2003 and are carried at the lower of cost or market. During 2003, the Company recorded lower of cost or market adjustments of $2.1 million on the loans held−for−sale. The Company may consider

future transfers with concentrations in hospitality and other related loans that may expose the Company to potential losses.

The efficiency ratio is a measure designed to show how well a company utilizes its resources and manages its expenses. The efficiency ratio is calculated by dividing noninterest expense by net interest income plus noninterest income. The Company's efficiency ratio for 2003 was 73.11% and reflects the impact of the lower of cost or market adjustments on loans held−for−sale and the decline in the net interest margin. The Company's efficiency ratio for 2002 was 60.53%, an improvement compared to 62.97% for 2001, primarily as a result of higher net interest income and higher noninterest income.

Salaries and employee benefits for the years ended December 31, 2003, 2002 and 2001 was $15.2 million, $14.7 million, and $13.2 million, respectively, reflecting an increase of $437,000 or 3.0% in 2003 compared to 2002 and a $1.6 million or 11.9% increase in 2002 compared to 2001. The increase in 2003 versus 2002 primarily reflected the result of annual salary adjustments. The increase in 2002 versus 2001 primarily reflected the full−year effect of increased staffing levels in lending operations and compliance functions in addition to the full−year effect of executive level additions made during the third and fourth quarters of 2002. Total full−time equivalent employees ("FTE") at December 31, 2003, 2002 and 2001 were 299, 309, and 298, respectively.

Non−staff expenses for 2003, 2002 and 2001 were $14.5 million, $11.3 million, and $12.2 million, respectively, reflecting an increase of $3.2 million in 2003 compared to 2002 and a decrease of $891,000 in 2002 compared to 2001.

The $3.2 million increase in non−staff expense during 2003 compared to 2002 was primarily due to the $2.1 million in lower of cost or market adjustments on loans held−for−sale. Legal and professional fees increased approximately $987,000 as a result of increased costs related to matters concerning problem assets. Occupancy and equipment expense increased approximately $272,000 and was primarily the result of additional lease space in the corporate offices. All other categories of noninterest expense in 2003, compared to 2002, decreased approximately $199,000.

The $891,000 decrease in non−staff expense during 2002 compared to 2001 was primarily due to lower legal and professional fees of $395,000, lower occupancy expense of $100,000, and lower other noninterest expense of $820,000, that was partially offset by higher net real estate expense of $527,000.

The following table presents the major categories of noninterest expense:

	Years Ended December 31,		
	2003	2002	2001
	(Dollars in thousands)		
Salaries and employee benefits	$15,183	$14,746	$13,180
Non−staff expenses:			
Lower of cost or market adjustment on loans held−for−sale	2,149	—	—
Occupancy and equipment	5,361	5,089	5,189
Foreclosed assets, net	248	680	153
Data processing	99	94	86
Legal and professional fees	1,555	568	963
Advertising	244	314	426
Printing and supplies	597	572	526
Telecommunications	500	578	623
Other noninterest expense	3,768	3,417	4,237
Total non−staff expenses	14,521	11,312	12,203
Total noninterest expenses	$29,704	$26,058	$25,383

Income Taxes

Income tax expense includes the regular federal income tax at the statutory rate plus the income tax component of the Texas franchise tax. The amount of federal income tax expense is influenced by the amount of taxable income, the amount of tax−exempt income, the amount of non−deductible interest expense and the amount of other non−deductible expenses. Taxable income for the income tax component of the Texas franchise tax is the federal pre−tax income, plus certain officers' salaries, less interest income on federal securities.

Income tax expense is influenced by the level and mix of taxable and tax−exempt income and the amount of non−deductible interest and other expenses. Income tax expense for 2003 was $1.5 million, down approximately $2.8 million or 64.9% from income tax of $4.4 million in 2002. Income tax expense for 2002 was up approximately $797,000 or 22.4% from income tax expense of $3.6 million in 2001. The effective income tax rates in 2003, 2002 and 2001 were 29.2%, 33.1%, and 31.9%, respectively. The effective income tax rate in 2003 was lower due to a higher percentage of non−taxable income, primarily from tax−exempt securities, to pre−tax income.

The Texas franchise tax was $185,000, $57,000, and $345,800, in 2003, 2002, and 2001, respectively. In 2002, the Company received a franchise tax refund as a result of a franchise tax audit conducted on tax years 1999, 2001, and 2002.

Impact of Inflation

The effects of inflation on the local economy and on the Company's operating results have been relatively modest for the past several years. Since substantially all of the Company's assets and liabilities are monetary in nature, such as cash, securities, loans and deposits, their values are less sensitive to the effects of inflation than to changing interest rates, which do not necessarily change in accordance with inflation rates. The Company tries to control the impact of interest rate fluctuations by managing the relationship between its interest rate sensitive assets and liabilities. See '— Financial Condition — Interest Rate Sensitivity and Liquidity."

Financial Condition

Loan Portfolio

Total loans, which include approximately $6.0 million in loans held−for−sale, were $553.8 million at December 31, 2003, up $26.0 million or 4.9% from $527.8 million at December 31, 2002. The increase in 2003 represented growth of $7.1 million in commercial and industrial loans, $18.8 million in real estate loans, and $161,000 in consumer and other loans. Total loans were $527.8 million at December 31, 2002, an increase of $34.7 million or 7.0% from $493.1 million at December 31, 2001. The $34.7 million increase in 2002 compared to 2001 reflected increases of $12.5 million in commercial and industrial loans, $23.3 million in real estate loans, that was partially offset by a decrease of $1.1 million in consumer and other loans.

For the years ended December 31, 2003, 2002, and 2001, the ratios of total loans to total deposits were 76.4%, 76.3%, and 76.7%, respectively. For the same periods, total loans represented 64.0%, 62.8%, and 66.4%, of total assets, respectively.

The following table summarizes the loan portfolio of the Company by type of loan:

	As of December 31,									
	2003		2002		2001		2000		1999	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)									
Commercial and industrial	$332,480	59.36%	$325,424	60.94%	$312,899	62.67%	$298,134	60.92%	$298,150	59.55%
Real estate mortgage:										
Residential	14,315	2.56	7,326	1.37	7,833	1.57	10,141	2.07	10,934	2.18
Commercial	178,290	31.83	165,608	31.01	131,022	26.24	128,242	26.20	126,363	25.24
	192,605	34.39	172,934	32.38	138,855	27.81	138,383	28.27	137,297	27.42
Real estate construction:										
Residential	12,652	2.26	10,589	1.99	5,962	1.19	7,542	1.54	11,348	2.27
Commercial	11,906	2.12	14,805	2.76	30,215	6.05	32,059	6.55	28,661	5.72
	24,558	4.38	25,394	4.75	36,177	7.24	39,601	8.09	40,009	7.99
Consumer and other	10,447	1.87	10,286	1.93	11,364	2.28	11,986	2.45	11,550	2.31
Factored receivables	—	—	—	—	—	—	1,297	0.27	13,700	2.73
Gross loans	560,090	100.00%	534,038	100.00%	499,295	100.00%	489,401	100.00%	500,706	100.00%
Less: unearned discounts, interest and deferred fees	(6,306)		(6,279)		(6,150)		(5,663)		(5,037)	
Total loans	$553,784		$527,759		$493,145		$483,738		$495,669	

Each of the following principal product lines is an outgrowth of the Company's expertise in meeting the particular needs of the small and medium−sized businesses and consumers in the multicultural communities it serves:

Commercial and Industrial Loans. The primary lending focus of the Company is on loans to small and medium−sized businesses in a wide variety of industries. The Company's commercial lending emphasis includes loans to wholesalers, manufacturers and business service companies. A broad range of short and medium−term commercial lending products are made available to businesses for working capital (including inventory and accounts receivable), purchases of equipment and machinery and business expansion (including acquisitions of real estate and improvements). Generally, the Company's commercial loans are underwritten on the basis of the borrower's ability to service such debt as reflected by cash flow projections. Commercial loans are generally collateralized by business assets, which may include accounts receivable and inventory, certificates of deposit, securities, real estate, guarantees or other collateral. The Company also generally obtains personal guarantees from the principals of the business. Working capital loans are primarily collateralized by short−term assets, whereas term loans are primarily collateralized by long−term assets. As a result, commercial loans involve additional complexities, variables and risks and require more thorough underwriting and servicing than other types of loans. Indigenous to individuals in the Asian business community is the desire to own the building and land which houses their businesses. Accordingly, while a loan may be principally driven and classified by the type of business operated, real estate is frequently the primary source of collateral. As of December 31, 2003, approximately $229.4 million or 68.9% of the commercial and industrial loan portfolio was collateralized by real estate. The Company continually monitors real estate value trends and takes into consideration changes in market trends in its underwriting standards. As of December 31, 2003, the Company's commercial and industrial loan portfolio totaled $332.5 million or 59.4% of the gross loan portfolio.

Commercial Mortgage Loans. In addition to commercial loans, the Company makes commercial mortgage loans to finance the purchase of real property, which generally consists of developed real estate. The Company's commercial mortgage loans are collateralized by first liens on real estate, typically have variable rates and amortize over a 15 to 20 year period with balloon payments due at the end of five to seven years. Payments on loans collateralized by such properties are dependent on the successful operation or management

of the properties. Accordingly, repayment of these loans may be subject to adverse conditions in the real estate market or the economy to a greater extent than other types of loans. In underwriting commercial mortgage loans, consideration is given to the property's historical cash flow, current and projected occupancy, location and physical condition. The underwriting analysis also includes credit checks, appraisals, environmental impact reports and a review of the financial condition of the borrower. As of December 31, 2003, the Company had a commercial mortgage portfolio of $178.3 million or 31.8% of the gross loan portfolio.

Construction Loans. The Company makes loans to finance the construction of residential and non−residential properties. The substantial majority of the Company's residential construction loans are for single−family dwellings that are pre−sold or are under earnest money contracts. The Company also originates loans to finance the construction of commercial properties such as multi−family, office, industrial, warehouse and retail centers. Construction loans involve additional risks attributable to the fact that loan funds are advanced upon the security of a project under construction, and the project is of uncertain value prior to its completion. Because of uncertainties inherent in estimating construction costs, the market value of the completed project and the effects of governmental regulation on real property, it can be difficult to accurately evaluate the total funds required to complete a project and the related loan to value ratio. As a result of these uncertainties, construction lending often involves the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project rather than the ability of a borrower or guarantor to repay the loan. If the Company is forced to foreclose on a project prior to completion, there is no assurance that the Company will be able to recover all of the unpaid portion of the loan. In addition, the Company may be required to fund additional amounts to complete a project and may have to hold the property for an indeterminable period of time. While the Company has underwriting procedures designed to identify what it believes to be acceptable levels of risks in construction lending, no assurance can be given that these procedures will prevent losses from the risks described above. As of December 31, 2003, the Company had a real estate construction portfolio of $24.6 million or 4.4% of the gross loan portfolio, of which $12.7 million was residential and $11.9 million was commercial.

Residential Mortgage Brokerage and Lending. The Company uses its existing branch network to offer a complete line of single−family residential mortgage products through third party mortgage companies. The Company specializes in mortgages that conform with government sponsored programs, such as those offered by Fannie Mae. The Company solicits and receives a fee to process these residential mortgage loans, which are then underwritten and pre−sold to third party mortgage companies. The Company does not fund or service these loans. The volume of residential mortgage loans processed by the Company and pre−sold to third party mortgage companies in 2003 was $20.0 million. Since the Company does not fund these loans, there is no interest rate or credit risk to the Company. The Company also makes five to seven year balloon residential mortgage loans primarily collateralized by non−owner occupied residential properties, which are retained in the Company's residential mortgage portfolio. At December 31, 2003, the Company's residential mortgage portfolio totaled $14.3 million.

Government Guaranteed Small Business Lending. The Company has developed an expertise in several government guaranteed lending programs in order to provide credit enhancement to its commercial and industrial and mortgage portfolio. As a Preferred Lender under the federally guaranteed SBA lending program, the Company's pre−approved status allows it to quickly respond to customers' needs. Under this program, the Company originates and funds SBA 7−A and 504 chapter loans qualifying for federal guarantees of 75% to 90% of principal and accrued interest. Depending upon prevailing market conditions, the Company may sell the guaranteed portion of these loans into the secondary market with servicing retained. The Company specializes in SBA loans to minority−owned businesses. As of December 31, 2003, the Company had $94.2 million in the retained portion of SBA loans, approximately $60.9 million of which was guaranteed by the SBA. These loans are included in most all types of loans such as commercial and industrial, real estate mortgage, and real estate construction.

For the SBA's fiscal year ended September 30, 2003, the Company was the third largest SBA loan originator in the 32−county Houston SBA District in terms of dollar volume. SBA loan originations were $25.7 million and $19.1 million for the years ended December 31, 2003 and 2002, respectively. Another source of government guaranteed lending is B&I loans which are collateralized by the U.S. Department of

Agriculture and are available to borrowers in areas with a population of less than 50,000. The Company also offers guaranteed loans through the OCCGF, which is sponsored by the government of Taiwan. These loans are for people of Chinese descent or origin, who are not mainland Chinese by birth and reside "overseas." As of December 31, 2003, the Company's OCCGF portfolio totaled $4.1 million.

Trade Finance. Since its inception in 1987, the Company has originated trade finance loans and letters of credit to facilitate export and import transactions for small and medium−sized businesses. In this capacity, the Company has worked with the Ex−Im Bank, an agency of the U.S. Government which provides guarantees for trade finance loans. Trade finance credit facilities rely heavily on the quality of the business customer's accounts receivable and the ability to perform the underlying transaction which, if monitored and controlled properly, limits the financial risks to the Company associated with this short−term financing. To mitigate the risk of nonpayment, the Company generally obtains a governmental guaranty or credit insurance from a governmental agency such as the Ex−Im Bank. As of December 31, 2003, the Company's aggregate trade finance portfolio commitments totaled approximately $7.3 million.

Consumer Loans. The Company offers a wide variety of loan products to retail customers through its branch network in Houston and Dallas. Loans to retail customers include residential mortgage loans, residential construction loans, automobile loans, lines of credit and other personal loans. The terms of these loans typically range from 12 to 60 months depending on the nature of the collateral and the size of the loan.

The Company selectively extends credit for the purpose of establishing long−term relationships with its customers. The Company mitigates the risks inherent in lending by focusing on businesses and individuals with demonstrated payment history, historically favorable profitability trends and stable cash flows. In addition to these primary sources of repayment, the Company looks to tangible collateral and personal guarantees as secondary sources of repayment. Lending officers are provided with detailed underwriting policies covering all lending activities in which the Company is engaged and that require all lenders to obtain appropriate approvals for the extension of credit. The Company also maintains documentation requirements and extensive credit quality assurance practices in order to identify credit portfolio weaknesses as early as possible so any exposures that are discovered may be reduced.

Inherent in all lending is the risk of nonpayment. The types of collateral required, the terms of the loans and the underwriting practices discussed under each category above are all designed to minimize the risk of nonpayment. In addition, as further risk protection, the Company rarely makes loans at its legal lending limit. Although the Company's legal loan limit is $11.8 million to one borrower, the Company generally does not make loans larger than $6.0 million to one borrower. Loans are approved by lending officers pursuant to a lending authorization schedule which is based on each loan officer's credit experience and portfolio. The Bank's Loan Committee approves loans between $1.5 million and $2.0 million. The Director's Credit Committee approves loans over $2.0 million. Control systems and procedures are in place to ensure all loans are approved in accordance with credit policies. The Company's policies and procedures, discussed under "Nonperforming Assets," are designed to minimize the risk of nonpayment with respect to outstanding loans.

The following table summarizes the industry concentrations (greater than 25% of capital) of the Company's loan portfolio, which includes gross loans of $6.0 million held−for−sale at December 31, 2003, 2002, and 2001:

	As of December 31,		
	2003	2002	2001
	(Dollars in thousands)		
Hotels/motels	$ 66,062	$ 82,015	$ 87,991
Retail centers	112,380	103,623	100,649
Restaurants	31,524	33,094	36,160
Apartment buildings	14,868	14,941	13,362
Convenience stores/gasoline stations	26,983	27,383	31,556
All other	308,273	272,982	229,577
Gross loans	$560,090	$534,038	$499,295

The contractual maturity ranges of the commercial and industrial, real estate, and consumer loan portfolios and the amount of such loans with predetermined interest rates and floating rates in each maturity range as of December 31, 2003 are summarized in the following table:

	As of December 31, 2003			
	One Year or Less	After One Through Five Years	After Five Years	Total
	(Dollars in thousands)			
Commercial and industrial	$ 74,573	$162,614	$ 95,293	$332,480
Real estate mortgage:				
Residential	5,263	6,472	2,580	14,315
Commercial	25,556	137,248	15,486	178,290
Real estate construction:				
Residential	8,909	3,743	—	12,652
Commercial	—	9,528	2,378	11,906
Consumer	1,592	8,319	536	10,447
Total	$115,893	$327,924	$116,273	$560,090
Loans with a predetermined interest rate	$ 27,384	$ 42,172	$ 13,880	$ 83,436
Loans with a floating interest rate	88,509	285,752	102,393	476,654
Total	$115,893	$327,924	$116,273	$560,090

Nonperforming Assets

The Company believes that it has adequate loan procedures in place. These procedures include the approval of lending policies and underwriting guidelines by the Board of Directors, review of the loan portfolio by the Company's internal loan review department (formally approved by the Board of Directors in the fourth quarter of 2002 and established in January 2003), review of the loan portfolio by an independent external loan review company as necessary, approval from the Directors Credit Committee for large credit relationships, and policy/administrative oversight by the Directors Loan Committee. The loan review department reports credit risk grade changes on a monthly basis to management and the Board of Directors. Facilitating the loan review process, loan review and problem resolution personnel were added during the first and second quarters of 2002. The Company performs monthly and quarterly concentration analyses based on industries, collateral types, business lines, large credit sizes and officer portfolio loads. There can be no assurance, however, that the Company's loan portfolio will not become subject to increasing pressures from deteriorating borrowers'

financial condition due to general economic and other factors. While future deterioration in the loan portfolio is possible, management is continuing its risk assessment and resolution program. In addition, management is focusing its attention on minimizing the Bank's credit risk through more diversified business development avenues.

The Company generally places a loan on nonaccrual status and ceases accruing interest when, in the opinion of management, full payment of loan principal or interest is in doubt. All loans past due 90 days are placed on nonaccrual status unless the loan is both well collateralized and in the process of collection. Cash payments received while a loan is classified as nonaccrual are recorded as a reduction of principal as long as significant doubt exists as to collection of the principal. In addition to nonaccrual loans, the Company evaluates on an ongoing basis additional loans which are potential problem loans as to risk exposure in determining the adequacy of the allowance for loan losses.

The Company reviews the real estate values, and when necessary, orders new appraisals on loans collateralized by real estate when loans are renewed, prior to foreclosure and at other times as necessary, particularly in problem loan situations. In instances where updated appraisals reflect reduced collateral values, an evaluation of the borrower's overall financial condition is made to determine the need, if any, for possible write−downs or appropriate additions to the allowance for loan losses. The Company records other real estate at fair value at the time of acquisition less estimated costs to sell.

A loan is considered impaired based on current information and events, if it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. The measurement of impaired loans is based on the present value of expected future cash flows discounted at the loan's effective interest rate or the loan's observable market price or based on the fair value of the collateral if the loan is collateral−dependent.

In addition to the Company's loan review process described in the preceding paragraphs, the OCC periodically examines and evaluates national banks. Based upon such an examination, the OCC may revalue the assets of the institution and require that it charge−off certain assets, establish specific reserves to compensate for the difference between the OCC−determined value and the book value of such assets or take other regulatory action designed to lessen the risk in the asset portfolio. The OCC is currently conducting its annual examination of the Bank and while no such actions have been taken by the OCC, no assurance can be provided that such actions will not occur in the future.

2003 versus 2002. Total nonperforming assets at December 31, 2003 and 2002 were $28.3 million and $18.8 million, respectively, an increase of $9.5 million. Nonaccrual loans at December 31, 2003 and 2002 were $25.4 million and $17.2 million, respectively, an increase of $8.2 million. The increase in nonperforming assets in 2003 compared to 2002 was primarily related to an $8.2 million increase in nonaccrual loans. The largest loan included in nonaccrual loans at December 31, 2003 was a $5.3 million hotel loan which was placed on nonaccrual status in the fourth quarter of 2003. The second largest is a $3.7 million commercial loan to a wholesale food distributor that was added to nonaccrual status in the third quarter of 2002. While each of these loans are continuing to make payments, they have been placed on nonaccrual status due to uncertainty of future cash flows and the ability of the borrower to service the debt. A restaurant loan in the amount of $3.6 million was added to nonaccrual status in 2003 and is not current due to lack of payments. Had the total of nonaccrual loans remained on an accrual basis, interest in the amount of approximately $1.0 million and $657,000 would have been recorded on these loans during the years ended December 31, 2003 and 2002, respectively.

2002 versus 2001. Total nonperforming assets at December 31, 2002 and 2001 were $18.8 million and $5.6 million, respectively, an increase of $13.2 million. Nonaccrual loans at December 31, 2002 and 2001 were $17.2 million and $3.8 million, respectively, an increase of $13.4 million. The increase in nonperforming assets and nonaccrual loans primarily occurred during the first quarter of 2002 with approximately $9.0 million added to nonaccrual loans as part of an identification process that represents an integral part of an overall effort to improve credit quality. The largest of these loans were a $3.2 million hotel loan, a $1.2 million entertainment facility, and two restaurant loans of $1.4 million and $1.3 million. The $1.3 million restaurant loan paid off in July 2002 and the $1.4 million loan was paid off in January 2003. During the third quarter of 2002, a

$5.1 million commercial loan to a wholesale food distributor was added to nonaccrual status. During the fourth quarter of 2002, a $1.1 million hotel loan and a $1.0 million convenience store loan were added to nonaccrual status. Had these nonaccrual loans remained on an accrual basis, interest in the amount of approximately $657,000 and $202,000 would have been recorded on these loans during the years ended December 31, 2002 and 2001, respectively.

Included in total nonperforming assets are the portions guaranteed by the SBA, OCCGF and Ex−Im Bank, which totaled $3.3 million at December 31, 2003 and 2002. Nonperforming assets, net of their guaranteed portions, were $25.0 million and $15.5 million, for the same periods, respectively. The ratios for net nonperforming assets to total loans and other real estate were 4.49% and 2.92% at December 31, 2003 and 2002, respectively. The ratios for net nonperforming assets to total assets were 2.89% and 1.84%, for the same periods, respectively.

The following table presents information regarding nonperforming assets at the periods indicated:

	As of December 31,				
	2003	2002	2001	2000	1999
	(Dollars in thousands)				
Nonaccrual loans	$25,442	$17,209	$ 3,758	$ 2,225	$ 6,552
Accruing loans 90 days or more past due	264	380	783	—	—
Other real estate (“ORE”) and other assets repossessed (“OAR”)	2,585	1,190	1,025	757	490
Total nonperforming assets	28,291	18,779	5,566	2,982	7,042
Less: nonperforming loans guaranteed by the SBA, Ex−Im Bank, or the OCCGF	(3,323)	(3,310)	(1,833)	(1,049)	(1,821)
Net nonperforming assets	$24,968	$15,469	$ 3,733	$ 1,933	$ 5,221
Total nonperforming assets to total loans and ORE/ OAR	5.08%	3.55%	1.13%	0.62%	1.42%
Total nonperforming assets to total assets	3.27%	2.24%	0.75%	0.40%	1.07%
Net nonperforming assets to total loans and ORE/ OAR	4.49%	2.92%	0.76%	0.40%	1.05%
Net nonperforming assets to total assets	2.89%	1.84%	0.50%	0.26%	0.79%

Allowance for Loan Losses

The allowance for loan losses is a reserve established through charges to earnings in the form of a provision for loan losses. Management has established an allowance for loan losses which it believes is adequate to absorb estimated losses inherent in the Company’s loan portfolio. Based on an evaluation of the loan portfolio, management presents a quarterly review of the allowance for loan losses to the Company’s Board of Directors, indicating any change in the allowance since the last review and any recommendations as to adjustments in the allowance. In making its evaluation, management considers the diversification by industry of the Company’s commercial loan portfolio, the effect of changes in the local real estate market on collateral values, the results of recent regulatory examinations, the effects on the loan portfolio of current economic indicators and their probable impact on borrowers, the amount of charge−offs for the period, the amount of nonperforming loans and related collateral security and the evaluation of its loan portfolio by the independent loan review function. Charge−offs occur when loans are deemed to be uncollectible in whole or in part.

The Company follows a loan review program to evaluate the credit risk in the loan portfolio as discussed under “Nonperforming Assets”. Through the loan review process, the Company maintains an internally classified loan list which, along with the delinquency list of loans, helps management assess the overall quality of the loan portfolio and the adequacy of the allowance for loan losses. Loans classified as “substandard” are those loans with clear and defined weaknesses such as a highly−leveraged position, unfavorable financial ratios,

uncertain repayment sources or poor financial condition, which may jeopardize recoverability of the debt. Loans classified as “doubtful” are those loans which have characteristics similar to substandard loans but with an increased risk that a loss may occur, or at least a portion of the loan may require a charge−off if liquidated at present. Although loans classified as substandard do not duplicate loans classified as doubtful, both substandard and doubtful loans include some loans that are delinquent at least 30 days or on nonaccrual status. Loans classified as “loss” are those loans which are in the process of being charged off.

In addition to the internally classified loan list and delinquency list of loans, the Company maintains a separate “watch list” which further aids the Company in monitoring loan portfolios. Watch list loans show warning elements where the present status portrays one or more deficiencies that require attention in the short−term or where pertinent ratios of the loan account have weakened to a point where more frequent monitoring is warranted. These loans do not have all of the characteristics of a classified loan (substandard or doubtful) but do show weakened elements compared with those of a satisfactory credit. The Company reviews these loans to assist in assessing the adequacy of the allowance for loan losses.

In order to determine the adequacy of the allowance for loan losses, management establishes specific allowances for loans which management believes require reserves greater than those allocated according to their classification or the delinquent status of specific loans. Management then considers the risk classification or delinquency status of the remaining portfolio and other factors, such as collateral value, portfolio composition, trends in economic conditions and the financial strength of borrowers. The Company then charges to operations a provision for loan losses to maintain the allowance for loan losses at a level determined by the foregoing methodology.

The Company allocates the allowance for loan losses according to management’s assessments of risk inherent in the portfolio. In addition, on July 6, 2002, the Securities and Exchange Commission released Staff Accounting Bulletin (SAB) No. 102, “Selected Loan Loss Allowance Methodology and Documentation Issues”, which requires companies to have adequate documentation on the development and application of a systematic methodology in determining allowance for loan losses. The Company believes that it is generally in compliance with the requirements, however, it is developing revisions to the process to utilize historical loan loss experience.

The following table presents an analysis of the allowance for loan losses and other related data:

	As of and for the Years Ended December 31,				
	2003	2002	2001	2000	1999
	(Dollars in thousands)				
Average total loans outstanding	$549,610	$505,495	$474,986	$486,549	$456,653
Total loans outstanding at end of period	$553,784	$527,759	$493,145	$483,738	$495,669
Allowance for loan losses at beginning of period	$ 10,150	$ 8,903	$ 9,271	$ 7,537	$ 6,119
Provision for loan losses	5,690	3,853	3,799	7,508	5,550
Charge−offs:					
Commercial and industrial	(5,173)	(2,721)	(4,075)	(1,479)	(3,563)
Real estate — mortgage	(755)	(271)	—	(23)	(32)
Real estate — construction	—	—	—	—	—
Consumer and other	(193)	(132)	(201)	(5,524)	(807)
Total charge−offs	(6,121)	(3,124)	(4,276)	(7,026)	(4,402)
Recoveries:					
Commercial and industrial	593	450	54	901	94
Real estate — mortgage	100	20	11	8	—
Real estate — construction	—	—	—	—	—
Consumer and other	36	48	44	343	176
Total recoveries	729	518	109	1,252	270
Net loan charge−offs	(5,392)	(2,606)	(4,167)	(5,774)	(4,132)
Allowance for loan losses at end of period	$ 10,448	$ 10,150	$ 8,903	$ 9,271	$ 7,537
Ratio of allowance to end of period total loans	1.89%	1.92%	1.81%	1.92%	1.52%
Ratio of net loan charge−offs to end of period total loans	0.97%	0.49%	0.84%	1.19%	0.83%
Ratio of allowance to end of period nonperforming loans	40.64%	57.71%	196.06%	416.67%	115.03%

For the years ended December 31, 2003, 2002, and 2001, net loan charge−offs were $5.4 million, $2.6 million, and $4.2 million, respectively. The significant charge−offs for the year 2003 were primarily related to the hospitality industry where approximately $3.0 million was charged off. The largest charge−off in this category was $1.9 million on a hospitality loan that was subsequently foreclosed and as of March 2, 2004 has a sale pending. The second largest charge−off in this category was approximately $659,000 on a hospitality loan that was subsequently transferred to loans held−for−sale. Approximately $612,000 in charge−offs was related to the wholesale trade business, where the largest charge−off was $404,000. Charge−offs related to the restaurant business were approximately $448,000, with the largest charge−off being $220,000.

The significant charge−offs for the year 2002 were related to the restaurant and grocery categories. Approximately $1.0 million in charge−offs was related to full−service restaurants and approximately $572,000 was related to the grocery category. The largest individual charge−off for 2002 totaled approximately $250,000. Of the $4.2 million in charge−offs in 2001, $3.0 million was charged−off in the fourth quarter following a

significant review of the loan portfolio. The significant charge−offs included in the $3.0 million were related to twelve credits, with the two largest being commercial operating lines of credit of $1.0 million and $900,000.

The ratios of net loan charge−offs to total loans outstanding for the years ended December 31, 2003, 2002, and 2001, were 0.97%, 0.49%, and 0.84%, respectively. The Company seeks recovery on its charge−offs through all available channels. At December 31, 2003, 2002, and 2001, the allowance for loan losses aggregated $10.4 million, $10.2 million, and $8.9 million, respectively, or 1.89%, 1.92%, and 1.81% of total loans, respectively.

The following table describes the allocation of the allowance for loan losses among various categories of loans and certain other information. The allocation is made for analytical purposes and is not necessarily indicative of the categories in which future losses may occur. The total allowance is available to absorb losses from any segment of the credit portfolio.

	As of December 31,									
	2003		2002		2001		2000		1999	
	Amount	Percent of Loans to Gross Loans	Amount	Percent of Loans to Gross Loans	Amount	Percent of Loans to Gross Loans	Amount	Percent of Loans to Gross Loans	Amount	Percent of Loans to Gross Loans
	(Dollars in thousands)									
Balance of allowance for loan losses applicable to:										
Commercial and industrial	$ 6,281	59.36%	$ 6,383	60.94%	$5,054	62.67%	$4,814	60.92%	$3,783	59.55%
Real estate — mortgage	2,460	34.39	2,285	32.38	1,947	27.81	758	28.27	823	27.42
Real estate — construction	267	4.38	355	4.75	274	7.24	230	8.09	204	7.99
Consumer and other	101	1.87	136	1.93	686	2.28	444	2.45	357	2.31
Factored receivables	—	—	—	—	—	—	20	0.27	243	2.73
Unallocated	1,339	—	991	—	942	—	3,005	—	2,127	—
Total allowance for loan losses	$10,448	100.00%	$10,150	100.00%	$8,903	100.00%	$9,271	100.00%	$7,537	100.00%

The level of allowance for loan losses has remained relatively constant in 2003 and 2002 even though net charge−offs have increased. This is primarily due to loans being charged down to their collateral value where there has been no further deterioration. In addition, the Company has observed a slowing in the migration of loans requiring charge−off, however, there is no assurance this trend will continue. While nonaccrual loans increased in 2003, no corresponding increase in the allowance for loan losses was required since collateral values were able to support the loan balances. Also, many of the loans on nonaccrual are paying as agreed but were placed on nonaccrual due to the uncertainty that the borrowers will continue making loan payments.

Securities

The Company uses its securities portfolio primarily as a source of income and secondarily as a source of liquidity. At December 31, 2003, the fair value of securities net of the Federal Home Loan Bank (“FHLB”) and Federal Reserve Bank stock was $257.1 million, a decrease of $3.0 million or 1.1% from the fair value of net securities at December 31, 2002. The decrease in 2003 was primarily the result of excess liquidity created from increased deposits that was reinvested into loans rather than securities. At December 31, 2002, the fair value of securities net of FHLB and Federal Reserve Bank stock totaled $260.0 million, an increase of $86.9 million or 50.2% from $173.1 million at December 31, 2001. The increase in 2002 was primarily due to liquidity created from increased deposits and loan prepayments in excess of loan funding requirements.

At the date of purchase, the Company 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. The Company does not have a trading account. 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, as a component of accumulated other comprehensive income in shareholders' equity until realized. On January 1, 2001, the Company reclassified its held−to−maturity investment securities to the available−for−sale category as allowed under SFAS 133. The adoption of SFAS 133 allowed this one−time reclassification of securities between held−to−maturity and available−for−sale.

The following table presents the amortized cost of securities classified as available−for−sale and their approximate fair values as of the date shown:

	As of December 31, 2003				As of December 31, 2002			
	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
	(Dollars in thousands)							
U.S. Treasury securities and obligations of U.S. government agencies	$ 4,965	$ —	$ (12)	$ 4,953	$ 2,488	$ 50	$ —	$ 2,538
Obligations of state and political subdivisions	18,925	1,249	—	20,174	22,059	591	(2)	22,648
Mortgage−backed securities and collateralized mortgage obligations	209,323	1,170	(1,254)	209,239	180,599	2,862	(151)	183,310
Other debt securities	1,096	3	(10)	1,089	2,378	33	(20)	2,391
Investment in an ARM and CRA funds	21,739	73	(203)	21,609	48,982	169	—	49,151
FHLB/ Federal Reserve Bank Stock	5,200	—	—	5,200	4,380	—	—	4,380
Total securities	$261,248	$2,495	$(1,479)	$262,264	$260,886	$3,705	$ (173)	$264,418

	As of December 31, 2001			
	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
	(Dollars in thousands)			
U.S. Treasury securities and obligations of U.S. government agencies	$ 2,453	$ 122	$ —	$ 2,575
Obligations of state and political subdivisions	25,045	183	(589)	24,639
Mortgage−backed securities and collateralized mortgage obligations	138,696	1,561	(671)	139,586
Other debt securities	3,229	20	(57)	3,192
Investment in an ARM and CRA funds	3,094	1	—	3,095
FHLB/ Federal Reserve Bank Stock	3,143	—	—	3,143
Total securities	$175,660	$1,887	$(1,317)	$176,230

The following table summarizes the contractual maturity of investment securities at amortized cost and their weighted average yields. No tax−equivalent adjustments were made.

	As of December 31, 2003									
	Within One Year		After One Year But Within Five Years		After Five Years But Within Ten Years		After Ten Years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
	(Dollars in thousands)									
U.S. Treasury securities and obligations of U.S. government agencies	$ —	—%	$ 4,965	4.37%	$ —	—%	$ —	—%	$ 4,965	4.37%
Obligations of state and political subdivisions	185	4.86	3,321	5.14	2,140	4.74	13,279	5.13	18,925	5.09
Mortgage−backed securities and collateralized mortgage obligations	—	—	2,650	4.93	52,413	4.16	154,260	3.81	209,324	3.91
Other debt securities	—	—	—	—	53	4.97	1,043	4.60	1,096	4.62
Investment in ARM and CRA funds	18,430	3.60	—	—	—	—	3,309	4.55	21,739	3.75
FHLB and Federal Reserve Bank stock(1)	—	—	—	—	—	—	5,200	3.00	5,200	3.00
Total securities	$ 18,615	3.61%	$ 10,936	4.74%	$ 54,606	4.18%	$ 177,091	3.90%	$ 261,248	3.98%

(1) FHLB and Federal Reserve Bank stock do not have maturities.

The following table summarizes the fair value and classification of securities:

	As of December 31,		
	2003	2002	2001
	(Dollars in thousands)		
Available−for−sale	$ 262,264	$ 264,418	$ 176,230
Held−to maturity	—	—	—
Total securities	$ 262,264	$ 264,418	$ 176,230

The securities portfolio includes mortgage−backed securities which have been developed by pooling a number of real estate mortgages and are principally issued by federal agencies such as Fannie Mae, Freddie Mac and Ginnie Mae. These securities are deemed to have high credit ratings, and certain minimum levels of regular monthly cash flows of principal and interest are insured or guaranteed by the issuing agencies. Included in the Company's mortgage−backed securities at December 31, 2003, 2002 and 2001, were $77.7 million, $100.2 million, and $89.2 million, respectively, in agency−issued collateral mortgage obligations (CMOs).

As of December 31, 2003, 2002 and 2001, 73.7%, 80.2%, and 81.1%, respectively, of the mortgage−backed securities held by the Company had final maturities of more than ten years. However, unlike U.S. Treasury and U.S. Government agency securities, which have a lump sum payment at maturity, mortgage−backed securities provide cash flows from regular principal and interest payments and principal prepayments throughout the lives of the securities. Mortgage−backed securities which are purchased at a premium will generally suffer decreasing net yields as interest rates drop because homeowners tend to refinance their mortgages. Thus, the premium paid must be amortized over a shorter period. Therefore, securities purchased at a discount will obtain higher net yields in a decreasing interest rate environment. As interest rates rise, the opposite will generally be true. During a period of increasing interest rates, fixed rate mortgage−backed securities do not tend to experience heavy prepayments of principal and consequently, the average life of this security will not be unduly shortened. Additionally, the value of mortgage−backed securities generally

decreases as interest rates increase. At December 31, 2003, approximately $9.0 million or 4.3% of the Company's mortgage−backed securities earn interest at floating rates and reprice within one year, and accordingly are less susceptible to declines in value should interest rates increase.

CMOs are bonds that are backed by pools of mortgages. The pools can be Ginnie Mae, Fannie Mae, or Freddie Mac pools or they can be private−label pools. The CMOs are designed so that the mortgage collateral will generate a cash flow sufficient to provide for the timely repayment of the bonds. The mortgage collateral pool can be structured to accommodate various desired bond repayment schedules, provided that the collateral cash flow is adequate to meet scheduled bond payments. This is accomplished by dividing the bonds into classes to which payments on the underlying mortgage pools are allocated in different order. The bond's cash flow, for example can be dedicated to one class of bondholders at a time, thereby increasing call protection to bondholders. In private−label CMOs, losses on underlying mortgages are directed to the most junior of all classes and then to the classes above in order of increasing seniority, which means that the senior classes have enough credit protection to be given the highest credit rating by the rating agencies.

Deposits

The Company's lending and investing activities are funded principally by deposits. At December 31, 2003, 49.9% of the Company's total deposits were interest−bearing certificates of deposit (CDs), 26.8% were interest−bearing savings, NOW, and money market accounts and 23.3% were noninterest−bearing demand deposit accounts. Total deposits at December 31, 2003 were $724.9 million compared with $691.4 million at December 31, 2002 and $642.8 million at December 31, 2001. This represents annual increases over the two−year period of $33.5 million or 4.9% and $48.6 million or 7.6%, respectively.

Average noninterest−bearing demand deposits for the year ended December 31, 2003 were $151.2 million, an increase of $18.5 million or 13.9%, compared with $132.7 million for the same period in 2002. Average noninterest−bearing demand deposits for the year ended December 31, 2002 compared with the same period in 2001 increased $23.1 million or 21.1% from $109.6 million.

Average interest−bearing deposits for the year ended December 31, 2003 were $557.4 million, an increase of $33.3 million or 6.4%, compared with $524.1 million for the same period in 2002. Average interest−bearing deposits for the year ended December 31, 2002 compared with the same period in 2001 increased $6.8 million or 1.3% from $517.3 million.

Average total deposits for the year ended December 31, 2003 were $708.6 million, an increase of $51.8 million or 7.9%, compared with $656.8 million for the same period in 2002. Average total deposits for the year ended December 31, 2002 compared with the same period in 2001 increased $29.9 million or 4.8%.

The increases in deposits during 2003 and 2002 were primarily the result of continued "relationship banking" initiatives. The Company's ratio of average noninterest−bearing demand deposits to average total deposits for the years ended December 31, 2003, 2002 and 2001 was 21.3%, 20.2%, and 17.5%, respectively.

As part of its effort to cross−sell its products and services, the Company actively solicits time deposits from existing customers. In addition, the Company receives time deposits from government municipalities and utility districts as well as from corporations seeking to place deposits in minority−owned businesses, such as the Company. These time deposits typically renew at maturity and have provided a stable source of funds. The Company believes that based on its historical experience its large time deposits have core−type characteristics. In pricing its time deposits, the Company seeks to be competitive but typically prices near the middle of a given market.

The average daily balances and weighted average rates paid on deposits for each of the years ended December 31, 2003, 2002 and 2001 are presented below:

	Years Ended December 31,					
	2003		2002		2001	
	Amount	Rate	Amount	Rate	Amount	Rate
	(Dollars in thousands)					
Interest−bearing deposits:						
Money market checking	$ 73,987	0.62%	$ 71,059	1.18%	$ 54,694	2.21%
Savings and money market deposits	111,867	0.79	110,372	1.25	102,268	2.27
Time deposits less than $100,000	169,314	2.19	176,941	2.69	182,588	5.13
Time deposits $100,000 and over	202,186	2.59	165,766	3.52	177,782	5.42
Total interest−bearing deposits	557,354	1.85	524,138	2.44	517,332	4.36
Non interest−bearing deposits	151,221	—	132,686	—	109,638	—
Total deposits	$708,575	1.45%	$656,824	1.95%	626,970	3.59%

The following table sets forth the amount of the Company's time deposits that are $100,000 or greater by time remaining until maturity:

	As of December 31, 2003
	(Dollars in thousands)
Three months or less	$ 44,829
Over three through six months	37,295
Over six through 12 months	65,241
Over 12 months	46,582
Total	$193,947

Other Borrowings

Other borrowings include $25.0 million of loans from the FHLB of Dallas, maturing in September 2008. The loans bear interest at an average rate of 4.99% per annum until the fifth anniversary at which time they may be repaid or the interest rate may be renegotiated.

Other borrowings also include several FHLB advances obtained in 2002 and 2003 to acquire mortgage−related securities in order to increase earning assets. These borrowings were $28.3 million at December 31, 2003 with maturities ranging from one month to five years and carried a weighted average interest rate of 1.52%.

Additionally, the Company had several unused, uncollateralized lines of credit with correspondent banks totaling $15.0 million at December 31, 2003, 2002, and 2001, respectively.

The following table presents the categories of other borrowings by the Company:

	As of December 31,		
	2003	2002	2001
	(Dollars in thousands)		
Federal funds purchased:			
on December 31,	$ —	$ —	$ —
average during the year	55	162	1
maximum month end balance during the year	—	—	—
FHLB notes:			
on December 31,	$53,300	$65,200	$25,000
average during the year	59,667	52,343	25,000
maximum month end balance during the year	69,300	69,700	25,000
Other short−term borrowings:			
on December 31,	$ 873	$ 574	$ 195
average during the year	587	551	570
maximum month end balance during the year	873	713	555

At December 31, 2003, the following table presents the payments due by period for the Company's contractual borrowing obligations (other than deposit obligations with no stated maturities):

	Within One Year	After One But Within Three Years	After Three But Within Five Years	After Five Years	Total
	(Dollars in thousands)				
Certificates of deposit	$292,978	$61,177	$7,359	$ 67	$361,581
Federal Reserve TT&L	873	—	—	—	873
Short−term borrowings	28,300	—	—	—	28,300
Long−term borrowings	—	—	—	25,000	25,000
Total borrowing obligations	322,151	61,177	7,359	25,067	415,754
Operating lease obligations	944	1,290	655	1,082	3,971
Total contractual obligations	$323,095	$62,467	$8,014	$26,149	$419,725

Interest Rate Sensitivity and Market Risk

As a financial institution, the Company's primary component of market risk is interest rate volatility, primarily in the prime lending rate. Fluctuations in interest rates will ultimately impact both the level of income and expense recorded on most of the Company's assets and liabilities, and the market value of all interest−earning assets and interest−bearing liabilities, other than those which have a short term to maturity. Based upon the nature of the Company's operations, the Company is not subject to foreign exchange or commodity price risk. The Company does not own any trading assets.

The Company's Funds Management Policy provides management with the necessary guidelines for effective funds management, and the Company has established a measurement system for monitoring its net interest rate sensitivity position. The Company manages its sensitivity position within established guidelines.

Interest rate risk is managed by the Asset and Liability Committee ("ALCO") which is composed of senior officers of the Company, in accordance with policies approved by the Company's Board of Directors. Interest rate risk is the potential of economic losses due to future interest rate changes. These economic losses can be reflected as a loss of future net interest income and/or a loss of current fair market values. The objective is to measure the effect on net interest income and to adjust the balance sheet to minimize the

inherent risk while at the same time maximizing income. Management realizes certain risks are inherent, and that the goal is to identify, monitor, manage or exploit the risks.

The ALCO formulates strategies based on appropriate levels of interest rate risk. In determining the appropriate level of interest rate risk, the ALCO considers the impact on earnings and capital of the current outlook on interest rates, potential changes in interest rates, regional economies, liquidity, business strategies and other factors. The ALCO meets regularly to review, among other things, the sensitivity of assets and liabilities to interest rate changes, the book and market values of assets and liabilities, unrealized gains and losses, purchase and sale activities, commitments to originate loans and the maturities of investments and borrowings. Additionally, the ALCO reviews liquidity, cash flow flexibility, maturities of deposits and consumer and commercial deposit activity. Management uses two methodologies to manage interest rate risk: (i) an analysis of relationships between interest−earning assets and interest−bearing liabilities and (ii) an interest rate shock simulation model. The Company has traditionally managed its business to reduce its overall exposure to changes in interest rates, however, under current policies of the Company's Board of Directors, management has been given some latitude to increase the Company's interest rate sensitivity position within certain limits if, in management's judgment, it will enhance profitability. As a result, changes in market interest rates may have a greater impact on the Company's financial performance in the future than they have had historically.

An interest rate sensitive asset or liability is one that, within a defined time period, either matures or experiences an interest rate change in line with general market interest rates. The management of interest rate risk is performed by analyzing the maturity and repricing relationships between interest−earning assets and interest−bearing liabilities at specific points in time ("GAP") and by analyzing the effects of interest rate changes on net interest income over specific periods of time by projecting the performance of the mix of assets and liabilities in varied interest rate environments. Interest rate sensitivity reflects the potential effect on net interest income of a movement in interest rates. A company is considered to be asset sensitive, or having a positive GAP, when the amount of its interest−earning assets maturing or repricing within a given period exceeds the amount of its interest−bearing liabilities also maturing or repricing within that time period. Conversely, a company is considered to be liability sensitive, or having a negative GAP, when the amount of its interest−bearing liabilities maturing or repricing within a given period exceeds the amount of its interest−earning assets also maturing or repricing within that time period. During a period of rising interest rates, a negative GAP would tend to adversely affect net interest income, while a positive GAP would tend to result in an increase in net interest income.

The following table sets forth an interest rate sensitivity analysis for the Company at December 31, 2003:

	Volumes Subject to Repricing							
	0−30 Days	31−180 Days	181−365 Days	1−3 Years	3−5 Years	5−10 Years	Greater Than 10 Years	Total
	(Dollars in thousands)							
Interest−earning assets:								
Securities	$ 34,466	$ 50,491	$ 46,401	$ 50,726	$ 37,490	$ 28,943	$ 8,547	$257,064
Total loans	460,904	22,342	17,327	34,243	6,684	1,798	38	543,336
Federal funds sold and other temporary investments	36,927	—	—	—	—	—	—	36,927
Total interest−bearing assets	532,297	72,833	63,728	84,969	44,174	30,741	8,585	837,327
Interest−bearing liabilities:								
Demand, money market and savings deposits	—	17,484	17,484	60,222	40,795	58,279	—	194,264
Time deposits	33,800	141,677	117,500	61,178	7,359	67	—	361,581
Federal funds purchased	—	—	—	—	—	—	—	—
Other borrowings	2,973	23,700	2,500	—	25,000	—	—	54,173
Total interest−bearing liabilities	36,773	182,861	137,484	121,400	73,154	58,346	—	610,018
Period GAP	$ 495,524	$(110,028)	$ (73,756)	$ (36,431)	$ (28,980)	$ (27,605)	$ 8,585	$227,309
Cumulative GAP	$ 495,524	$ 385,496	$311,740	$275,309	$246,329	$218,724	$227,309	
Period GAP to total assets	58.99%	(13.10) %	(8.78)%	(4.34) %	(3.45) %	(3.29)%	1.02%	
Cumulative GAP to total assets	58.99%	45.89%	37.11%	32.77%	29.32%	26.04%	27.06%	
Cumulative interest−earning assets to cumulative interest−bearing liabilities	1,447.52%	275.52%	187.29%	157.53%	144.65%	135.86%	137.26%	

The preceding table provides Company management with repricing data within given time frames. The purpose of this information is to assist management in the elements of pricing and of matching interest sensitive assets with interest sensitive liabilities within time frames. The table indicates a positive GAP on a cumulative basis for the three time periods covering the next 365 days of $495.5 million (1−30 days), $385.5 million (31−180 days) and $311.7 million (181−365 days), respectively. With this condition, the Company is susceptible to a decrease in net interest income should market interest rates decrease. GAP reflects a one−day position that is continually changing and is not indicative of the Company's position at any other time. While the GAP position is a useful tool in measuring interest rate risk and contributes toward effective asset and liability management, it is difficult to predict the effect of changing interest rates solely on that measure, without accounting for alterations in the maturity or repricing characteristics of the balance sheet that occur during changes in market interest rates. For example, the GAP position reflects only the prepayment assumptions pertaining to the current rate environment. Assets tend to prepay more rapidly during periods of declining interest rates than during periods of rising interest rates. Because of this and other risk factors not contemplated by the GAP position, an institution could have a matched GAP position in the current rate environment and still have its net interest income exposed to increased rate risk. The Company's Rate Committee and the ALCO review the Company's interest rate risk position on a weekly and monthly basis, respectively.

The Company applies an economic value of equity ("EVE") methodology to gauge its interest rate risk exposure as derived from its simulation model. Generally, EVE is the discounted present value of the difference between incoming cash flows on interest−earning assets and other investments and outgoing cash flows on interest−bearing liabilities. The application of the methodology attempts to quantify interest rate risk by measuring the change in the EVE that would result from a theoretical instantaneous and sustained 100 or 200 basis point shifts in market interest rates.

Presented below, as of December 31, 2003, is an analysis of the Company's interest rate risk as measured by changes in EVE for a 200 basis point increase and a 100 basis point decrease in market interest rates:

			EVE as a % of Present Value of Assets	
Change in Rates	**$ Change in EVE**	**% Change in EVE**	**EVE Ratio**	**Change**
	(Dollars in thousands)			
−100 bp	$ (9,073)	(8.98)%	10.60%	(105) bp
0 bp	—	—	11.65%	—
+200 bp	$ 8,537	8.45%	12.63%	98 bp

The percentage change in EVE as a result of a 100 basis point decrease in interest rates at December 31, 2003 was (8.98)% compared with (10.24)% as of December 31, 2002. The percentage change in EVE as a result of a 200 basis point increase in interest rates on December 31, 2003 of 8.45% compared with 7.53% as of December 31, 2002.

In 2003, the investment portfolio experienced a significant amount of mortgage−backed security prepayments and agency security calls as a result of interest rate declines. The proceeds from these cash flows were generally invested in shorter−term securities resulting in a shortening in the weighted−average life of the portfolio. The shorter duration should mitigate future portfolio price depreciation as interest rates increase.

Management believes that the EVE methodology overcomes three shortcomings of the typical maturity GAP methodology. First, it does not use arbitrary repricing intervals and accounts for all expected future cash flows. Second, because the EVE method projects cash flows of each financial instrument under different interest rate environments, it can incorporate the effect of embedded options on an institution's interest rate risk exposure. Third, it allows interest rates on different instruments to change by varying amounts in response to a change in market interest rates, resulting in more accurate estimates of cash flows.

As with any method of gauging interest rate risk, however, there are certain shortcomings inherent to the EVE methodology. The model assumes interest rate changes are instantaneous parallel shifts in the yield curve. In reality, rate changes are rarely instantaneous. The use of the simplifying assumption that short−term and long−term rates change by the same degree may also misstate historical rate patterns which rarely show parallel yield curve shifts. Further, the model assumes that certain assets and liabilities of similar maturity or repricing will react identically to changes in rates. In reality, the market value of certain types of financial instruments may adjust in anticipation of changes in market rates, while any adjustment in the valuation of other types of financial instruments may lag behind the change in general market rates. Additionally, the EVE methodology does not reflect the full impact of contractual restrictions on changes in rates for certain assets, such as adjustable rate loans. When interest rates change, actual loan prepayments and actual early withdrawals from time deposits may deviate significantly from the assumptions used in the model. Finally, this methodology does not measure or reflect the impact that higher rates may have on the ability of adjustable rate loan clients to service their debt. All of these factors are considered in monitoring the Company's exposure to interest rate risk.

The prime rate in effect for December 31, 2003 and December 31, 2002 was 4.00% and 4.25% respectively. In November 2002, the Federal Reserve lowered interest rates 50 basis points, and another 25 basis points in June 2003.

Liquidity

Liquidity involves the Company's ability to raise funds to support asset growth or reduce assets to meet deposit withdrawals and other payment obligations, to maintain reserve requirements and otherwise to operate the Company on an ongoing basis. The Company's liquidity needs are met primarily by financing activities, which consist mainly of growth in deposits, supplemented by available−for−sale investment securities, other borrowings and earnings through operating activities. Although access to purchased funds from correspondent banks is available and has been utilized on occasion to take advantage of investment opportunities, the Company does not generally rely on these external funding sources. The cash and federal funds sold position, supplemented by amortizing investments along with payments and maturities within the loan portfolio, have historically created an adequate liquidity position.

The Company uses federal funds purchased and other borrowings as funding sources and in its management of interest rate risk. Federal funds purchased generally represent overnight borrowings. Other borrowings principally consist of U.S. Treasury tax note option accounts that have maturities of 14 days or less and borrowings from the FHLB.

FHLB advances may be utilized from time to time as either a short−term funding source or a longer−term funding source. FHLB advances can be particularly attractive as a longer−term funding source to balance interest rate sensitivity and reduce interest rate risk. The Company is eligible for several borrowing programs through the FHLB. The first, a short−term borrowing program, requires delivery of eligible securities for collateral. Maturities under this program range from one to 365 days. The Company currently maintains most of its investment securities in safekeeping at the FHLB of Dallas.

Under another borrowing program, long−term borrowings are available to the Company from the FHLB. These borrowings have maturities greater than one year and are collateralized first by FHLB stock, second by the Company's one to four family mortgage loans and third by the Company's investment securities in safekeeping at the FHLB. Borrowings collateralized by the Company's one to four family mortgage loans are limited to 75% of the loan value. At December 31, 2003, the Company had $53.3 million in borrowings under this program.

Off−Balance Sheet Arrangements

The Bank is 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 various guarantees, commitments to extend credit and standby letters of credit. Additionally, these instruments may involve, to varying degrees, credit risk in excess of the amount recognized in the statement of financial condition. The Bank's maximum exposure to credit loss under such arrangements is represented by the contractual amount of those instruments. The Bank applies the same credit policies and collateralization guidelines in making commitments and conditional obligations as it does for on−balance sheet instruments. Unfunded loan commitments including unfunded lines of credit at December 31, 2003 and 2002 aggregated approximately $87.7 million and $74.9 million, respectively. Commitments under standby and commercial letters of credit at December 31, 2003 and 2002 totaled $14.9 million and $10.4 million, respectively. Operating leases at December 31, 2003 and 2002 totaled $4.0 million and $3.3 million, respectively.

The contractual amount of the Company's financial instruments with off−balance sheet risk expiring by period at December 31, 2003 is presented below:

	Within One Year	After One but Within Three Years	After Three but Within Five Years	After Five Years	Total
	(Dollars in thousands)				
Unfunded loan commitments including unfunded lines of credit	$ 87,706	$ —	$ —	$ —	$ 87,706
Standby letters of credit	7,215	115	—	—	7,330
Commercial letters of credit	7,527	—	—	—	7,527
Operating leases	944	1,290	656	1,082	3,972
Total financial instruments with off−balance sheet risk	$ 103,392	$ 1,405	$ 656	$ 1,082	$ 106,535

Capital Resources

Capital management consists of providing equity to support both current and future operations. The Company is subject to capital adequacy requirements imposed by the Federal Reserve Board and the Bank is subject to capital adequacy requirements imposed by the OCC. Both the Federal Reserve Board and the OCC have adopted risk−based capital requirements for assessing bank holding company and bank capital adequacy. These standards define capital and establish minimum capital requirements in relation to assets and off−balance sheet exposure, adjusted for credit risk. The risk−based capital standards currently in effect are designed to make regulatory capital requirements more sensitive to differences in risk profiles among bank holding companies and banks, to account for off−balance sheet exposure and to minimize disincentives for holding liquid assets. Assets and off−balance sheet items are assigned to broad risk categories, each with appropriate relative risk weights. The resulting capital ratios represent capital as a percentage of total risk−weighted assets and off−balance sheet items.

The risk−based capital standards of the Federal Reserve Board require all bank holding companies to have "Tier 1 capital" of at least 4.0% and "total risk−based" capital (Tier 1 and Tier 2) of at least 8.0% of total risk−adjusted assets. "Tier 1 capital" generally includes common shareholders' equity and qualifying perpetual preferred stock together with related surpluses and retained earnings, less deductions for goodwill and various other intangibles. "Tier 2 capital" may consist of a limited amount of intermediate−term preferred stock, a limited amount of term subordinated debt, certain hybrid capital instruments and other debt securities, perpetual preferred stock not qualifying as Tier 1 capital, and a limited amount of the general valuation allowance for loan losses. The sum of Tier 1 capital and Tier 2 capital is "total risk−based capital."

The Federal Reserve Board has also adopted guidelines which supplement the risk−based capital guidelines with a minimum ratio of Tier 1 capital to average total consolidated assets ("leverage ratio") of 3.0% for institutions with well diversified risk, including no undue interest rate exposure; excellent asset quality; high liquidity; good earnings; and that are generally considered to be strong banking organizations, rated composite 1 under applicable federal guidelines, and that are not experiencing or anticipating significant growth. Other banking organizations are required to maintain a leverage ratio of at least 4.0%. These rules further provide that banking organizations experiencing internal growth or making acquisitions will be expected to maintain capital positions substantially above the minimum supervisory levels and comparable to peer group averages, without significant reliance on intangible assets.

Pursuant to FDICIA, each federal banking agency revised its risk−based capital standards to ensure that those standards take adequate account of interest rate risk, concentration of credit risk and the risks of nontraditional activities, as well as reflect the actual performance and expected risk of loss on multifamily mortgages. The Bank is subject to capital adequacy guidelines of the OCC that are substantially similar to the Federal Reserve Board's guidelines. Also pursuant to FDICIA, the OCC has promulgated regulations setting the levels at which an insured institution such as the Bank would be considered "well capitalized,"

"adequately capitalized as," "undercapitalized," "significantly undercapitalized" and "critically undercapitalized." The Bank is classified "well capitalized" for purposes of the OCC's prompt corrective action regulations. See "Business — Supervision and Regulation — The Company" and "— The Bank."

Shareholders' equity at December 31, 2003 was $76.2 million, an increase of $1.7 million or 2.3% compared to shareholders' equity of $74.5 million at December 31, 2002. This increase was primarily the result of net income of $3.7 million, common and treasury stock issuances of $150,000, and an increase in paid−in capital of $1.3 million that was partially offset by a reduction in the net unrealized gain on securities of approximately $1.7 million and dividend payments of $1.7 million.

The following table provides a comparison of the Company's and the Bank's leverage and risk−weighted capital ratios as of December 31, 2003 to the minimum and well−capitalized regulatory standards:

	Minimum Required For Capital Adequacy Purposes	To Be Well Capitalized Under Prompt Corrective Action Provisions	Actual Ratio At December 31, 2003
The Company			
Leverage ratio	4.00%(1)	N/A%	8.84%
Tier 1 risk−based capital ratio	4.00	N/A	12.42
Risk−based capital ratio	8.00	N/A	13.67
The Bank			
Leverage ratio	4.00%(2)	5.00%	8.30%
Tier 1 risk−based capital ratio	4.00	6.00	11.66
Risk−based capital ratio	8.00	10.00	12.92

(1) The Federal Reserve Board may require the Company to maintain a leverage ratio above the required minimum.
(2) The OCC may require the Bank to maintain a leverage ratio above the required minimum.

Critical Accounting Policies

The Company has established various accounting policies which govern the application of accounting principles generally accepted in the United States in the preparation of the Company's financial statements. Certain accounting policies involve significant judgments and assumptions by management which have a material impact on the carrying value of certain assets and liabilities; management considers such accounting policies to be critical accounting policies. The judgments and assumptions used by management are based on historical experience and other factors, which are believed to be reasonable under the circumstances. Because of the nature of the judgments and assumptions made by management, actual results could differ from these judgments and estimates which could have a material impact on the carrying values of assets and liabilities and the results of operations of the Company. The Company believes the allowance for loan losses is a critical accounting policy that requires the most significant judgments and estimates used in the preparation of its consolidated financial statements. In estimating the allowance for loan losses, management reviews effect of changes in the local real estate market on collateral values, the effect of current economic indicators on the loan portfolio and their probable impact on borrowers and increases or decreases in nonperforming and impaired loans. Changes in these factors may cause management's estimate of the allowance to increase or decrease and result in adjustments to the Company's provision for loan losses. See "Financial Condition — Allowance for Loan Losses."

The Company believes that loans held−for−sale and the related lower of cost or market adjustment is also a critical accounting policy that requires significant judgments and estimates in preparation of its consolidated financial statements. In estimating the requirement for market adjustments, management utilizes outside sources to determine the market value of the loans held−for−sale through solicitation of market bids or

indications of market value. Decreases in market value will be reflected in the consolidated statement of income under noninterest expense as “Lower of Cost or Market Adjustment.”

New Accounting Pronouncements

On November 25, 2002, the FASB issued FASB Interpretation (“FIN”) No. 45, *Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others.* FIN No. 45 considers standby letters of credit, excluding commercial letters of credit and other lines of credit, a guarantee of the Bank. The Bank enters into a standby letter of credit to guarantee performance of a customer to a third party. These guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved is represented by the contractual amounts of those instruments. Under the standby letters of credit, the Bank is required to make payments to the beneficiary of the letters of credit upon request by the beneficiary so long as all performance criteria have been met. Most guarantees extend up to one year. At December 31, 2003 the maximum potential amount of future payments is $7.3 million. The Company has recorded a liability of approximately $2,542 at December 31, 2003, for the fair value of the Company’s potential obligations, which represents the unamortized portion of the letter of credit fees. See “Note 12 — Off−Balance Sheet Risk” for a discussion of significant guarantees that have been entered into by the Company.

On January 17, 2003, the FASB issued FIN No. 46, *Consolidation of Variable Interest Entities,* which addresses consolidation by business enterprises of variable interest entities. FIN No. 46 clarifies the application of ARB No. 51, *Consolidated Financial Statements,* to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. The Company has determined the impact of this interpretation will not have any effect on its financial condition or results of operations.

On April 30, 2003, the FASB approved SFAS No. 149, an amendment to SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities.* This statement amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities under SFAS No. 133. The provisions of this statement were effective for contracts entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003. The adoption of SFAS No. 149 did not have a material effect on the Company’s financial condition or results of operations.

On May 15, 2003, the FASB approved SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity.* This statement changes the accounting for certain financial instruments that, under previous guidance, could be classified as equity or “mezzanine” equity, but now is requiring those instruments to be classified as liabilities (or assets in some circumstances) in the statement of financial condition. Further, SFAS No. 150 requires disclosure regarding the terms of those instruments and settlement alternatives. This statement is generally effective for all such financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003, except for mandatorily redeemable financial instruments of non−public entities. It is not expected that this statement will have a material effect on the Company’s financial condition or results of operations. On October 29, 2003, the FASB deferred certain provisions of this statement.

Item 7A. ***Quantitative and Qualitative Disclosure About Market Risk***

For information regarding the market risk of the Company’s financial instruments, see “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations−Interest Rate Sensitivity and Market Risk.” The Company’s principal market risk exposure is to interest rates.

Item 8. ***Financial Statements and Supplementary Data***

Reference is made to the financial statements, the reports thereon, the notes thereto and supplementary data commencing at page 53 of this Form 10−K, which financial statements, reports, notes and data are incorporated herein by reference.

Quarterly Financial Data

The following table represents summarized data for each of the quarters in fiscal 2003 and 2002 (in thousands, except per share data):

	2003				2002			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Interest income	$ 11,032	$ 10,749	$ 10,966	$ 11,091	$ 11,865	$ 12,298	$ 12,354	$ 11,687
Interest expense	2,740	2,956	3,189	3,249	3,532	3,610	3,596	3,891
Net interest income	8,292	7,793	7,777	7,842	8,333	8,688	8,758	7,796
Provision for loan losses	300	575	4,015	800	1,533	750	970	600
Net interest income after provision for loan losses	7,992	7,218	3,762	7,042	6,800	7,938	7,788	7,196
Noninterest income	2,034	2,429	2,170	2,294	2,261	2,440	2,297	2,476
Noninterest expense	7,358	7,798	8,028	6,520	6,023	6,519	6,892	6,623
Income before income taxes	2,668	1,849	(2,096)	2,816	3,038	3,859	3,193	3,049
Provision for income taxes	860	504	(742)	907	1,060	1,329	1,003	958
Net income	$ 1,808	$ 1,345	$ (1,354)	$ 1,909	$ 1,978	$ 2,530	$ 2,190	$ 2,091
Earnings per share:								
Basic	$ 0.25	$ 0.19	$ (0.19)	$ 0.27	$ 0.28	$ 0.36	$ 0.31	$ 0.30
Diluted	$ 0.24	$ 0.19	$ (0.19)	$ 0.27	$ 0.28	$ 0.35	$ 0.30	$ 0.29
Weighted average shares outstanding:								
Basic	7,154	7,132	7,037	7,033	7,031	7,026	7,020	7,020
Diluted	7,242	7,215	7,037	7,196	7,179	7,147	7,140	7,140
Dividends per common share	$ 0.06	$ 0.06	$ 0.06	$ 0.06	$ 0.06	$ 0.06	$ 0.06	$ 0.06

Item 9. ***Changes in and Disagreements With Accountants on Accounting and Financial Disclosure***

There were no changes in and disagreements with accountants on accounting and financial disclosure.

Item 9A. ***Controls and Procedures***

Evaluation of disclosure controls and procedures. As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of our management, including our President and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on this evaluation, the Company's President and Chief Financial Officer concluded that the Company's disclosure controls and procedures (as defined in Rules 13a−15(e) and 15d−15(e) under the Securities Exchange Act of 1934 (the "Exchange Act")) are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported to the Company's management within the time periods specified in the Securities and Exchange Commission's rules and forms.

Changes in internal controls over financial reporting. There were no changes in the Company's internal controls over financial reporting during the last fiscal quarter that materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART III

Item 10. *Directors and Executive Officers of the Company*

The information under the captions "Election of Directors", "Continuing Directors and Executive Officers," "Section 16(a) Beneficial Ownership Reporting Compliance" and "Code of Ethics" in the Company's definitive Proxy Statement for its 2004 Annual Meeting of Shareholders to be filed with the Commission within 120 days after December 31, 2003 pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended (the "2004 Proxy Statement"), is incorporated herein by reference in response to this item.

Item 11. *Executive Compensation*

The information under the caption "Executive Compensation and Other Matters" in the 2004 Proxy Statement is incorporated herein by reference in response to this item.

Item 12. *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters*

The information under the caption "Beneficial Ownership of Common Stock by Management of the Company and Principal Shareholders" in the 2004 Proxy Statement is incorporated herein by reference in response to this item.

Item 13. *Certain Relationships and Related Transactions*

The information under the caption "Interests of Management and Others in Certain Transactions" in the 2004 Proxy Statement is incorporated herein by reference in response to this item.

Item 14. *Principal Accounting Fees and Services*

The information under the caption "Principal Accounting Fees and Services" in the 2004 Proxy Statement is incorporated herein by reference in response to this item.

PART IV

Item 15. ***Exhibits, Financial Statement Schedules, and Reports on Form 10−K***

Consolidated Financial Statements and Financial Statement Schedules

Reference is made to the Consolidated Financial Statements, the reports thereon, the notes thereto and supplementary data commencing at page 53 of this Annual Report on Form 10−K. Set forth below is a list of such Consolidated Financial Statements:

Report of Independent Auditors
Independent Auditors' Report
Consolidated Balance Sheets as of December 31, 2003 and 2002
Consolidated Statements of Income for the Years Ended December 31, 2003, 2002, and 2001
Consolidated Statements of Comprehensive Income for the Years Ended December 31, 2003, 2002, and 2001
Consolidated Statements of Changes in Shareholders' Equity for the Years Ended December 31, 2003, 2002, and 2001
Consolidated Statements of Cash Flows for the Years Ended December 31, 2003, 2002, and 2001
Notes to Consolidated Financial Statements

Financial Statement Schedules

All supplemental schedules are omitted as inapplicable or because the required information is included in the Consolidated Financial Statements or notes thereto.

Exhibit Number	Description
3.1	Amended and Restated Articles of Incorporation of the Company (incorporated herein by reference to Exhibit 3.1 to the Company's Registration Statement on Form S−1 (Registration No. 333−62667) (the "Registration Statement")).
3.2	Amended and Restated Bylaws of the Company (incorporated herein by reference to Exhibit 3.2 to the Registration Statement).
4	Specimen form of certificate evidencing the Common Stock (incorporated herein by reference to Exhibit 4 to the Registration Statement).
10.1	Agreement and Plan of Reorganization by and among MetroCorp Bancshares, Inc., MC Bancshares of Delaware, Inc. and MetroBank, N.A. (incorporated herein by reference to Exhibit 10.1 to the Registration Statement).
10.2†	Form of Director Stock Option Agreement (incorporated herein by reference to Exhibit 10.2 to the Registration Statement).
10.3†	MetroCorp Bancshares, Inc. Non−Employee Director Stock Bonus Plan (incorporated herein by reference to Exhibit 10.3 to the Registration Statement).
10.4	MetroCorp Bancshares, Inc. 1998 Employee Stock Purchase Plan (incorporated herein by reference to Exhibit 10.4 to the Registration Statement).
10.5†	MetroCorp Bancshares, Inc. 1998 Stock Incentive Plan (incorporated herein by reference to Exhibit 10.5 to the Registration Statement).
10.6†	First Amendment to the MetroCorp Bancshares, Inc. 1998 Employee Stock Purchase Plan (incorporated herein by reference to Exhibit 10.6 to the Company's Annual Report on Form 10−K for the year ended December 31, 1998).
10.7†	First Amendment to the MetroCorp Bancshares, Inc. Non−Employee Director Stock Bonus Plan (incorporated herein by reference to Exhibit 4.5 to the Company's Registration Statement on Form S−8 (Registration Number 333−94327)).

Exhibit Number	Description
10.8†	Second Amendment to the MetroCorp Bancshares, Inc. Non−Employee Director Stock Bonus Plan (incorporated herein by reference to Exhibit 4.6 to the Company's Registration Statement on Form S−8 (Registration Number 333−94327)).
10.9†	Employment Agreement between MetroCorp Bancshares, Inc. and Allen D. Brown (incorporated herein by reference to Exhibit 10.9 to the Company's Annual Report on Form 10−K for the year ended December 31, 2003).
21	Subsidiaries of MetroCorp Bancshares, Inc. (incorporated herein by reference to Exhibit 21 to the Registration Statement).
23.1*	Consent of PricewaterhouseCoopers LLP.
23.2*	Consent of Deloitte & Touche LLP.
31.1*	Certification of the President pursuant to Rule 13a−14(a) of the Securities Exchange Act of 1934, as amended.
31.2*	Certification of the Chief Financial Officer pursuant to Rule 13a−14(a) of the Securities Exchange Act of 1934, as amended.
32.1*	Certification of President pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes−Oxley Act of 2002.
32.2*	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002.

* Filed herewith.

† Management contract or compensatory plan or arrangement.

Reports on Form 8−K

The following reports on Form 8−K were filed during the quarter ended December 31, 2003:

Current report on Form 8−K filed October 29, 2003 announcing the release of the Company's earnings for the third quarter of 2003.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Houston, on March 17, 2004.

METROCORP BANCSHARES, INC.

By: /s/ ALLEN D. BROWN

Allen D. Brown
President

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons in the indicated capacities on March 17, 2004.

Signature	Title
/s/ DON J. WANG Don J. Wang	Chairman of the Board
/s/ GEORGE M. LEE George M. Lee	Executive Vice Chairman
/s/ ALLEN D. BROWN Allen D. Brown	Director and President (principal executive officer)
/s/ DAVID TAI David Tai	Director
/s/ DAVID D. RINEHART David D. Rinehart	Chief Financial Officer and Executive Vice President (principal financial officer and principal accounting officer)
/s/ TIONG L. ANG Tiong L. Ang	Director
/s/ HELEN F. CHEN Helen F. Chen	Director
/s/ TOMMY F. CHEN Tommy F. Chen	Director
/s/ MAY P. CHU May P. Chu	Director
/s/ JOHN LEE John Lee	Director
/s/ EDWARD A. MONTO Edward A. Monto	Director
/s/ CHARLES L. ROFF Charles L. Roff	Director
/s/ JOE TING Joe Ting	Director

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REPORT OF INDEPENDENT AUDITORS

To the Board of Directors and Shareholders of

MetroCorp Bancshares, Inc.

In our opinion, the accompanying consolidated balance sheets as of December 31, 2003 and 2002 and the related consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows present fairly, in all material respects, the consolidated financial position of MetroCorp Bancshares, Inc. and subsidiaries (the "Company") at December 31, 2003 and 2002, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PRICEWATERHOUSECOOPERS LLP

March 12, 2004

Houston, Texas

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholders of

MetroCorp Bancshares, Inc.
Houston, Texas

We have audited the accompanying consolidated statements of income, shareholders' equity and cash flows of MetroCorp Bancshares, Inc. and subsidiary (the "Company") for the year ended December 31, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the results of their operations and their cash flows for the year ended December 31, 2001 in conformity with accounting principles generally accepted in the United States of America.

/s/ DELOITTE & TOUCHE LLP

March 20, 2002

Houston, Texas

METROCORP BANCSHARES, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share amounts)

	December 31,	
	2003	2002
ASSETS		
Cash and due from banks	$ 26,347	$ 30,195
Federal funds sold and other temporary investments	10,580	7,991
Total cash and cash equivalents	36,927	38,186
Securities available−for−sale, at fair value	257,064	260,038
Other investments	5,200	4,380
Loans, net of allowance for loan losses of $10,448 and $10,150, respectively	537,305	517,609
Loans, held−for−sale	6,030	—
Premises and equipment, net	5,674	5,841
Accrued interest receivable	3,452	3,391
Deferred tax asset	5,774	4,584
Customers' liability on acceptances	3,352	4,080
Foreclosed assets, net	2,585	1,190
Other assets	1,410	766
Total assets	$864,773	$840,065
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Noninterest−bearing	$169,097	$144,544
Interest−bearing	555,844	546,817
Total deposits	724,941	691,361
Other borrowings	54,173	65,774
Accrued interest payable	567	717
Acceptances outstanding	3,352	4,080
Other liabilities	5,530	3,670
Total liabilities	788,563	765,602
Shareholders' equity:		
Common stock, $1.00 par value, 20,000,000 shares authorized; 7,306,627 shares and 7,195,927 shares issued and 7,156,689 shares and 7,031,882 shares outstanding at December 31, 2003 and 2002, respectively	7,307	7,196
Additional paid−in−capital	27,620	26,344
Retained earnings	41,942	39,938
Accumulated other comprehensive income	671	2,354
Treasury stock, at cost	(1,330)	(1,369)
Total shareholders' equity	76,210	74,463
Total liabilities and shareholders' equity	$864,773	$840,065

The accompanying notes are an integral part of these consolidated financial statements.

METROCORP BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share amounts)

	Years Ended December 31,		
	2003	2002	2001
Interest income:			
Loans	$35,242	$37,987	$43,926
Securities:			
Taxable	7,321	9,080	8,356
Tax−exempt	997	1,160	1,177
Federal funds sold and other investments	278	484	1,992
Total interest income	43,838	48,711	55,451
Interest expense:			
Time deposits	8,942	10,595	19,003
Demand and savings deposits	1,345	2,215	3,531
Other borrowings	1,847	1,818	1,265
Total interest expense	12,134	14,628	23,799
Net interest income	31,704	34,083	31,652
Provision for loan losses	5,690	3,853	3,799
Net interest income after provision for loan losses	26,014	30,230	27,853
Noninterest income:			
Service fees	6,544	6,670	6,360
Other loan−related fees	1,009	1,083	936
Letters of credit commissions and fees	516	610	655
Gain on sale of securities, net	165	34	189
Gain on sale of loans	600	322	127
Other noninterest income	93	248	393
Total noninterest income	8,927	8,967	8,660
Noninterest expense:			
Salaries and employee benefits	15,183	14,746	13,180
Lower of cost or market adjustment on loans held−for−sale	2,149	—	—
Occupancy and equipment	5,361	5,089	5,189
Foreclosed assets, net	248	680	153
Other noninterest expense	6,763	5,543	6,861
Total noninterest expense	29,704	26,058	25,383
Income before provision for income taxes	5,237	13,139	11,130
Provision for income taxes	1,529	4,350	3,553
Net income	$ 3,708	$ 8,789	$ 7,577
Earnings per common share:			
Basic	$ 0.52	$ 1.25	$ 1.08
Diluted	$ 0.51	$ 1.23	$ 1.07
Weighted average shares outstanding:			
Basic	7,089	7,024	6,998
Diluted	7,213	7,154	7,059
Dividends per common share	$ 0.24	$ 0.24	$ 0.24

The accompanying notes are an integral part of these consolidated financial statements.

METROCORP BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

	2003	2002	2001
Net income	$ 3,708	$ 8,789	$7,577
Other comprehensive income, net of tax:			
Unrealized gains on investment securities, net of tax:			
Unrealized holding (losses) gains arising during the period	(1,576)	2,000	380
Less: reclassification adjustment for gains included in net income	(107)	(22)	(125)
Other comprehensive (loss) income	(1,683)	1,978	255
Total comprehensive income	$ 2,025	$10,767	$7,832

The accompanying notes are an integral part of these consolidated financial statements.

METROCORP BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

Years Ended December 31, 2003, 2000 and 2001
(In thousands)

	Common Stock		Additional Paid−in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock At Cost	Total
	Shares	At Par					
Balance at December 31, 2000	6,979	$7,180	$26,033	$26,936	$ 121	$(1,569)	$58,701
Issuance of common stock	7	7	52	—	—	—	59
Re−issuance of treasury stock	31	—	59	—	—	257	316
Net income	—	—	—	7,577	—	—	7,577
Other comprehensive income	—	—	—	—	255	—	255
Dividends ($0.24 per share)	—	—	—	(1,679)	—	—	(1,679)
Balance at December 31, 2001	7,017	7,187	26,144	32,834	376	(1,312)	65,229
Issuance of common stock	9	9	67	—	—	—	76
Re−issuance of treasury stock	37	—	133	—	—	292	425
Repurchase of common stock	(31)	—	—	—	—	(349)	(349)
Net income	—	—	—	8,789	—	—	8,789
Other comprehensive income	—	—	—	—	1,978	—	1,978
Dividends ($0.24 per share)	—	—	—	(1,685)	—	—	(1,685)
Balance at December 31, 2002	7,032	7,196	26,344	39,938	2,354	(1,369)	74,463
Issuance of common stock	111	111	1,075	—	—	—	1,186
Re−issuance of treasury stock	32	—	146	—	—	251	397
Repurchase of common stock	(18)	—	—	—	—	(212)	(212)
Tax benefit from stock options exercised	—	—	55	—	—	—	55
Net income	—	—	—	3,708	—	—	3,708
Other comprehensive loss	—	—	—	—	(1,683)	—	(1,683)
Dividends ($0.24 per share)	—	—	—	(1,704)	—	—	(1,704)
Balance at December 31, 2003	7,157	$7,307	$27,620	$41,942	$ 671	$(1,330)	$76,210

The accompanying notes are an integral part of these consolidated financial

METROCORP BANCSHARES, INC

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Years Ended December 31,		
	2003	2002	2001
Cash flows from operating activities:			
Net income	$ 3,708	$ 8,789	$ 7,577
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation	1,337	1,435	1,636
Provision for loan losses	5,690	3,853	3,799
Lower of cost or market adjustment on loans held−for−sale	2,149	—	—
Gain on securities sales, net	(165)	(34)	(189)
Gain on sale of premises and equipment	—	(5)	—
Gain on sale of loans, net	(600)	(322)	(127)
Amortization of premiums and discounts on securities	2,251	1,332	39
Amortization of deferred loan fees and discounts	(32)	142	507
Deferred income taxes	(386)	(121)	195
Changes in:			
Loans held−for−sale	(5,891)	—	—
Accrued interest receivable	(61)	211	669
Accrued interest payable	(150)	(146)	(953)
Income taxes payable	(299)	(63)	(1,279)
Other liabilities	1,923	866	(16,516)
Other assets	(614)	2,506	2,312
Net cash provided by (used in) operating activities	8,860	18,443	(2,330)
Cash flows from investing activities:			
Purchases of securities available−for−sale	(182,039)	(179,932)	(111,207)
Proceeds from sales, maturities and principal paydowns of securities available−for−sale	179,591	93,406	79,273
Net change in loans	(31,546)	(38,504)	(15,415)
Proceeds from sale of foreclosed assets	3,391	659	1,078
Proceeds from sale of premises and equipment	—	5	—
Purchases of premises and equipment	(1,170)	(1,653)	(684)
Net cash used in investing activities	(31,773)	(126,019)	(46,955)
Cash flows from financing activities:			
Net change in:			
Deposits	33,580	48,610	16,845
Other borrowings	(11,601)	40,579	(378)
Proceeds from issuance of common stock	1,186	76	59
Treasury stock sold	397	425	316
Treasury stock purchased	(212)	(349)	—
Dividends paid	(1,696)	(1,685)	(1,677)
Net cash provided by financing activities	21,654	87,656	15,165
Net decrease in cash and cash equivalents	(1,259)	(19,920)	(34,120)
Cash and cash equivalents at beginning of period	38,186	58,106	92,226
Cash and cash equivalents at end of period	$ 36,927	$ 38,186	$ 58,106

The accompanying notes are an integral part of these consolidated financial statements.

METROCORP BANCSHARES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

The consolidated financial statements of MetroCorp Bancshares, Inc. (the “Company”) include the accounts of the Company and its wholly−owned subsidiary, MetroBank, National Association (the “Bank”). The Bank was formed in 1987 and is engaged in commercial banking activities through its fourteen branches in Houston and Dallas, Texas.

The accounting principles followed by the Company and the methods of applying these principles conform with accounting principles generally accepted in the United States and with general practices within the banking industry. Certain principles which significantly affect the determination of financial position, results of operations and cash flows are summarized below.

Use of Estimates

These financial statements are prepared in conformity with accounting principles generally accepted in the United States of America, which require management to make estimates and assumptions. These assumptions affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates include the allowance for loan losses. Amounts are recognized when it is probable that an asset has been impaired or a liability has been incurred and the cost can be reasonable estimated. Actual results could differ from those estimates.

Principles of Consolidation

All significant intercompany accounts and transactions are eliminated in consolidation.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, amounts due from banks, federal funds sold, and other temporary investments with original maturities of less than three months.

Securities

Investments in securities for which the Company has both the ability and intent to hold to maturity are classified as investments held−to−maturity and are stated at amortized cost. Amortization of premiums and accretion of discounts are recognized as adjustments to interest income using the effective−interest method. Investments in securities which management believes may be sold prior to maturity are classified as investments available−for−sale and are stated at fair value. Unrealized net gains and losses, net of the associated deferred income tax effect, are excluded from income and reported as a separate component of shareholders’ equity in “Accumulated other comprehensive income.” Realized gains and losses from sales of investments available−for−sale are recorded on the trade date and determined using the specific identification method.

Loans and Allowance for Loan Losses

Loans are reported at the principal amount outstanding, reduced by unearned discounts, net deferred loan fees, and an allowance for loan losses. Unearned income on installment loans is recognized using the effective interest method over the term of the loan. Interest on other loans is calculated using the simple interest method on the daily principal amount outstanding.

Loans are placed on nonaccrual status when principal or interest is past due more than 90 days or when, in management’s opinion, collection of principal and interest is not likely to be made in accordance with a loan’s contractual terms. Interest accrued but not collected at the date a loan is placed on nonaccrual status is

reversed against interest income. In addition, the amortization of deferred loan fees is suspended when a loan is placed on nonaccrual status. Interest income on nonaccrual loans is recognized only to the extent received in cash; however, where there is doubt regarding the ultimate collectibility of the loan principal, cash receipts, whether designated as principal or interest, are thereafter applied to reduce the principal balance of the loan. Loans are restored to accrual status only when interest and principal payments are brought current and, in management's judgment, future payments are reasonably assured.

A loan, with the exception of groups of smaller−balance homogenous loans that are collectively evaluated for impairment, is considered impaired when, based on current information, it is probable that the borrower will be unable to pay contractual interest or principal payments as scheduled in the loan agreement. A creditor may use existing methods for recognizing interest income on impaired loans. The Bank recognizes interest income on impaired loans pursuant to the discussion above for nonaccrual loans.

The allowance for loan losses related to impaired loans is determined based on the difference of carrying value of loans and the present value of expected cash flows discounted at the loan's effective interest rate or, as a practical expedient, the loan's observable market price or the fair value of the collateral if the loan is collateral dependent.

Estimates of loan losses involve an exercise of judgment. While it is possible that in the short−term the Company may sustain losses which are substantial in relation to the allowance for loan losses, it is the judgment of management that the allowance for loan losses reflected in the consolidated balance sheets is adequate to absorb probable losses that exist in the current loan portfolio.

The allowance for loan losses provides for the risk of losses inherent in the lending process. The allowance for loan losses is based on periodic reviews and analyses of the loan portfolio which include consideration of such factors as the risk rating of individual credits, the size and diversity of the portfolio, economic conditions, prior loss experience and results of periodic credit reviews of the portfolio. The allowance for loan losses is increased by provisions for loan losses charged against income and reduced by charge−offs, net of recoveries. In management's judgment, the allowance for loan losses is considered adequate to absorb losses inherent in the loan portfolio.

Nonrefundable Fees and Costs Associated with Lending Activities

Loan origination fees in excess of the associated costs are recognized over the life of the related loan as an adjustment to yield using the interest method.

Generally, loan commitment fees are deferred and recognized as an adjustment of yield by the interest method over the related loan life or, if the commitment expires unexercised, recognized in income upon expiration of the commitment.

Premises and Equipment

Premises and equipment are stated at cost, less accumulated depreciation. For financial accounting purposes, depreciation is computed using the straight−line method over the estimated useful lives of the assets. Expenditures for maintenance and repairs, which do not extend the life of bank premises and equipment, are charged to operations as incurred.

Other Real Estate

Other real estate consists of properties acquired through a foreclosure proceeding or acceptance of a deed in lieu of foreclosure. These properties are initially recorded at fair value less estimated costs to sell. On an ongoing basis they are carried at the lower of cost or fair value minus estimated costs to sell based on appraised

value. Operating expenses, net of related revenue and gain and losses on sale of such assets, are reported in noninterest expense.

Other Borrowings

Other borrowings include U.S. Treasury tax note option accounts with maturities of 14 days or less and Federal Home Loan Bank (FHLB) borrowings.

Income Taxes

The Company provides for an asset and liability approach to income taxes that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in the Company's financial statements or tax returns. When management determines that it is more likely than not that a deferred tax asset will not be realized, a valuation allowance is established. In estimating future tax consequences, all expected future events other than enactments of changes in tax laws or rates are considered.

Earnings Per Share

Basic earnings per common share is calculated by dividing net earnings available for common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated by dividing net earnings available for common shareholders by the weighted average number of common and potentially dilutive common shares. Stock options can be dilutive common shares and are therefore considered in the earnings per share calculation, if dilutive. The number of potentially dilutive common shares is determined using the treasury stock method.

Interest Rate Risk Management

The operations of the Bank are subject to the risk of interest rate fluctuations to the extent that interest−bearing assets and interest−bearing liabilities mature or reprice at different times or in differing amounts. Risk management activities are aimed at optimizing net interest income, given a level of interest rate risk consistent with the Bank's business strategies.

Asset liability management activities are conducted in the context of the Bank's asset sensitivity to interest rate changes. This asset sensitivity arises due to interest−earning assets repricing more frequently than interest−bearing liabilities. For example, if interest rates are declining, margins will narrow as assets reprice downward more quickly than liabilities. The converse applies when interest rates are on the rise.

As part of the Bank's interest rate risk management, loans of approximately $362.7 million and $316.7 million, at December 31, 2003 and 2002, respectively, contain interest rate floors to reduce the unfavorable impact to the Bank during interest rate declines. The weighted average interest rate on these loans at December 31, 2003 and 2002 was 5.88% and 6.58%, respectively, and the interest rate floors ranged from 4.00% to 10.00% and 4.75% to 11.00%, respectively.

Stock Compensation

The Company grants stock options under several stock−based incentive compensation plans. The Company applies APB Opinion 25 and related Interpretations in accounting for such plans. The Company utilizes the intrinsic value method for its stock compensation plans. No compensation cost is recognized for fixed stock options in which the exercise price is equal to or greater than the estimated market price on the date of grant. In 1995, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 123 *Accounting for Stock−Based Compensation,* as amended by SFAS No. 198, which, if fully adopted by the Company, would change the methods the Company applies in recognizing the cost of the plans. Adoption of the expense recognition provisions of SFAS No. 123, as

amended by SFAS No. 198, is optional and the Company has decided not to elect these provisions of SFAS No. 123. However, pro forma disclosures as if the Company adopted the expense recognition provisions of SFAS No. 123 are required by SFAS No. 123, as amended by SFAS No. 198.

If the fair value based method of accounting under SFAS No. 123 had been applied, the Company's net income available for common shareholders and earnings per common share would have been reduced to the pro forma amounts indicated below (assuming that the fair value of options granted during the year are amortized over the vesting period) (in thousands except per share amounts):

	Years Ended December 31,		
	2003	2002	2001
Net income:			
As reported	$3,708	$8,789	$7,577
Pro forma	$3,598	$8,681	$7,546
Stock−based compensation cost, net of income taxes:			
As reported	$ —	$ —	$ —
Pro forma	$ 110	$ 108	$ 31
Basic earnings per common share:			
As reported	$ 0.52	$ 1.25	$ 1.08
Pro forma	$ 0.51	$ 1.24	$ 1.07
Diluted earnings per common share:			
As reported	$ 0.51	$ 1.23	$ 1.08
Pro forma	$ 0.50	$ 1.21	$ 1.07

The effects of applying SFAS No. 123 in this pro forma disclosure are not indicative of future amounts. SFAS No. 123 does not apply to awards prior to 1995, and the Company anticipates making awards in the future under its stock−based compensation plans. The Black−Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

Off−Balance Sheet Instruments

The Company has entered into off−balance sheet financial instruments consisting of commitments to extend credit. Such financial instruments are recorded in the financial statements when they are funded.

New Accounting Pronouncements

On November 25, 2002, the FASB issued FASB Interpretation ("FIN") No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others.* FIN No. 45 considers standby letters of credit, excluding commercial letters of credit and other lines of credit, a guarantee of the Bank. The Bank enters into a standby letter of credit to guarantee performance of a customer to a third party. These guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved is represented by the contractual amounts of those instruments. Under the standby letters of credit, the Bank is required to make payments to the beneficiary of the letters of credit upon request by the beneficiary so long as all performance criteria have been met. Most guarantees extend up

to one year. At December 31, 2003 the maximum potential amount of future payments is $7.3 million. See “Note 12 — Off−Balance Sheet Risk” for a discussion of significant guarantees that have been entered into by the Company. The adoption of FIN No. 45 has not had a material effect on the Company’s financial condition or results of operations.

On January 17, 2003, the FASB issued FIN No. 46, *Consolidation of Variable Interest Entities*, which addresses consolidation by business enterprises of variable interest entities. FIN No. 46, as amended by FIN No. 46R, clarifies the application of ARB No. 51, *Consolidated Financial Statements*, to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. The adoption has not had a material impact on the Company’s financial condition or results of operations.

On May 15, 2003, the FASB approved SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. This statement changes the accounting for certain financial instruments that, under previous guidance, could be classified as equity or “mezzanine” equity, but now is requiring those instruments to be classified as liabilities (or assets in some circumstances) in the statement of financial condition. Further, SFAS No. 150 requires disclosure regarding the terms of those instruments and settlement alternatives. This statement is generally effective for all such financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003, except for mandatorily redeemable financial instruments of non−public entities. It is not expected that this statement will have a material effect on the Company’s financial condition or results of operations. On October 29, 2003, the FASB deferred certain provisions of this statement.

Reclassifications

Certain 2002 and 2001 amounts have been reclassified to conform to the 2003 presentation, and has had no impact on net income or shareholders’ equity.

2. Cash and Cash Equivalents

The Bank is required by the Board of Governors of the Federal Reserve System to maintain average reserve balances. The balance requirement is more than satisfied by the Bank’s vault cash.

METROCORP BANCSHARES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

3. Securities

In the normal course of business, the Bank invests in Federal government, Federal agency, state and municipal securities, which inherently carry interest rate risks based upon overall economic trends and related market yield fluctuations. Securities within the available−for−sale portfolio may be used as part of the Company's asset/liability strategy and may be sold in response to changes in interest rate risk, prepayment risk or other similar economic factors. Declines in the fair value of individual available−for−sale securities below their cost that are other than temporary would result in write−down of the individual securities to their fair value. The related write−downs would be included in earnings as realized losses. At December 31, 2003 and 2002, the amortized cost and fair value of securities classified as available−for−sale is as follows:

	As of December 31, 2003			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Available−for−sale:				
U.S. Treasury securities and obligations of U.S. government agencies	$ 4,965	$ —	$ (12)	$ 4,953
Obligations of state and political subdivisions	18,925	1,249	—	20,174
Mortgage−backed securities and collateralized mortgage obligations	209,323	1,170	(1,254)	209,239
Other debt securities	1,096	3	(10)	1,089
Investment in ARM and CRA funds	21,739	73	(203)	21,609
FHLB and Federal Reserve Bank stock(1)(2)	5,200	—	—	5,200
Total securities	$261,248	$2,495	$(1,479)	$262,264

	As of December 31, 2002			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Available−for−sale:				
U.S. Treasury securities and obligations of U.S. government agencies	$ 2,488	$ 50	$ —	$ 2,538
Obligations of state and political subdivisions	22,059	591	(2)	22,648
Mortgage−backed securities and collateralized mortgage obligations	180,599	2,862	(151)	183,310
Other debt securities	2,378	33	(20)	2,391
Investment in ARM and CRA funds	48,982	169	—	49,151
FHLB and Federal Reserve Bank stock (1)(2)	4,380	—	—	4,380
Total securities	$260,886	$3,705	$(173)	$264,418

(1) FHLB stock held by the Bank is subject to certain restrictions under a credit policy of the FHLB dated May 1, 1997. Redemption of FHLB stock is dependent upon repayment of borrowings from the FHLB.

(2) Federal Reserve Bank stock held by the Bank is subject to certain restrictions under Federal Reserve Bank Policy.

METROCORP BANCSHARES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The following sets forth information concerning sales (excluding maturities) of available−for−sale securities (in thousands):

	Years Ended December 31,		
	2003	2002	2001
Amortized cost	$19,818	$18,981	$37,059
Proceeds	19,983	19,015	37,248
Gross realized gains	165	98	201
Gross realized losses	—	64	12

Investments carried at approximately $1.6 million and $1.8 million at December 31, 2003 and 2002, respectively, were pledged to collateralize public deposits and short−term borrowings of approximately $1.4 million and $1.6 million, respectively. Additionally, investments in the securities portfolio carried at approximately $25.7 million and $34.5 million were pledged as collateral for other borrowings at December 31, 2003 and 2002, respectively.

At December 31, 2003, future contractual maturities of securities are as follows (in thousands):

	Securities Available−for−Sale	
	Amortized Cost	Fair Value
Within one year	$ 185	$ 186
Within two to five years	3,321	3,367
Within six to ten years	7,159	7,309
After ten years	14,321	15,354
Mortgage−backed securities and collateralized mortgage obligations	209,323	209,239
Debt securities	234,309	235,455
Investment in ARM and CRA funds	21,739	21,609
FHLB and Federal Reserve Bank stock	5,200	5,200
Total securities	$ 261,248	$ 262,264

The Company had one security with a fair value of $472,000 where the fair value was less than the amortized cost for twelve consecutive months. The amount of unrealized loss at December 31, 2003, was $19,000.

The Bank holds mortgage−backed securities which may mature at an earlier date than the contractual maturity due to prepayments. The Bank also holds certain securities which may be called by the issuer at an earlier date than the contractual maturity date.

The Company does not own any securities of any one issuer (other than U.S. government and its agencies) of which aggregate adjusted cost exceeded 10% of consolidated shareholders' equity at December 31, 2003 or 2002.

4. Loans and Allowance for Loan Losses

The Bank originates commercial, real estate and other loans to commercial and individual customers throughout the markets it serves in Texas.

In June 2003, the Company transferred the status of approximately $13.1 million in hospitality−related loans to held−for−sale. While the Company has not historically made such transfers, the high concentration of

these loans was deemed necessary to reduce the Company's exposure to credit risk. In August 2003, an additional $3.9 million composed of two restaurant loans totaling $2.6 million and an office building loan of $1.3 million, was transferred to held−for−sale. Approximately $11.0 million of the loans held−for−sale were sold during 2003 and a gain of approximately $139,000 was recognized. The remaining $6.0 million were held−for−sale at December 31, 2003 and are carried at the lower of cost or market. During 2003, the Company recorded lower of cost or market adjustments of $2.1 million on the loans held−for−sale. The Company may consider future transfers with concentrations in hospitality and other related loans that may expose the Company to potential losses.

The loan portfolio is summarized by major categories as follows (in thousands):

	As of December 31,	
	2003	2002
Commercial and industrial	$332,480	$325,424
Real estate−mortgage	192,605	172,934
Real estate−construction	24,558	25,394
Consumer and other	10,447	10,286
Gross loans	560,090	534,038
Unearned discounts and interest	(864)	(805)
Deferred loan fees	(5,443)	(5,474)
Total loans	553,783	527,759
Allowance for loan losses	(10,448)	(10,150)
Loans, net(1)	$543,335	$517,609
Variable rate loans	$476,654	$447,655
Fixed rate loans	83,436	86,383
Gross loans	$560,090	$534,038

(1) Includes $6.0 million in commercial loans held−for−sale.

Although the Bank's loan portfolio is diversified, a substantial portion of its customers' ability to service their debts is dependent primarily on the service sectors of the economy. At December 31, 2003 and 2002, the Bank's loan portfolio consisted of concentrations in the following industries. With the exception of the concentration in apartment buildings, all such amounts represent a concentration greater than 25% of capital (in thousands):

	As of December 31,	
	2003	2002
Hotels/motels	$ 66,062	$ 82,015
Retail centers	112,380	103,623
Restaurants	31,524	33,094
Apartment buildings	14,868	14,941
Convenience/gasoline stations	26,983	27,383
All other	308,273	272,982
Gross loans	$560,090	$534,038

METROCORP BANCSHARES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

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

	As of December 31,	
	2003	2002
Balance at beginning of year	$10,150	$ 8,903
Provision for loan losses	5,690	3,853
Charge−offs	(6,121)	(3,124)
Recoveries	729	518
Balance at end of year	$10,448	$10,150

Loans for which the accrual of interest has been discontinued totaled approximately $25.4 million and $17.2 million at December 31, 2003 and 2002, respectively. Had these loans remained on an accrual basis, interest in the amount of approximately $1.0 million and $657,000 would have been accrued on these loans during the years ended December 31, 2003 and 2002, respectively.

Included in other assets on the balance sheet at December 31, 2003 and 2002 is $125,000 and $105,000, respectively, due from the SBA, the Export Import Bank of the United States ("Ex−Im Bank"), an independent agency of the United States Government, and the Overseas Chinese Community Guaranty Fund ("OCCGF"), an agency sponsored by the government of Taiwan. These amounts represent the guaranteed portions of loans previously charged−off.

The recorded investment in loans for which impairment has been recognized and the related specific allowance for loan losses on such loans at December 31, 2003 and 2002, is presented below (in thousands):

	Real Estate	Commercial	Consumer	Total
December 31, 2003:				
Impaired loans having related allowance for loan losses	$ 6,041	$ 19,341	$ 60	$25,442
Less: Allowance for loan losses	(914)	(7,956)	(30)	(8,900)
Less: Guaranteed portion (SBA, OCCGF and Ex−Im Bank)	—	(3,323)		(3,323)
Impaired loans, net of allowance for loan losses and guarantees	$ 5,127	$ 8,062	$ 30	$13,219
December 31, 2002:				
Impaired loans having related allowance for loan losses	$ —	$ 17,101	$ 108	$17,209
Less: Allowance for loan losses	—	(3,224)	(54)	(3,278)
Less: Guaranteed portion (SBA, OCCGF and Ex−Im Bank)	—	(3,310)	—	(3,310)
Impaired loans, net of allowance for loan losses and guarantees	$ —	$ 10,567	$ 54	$10,621

As of December 31, 2003 and 2002, the average recorded investment in impaired loans was approximately $21.8 million and $13.0 million, respectively. The related amount of interest income recognized while the loans were impaired approximated $215,000 for the year ended December 31, 2002. No interest income was recognized in the year ended December 31, 2003.

METROCORP BANCSHARES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Additionally, at December 31, 2003, loans with a value of approximately $28.0 million were available as collateral under a blanket loan agreement with the Federal Home Loan Bank of Dallas. At December 31, 2003, there were no loans specifically pledged to collateralize borrowed funds.

5. Premises and Equipment

Premises and equipment are summarized as follows (in thousands):

	Estimated useful lives (in years)	As of December 31, 2003	As of December 31, 2002
Furniture, fixtures and equipment	3−10	$ 12,382	$ 11,633
Building and improvements	3−20	4,379	4,018
Land	—	1,679	1,679
Leasehold improvements	5	2,715	2,655
		21,155	19,985
Accumulated depreciation		(15,481)	(14,144)
Premises and equipment, net		$ 5,674	$ 5,841

6. Interest−Bearing Deposits

The types of accounts and their respective balances included in interest−bearing deposits are as follows (in thousands):

	As of December 31, 2003	As of December 31, 2002
Interest−bearing demand deposits	$ 74,112	$ 78,147
Savings and money market accounts	120,151	107,722
Time deposits less than $100,000	167,672	166,261
Time deposits $100,000 and over	193,909	194,687
Interest−bearing deposits	$555,844	$546,817

At December 31, 2003, the scheduled maturities of time deposits are as follows (in thousands):

2004	$292,978
2005	33,144
2006	28,033
2007	3,141
2008	4,218
After 2008	67
	$361,581

The Bank had no brokered deposits as of December 31, 2003 or 2002. There were no major deposit concentrations as of December 31, 2003 or 2002.

7. Other Borrowings

Other borrowings include $25.0 million of loans from the FHLB of Dallas, maturing in September 2008. The loans bear interest at an average rate of 4.99% per annum until September 2003 after which time the FHLB may request repayment or the interest rate may be renegotiated.

Other borrowings also include several FHLB advances obtained to acquire mortgage−related securities in order to increase earning assets. These borrowings were $28.3 million and $65.2 million at December 31, 2003 and 2002, respectively, with maturities ranging from one month to two years and carried a weighted average interest rate of 1.52% and 1.85%, respectively.

The following is a schedule by year of payments required on the Company's FHLB borrowings (in thousands):

Year	Amount
2004	$28,300
2005	—
2006	—
2007	—
2008	25,000
After 2008	—
	$53,300

Other short−term borrowings at December 31, 2003 and 2002 consist of $873,000 and $574,000, respectively, in Treasury, Tax and Loan ("TT&L") payments in Company accounts for the benefit of the U.S. Treasury. These funds typically remain in the Company for one day and are then moved to the U.S. Treasury.

Additionally, the Bank has several unused, unsecured lines of credit with correspondent banks totaling $15.0 million at December 31, 2003 and 2002.

8. Income Taxes

Deferred income taxes result from differences between the amounts of assets and liabilities as measured for income tax return and for financial reporting purposes. The significant components of the net deferred tax asset are as follows (in thousands):

	As of December 31,	
	2003	2002
Deferred Tax Assets:		
Allowance for loan losses	$3,552	$3,451
Recognition of deferred loan fees	1,850	1,861
Premises and equipment	1,044	1,011
Recognition of interest on nonaccrual loans	435	640
Gross deferred tax assets	6,881	6,963
Deferred Tax Liabilities:		
Unrealized gains on investments securities available−for−sale, net	346	1,201
FHLB stock dividends	403	374
Other	358	804
Gross deferred tax liabilities	1,107	2,379
Net deferred tax asset	$5,774	$4,584

The Bank has not provided a valuation allowance for the net deferred tax asset at December 31, 2003 and 2002 due primarily to its ability to offset reversals of net deductible temporary differences against income taxes paid in previous years and expected to be paid in future years.

Components of the provision for income taxes are as follows (in thousands):

	Years Ended December 31,		
	2003	2002	2001
Current provision for federal income taxes	$1,915	$4,471	$3,358
Deferred federal income tax provision (benefit)	(386)	(121)	195
Total provision for income taxes	$1,529	$4,350	$3,553

A reconciliation of the provision for income taxes computed at statutory rates compared to the actual provision for income taxes is as follows (in thousands):

	Years Ended December 31,					
	2003		2002		2001	
	Amount	Percent	Amount	Percent	Amount	Percent
Federal income tax expense at statutory rate	$1,781	34%	$4,467	34%	$3,784	34%
Tax−exempt interest income	(315)	(6)	(361)	(3)	(400)	(3)
Other, net	63	1	244	2	169	1
Provision for income taxes	$1,529	29%	$4,350	33%	$3,553	32%

The following sets forth the deferred tax benefit (expense) related to other comprehensive income (in thousands):

	Years Ended December 31,		
	2003	2002	2001
Unrealized gains (losses) arising during the period	$(775)	$1,020	$196
Less: reclassification adjustment for gains realized in net income	(58)	(12)	(64)
Other comprehensive income	$(833)	$1,008	$132

9. 401(k) Profit Sharing Plan

The Company has established a defined contributory profit sharing plan pursuant to Internal Revenue Code Section 401(k) covering substantially all employees (the "Plan"). The Plan provides for pretax employee contributions of up to 15% of annual compensation. The Company matches each participant's contributions to the Plan up to 4% of such participant's salary. The Company made contributions, before expenses, to the Plan of approximately $389,000, $354,000, and $308,000 during the years ended December 31, 2003, 2002, and 2001, respectively.

10. Shareholders' Equity

The Company declared and paid dividends of $0.24 per share to the shareholders of record during the year ended December 31, 2003 which included a dividend declared of $0.06 per share to shareholders of record as of December 31, 2003, which was paid on January 15, 2004. The Company also paid dividends of $0.24 per share in 2002 and 2001.

The declaration and payment of dividends on the Common Stock by the Company depends upon the earnings and financial condition of the Company, liquidity and capital requirements, the general economic and regulatory climate, the Company's ability to service any equity or debt obligations senior to the Common Stock and other factors deemed relevant by the Company's Board of Directors.

The Company's Non−Employee Director Stock Bonus Plan ("Non−Employee Director Plan") authorizes the issuance of up to 60,000 shares of Common Stock to the directors of the Company who do not serve as an officer or employee of the Company. Under the Non−Employee Director Plan, up to 12,000 shares of Common Stock may be issued each year for a five−year period beginning in 1998 if the Company achieves a certain return on equity ratio with no shares to be issued if the Company's return on equity is below 13.0%. This return on equity goal was not achieved in 2003, 2002 or 2001. As of December 31, 2003, 24,000 shares have been issued under the Non−Employee Director Plan and no additional shares are available for issuance under this plan.

The Company's 1998 Employee Stock Purchase Plan ("Purchase Plan") authorizes the offer and sale of up to 200,000 shares of Common Stock to employees of the Company and its subsidiaries. The Purchase Plan will be implemented through ten annual offerings. Each year the Board of Directors determines the number of shares to be offered under the Purchase Plan; provided that in any one year the offering may not exceed 20,000 shares plus any unsubscribed shares from prior years. The offering price per share will be an amount equal to 90% of the closing trading price of a share of Common Stock on the business day immediately prior to the commencement of such offering. In each offering, each employee may purchase a number of whole shares of Common Stock that are equal to 20% of the employee's base salary divided by the offering price. Pursuant to the Purchase Plan, the employee pays for the Common Stock either immediately or through a payroll deduction program over a period of up to one year, at the employee's option. The first annual offering under the Purchase Plan began in the second quarter of 1999. As of December 31, 2003 there were 23,743 shares issued under the Purchase Plan.

11. Regulatory Matters

Regulatory restrictions limit the payment of cash dividends by the Bank. The approval of the Office of the Comptroller of the Currency (OCC) is required for any cash dividend paid by the Bank if the total of all cash dividends declared in any calendar year exceeds the total of its net income for that year combined with the net addition to undivided profits for the preceding two years. As of December 31, 2003, approximately $15.0 million was available for payment of dividends by the Bank to the Company under applicable restrictions, without regulatory approval.

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. The regulations require the Company to meet specific capital adequacy guidelines that involve quantitative measures of the Company's assets, liabilities, and certain off−balance sheet items as calculated under regulatory accounting practices. The Bank's capital classification is also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios of total and Tier 1 capital to risk−weighted assets, and of Tier 1 capital to average assets. Management believes, as of December 31, 2003 that the Company and the Bank meet all capital adequacy requirements to which it is subject.

The most recent notifications from the OCC categorized the Bank as "well capitalized", as defined, under the regulatory framework for prompt corrective action. To be categorized as adequately capitalized, the Bank must maintain minimum total risk−based, Tier 1 risk−based and Tier leverage ratios as set forth in the table below. There are no conditions or events since the notifications that management believes have changed the Bank's level of capital adequacy.

METROCORP BANCSHARES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The Company's and the Bank's actual capital amounts and ratios are presented in the following table:

	Actual		Minimum Required for Capital Adequacy Purposes		To be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in thousands)					
As of December 31, 2003						
Total risk−based capital ratio						
MetroCorp Bancshares, Inc.	$83,034	13.67%	$48,577	8.00%	$ N/A	N/A%
MetroBank, N.A.	78,446	12.92	48,576	8.00	60,720	10.00
Tier 1 risk−based capital ratio						
MetroCorp Bancshares, Inc.	75,409	12.42	24,288	4.00	N/A	N/A
MetroBank, N.A.	70,821	11.66	24,288	4.00	36,432	6.00
Leverage ratio						
MetroCorp Bancshares, Inc.	75,409	8.84	34,141	4.00	N/A	N/A
MetroBank, N.A.	70,821	8.30	34,138	4.00	42,673	5.00
As of December 31, 2002						
Total risk−based capital ratio						
MetroCorp Bancshares, Inc.	$79,237	13.97%	$45,375	8.00%	$ N/A	N/A%
MetroBank, N.A.	76,072	13.41	45,374	8.00	56,718	10.00
Tier 1 risk−based capital ratio						
MetroCorp Bancshares, Inc.	72,109	12.71	22,688	4.00	N/A	N/A
MetroBank, N.A.	68,944	12.16	22,687	4.00	34,031	6.00
Leverage ratio						
MetroCorp Bancshares, Inc.	72,108	8.58	33,627	4.00	N/A	N/A
MetroBank, N.A.	68,944	8.20	33,625	4.00	42,031	5.00

The OCC periodically examines and evaluates national banks. Based upon such an examination, the OCC may revalue the assets of the institution and require that it charge−off certain assets, establish specific reserves to compensate for the difference between the OCC−determined value and the book value of such assets or take other regulatory action designed to lessen the risk in the asset portfolio. The OCC is currently conducting its annual examination of the Bank and while no such actions have been taken by the OCC, no assurance can be provided that such actions will not occur in the future.

12. Off−Balance Sheet Risk

The Bank is 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 various guarantees, commitments to extend credit and standby letters of credit. Additionally, these instruments may involve, to varying degrees, credit risk in excess of the amount recognized in the statement of financial condition. The Bank's maximum exposure to credit loss under such arrangements is represented by the contractual amount of those instruments. The Bank applies the same credit policies and collateralization guidelines in making commitments and conditional obligations as it does for on−balance sheet instruments. Commitments to extend credit at December 31, 2003 and 2002 aggregated approximately $102.6 million and $85.4 million,

respectively. Commitments under letters of credit at December 31, 2003 and 2002 totaled $14.9 million and $10.4 million, respectively.

The contractual amount of the Company's financial instruments with off−balance sheet risk expiring by period at December 31, 2003 is presented below:

	Within One Year	After One but Within Three Years	Total
	(Dollars in thousands)		
Unfunded loan commitments including unfunded lines of credit	$ 87,706	$ —	$ 87,706
Standby letters of credit	7,215	115	7,330
Commercial letters of credit	7,527	—	7,527
Total financial instruments with off−balance sheet risk	$ 102,448	$ 115	$ 102,563

13. Fair Value of Financial Instruments

SFAS No. 107, *Disclosures About Fair Value of Financial Instruments*, requires disclosures of estimated fair values for all financial instruments and the methods and assumptions used by management to estimate the fair value for each type of financial instrument. The fair value of a financial instrument is the current amount that would be exchanged between willing parties other than in a forced liquidation. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments.

In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. SFAS No. 107 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company.

The following summary presents the methodologies and assumptions used to estimate the fair value of the Company's financial instruments, required to be valued pursuant to SFAS No. 107:

Assets for Which Fair Value Approximates Carrying Value

The fair values of certain financial assets and liabilities carried at cost, including cash and due from banks, deposits with banks, federal funds sold, due from customers on acceptances and accrued interest receivable, are considered to approximate their respective carrying values due to their short−term nature and negligible credit losses.

Investment Securities

Fair values are based upon publicly quoted market prices. See Note 3 in "Notes to Consolidated Financial Statements."

Loans

The fair value of loans originated by the Bank is estimated by discounting the expected future cash flows using a discount rate commensurate with the risks involved. The loan portfolio is segregated into groups of loans with homogeneous characteristics and expected future cash flows and interest rates reflecting appropriate credit risk are determined for each group. An estimate of future credit losses based on historical

experience is factored into the discounted cash flow calculation. The estimated fair value of the loan portfolio at December 31, 2003 and 2002 was $544.4 million and $519.3 million, respectively.

Liabilities for Which Fair Value Approximates Carrying Value

SFAS No. 107 requires that the fair value disclosed for deposit liabilities with no stated maturity (i.e., demand, savings, and certain money market deposits) be equal to the carrying value. SFAS No. 107 does not allow for the recognition of the inherent funding value of these instruments. The fair value of federal funds purchased, borrowed funds, acceptances outstanding, accounts payable and accrued liabilities are considered to approximate their respective carrying values due to their short−term nature.

Time Deposits

The fair values disclosed for demand deposits (e.g., interest and noninterest checking, passbook savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). The carrying amounts of variable−rate, fixed−term money market accounts and certificates of deposit (time deposits) approximate their fair values at the reporting date. Fair values for fixed−rate time deposits are estimated using a discounted cash flow calculation that applies interest rates currently being offered on time deposits to a schedule of aggregated expected monthly maturities on time deposits. The estimated fair value of time deposits at December 31, 2003 and 2002 was $364.5 million and $365.0 million, respectively.

Other Borrowings

The carrying amounts of Federal funds purchased, borrowings under repurchase agreements, and other borrowings maturing within ninety days approximate their fair values. Fair values of other borrowings are estimated using discounted cash flow analyses based on the Company’s current incremental borrowing rates for similar types of borrowing arrangements. The estimated fair value of other borrowings at December 31, 2003 and 2002 was $55.2 million and $67.3 million, respectively.

Commitments to Extend Credit and Standby Letters of Credit

The fair value of the commitments to extend credit of $102.6 million and $85.4 million is considered to approximate carrying value at December 31, 2003 and 2002, respectively.

14. Commitments and Contingencies

The Bank leases certain branch premises and equipment under operating leases which expire between 2004 through 2008 and thereafter. The Bank incurred rental expense of approximately $867,000, $859,000, and $825,000, for the years ended December 31, 2003, 2002 and 2001, respectively, under these lease

METROCORP BANCSHARES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

agreements. Future minimum lease payments at December 31, 2003 due under these lease agreements are as follows (in thousands):

Year	Amount
2004	$ 944
2005	873
2006	417
2007	354
2008	302
After 2008	1,082
	$3,972

In September 2003 a subsidiary of the Company that is no longer active, Advantage Finance Corporation ("AFC"), was served in connection with a lawsuit based on alleged "malicious prosecution" and "conspiracy". Also included in the lawsuit are BDO Seidman LLP and the CIT Group/ Commercial Services, Inc. The plaintiff has filed his case in both Federal and State courts. In December 2003 the case was dismissed from Federal court and a request for dismissal from State court is anticipated. An appeal is expected, however none has been filed to date. Management is unable to determine whether the outcome will have a material impact on the Company's financial statements. The lawsuit does not seek a specified amount.

METROCORP BANCSHARES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

15. Parent Company Financial Information

The condensed balance sheets, statements of income and statements of cash flows for MetroCorp Bancshares, Inc. (parent only) are presented below:

Condensed Balance Sheets

(In thousands, except share amounts)

	As of December 31,	
	2003	2002
Assets		
Cash and due from subsidiary bank	$ 4,954	$ 3,587
Investment in bank subsidiary	71,631	71,298
Total assets	$76,585	$74,885
Liabilities and Shareholders' Equity		
Other liabilities	$ 375	$ 422
Total liabilities	375	422
Shareholders' equity:		
Common stock, $1.00 par value, 20,000,000 shares authorized; 7,306,627 and 7,195,927 shares issued and 7,156,689 and 7,031,882 shares outstanding at December 31, 2003 and 2002, respectively	7,307	7,196
Additional paid−in−capital	27,620	26,344
Retained earnings	41,942	39,938
Net accumulated other comprehensive income from subsidiary	671	2,354
Treasury stock, at cost	(1,330)	(1,369)
Total shareholders' equity	76,210	74,463
Total liabilities and shareholders' equity	$76,585	$74,885

Condensed Statement of Income

(In thousands)

	Years Ended December 31,		
	2003	2002	2001
Equity in undistributed income of subsidiary	$3,708	$8,789	$7,577
Net income	$3,708	$8,789	$7,577

METROCORP BANCSHARES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Condensed Statement of Cash Flows

(In thousands)

	Years Ended December 31,		
	2003	2002	2001
Cash flow from operating activities:			
Net income	$ 3,708	$ 8,789	$ 7,577
Equity in undistributed income of subsidiary	(2,004)	(7,104)	(5,898)
Decrease in other liabilities	—	(35)	(92)
Net cash provided by operating activities	1,704	1,650	1,587
Cash flow from investment activities:			
Investment in subsidiary	(12)	—	—
Net cash used in investing activities	(12)	—	—
Cash flow from financing activities:			
Proceeds from issuance of common stock	1,186	76	59
Proceeds from re−issuance of treasury stock	397	425	316
Payment to repurchase common stock	(212)	(349)	—
Dividends paid	(1,696)	(1,685)	(1,679)
Net cash used in financing activities	(325)	(1,533)	(1,304)
Net increase in cash and cash equivalents	1,367	117	283
Cash and cash equivalents at beginning of year	3,587	3,470	3,187
Cash and cash equivalents at end of year	$ 4,954	$ 3,587	$ 3,470
Dividends declared but not paid	$ 429	$ 422	$ 421

16. Related Party Transactions

In the ordinary course of business, the Bank enters into transactions with its and the Company's officers and directors and their affiliates. It is the Bank's policy that all transactions with these parties are on the same terms, including interest rates and collateral requirements on loans, as those prevailing at the same time for comparable transactions with unrelated parties. At December 31, 2003 and 2002, certain of these officers and directors and their affiliated companies were indebted to the Bank in the aggregate amounts of approximately $2.5 million and $2.6 million, respectively.

The following is an analysis of activity for the years ended December 31, 2003 and 2002 for such amounts (in thousands):

	2003	2002
Balance at January 1,	$ 2,635	$ 4,846
New loans and advances	1,790	1,190
Repayments	(1,893)	(3,401)
Balance at December 31,	$ 2,532	$ 2,635

In addition, as of December 31, 2003 and 2002, the Bank held demand and other deposits for related parties of approximately $4.5 million and $6.8 million, respectively.

METROCORP BANCSHARES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

New Era Life Insurance Company is the agency used by the Company for the insurance coverage the Company provides to employees of the Company and the Bank and their dependents. The insurance coverage consists of medical, dental, life, accidental death and dismemberment and long−term disability insurance. The Company's Chairman is a principal shareholder in New Era Life Insurance Company. The Company paid New Era Life Insurance Company $1.4 million and $1.2 million for such insurance coverage for the years ended December 31, 2003 and 2002, respectively.

In addition to the insurance transactions, the Bank has two commercial real estate loan participations with New Era Life Insurance Company. These loans were originated and are being serviced by the Bank. Both loans are contractually current on their payments. The following is an analysis of these loans as of December 31, 2003 and 2002, respectively (in thousands):

	2003	2002
Gross balance	$ 5,268	$ 7,558
Less: participation portion sold to New Era Life Insurance Co.	(1,040)	(2,310)
Net balance outstanding	$ 4,228	$ 5,248

The loans have interest rates which float with the prime rate and mature in May 2005 and October 2008. The percent of the participation portions sold to New Era Life Insurance Company varies from 8.29% to 50.00%.

Guamnitz, Inc. owns the building in which the Company's corporate headquarters and the Bank's Bellaire branch are located and has entered into lease agreements for these locations with the Company. A Company director is Chairman of the Board and the controlling shareholder of Gaumnitz, Inc. The lease covering the Company's headquarters commenced on February 1, 2001 at a net rent of $34,787 per month. The lease covering the Bank's Bellaire branch commenced on January 1, 2003 at a net rent of $10,853 per month. For these respective lease agreements, the Company paid Gaumnitz, Inc. $511,000 and $441,000 during the years ended December 31, 2003 and 2002, respectively.

17. Earnings Per Share

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

	Years Ended December 31,		
	2003	2002	2001
Net income	$3,708	$8,789	$7,577
Weighted average common shares in basic EPS	7,089	7,024	6,998
Effects of dilutive securities: Options	124	130	61
Weighted average common and potentially dilutive common shares used in diluted EPS	7,213	7,154	7,059
Earnings per common share:			
Basic	$ 0.52	$ 1.25	$ 1.08
Diluted	$ 0.51	$ 1.23	$ 1.07

18. Supplemental Statement of Cash Flow Information:

	Years Ended December 31,		
	2003	2002	2001
		(In thousands)	
Cash payments during the year for:			
Interest	$12,284	$14,774	$24,752
Income taxes	2,000	4,510	4,337
Noncash investing and financing activities:			
Dividends declared not paid	429	422	421
Foreclosed assets acquired	4,583	1,464	1,461
Loans to facilitate the sale of foreclosed assets	300	325	106
Transfer of held−to−maturity securities to available−for−sale	—	—	31,743

19. Stock Options

The Company has outstanding options issued to five of the six founding directors of the Bank to purchase an aggregate of 100,000 shares of Common Stock pursuant to the 1998 Director Stock Option Agreement (“Found Director Plan”). Pursuant to the Founding Director Plan, each of the five participants was granted non−qualified options to purchase 20,000 shares of Common Stock at a price of $11.00 per share. A total of 20,000 options which were initially granted to one of the founding directors were cancelled upon his resignation as a director. Of the six founding directors of the Bank, the five participants (Tommy F. Chen, May P. Chu, John Lee, David Tai, and Don J. Wang) currently serve as directors of the Company and the Bank. The options expired on July 24, 2003 and the participants exercised their options prior to expiration.

The Company’s 1998 Stock Incentive Plan (“Incentive Plan”) authorizes the issuance of up to 700,000 shares of Common Stock under both “non−qualified” and “incentive” stock options and performance shares of Common Stock. Non−qualified options and incentive stock options will be granted at no less than the fair market value of the Common Stock and must be exercised within ten years. Performance shares are certificates representing the right to acquire shares of Common Stock upon the satisfaction of performance goals established by the Company. Holders of performance shares have all of the voting, dividend and other rights of shareholders of the Company, subject to the terms of the award agreement relating to such shares. If the performance goals are achieved, the performance shares will vest and may be exchanged for shares of Common Stock. If the performance goals are not achieved, the performance shares may be forfeited. In 2003, there were options granted to acquire 22,500 shares of common stock. As of December 31, 2003, there are options to acquire 212,000 shares of common stock outstanding under the Incentive Plan. No performance shares have been awarded under the Incentive Plan.

The options granted during 2001 and 2003 under the Incentive Plan vest 30% in each of the two years following the date of the grant and 40% in the third year following the date of the grant and have contractual terms of seven years. The options granted in 2002 under the Incentive Plan vest at 20% per year. All options are granted at a fixed exercise price. The exercise price for the options granted under the Incentive Plan is the fair market value of the Company’s common stock on the grant date, which was $7.25 for the options granted in 2001, and a weighted average of $11.30 for the options granted in 2002 and a weighted average of $13.05 for the options granted in 2003. Any excess of the fair market value on the grant date over the exercise price is recognized as compensation expense in the accompanying financial statements. There was no compensation expense under any of the plans for the years ended December 31, 2003, 2002 or 2001.

METROCORP BANCSHARES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

A summary of the status of the Company's stock options granted to employees as of December 31, 2003, 2002 and 2001 and the changes during the years ended on these dates is presented below:

	2003		2002		2001	
	# Shares of Underlying Options	Weighted Average Exercise Prices	# Shares of Underlying Options	Weighted Average Exercise Prices	# Shares of Underlying Options	Weighted Average Exercise Prices
Outstanding at beginning of the year	300,200	$10.81	300,000	$10.78	150,700	$10.03
Granted	22,500	13.07	1,100	13.05	163,900	11.30
Exercised	(110,700)	10.71	(900)	8.31	(2,760)	8.31
Canceled	—	—	—	—	(11,840)	8.31
Outstanding at end of the year	212,000	$11.10	300,200	$10.81	300,000	$10.78
Exercisable at end of the year	92,500	$10.40	165,200	$10.51	131,400	$10.33
Weighted average fair value of all options granted	$ 2.56		$ 2.53		$ 4.65	

The fair value of each stock option granted is estimated on the date of grant using the Black−Scholes option−pricing model with the following weighted−average assumptions:

Assumptions	2003	2002	2001
Expected term	3 years	3 years	5 years
Expected volatility	19.00%	20.00%	30.00%
Expected dividend	$ 0.24	$ 0.24	$ 0.24
Risk−free interest rate	2.28%	1.99%	5.30%

The following table summarizes information about stock options outstanding at December 31, 2003:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding at 12/31/03	Weighted Average Exercise Price	Wgtd. Avg. Remaining Contractual Life	Number Outstanding at 12/31/03	Weighted Average Exercise Price
$7.25−$8.31	24,500	$ 8.0089	2.71 years	24,500	$ 8.0089
$10.50−$13.10	187,500	$ 11.5037	7.66 years	68,000	$ 11.2674

EXHIBIT INDEX

Exhibit Number	Description
3.1	Amended and Restated Articles of Incorporation of the Company (incorporated herein by reference to Exhibit 3.1 to the Company's Registration Statement on Form S−1 (Registration No. 333−62667) (the "Registration Statement")).
3.2	Amended and Restated Bylaws of the Company (incorporated herein by reference to Exhibit 3.2 to the Registration Statement).
4	Specimen form of certificate evidencing the Common Stock (incorporated herein by reference to Exhibit 4 to the Registration Statement).
10.1	Agreement and Plan of Reorganization by and among MetroCorp Bancshares, Inc., MC Bancshares of Delaware, Inc. and MetroBank, N.A. (incorporated herein by reference to Exhibit 10.1 to the Registration Statement).
10.2†	Form of Director Stock Option Agreement (incorporated herein by reference to Exhibit 10.2 to the Registration Statement).
10.3†	MetroCorp Bancshares, Inc. Non−Employee Director Stock Bonus Plan (incorporated herein by reference to Exhibit 10.3 to the Registration Statement).
10.4	MetroCorp Bancshares, Inc. 1998 Employee Stock Purchase Plan (incorporated herein by reference to Exhibit 10.4 to the Registration Statement).
10.5†	MetroCorp Bancshares, Inc. 1998 Stock Incentive Plan (incorporated herein by reference to Exhibit 10.5 to the Registration Statement).
10.6†	First Amendment to the MetroCorp Bancshares, Inc. 1998 Employee Stock Purchase Plan (incorporated herein by reference to Exhibit 10.6 to the Company's Annual Report on Form 10−K for the year ended December 31, 1998).
10.7†	First Amendment to the MetroCorp Bancshares, Inc. Non−Employee Director Stock Bonus Plan (incorporated herein by reference to Exhibit 4.5 to the Company's Registration Statement on Form S−8 (Registration Number 333−94327)).
10.8†	Second Amendment to the MetroCorp Bancshares, Inc. Non−Employee Director Stock Bonus Plan (incorporated herein by reference to Exhibit 4.6 to the Company's Registration Statement on Form S−8 (Registration Number 333−94327)).
10.9†	Employment Agreement between MetroCorp Bancshares, Inc. and Allen D. Brown (incorporated herein by reference to Exhibit 10.9 to the Company's Annual Report on Form 10−K for the year ended December 31, 2003).
21	Subsidiaries of MetroCorp Bancshares, Inc. (incorporated herein by reference to Exhibit 21 to the Registration Statement).
23.1*	Consent of PricewaterhouseCoopers LLP.
23.2*	Consent of Deloitte & Touche LLP
31.1*	Certification of the President pursuant to Rule 13a−14(a) of the Securities Exchange Act of 1934, as amended.
31.2*	Certification of the Chief Financial Officer pursuant to Rule 13a−14(a) of the Securities Exchange Act of 1934, as amended.
32.1*	Certification of President pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes−Oxley Act of 2002.
32.2*	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002.

* Filed herewith.

† Management contract or compensatory plan or arrangement.

Exhibit 23.1

We hereby consent to the incorporation by reference in the Registration Statement on Form S−3 (File No. 333−33730) and in the Registration Statements on Form S−8 (File Nos. 333−75487, 333−91589, 333−94327, and 333−100515) of MetroCorp Bancshares, Inc. of our report dated March 12, 2004 relating to the consolidated financial statements, which appear in this Form 10−K.

/s/ PricewaterhouseCoopers LLP

Houston, Texas
March 17, 2004

Exhibit 23.2

We consent to the incorporation by reference in Registration Statement No. 333−75487, 333−91589, 333−94327 and 333−100515 of MetroCorp Bancshares, Inc. on Form S−8 and Registration Statement No. 333−33730 of MetroCorp Bancshares, Inc. on form S−3 of our report dated March 20, 2002, appearing in this Annual Report on Form 10−K of MetroCorp Bancshares, Inc. for the year ended December 31, 2003.

/s/ Deloitte & Touche LLP

Houston, Texas
March 17, 2004

Exhibit 31.1

Certification Pursuant to Section 302
Of the Sarbanes−Oxley Act of 2002

I, Allen D. Brown, certify that:

1. I have reviewed this annual report on Form 10−K of MetroCorp Bancshares, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a−15(e) and 15d−15(e)) for the registrant and have:

   a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 17, 2004

/s/ Allen D. Brown

Allen D. Brown
President

Exhibit 31.2

Certification Pursuant to Section 302
Of the Sarbanes−Oxley Act of 2002

I, David D. Rinehart, certify that:

1. I have reviewed this annual report on Form 10−K of MetroCorp Bancshares, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a−15(e) and 15d−15(e)) for the registrant and have:

   a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 17, 2004

/s/ David D. Rinehart

David D. Rinehart
Executive Vice President and
Chief Financial Officer

Exhibit 32.1

Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes−Oxley Act of 2002

In connection with the annual report of MetroCorp Bancshares, Inc. (the "Company") on Form 10−K for the period ending December 31, 2003 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Allen D. Brown, President of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes−Oxley act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and operating results of the Company.

/s/ Allen D. Brown

Allen D. Brown
President
March 17, 2004

Exhibit 32.2

Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes−Oxley Act of 2002

In connection with the annual report of MetroCorp Bancshares, Inc. (the "Company") on Form 10−K for the period ending December 31, 2003 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, David D. Rinehart, Executive Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes−Oxley act of 2002, that:

3. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

4. The information contained in the Report fairly presents, in all material respects, the financial condition and operating results of the Company.

/s/ David D. Rinehart

David D. Rinehart
Executive Vice President and
Chief Financial Officer
March 17, 2004

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