SUSSEX BANCORP
Form 10QSB
August 06, 2003

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

FORM 10-QSB

(Mark One)

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

For the quarterly period ended June 30, 2003

or

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

For the transition period from __________________ to ___________________

Commission file number 0-29030

SUSSEX BANCORP.
(Exact name of registrant as specified in its charter)

New Jersey	22-3475473
(State of other jurisdiction of incorporation or organization)	(I. R. S. Employer Identification No.)
399 Route 23, Franklin, New Jersey	07416
(Address of principal executive offices)	(Zip Code)

Issuer's telephone number, including area code) (973) 827-2914

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities and 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 |X| No |_|

As of August 6, 2003 there were 1,701,217 shares of common stock, no par value, outstanding.

SUSSEX BANCORP
FORM 10-QSB

INDEX

Part I - Financial Information Page(s)

Item 1. Financial Statements and Notes to Consolidated Financial Statements (Unaudited) 3

Item 2.	Management's Discussion and Analysis of Results of Operations and Financial Condition	9
Item 3.	Controls and Procedures	14
Part II - Other Information		
Item 1.	Legal Proceedings	14
Item 2.	Changes in Securities	14
Item 3.	Defaults Upon Senior Securities	14
Item 4.	Submission of Matters to a Vote of Security Holders	14
Item 5.	Other Information	15
Item 6.	Exhibits and Reports on Form 8-K	15
Signatures		15
Exhibits		15

PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

SUSSEX BANCORP
CONSOLIDATED BALANCE SHEETS
(In Thousands, Except Share Data)
(Unaudited)

ASSETS	June 30, 2003	Decembe
Cash and due from banks	$ 12,238	
Federal funds sold	9,140	
Cash and cash equivalents	21,378	
Interest bearing time deposits with other banks	3,500	
Securities available for sale	74,709	
Federal Home Loan Bank Stock, at cost	760	
Loans receivable, net of unearned income	125,702	
Less: allowance for loan losses	1,590	
Net loans receivable	124,112	
Premises and equipment, net	4,469	
Accrued interest receivable	1,208	
Goodwill	1,932	
Other assets	3,331	

Total Assets	$235,399
LIABILITIES AND STOCKHOLDERS' EQUITY	
Liabilities:	
Deposits:	
Non-interest bearing demand	$ 32,317
Savings and interest bearing demand	115,332
Time of less than $100,000	43,038
Time of $100,000 and over	9,740
Total Deposits	200,427
Borrowings	13,000
Accrued interest payable and other liabilities	2,546
Mandatory redeemable capital debentures	5,000
Total Liabilities	220,973
Stockholders' Equity:	
Common stock, no par value, authorized 5,000,000 shares; issued and outstanding 1,699,981 in 2003 and 1,688,130 in 2002	7,978
Retained earnings	5,685
Accumulated other comprehensive income	763
Total Stockholders' Equity	14,426
Total Liabilities and Stockholders' Equity	$235,399

See Notes to Consolidated Financial Statements

-3-

SUSSEX BANCORP
CONSOLIDATED STATEMENTS OF INCOME
(In Thousands Except Share Data)
(Unaudited)

	Three Months Ended June 30,	
	2003	2002
INTEREST INCOME		
Loans receivable, including fees	$2,033	$1,900
Securities:		
Taxable	445	499
Tax-exempt	169	116
Federal funds sold	36	112
Interest bearing deposits	12	33
Total Interest Income	2,695	2,660

INTEREST EXPENSE		
Deposits	535	710
Borrowings	146	125
Mandatory redeemable capital debentures	63	--
Total Interest Expense	744	835
Net Interest Income	1,951	1,825
Provision for Loan Losses	120	75
Net Interest Income after Provision for Loan Losses	1,831	1,750
NON-INTEREST INCOME		
Service fees on deposit accounts	189	174
ATM fees	90	65
Insurance commissions and fees	523	434
Investment brokerage fees	75	76
Net gain on sale of loans held for sale	24	6
Net gain on sale of other real estate owned	63	--
Other	58	77
Total Non-Interest Income	1,022	832
NON-INTEREST EXPENSE		
Salaries and employee benefits	1,341	1,138
Occupancy, net	149	149
Furniture and equipment	195	214
Stationary and supplies	50	41
Audit and exams	27	30
Advertising and promotion	94	131
Postage and freight	46	38
Amortization of intangible assets	39	32
Other	425	334
Total Non-Interest Expense	2,366	2,107
Income before Income Taxes	487	475
Provision for Income Taxes	127	144
Net Income	$ 360	$ 331
Earnings per share		
Basic	$ 0.21	$ 0.20
Diluted	$ 0.21	$ 0.19

See Notes to Consolidated Financial Statements

SUSSEX BANCORP
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
Six Months Ended June 30, 2003 and 2002
(Unaudited)

	Number of Shares Outstanding	Common Stock	Retained Earnings	Accum Compreh
	(Dollars in thousands, except p			
Balance December 31, 2001	1,659,057	$7,732	$4,509	
Comprehensive income:				
Net income	--	--	562	
Change in unrealized gains (losses) on securities available for sale	--	--	--	
Total Comprehensive Income				
Treasury shares purchased	(10,052)	--	--	
Issuance of common stock and exercise of stock options	4,090	25	--	
Issuance of common stock through dividend reinvestment plan	6,455	60	--	
Dividends on common stock ($.12 per share)	--	--	(200)	
Balance June 30, 2002	1,659,550	$7,817	$4,871	
Balance December 31, 2002	1,688,130	$7,869	$5,249	
Comprehensive income:				
Net income	--	--	673	
Change in unrealized gains (losses) on securities available for sale	--	--	--	
Total Comprehensive Income				
Treasury shares purchased	(2,400)	--	--	
Treasury shares retired	--	(25)	--	
Issuance of common stock and exercise of stock options	5,186	40	--	
Shares issued through dividend reinvestment plan	9,065	94	--	
Dividends on common stock ($.14 per share)	--	--	(237)	
Balance March 31, 2003	1,699,981	$7,978	$5,685	

See Notes to Consolidated Financial Statements

SUSSEX BANCORP
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands)
(Unaudited)

	Six Months
	2003
	(In T
Cash Flows from Operating Activities	
Net income	$ 673
Adjustments to reconcile net income to net cash provided by operating activities:	
Provision for loan losses	245
Provision for depreciation and amortization	264
Net amortization of securities premiums and discounts	580
Net realized gain on sale of foreclosed real estate	(63)
Proceeds from sale of loans	668
Net gains on sale of loans	(24)
Loans originated for sale	(644)
Earnings on investment in life insurance	(25)
(Increase) decrease in assets:	
Accrued interest receivable	(64)
Other assets	(445)
Increase (decrease) in accrued interest payable and other liabilities	180
Net Cash Provided by Operating Activities	1,345
Cash Flows from Investing Activities	
Securities available for sale:	
Purchases	(29,513)
Maturities, calls and principal repayments	27,279
Net (increase) decrease in loans	(12,511)
Purchases of bank premises and equipment	(99)
(Purchase) redemption of FHLB stock	(10)
Proceeds from sale of foreclosed real estate	250
Decrease (increase) in interest bearing time deposits with other banks	100
Net Cash Used in Investing Activities	(14,504)
Cash Flows from Financing Activities	
Net increase in deposits	10,569
Repayment of borrowings	(2,000)
Proceeds from the issuance of common stock	40
Purchase of treasury stock	(25)
Dividends paid, net of reinvestments	(143)
Net Cash Provided by Financing Activities	8,441
Net (Decrease) Increase in Cash and Cash Equivalents	(4,718)

Cash and Cash Equivalents - Beginning	26,096
Cash and Cash Equivalents - Ending	$ 21,378
Supplementary Cash Flows Information	
Interest paid	$ 1,549
Income taxes paid	$ 434
Supplementary Schedule of Noncash Investing and Financing Activities	
Other real estate acquired in settlement of loans	$ 223

See Notes to Consolidated Financial Statements

SUSSEX BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. Basis of Presentation

The consolidated financial statements include the accounts of Sussex Bancorp (the "Company") and its wholly-owned subsidiaries, Sussex Bank (the "Bank") and Sussex Capital Trust I. The Bank's wholly-owned subsidiaries are Sussex Bancorp Mortgage Company, Inc., SCB Investment Company, Inc., and Tri-State Insurance Agency, Inc. All inter-company transactions and balances have been eliminated in consolidation. The Bank operates eight banking offices all located in Sussex County, New Jersey and is the parent of Tri-State Insurance Agency, Inc., ("Tri-State") a full service insurance agency located in Sussex County, New Jersey. The Company is subject to the supervision and regulation of the Board of Governors of the Federal Reserve System (the "FRB"). The Bank's deposits are insured by the Bank Insurance Fund ("BIF") of the Federal Deposit Insurance Corporation ("FDIC") up to applicable limits. The operations of the Company and the Bank are subject to the supervision and regulation of the FRB, FDIC and the New Jersey Department of Banking and Insurance (the "Department") and the operations of Tri-State are subject to the supervision and regulation by the Department.

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for full year financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included and are of a normal, recurring nature. Operating results for the six-month period ended June 30, 2003, are not necessarily indicative of the results that may be expected for the year ended December 31, 2003. These consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto that are included in the Company's Annual Report on Form 10-KSB for the fiscal period ended December 31, 2002.

2. Net Income Per Common Share

Basic net income per share of common stock is calculated by dividing net income by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share reflects additional common shares

that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance of potential common shares that may be issued by the Company relating to outstanding stock options and guaranteed and contingently issuable shares from the acquisition of Tri-State. Potential common shares related to stock options are determined using the treasury stock method.

The following table sets forth the computations of basic and diluted earnings per share (dollars in thousands, except per share data):

	Three Months Ended June 30, 2003		
	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic earnings per share:			
Net income applicable to common stockholders	$ 360	1,699	$ 0.21
Effect of dilutive securities:			
Stock options	--	18	
Deferred common stock payments for purchase of insurance agency	2	38	
Diluted earnings per share:			
Net income applicable to common stock-holders and assumed conversions	$ 362	1,755	$ 0.21

	Six Months Ended June 30, 2003		
	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic earnings per share:			
Net income applicable to common stockholders	$ 673	1,696	$ 0.40
Effect of dilutive securities:			
Stock options	--	16	
Deferred common stock payments for purchase of insurance agency	5	38	
Diluted earnings per share:			
Net income applicable to common stock-holders and assumed conversions	$ 678	1,750	$ 0.39

3. Comprehensive Income

The components of other comprehensive income and related tax effects for the three and six months ended June 30, 2003 and 2002 are as follows:

	Three Months Ended June	
	2003	20
	(in Thousands)	
Unrealized holding gains on available for sale securities	$ 622	$
Less: reclassification adjustments for gains included in net income	--	
Net unrealized gains	622	
Tax effect	249	
Other comprehensive income, net of tax	$ 373	$

4. Segment Information

The Company's insurance agency operations are managed separately from the traditional banking and related financial services that the Company also offers. The insurance agency operation provides commercial, individual, and group benefit plans and personal coverage.

	Three Months Ended June 30, 2003			Thre
	Banking and Financial Services	Insurance Services	Total	Ban Financial
	(In Thousands)			
Revenues from external sources	$3,194	$ 523	$3,717	
Income before income taxes	408	79	487	

	Six Months Ended June 30, 2003			Six
	Banking and Financial Services	Insurance Services	Total	Ban Financial
	(In Thousands)			
Revenues from external sources	$6,310	$1,087	$7,397	
Income before income taxes	754	159	913	

5. Stock Option Plans

The Company accounts for stock option plans under the recognition and measurement principles of APB Opinion No. 25. "Accounting for Stock Issued to Employees," and related interpretations. No stock-based employee compensation cost is reflected in net income, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income and

earnings per share if the Company had applied the fair value recognition provisions of FASB Statement No. 123, "Accounting for Stock-Based Compensation," to stock-based compensation for the periods presented:

	Three Months Ended June 3	
	2003	2002
	(In Thousands)	
Net income, as reported	$ 360	$ 331
Total stock-based compensation expense determined under fair value based method for all awards, net of related tax effects	(11)	(7)
Pro forma net income	$ 349	$ 324
Basic earnings per share:		
As reported	$ 0.21	$ 0.20
Pro forma	$ 0.21	$ 0.20
Diluted earnings per share:		
As reported	$ 0.21	$ 0.19
Pro forma	$ 0.20	$ 0.19

6. Acquisition

On January 2, 2003, the Company acquired certain assets of the Garrera Insurance Agency through its subsidiary, Tri-State Insurance Agency, Inc. and hired the former principal pursuant to an employment agreement. The acquisition was accounted for using the purchase method of accounting. The entire purchase price, which was not material to the Company, was allocated to the identifiable intangible asset representing the fair value of the acquired book of business, which will be amortized over 3 years. The purchase price was based, in part, upon the future performance of the acquired book of business, with certain payments deferred until the 25th month after the closing. The value of these deferred payments will be added monthly to the value of the purchase price, increasing the identifiable intangible. The value of this intangible asset is included in Other Assets on the Company's balance sheet. The performance of the acquired book of business since January 2, 2003 is included in the accompanying consolidated financial statement.

7. New Accounting Standards

In November 2002, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 45 (FIN 45), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." This Interpretation expands the disclosures to be made by a guarantor in its financial statements about its obligations under certain guarantees and requires the guarantor to recognize a liability for the fair value of an obligation assumed under certain specified guarantees. FIN 45 clarifies the requirements of FASB Statement No. 5, "Accounting for Contingencies." In

general, FIN 45 applies to contracts or indemnification agreements that contingently require the guarantor to make payments to the guaranteed party based on changes in an underlying that is related to an asset, liability or equity security of the guaranteed party, which would include financial standby letters of credit. Certain guarantee contracts are excluded from both the disclosure and recognition requirements of this Interpretation, including, among others, guarantees related to commercial letters of credit and loan commitments. The disclosure requirements of FIN 45 require disclosure of the nature of the guarantee, the maximum potential amount of future payments that the guarantor could be required to make under the guarantee and the current amount of the liability, if any, for the guarantor's obligations under the guarantee. The accounting recognition requirements of FIN 45 are to be applied prospectively to guarantees issued or modified after December 31, 2002. Adoption of FIN 45 did not have a significant impact on the Company's financial condition or results of operations.

Outstanding letters of credit written are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for standby letters of credit is represented by the contractual amount of those instruments. The Company had $724,000 of standby letters of credit as of June 30, 2003. The Bank uses the same credit policies in making conditional obligations as it does for on-balance sheet instruments.

These standby letters of credit expire within the next twelve months. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending other loan commitments. The Company requires collateral and personal guarantees supporting these letters of credit as deemed necessary. Management believes that the proceeds obtained through a liquidation of such collateral and enforcement of personal guarantees would be sufficient to cover the maximum potential amount of future payments required under the corresponding guarantees. The current amount of the liability as of June 30, 2003 for guarantees under standby letters of credit issued after December 31, 2002 is not material.

In January 2003, the Financial Accounting Standards Board issued FAB Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51". This interpretation provides new guidance for the consolidation of variable interest entities (VIEs) and requires such entities to be consolidated by their primary beneficiaries if the entities do not effectively disperse risk among parties involved. The interpretation also adds disclosure requirements for investors that are involved with unconsolidated VIEs. The disclosure requirements apply to all financial statements issued after January 31, 2003. The consolidation requirements apply immediately to VIEs created after January 31, 2003 and are effective for the first fiscal year or interim period beginning after June15, 2003 for VIEs acquired before February 1, 2003. The adoption of this interpretation did not have a significant impact on the Company's financial condition of results of operations.

In April 2003, the Financial Accounting Standards Board (FASB) issued Statement No. 149, "Amendment of Statement No. 133, Accounting for Derivative Instruments and Hedging Activities". This statement clarifies the definition of a derivative and incorporates certain decisions made by the board as part of the Derivatives Implementation Group process. This Statement is effective for contracts entered into or modified and for hedging relationships designated after June 30, 2003, and should be applied prospectively. The provisions of the statement that relate to implementation issues addressed by the Derivatives Implementation Group that have been effective should continue to be applied in accordance with their respective dates. Adoption of this standard is not expected to have a significant impact on the Company's financial condition or results of operations.

In May 2003, the Financial Accounting Standards Board issued Statement No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." This Statement requires that an issuer classify a financial instrument that is within its scope as a liability. Many of these instruments were previously classified as equity. This Statement was effective for financial instruments entered into or modified after May 31, 2003 and otherwise was effective beginning July 1, 2003. The adoption of this standard did not have a significant impact on the Company's financial condition or results of operations.

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

RESULTS OF OPERATIONS

Three and Six Months ended June 30, 2003 and June 30, 2002

CRITICAL ACCOUNTING POLICIES

Disclosure of the Company's significant accounting policies is included in Note 1 to the consolidated financial statements of the Company's Annual Report on Form 10-KSB for the year ended December 31, 2002. Some of these policies are particularly sensitive, requiring significant judgments, estimates and assumptions to be made by management, most particularly in connection with determining the provision for loan losses and the appropriate level of the allowance for loan losses. Additional information is contained on pages 11 and 13 of this Form 10-QSB for the provision and allowance for loan losses.

FORWARD LOOKING STATEMENTS

When used in this discussion, the words "believes", "anticipates", "contemplated", "expects", or similar expressions are intended to identify forward looking statements. Such statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those projected. Those risks and uncertainties include changes in interest rates, the ability to control costs and expenses, and general economic conditions. The Company undertakes no obligation to publicly release the results of any revisions to those forward looking statements that may be made to reflect events or circumstances after this date or to reflect the occurrence of unanticipated events.

OVERVIEW

The Company realized net income of $360 thousand for the second quarter of 2003, an increase of $29 thousand from the $331 thousand reported for the same period in 2002. Basic earnings per share increased from $0.20 in the second quarter of 2002 to $0.21 for the second quarter of 2003. Diluted earnings per share were $0.19 in the second quarter of 2002 and increased to $0.21 in the second quarter of 2003.

For the six months ended June 30, 2003, net income was $673 thousand, an increase of $111 thousand from the $562 thousand reported for the same period in 2002. Basic earnings per share were $0.40 for the six months ended June 30, 2003 compared to $0.34 for the six-month period ended June 30, 2002. Diluted earnings

per share were $0.39 for the six months ended June 30, 2003, an increase from $0.33 from the first six months of 2002.

The results reflect a substantial decrease in interest expense due to declining market rates of interest, coupled with increases in interest income due to growth of $21.8 million in average earning assets from the first six months of 2002 to the same period this year.

RESULTS OF OPERATIONS

Interest Income. Total interest income increased $35 thousand, or 1.3%, to $2.7 million for the quarter ended June 30, 2003 from the same period in 2002. This increase was primarily attributable to an increase of $21.9 million in average second quarter interest earning assets from $190.9 million in 2002 to $212.8 million in 2003, while the average yield declined 46 basis points, on a fully taxable equivalent basis, from 5.67% during the second quarter of 2002 to 5.21% in the second quarter of 2003. Although the average rate earned on investment securities declined by 133 basis points, the average balance increased by $21.7 million, or 40.9%, to $74.7 million in the second quarter of 2003 and resulted in a $25 thousand increase to interest income, on a fully taxable equivalent basis, for the same period. Similarly, while the average rate earned in the loan portfolio decreased 50 basis points to 6.65% for the second quarter of 2003 from 7.15% in the second quarter of 2002, the average loan balance increased 15.5% from $106.1 million to $122.6 million from second quarter 2002 to second quarter 2003 and the interest income earned on the loan portfolio increased $140 thousand. The interest earned on other interest bearing assets declined $97 thousand while the average balance in other interest earning assets decreased by $16.3 million, or 51.2%, to $15.5 million from $31.8 million from the second quarter of 2002, primarily reflecting a decline in federal funds sold. The impact of volume increases in average balances on interest income exceeded the market declines in interest rates, resulting in an increase in interest income for the second quarter of 2003 compared to the second quarter if 2002.

For the six months ended June 30, 2003, interest income, on a fully taxable equivalent basis, increased $170 thousand, or 2.2%, to $5.5 million from the $5.3 million reported for the same period in 2002. During the first six months of 2003 average interest earning assets increased $21.8 million to $210.5 million from $188.8 million during the same period in 2002. The average balance in the loan portfolio increased $12.7 million, taxable securities increased $19.6 million and tax exempt securities increased $5.1 million, while the average balance of other interest-earning assets decreased $15.7 million during the first six months of 2003 over the same period in 2002. While average interest bearing asset balances increased, the continued effect of lower market rates of interest resulted in a 42 basis point decrease in the average yield on interest earning assets on a fully taxable equivalent basis from 5.71% from the first half of 2002 to 5.29% for the same period of 2003.

Interest Expense. The Company's interest expense for the second quarter of 2003 decreased $91 thousand, or 10.9% to $744 thousand from $835 thousand in the second quarter of 2002. The average balance of interest bearing liabilities increased $18.7 million, or 11.2% to $185.0 million during the second quarter of 2003 from $166.3 million in the same period of 2002. The increase in the average balance of interest bearing liabilities was more than offset by the reduction in rates, as the average cost of funds declined to 1.61% for the second quarter of 2003 from 2.01% in the second quarter of 2002. NOW deposit average balances grew $13.6 million, or 43.1%, from $31.7 million during the second quarter 2002 to $45.3 million in the second quarter of 2003. However, the interest expense on NOW deposits increased only $10 thousand from the second quarter of 2002, as the average interest rate paid decreased 14 basis points from 0.75% to 0.61% during the same period. Average savings deposits increased $2.8 million, or 4.5%, while the average rate paid declined 45 basis points from 1.31% in the second quarter

of 2002 to 0.86% in the second quarter of 2003. The average balance in time deposits decreased $6.0 million, or 10.1% in the second quarter of 2003 compared to the same period in 2002 as the interest expense on time deposits declined $121 thousand, or 37.8% to $320 thousand between the same two periods. The increase in NOW and savings account average balances and the decline in time deposit average balances reflects management's continued efforts to reposition the Company's deposit portfolio away from higher cost deposits through an ongoing marketing promotion for transaction accounts and other low cost deposits. Average borrowed funds and capital debenture balances increased to $18.3 million in the second quarter of 2003 from $10 million in the second quarter of 2002. In the third quarter of 2002, the Company entered into several short-term FHLB advances and issued $5 million in mandatory redeemable capital debentures that were not present during the second quarter of 2002. The capital debentures bear a floating rate of interest, which averaged 4.98% in the second quarter of 2003, and the related interest expense was $63 thousand for the quarter ended June 30, 2003.

For the six months ended June 30, 2003 interest expense decreased $272 thousand, or 15.2%, to $1.5 million from $1.8 million for the same period last year. This decrease was largely due to a decrease in interest expense on time deposits of $324 thousand, or 32.9%, from $1.0 million for the first half of 2002 to $660 thousand during the first six months of 2003. The average balance in time deposit accounts decreased $5.8 million, or 9.9%, over the same six-month periods, as higher costing time deposits have matured and management has elected not to compete for these deposits solely on the basis of rate. The Company has shifted it's focus from attracting time deposits to attracting and retaining customers through a long term marketing promotion of lower costing NOW and savings accounts. The average balance of NOW deposits increased $12.4 million, or 39.0%, from $31.7million during the first half of 2002 to $44.1 million in the first half of 2003. Savings deposits increased $4.0 million, or 6.7%, from $59.9 million during the first six months of 2002 to $63.9 million during the same period of 2003. The Company's borrowed funds increased $3.8 million, or 37.8%, from $10.0 million during the first six months of 2002 to $13.8 million for the first half of 2003. The issuance of $5 million in capital debentures during July of 2002, which bore an average rate of 5.01% during the first six months of 2003, increased the Company's interest expense by $126 thousand during the first six months of 2003. The average rate paid on total interest bearing liabilities decreased 53 basis points from 2.19% in the first six months of 2002 to 1.66% during the same period in 2003. This decrease in the average cost of funds was the combination of the Company decreasing its rates of interest paid on interest bearing deposits due to the decline in market rates and the Company's strategy of attracting lower cost deposits.

The following table presents, on a fully taxable equivalent basis, a summary of the Company's interest-earning assets and their average yields, and interest-bearing liabilities and their average costs and shareholders' equity for the six months ended June 30, 2003 and 2002. The average balance of loans includes non-accrual loans, and associated yields include loan fees, which are considered adjustment to yields.

		Six Months Ende
(dollars in thousands)	2003	
	Average	Average Av

Earning Assets:	Balance	Interest(1)	Rate(2)	Ba
Securities:				
Tax exempt(3)	$ 16,191	$ 474	5.90%	$
Taxable	58,475	968	3.34%	
Total securities	74,666	1,442	3.89%	
Taxable loans: (net of unearned income)				
Mortgage and construction	72,110	2,495	6.98%	
Commercial	16,590	473	5.75%	
Consumer	30,122	1,003	6.71%	
Total loans receivable(4)	118,822	3,971	6.74%	1
Other interest-earning assets	17,029	106	1.26%	
Total earning assets	210,517	$ 5,519	5.29%	1
Non-interest earning assets	21,191			
Allowance for loan losses	(1,472)			
Total Assets	$ 230,236			$ 2
Sources of Funds:				
Interest bearing deposits:				
NOW	$ 44,059	$ 136	0.62%	$
Money market	4,302	18	0.84%	
Savings	63,938	281	0.89%	
Time	53,264	660	2.50%	
Total interest bearing deposits	165,563	1,095	1.33%	1
Borrowed funds	13,779	295	4.26%	
Capital debentures	5,000	126	5.01%	
Total interest bearing liabilities	184,342	$ 1,516	1.66%	1
Non-interest bearing liabilities:				
Demand deposits	29,680			
Other liabilities	2,296			
Total non-interest bearing liabilities	31,976			
Stockholders' equity	13,918			
Total Liabilities and Stockholders' Equity	$ 230,236			$ 2
Net Interest Income and Margin(5)		$ 4,003	3.83%	

(1) Includes loan fee income

(2) Average rates on securities are calculated on amortized costs

(3) Full taxable equivalent basis, using a 34% effective tax rate and adjusted for "TEFRA" disallowance

(4) Loans outstanding include non-accrual loans

(5) Represents the difference between interest earned and interest paid,

divided by average total interest-earning assets

Net-Interest Income. On a fully taxable equivalent basis, the net interest income for the second quarter of 2003 increased $159 thousand over the same period last year. This increase was the result of the increased volume of earning assets exceeding the increased volume of interest bearing liabilities. However, the net interest margin decreased, on a fully taxable equivalent basis, by 10 basis points to 3.81% in the second quarter of 2003 compared to 3.91% the year earlier due to the average rate earned on total earning assets declining 46 basis points compared to the average rate paid on total interest bearing liabilities declining only 40 basis points.

Net interest income for the six months ended June 30, 2003 increased $442 thousand, or 12.4%, over the same period last year. The net interest margin increased, on a fully taxable equivalent basis, 3 basis points from 3.80% for the first six months of 2002 to 3.83% for the first half of 2003. Comparing the first six months of 2002 to the first six months of 2003, the average rate paid on interest bearing liabilities repriced faster and lower than the average rate earned on interest earning assets.

Provision for Loan Losses. For the three months ended June 30, 2003 the provision for loan losses was $120 thousand compared to $75 thousand for the second quarter ended June 30, 2002. The provision for loan losses was $245 thousand for the six months ended June 30, 2003 as compared to $150 thousand for the same period last year. The provision for loan losses reflects management's judgment concerning the risks inherent in the Company's existing loan portfolio and the size of the allowance necessary to absorb the risks, as well as the average balance of the portfolio over both periods. Management reviews the adequacy of its allowance on an ongoing basis and will provide for additional provisions, as management may deem necessary. The Company's loan portfolio has shifted from loans secured by residential properties toward loans secured by non-residential properties from year-end 2002 to June 30, 2003. As commercial loans may be deemed more risky than residential lending, the Company allocated additional provisions to the allowance during the first six months of 2003.

-11-

Non-Interest Income. For the second quarter of 2003, total non-interest income increased $190 thousand, or 22.8%, from the same period in 2002. In the second quarter of 2003 insurance commissions and fees increased $89 thousand, or 20.5%, from $434 thousand reported in the second quarter of 2002 to $523 thousand for the quarter ended June 30, 2003. On January 2, 2003, the Company acquired the book of insurance business of the Garrera Insurance Agency through Tri-State. The Garrera acquisition accounted for $27 thousand of the second quarter increase and industry-wide insurance premium increases of 10% to 15% account for the balance of the increase. Service charges on deposit accounts increased $15 thousand and ATM fees increased $25 thousand for the quarter ended June 30, 2003 compared to the same period in 2002. Both of these increases are attributable to the growth in the Company's deposits. Other factors effecting non-interest income include an increase of $18 thousand in the sale of loans held for sale in the second quarter of 2003 compared to the second quarter of 2002 and a net gain on the sale of other real estate owned of $63 thousand recorded in the second quarter of 2003.

For the six months ended June 30, 2003, non-interest income increased $420 thousand, or 23.3%, from the same period in 2002. Insurance commissions and fees increased $225 thousand, a 26.1% increase over the first half of 2002. Service charges on deposit accounts increased $57 thousand, or 18.1%, and ATM fees increased $47 thousand, or 40.2%, for the six-month period ending June 30, 2003

over the same period in 2002. Mortgage banker fees, which are included in other income, increased in the first half of 2003 to $44 thousand from $14 thousand during the first six months of 2002. In the first six months of 2003, a $63 thousand gain on the sale of other real estate owned was recorded, while there were no similar gains during the first six months of 2002.

Non-Interest Expense. For the quarter ended June 30, 2003, non-interest expense increased $259 thousand from the same period last year. The Company's salaries and employee benefits increased $203 thousand, or 17.8%, from the addition of thirteen full time equivalent employees, a 12% increase in medical insurance premiums effective April 1, 2003 and $14 thousand for reinstating the funding of the Company's ESOP plan. Other non-interest expense increases from second quarter 2002 to second quarter 2003 were education and training expenses of $15 thousand due to a new Company commitment to a comprehensive employee training program which began in the fourth quarter of 2002, a $15 thousand increase in internet banking fees due to the increased activity in the Company's internet banking product and increased legal and professional fees of $28 thousand incurred in connection with the commencement of the Company's residential mortgage banking division and the sale of the Company's credit card portfolio.

For the six months ended June 30, 2003, non-interest expense increased $596 thousand, to $4.7 million, from the first six months of 2002. Salaries and employee benefits increased $398 thousand, or 17.9%, related to staff increases and increased costs associated with standard employee benefits offered by the Company. Other non-interest expense increases compared to the first six months of 2002 were professional fees increases of $75 thousand for the review of possible expansion of our insurance operations and the expensing of origination costs associated with the issuance of the Company's Trust Preferred securities and legal expenses increases of $31 thousand incurred in connection with the commencement of the Company's residential mortgage banking division and the sale of the Company's credit card portfolio. Advertising and marketing expenses decreased $67 thousand over the first six months of 2003 compared to the same period in 2002 as the Company reduced its direct mail promotion efforts, focusing its advertising of new low cost accounts to selected households.

Income Taxes. Income tax expense decreased $17 thousand to $127 thousand for the three months ended June 30, 2003 as compared to $144 thousand for the same period in 2002. This decrease in income taxes resulted from an increased level of tax-exempt income in the current quarterly period. Income taxes increased $3 thousand for the six months ended June 30, 2003 to $240 thousand as compared to $237 thousand for the six months ended June 30, 2002. The small increase in income taxes resulted from a higher level of income before income taxes in combination with an increased level of tax-exempt income.

FINANCIAL CONDITION

June 30, 2003 as compared to December 31, 2002

Total assets increased to $235.4 million at June 30, 2003, a $9.5 million increase from total assets of $225.9 million at December 31, 2002. Increases in total assets include increases of $12.0 million in net loans and $2.0 million in securities available for sale, partially offset by a $4.7 million reduction in cash and cash equivalents. Asset increases were financed through an increase in total deposits of $10.5 million from $189.9 million at year-end 2002 to $200.4 million on June 30, 2003, offset by a $2 million decrease in borrowings. Total stockholder's equity increased $746 thousand from $13.7 million at December 31, 2002 to $14.4 million at June 30, 2003.

Total loans at June 30, 2003 increased $12.3 million to $125.7 million

from $113.4 million at year-end 2002. During the six-month period ending June 30, 2003, new originations have exceeded payoffs both through scheduled maturities and prepayments. The Company continues to see high levels of prepayments as borrowers seek to refinance loans in the current low interest rate environment. The Company is emphasizing the origination of commercial, industrial, and non-residential real estate loans to increase the yield in its loan portfolio and reduce its dependence on loans secured by 1-4 family properties. The balance in non-residential real estate loans increased $12.4 million from $41.0 million at December 31, 2002 to $53.4 million on June 30, 2003 and other loans, which include loans secured by farmland, increased $3.7 million over the same six-month period. Construction and land development loans have decreased $2.5 million and residential 1-4 family real estate loans have decreased $1.0 million from December 31, 2002 to June 30, 2003. Other minor shifts in ending balances occurred between December 31, 2002 and June 30, 2003 according to loan demand.

Federal funds sold decreased by $7.8 million to $9.1 million at June 30, 2003 from $16.9 million on December 31, 2002. During the first six months of 2003, these funds were used fund loan demand and to purchase higher yielding investment securities.

Securities, available for sale, at market value, increased $2.0 million, or 2.7%, from $72.7 million at year-end 2002 to $74.7 million at June 30, 2003. The Company purchased $29.5 million in new securities in the first six months of 2003 and $27.3 million in available for sale securities matured, were called and were repaid. There was a $335 thousand increase in unrealized gains in the available for sale portfolio and $580 thousand in net amortization expenses recorded during the first six months of 2003. There were no held to maturity securities at June 30, 2003 or at December 31, 2002.

Total deposits increased $10.5 million, or 5.6%, to $200.4 million during the first six months of 2003 from $189.9 million at December 31, 2002. Non-interest bearing deposits increased $5.8 million, or 21.9%, interest-bearing and savings deposits increased $4.6 million, or 4.2% and time deposits increased $164 thousand from December 31, 2002 to June 30, 2003. Business non-interest bearing demand accounts account for $4.8 million of the growth in non-interest bearing demand accounts. Management continues to monitor the shift in deposits through its Asset/Liability Committee.

ASSET QUALITY

At June 30, 2003, non-accrual loans decreased $355 thousand to $903 thousand, as compared to $1.3 million at December 31, 2002. There were no loans ninety days past due and still accruing or renegotiated loans at June 30, 2003. Management continues to monitor the Company's asset quality and believes that the non-accrual loans are adequately collateralized and does not anticipate any material losses.

The following table provides information regarding risk elements in the loan portfolio:

	June 30, 2003	December 31, 2002
Non-accrual loans	$903,000	$ 1,258,000

Non-accrual loans to total loans	0.72%	1.11%
Non-performing assets to total assets	0.48%	0.67%
Allowance for loan losses as a % of non-performing loans	176.08%	107.11%
Allowance for possible loan losses to total loans	1.26%	1.22%

ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses is maintained at a level considered adequate to provide for potential loan losses. The level of the allowance is based on management's evaluation of potential losses in the portfolio, after consideration of risk characteristics of the loans and prevailing and anticipated economic conditions. Provisions charged to expense and reduced by charge-offs, net of recoveries, increase the allowance for loan losses. Although management strives to maintain an allowance it deems adequate, future economic changes, deterioration of borrowers' credit worthiness, and the impact of examinations by regulatory agencies all could cause changes to the Company's allowance for loan losses.

At June 30, 2003, the allowance for loan losses was $1.6 million, an increase of 14.7% from the $1.4 million at year-end 2002. There were $43 thousand in charge offs and $1 thousand in recoveries reported in the first six months of 2003. The allowance for loan losses as a percentage of total loans was 1.26% at June 30, 2003 compared to 1.22% on December 31, 2002.

INTEREST RATE SENSITIVITY

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. Interest rate sensitivity is the volatility of a company's earnings from a movement in market interest rates. Interest rate "gap" analysis is a common, though imperfect, measure of interest rate risk. We do not employ gap analysis as a rate risk management tool, but rather we rely upon an earnings at risk analysis to forecast the impact on our net interest income of instantaneous 100 and 200 basis point increases and decreases in market rates. In assessing the impact on earnings, the rate shock analysis assumes that no change occurs in our funding sources or types of assets in response to the rate change. The interest rate sensitivity of the Company's assets and liabilities, and the impact on net interest income would vary substantially if different assumptions were used or if actual experience differs from that indicated by the assumptions. The following table sets forth the Company's interest rate risk profile at June 30, 2003 and 2002.

	June 30, 2003		
(Dollars in Thousands)	Change in Net Interest Income	% Change in Net Interest Income	Cha Net I
Down 200 basis points	($154)	3.27%	(
Down 100 basis points	(33)	1.39%	
Up 100 basis points	(213)	-9.05%	
Up 200 basis points	(517)	-10.99%	

LIQUIDITY MANAGEMENT

At June 30, 2003, the amount of liquid assets remained at a level management deemed adequate to ensure that contractual liabilities, depositors' withdrawal requirements, and other operational and customer credit needs could be satisfied.

At June 30, 2003, liquid investments totaled $21.4 million, and all mature within 30 days.

It is management's intent to fund future loan demand primarily with deposits. In addition, the Bank is a member of the Federal Home Loan Bank of New York and as of June 30, 2003, had the ability to borrow up to $16.8 million against its one to four family mortgages and selected investment securities as collateral for borrowings. The Bank also has available an overnight line of credit and a one-month overnight repricing line of credit, each in the amount of $11.3 million. The Company at June 30, 2003 had borrowings totaling $13 million secured by the pledge of its one to four family mortgages and selected securities. Three short-term borrowings have maturities from July 2003 through July 2004 with interest rates ranging from 2.23% to 3.01%. The remaining $10 million in borrowings consist of three notes that mature on December 21, 2010 with a convertible quarterly option which allows the Federal Home Loan Bank to change the note to then current market rates. The interest rates on these three borrowings range from 4.77% to 5.14%.

13

CAPITAL RESOURCES

Total stockholders' equity increased $746 thousand to $14.4 million at June 30, 2003 from $13.7 million at year-end 2002. Activity in stockholder's equity consisted of a net increase in retained earnings of $436 thousand derived from $673 thousand in net income earned during the first six months of 2003, offset by $237 thousand in payments for cash dividends. Other increases were $40 thousand in stock options exercised, $94 thousand for shares issued through the dividend reinvestment plan, an unrealized gain on securities available for sale, net of income tax, of $201 thousand, partially offset by the retirement of $25 thousand in treasury stock.

On July 11, 2002, the Company raised an additional $4.8 million, net of offering costs, in capital through the issuance of junior subordinated debentures to a statutory trust subsidiary. The subsidiary in turn issued $5.0 million in variable rate capital trust pass through securities to investors in a private placement. The interest rate is based on the three-month LIBOR rate plus 365 basis points and is adjusted quarterly. Beginning July 7, 2003, the new quarterly rate of interest on the debentures will be 4.76%. The rate is capped at 12.5% through the first five years, and the securities may be called at par any time after October 7, 2007. These trust preferred securities are included in the Company's and the Bank's capital ratio calculations.

At June 30, 2003 the Company and the Bank both meet the well-capitalized regulatory standards applicable to them. The table below presents the capital ratios at June 30, 2003, for the Company and the Bank, as well as the minimum regulatory requirements.

	Amount	Ratio	Amount	Minimum Ratio

The Company:				
Leverage Capital	$15,667	6.82%	$ 9,185	4%
Tier 1 - Risk Based	15,667	11.08%	5,657	4%
Total Risk-Based	17,703	12.52%	11,314	8%
The Bank:				
Leverage Capital	15,757	6.87%	9,178	4%
Tier 1 Risk-Based	15,757	11.16%	5,646	4%
Total Risk-Based	17,347	12.29%	11,292	8%

ITEM 3 - CONTROLS AND PROCEDURES

(a) Evaluation of disclosure controls and procedures

The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-14. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are, as of the end of the period covered by this report, effective in timely alerting them to material information relating to the Company (including its consolidated subsidiaries) required to be included in the Company's periodic SEC filings.

(b) Changes in internal controls.

Not applicable

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

The Company and the Bank are periodically involved in various legal proceedings as a normal incident to their businesses. In the opinion of management, no material loss is expected from any such pending lawsuit.

Item 2. Changes in Securities

Not applicable

Item 3. Defaults Upon Served Securities

Not applicable

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

On April 23, 2003, the Registrant held its annual meeting of shareholders to elect members of the Company's Board of Directors whose terms expired. Nominees for election to the Board of Directors received the following votes:

Nominees:	For	Withhold Authority
Mark Hontz	1,245,551	116,678
Donald L. Kovach	1,342,433	19,796
Edward Leppert	1,342,488	19,742

Joel Marvil	1,339,120	23,111

Item 5. Other Information

Not applicable

Item 6. Exhibits and Report on form 8-K

(a). Exhibits

Number	Description
10	Employment Agreement between Sussex Bank and Samuel Chazanow
31.1	Certification of Donald L Kovach pursuant to Section 302 of the Sarbanes -Oxley Act of 2002
31.2	Certification of Candace Leatham pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b). Reports on Form 8-K

Filing Date	Item Number	Description
April 21, 2003	5 & 9	Press release announcing first quarter 2003 results and cash dividend.
April 24, 2003	9	Press release setting forth comments made by Chairman and Chief Executive Officer at the Registrant's 2003 Annual Meeting of Shareholders on April 23, 2003.

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

SUSSEX BANCORP

By: /s/ Candace A. Leatham

CANDACE A. LEATHAM
Executive Vice President and
Chief Financial Officer

Date: