GUARANTY FINANCIAL CORP /VA/
Form 10QSB
May 15, 2002

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

FORM 10-QSB

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

For Quarter Ended March 31, 2002

Commission File No. 0-25905

GUARANTY FINANCIAL CORPORATION

Virginia
(State or Other Jurisdiction of Incorporation or Organization)

54-1786496
(I.R.S. Employer Identification No.)

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

(434) 970-1100
(Issuer's Telephone Number, Including Area Code)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes _X_ No __

As of May 1, 2002, 1,962,777 shares of Common Stock, par value $1.25 per share, were outstanding.

GUARANTY FINANCIAL CORPORATION

QUARTERLY REPORT ON FORM 10-QSB

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Part I. Financial Information

Item 1 Financial Statements

GUARANTY FINANCIAL CORPORATION
CONSOLIDATED BALANCE SHEETS
(In Thousands)

	March 31, 2002	December 31 2001
ASSETS	(Unaudited)	
Cash and cash equivalents	$ 16,856	$ 12,4
Investment securities		
Held-to-maturity	957	9
Available for sale	20,344	20,5

Investment in FHLB and other stocks	1,972	1,9
Loans receivable, net	163,584	177,5
Accrued interest receivable	1,281	1,2
Real estate owned	327	7
Office properties and equipment, net	7,981	8,1
Other assets	4,496	1,5
Total assets	$ 217,798	$ 225,1
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Deposits:		
Interest bearing demand	$ 26,687	$ 25,4
Non-interest bearing demand	23,005	22,1
Money market accounts	20,322	22,3
Savings accounts	13,546	12,9
Certificates of deposit	103,238	117,6
	186,798	200,6
Bonds payable	591	5
Advances from Federal Home Loan Bank	7,000	1,0
Accrued interest payable	105	1
Payments by borrowers for taxes and insurance	350	1
Other liabilities	590	5
Total liabilities	195,434	203,0
Convertible preferred securities	6,012	6,0
STOCKHOLDERS' EQUITY		
Preferred stock, par value $1 per share, 500,000 shares authorized, none issued	-	
Common stock, par value $1.25 per share, 4,000,000 shares authorized, 1,962,777 issued and outstanding (1,961,727 in 2001)	2,453	2,4
Additional paid-in capital	8,960	8,9
Accumulated comprehensive loss	(836)	(6
Retained earnings	5,775	5,3
Total stockholders' equity	16,352	16,0
Total liabilities and stockholders' equity	$ 217,798	$ 225,1

See accompanying notes to consolidated financial statements

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GUARANTY FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(In Thousands, Except Per Share Amounts)

	Three Months Ended March 31, 2002	Three Months Ended March 31, 2001
	(unaudited)	
Interest income		
Loans	$ 3,060	$ 4,598
Investment securities	412	507
Total interest income	3,472	5,105
Interest expense		
Deposits	1,209	2,593
Borrowings	179	336
Total interest expense	1,388	2,929
Net interest income	2,084	2,176
Provision for loan losses	25	150
Net interest income after provision for loan losses	2,059	2,026
Non-interest income		
Deposit account fees	183	177
Mortgage banking income	314	175
Investment sales commissions	26	94
Other	115	116
Total noninterest income	638	562
Non-interest expense		
Personnel	1,144	1,261
Occupancy	289	339
Information services	291	278
Marketing	14	63
Deposit insurance premiums	25	26
Other	331	367
Total noninterest expense	2,094	2,334
Income before income taxes	603	254
Provision for income taxes	197	86
Net income	$ 406	$ 168
Basic and diluted earnings per common share	$ 0.21	$ 0.09

See accompanying notes to consolidated financial statements.

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

	Three Months Ended March 31, 2002	Three Months Ended March 31, 2001
	(unaudited)	
Net income	$ 406	$ 168
Other comprehensive income:		
Unrealized gain (loss) on securities available for sale	(213)	641
Other comprehensive income (loss), before tax	(213)	641
Income tax (expense) benefit related to items of other comprehensive income	72	(218)
Other comprehensive income (loss), net of tax	(141)	423
Comprehensive income	$ 265	$ 591

See accompanying notes to consolidated financial statements.

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

Three Mon
Mar

	2002
	(unau
Operating Activities	
Net Income	$ 406
Adjustments to reconcile net income to net cash provided (absorbed) by operating activities:	
Provision for loan losses	25
Provision for loss on sale of other real estate owned	40
Depreciation and amortization	151
Deferred loan fees	(16)
Net amortization of premiums and accretion of discounts	44
Gain on sale of loans	(314)
Originations of loans held for sale	(12,366)
Proceeds from sale of loans	19,975
Gain on sale of other real estate owned	(18)
Other	-
Changes in:	
Accrued interest receivable	(36)
Other assets	89
Accrued interest payable	(32)
Prepayments by borrowers for taxes and insurance	185
Other liabilities	44
Net cash provided by operating activities	8,177
Investing activities	
Net decrease in loans	6,683
Mortgage-backed securities principal repayments	169
Purchase of securities held to maturity	(406)
Proceeds from maturity of securities held to maturity	250
Purchase of securities available for sale	-
Proceeds from sale of real estate owned	415
Purchase of bank-owned life insurance	(3,000)
Origination of servicing rights	-
Proceeds from sale of office properties and equipment	21
Purchase of office properties and equipment	(34)
Net cash provided by investing activities	4,098
Financing activities	
Net increase in deposits	(13,834)
Proceeds from FHLB advances	21,000
Repayment of FHLB advances	(15,000)
Proceeds from issuance of common stock	8
Principal payments on bonds payable, including unapplied payments	(30)
Net cash absorbed by financing activities	(7,856)
Increase in cash and cash equivalents	4,419
Cash and cash equivalents, beginning of period	12,437
Cash and cash equivalents, end of period	$ 16,856

See accompanying notes to consolidated financial statements.

GUARANTY FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the Three Months Ended March 31, 2002 and 2001
(unaudited)

Note 1 Principles of Presentation

The accompanying consolidated financial statements of Guaranty Financial Corporation ("Guaranty") have not been audited by independent accountants, except for the balance sheet at December 31, 2001. These financial statements have been prepared in accordance with the regulations of the Securities and Exchange Commission in regard to quarterly (interim) reporting. In management's opinion, the financial information presented reflects all adjustments, comprised only of normal recurring accruals, that are necessary for a fair presentation of the results for the interim periods. Significant accounting policies and accounting principles have been consistently applied in both the interim and annual consolidated financial statements. Certain notes and the related information have been condensed or omitted from the interim financial statements presented in this Quarterly Report on Form 10-QSB. Therefore, these financial statements should be read in conjunction with Guaranty's Annual Report on Form 10-KSB for the year ended December 31, 2001. The results for the three months ended March 31, 2002, are not necessarily indicative of future financial results.

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

Amounts in the year 2001 financial statements have been reclassified to conform to the year 2002 presentation. These reclassifications had no effect on previously reported net income.

Note 2 Estimates

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

Note 3 Earnings Per Share

Basic earnings per share is based on net income divided by the weighted average number of common shares outstanding during the period. Diluted earnings per share shows the dilutive effect of additional common shares issuable under stock option plans. The basic and diluted earnings per share for the three months ended March 31, 2002 and 2001, have been determined by dividing net income by the weighted average number of shares of common stock outstanding during these periods. The following table indicates the weighted average shares outstanding for each period.

	March 31, 2002	March 31, 2001
Basic shares	1,962,777	1,961,727
Diluted shares	1,970,631	1,961,727

Note 4 Loans

The loan portfolio is comprised of the following:

	March 31, 2002	December 31, 2001
	(In thousands)	
Mortgage loans:		
Residential	$ 30,445	$ 39,864
Commercial	12,803	16,277
Construction and land loans	36,444	36,307
Total real estate loans	79,692	92,448
Commercial business loans	65,127	66,603
Consumer loans	21,227	20,973
Total loans receivable	166,046	180,024
Adjustments:		
Allowance for losses	(2,537)	(2,512)
Deferred costs	75	67
Total loans receivable, net	$ 163,584	$ 177,579

Note 5 Allowance for Loan Loss

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

	March 31, 2002	December 31, 2001
	(In thousands)	
Balance at January 1	$ 2,512	$ 2,396
Provision charged to operating expense	25	333
Recoveries added to the reserve	0	9
Loans charged off	0	(226)
Balance at the end of the period	$ 2,537	$ 2,512

Note 6 Investments

The investment portfolio was comprised of the following:

	March 31, 2002	December 31, 2001
	(In thousands)	
Held to maturity:		
Mortgage-backed securities	$ 551	$ 720
U.S. Government obligations	406	250
Available for sale:		
Corporate Bonds	12,496	12,597
U.S. Government obligations	7,848	7,970
Other:		
Federal Home Loan Bank stock	1,550	1,550
Federal Reserve Bank & other stocks	$ 422	422
	$ 23,273	$ 23,509

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

Guaranty Financial Corporation ("Guaranty") is a single bank holding company organized under Virginia law that provides financial services through its primary operating subsidiary, Guaranty Bank (the "Bank"). The Bank is a full service commercial bank offering a wide range of banking and related financial services, including time and demand deposits, as well as commercial, industrial, residential construction, residential and commercial mortgage and consumer loans. Guaranty Investments Corporation, a subsidiary of the Bank, provides a full range of investment services and, through a contractual arrangement with a third party, sells mutual funds, stocks, bonds and annuities.

Management's discussion and analysis is presented to aid the reader in understanding and evaluating the financial condition and results of operations of Guaranty. The analysis focuses on the consolidated financial statements, the footnotes thereto, and the other financial data herein. Highlighted in the discussion are material changes from prior reporting periods and any identifiable trends affecting Guaranty. Amounts are rounded for presentation purposes, while the percentages presented are computed based on unrounded amounts.

Analysis of Financial Condition

Total assets decreased 3.3% to $217.8 million at March 31, 2002, from $225.2 million at December 31, 2001. Cash and cash equivalents increased $4.4 million or 35.5%, to $16.9 million at March 31, 2002, from $12.4 million at December 31, 2001. Net loans were $163.6 million at March 31, 2002, a decrease of $14.0 million, or 7.9%, from net loans of $177.6 million at December 31, 2001. Total deposits at March 31, 2002, were $186.8 million compared to $200.6 million at December 31, 2001. FHLB borrowings were $7.0 million at March 31, 2002, compared to $1.0 million at December 31, 2001. Total stockholders' equity at March 31, 2002, increased by $300,000 to $16.4 million from $16.1 million at December 31, 2001.

The factors causing the fluctuations in the major balance sheet categories are further discussed in the following sections.

Loans

During the first three months of 2002, Guaranty continued to strategically reposition its loan portfolio. Net loans receivable decreased by 7.9% to $163.6 million at March 31, 2002, from $177.6 million at December 31, 2001. This change was primarily attributable to a $9.4 million reduction in residential mortgage loans and a $3.5 million reduction in commercial mortgage loans. During the most recent quarter, Guaranty originated $12.4 million in residential mortgage loans and sold $19.7 million in residential mortgage loans in the secondary market. Residential mortgage loans held for sale were $7.1 million at March 31, 2002, down from $14.3 million at December 31, 2001. All other segments of the loan portfolio were relatively constant during the most recent quarter.

Investments

Total investments declined by 1.0% to $23.3 million at March 31, 2002, compared to $23.5 million at December 31, 2001. The majority of this change was due to an increase in the mark to market loss adjustment of Guaranty's available for sale investments of approximately $141,000.

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Real Estate Owned

Real estate owned decreased to $327,000 at March 31, 2002, from $764,000 at December 31, 2001. The decline was primarily due to the sale of a residential property during the period. The remainder of real estate owned consists of developed lots listed for sale. No material losses are anticipated on the ultimate sale of these properties.

Office Properties and Equipment

Guaranty's investment in office properties and equipment decreased to $8.0 million at March 31, 2002, from $8.1 million at December 31, 2001. This decrease was primarily due to depreciation of existing assets.

Other Assets

Other assets increased to $4.5 million at March 31, 2002, primarily due to the purchase of $3.0 million of bank owned life insurance.

Deposits

Deposits were $186.8 million at March 31, 2002, a decrease of $13.8 million, or 6.9%, from total deposits of $200.6 million at December 31, 2001. Although total deposits declined during the most recent quarter, demand accounts increased by 4.5% to $49.7 million from $47.6 million. This increase represents Guaranty's continued emphasis on providing full service banking relationships to its customers. Certificates of deposit comprise 55.3% of total deposits at March 31, 2002, compared to 58.7% at December 31, 2001.

FHLB Borrowings

Guaranty's borrowings from the Federal Home Loan Bank ("FHLB") at March 31, 2002 increased to $7.0 million from $1.0 million at December 31, 2001. Guaranty was able to reduce its cost on certificates of deposit by increasing its borrowings from the FHLB. At March 31, 2002, Guaranty's available but unused borrowings with the FHLB were approximately $19.6 million.

Stockholders' Equity

Stockholders' equity at March 31, 2002, increased by 1.7% to $16.4 million from $16.1 million at December 31, 2001. The primary factors for the increase were the quarterly net income of $406,000 and $8,000 related to the issuance of 1,050 shares for the 2002 annual retainer for outside directors offset by an increase in the mark to market loss adjustment of Guaranty's available for sale investments by approximately $141,000.

Results of Operations

Net Income

Guaranty reported net income of $406,000 ($.21 per share) for the three months ended March 31, 2002, compared with a net income of $168,000 ($.09 per share) for the three months ended March 31, 2001. The increase in the net income was primarily due to the combination of reduced operating expenses, a lower provision for loan loss, and increased mortgage banking income which offset lower net interest income.

Net Interest Income

Net interest income decreased to $2.1 million for the three months ended March 31, 2002, from the $2.2 million reported during the same period in 2001. The primary cause for the decline in net interest income was due to the decline in average earning assets for the most recent quarter. Average earning assets for the three months ended March 31, 2002, were $201.1 million compared to $232.9 million for the same period in 2001. The decline in average loans outstanding to $171.6 million from $203.1 million represented the majority of this change. For these same periods, certificates of deposit decreased by $36.7 million to $110.5 million. The negative impact on net interest income because of the decrease in earning assets was partially offset by an increase in Guaranty's net interest margin percentage during the most recent quarter. The net interest margin percentage increased to 4.20% for the most recent quarter from 3.79% for the same period a year ago. The cost of interest bearing deposits declined by 238 basis points primarily due to lower interest rates being paid on certificates of deposit. For the same time periods, the yield on loans decreased by 195 basis points to 7.23%, primarily due to the impact of prime rate reductions throughout 2001 on adjustable rate loans. The following table summarizes the factors determining net interest income (dollars in thousands).

	Three Months Ended March 31, 2002	Three Months Ended March 31, 2001
Average Interest Earning Assets	$ 201,140	$ 232,835
Average Yield	7.00%	8.89%
Average Interest Bearing Liabilities	$ 180,359	$ 219,188
Average Cost	3.13%	5.42%
Interest Spread	3.87%	3.48%
Interest Margin	4.20%	3.79%

Provision for Loan Losses

Guaranty recorded a provision of $25,000 and $150,000 for the three months ended March 31, 2002 and 2001, respectively. The decrease in the provision for the current year resulted from the decrease in the size of the loan portfolio and the increased level of the allowance for loan losses as a percentage of total loans. The allowance for loan losses is maintained at a level considered by management to be adequate to absorb future loan losses currently inherent in the loan portfolio. Management's assessment of the adequacy of the allowance is based upon type and volume of the loan portfolio, past loan loss experience, existing and anticipated economic conditions, and other factors that deserve current recognition in estimating future loan losses. Management's assessment of the adequacy of the allowance is subject to evaluation and adjustment by Guaranty's regulators.

There were no loan charge-offs for the three months ended March 31, 2002, compared to $34,000 for the same period a year ago. At March 31, 2002, Guaranty had $338,000 of loans that were 90 days or more past due. Of this total, $187,000 of loans were considered to be non-accrual. At March 31, 2002, the allowance for loan losses was $2.5 million or 1.53% of total loans. Management believes that the allowance for loan losses is adequate to cover loan losses inherent in the loan portfolio at March 31, 2002, and that loans classified as special mention, substandard, doubtful and loss have been adequately reserved. Although management believes that it uses the best information available to make such determinations, future adjustments to the allowance for loan losses may be necessary, and net income could be significantly affected, if circumstances differ substantially from assumptions used in making the initial determinations.

Non-interest Income

Non-interest income was $638,000 for the three months ended March 31, 2002, compared with $562,000 for the same period a year ago. This change was primarily due to an increase in mortgage banking income to $314,000 for the most recent quarter compared to $175,000 for the same period a year ago. During 2001 Guaranty changed its mortgage banking business model to sell all residential fixed rate mortgage loans on a servicing released basis. In addition, Guaranty sold its mortgage loan servicing rights related to mortgage loans serviced for others. The revised mortgage banking business model eliminates the secondary market interest rate risk through simultaneously locking a mortgage loan rate with the borrower and a correspondent investor at the same time. The 2001 sale of existing mortgage servicing rights and the continued sale of mortgage loans on a servicing released basis eliminates the valuation volatility associated with retained servicing rights. The results for the three months ended March 31, 2001, included a $151,000 charge for impairment in the value of the mortgage loan servicing rights.

Fees on deposit accounts increased by 3.4% to $183,000 for the most recent quarter compared to $177,000 for the same period a year ago. This increase is related to an increase in demand accounts. Investment sales commissions decreased to $26,000 for the three months ended March 31, 2002, compared to $94,000 for the same period a year ago due to reduced sales volume.

Non-interest Expense

Non-interest expense was $2.1 million for the quarter ended March 31, 2002, a $240,000 decrease over the amount reported for the same period last year. The decrease is primarily attributable to the elimination of personnel and occupancy expenses due to the sale of a retail banking office in the suburban Richmond market and limited marketing expense in the most recent quarter. The expenses related to the suburban Richmond retail banking office were included in the 2001 financial statements until July 2001 when the sale transaction was consummated. Marketing expense was $14,000 for the most recent quarter compared to $63,000 for the same period a year ago. Marketing expense should increase throughout the remainder of 2002 as activity increases.

Income Tax Expense

Guaranty recognized income tax expense of $197,000 for the three months ended March 31, 2002, compared to income tax expense of $86,000 for the same period in 2001. The effective tax rate for the most recent quarter was 32.7% compared to 33.9% for the same period a year ago. The lower effective tax rate for the most recent quarter was due to an increase in non-taxable income from bank owned insurance. The net increase in income tax expense between periods was a result of increases in the level of taxable income.

Liquidity and Capital Resources

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

Guaranty uses its sources of funds primarily to meet its on-going operating expenses, to pay deposit withdrawals and to fund loan commitments. During the most recent quarter, total loans declined by approximately $14.0 million and certificates of deposit declined by approximately $14.5 million. These decreases were a result of strategic decisions. Guaranty has been very targeted in its lending approach and has desired to reduce its funding reliance on certificates of deposit. At March 31, 2002, total approved loan commitments outstanding were approximately $5.6 million. At the same date, commitments under unused lines of credit were approximately $51.8 million. Certificates of deposit scheduled to mature in one year or less at March 31, 2002, were $92.4 million. Management believes that a significant portion of maturing deposits will remain with Guranty. If these certificates of deposit do not remain with Guaranty, it will have to seek other sources of funding that may be at higher rates or reduce assets.

The reduction in total assets has positively impacted Guaranty's regulatory capital ratios. At March 31, 2002, regulatory capital was in excess of amounts required by Federal Reserve regulations to be considered well capitalized as shown in the following table (dollars in thousands):

	Actual Amount	Actual Percentage	Amount Required	Percent Require
Leverage Ratio	$ 22,919	10.45%	$ 8,770	4.00%
Tier 1 Risk Based Capital	22,919	12.96%	7,074	4.00%
Total Risk Based Capital	25,417	14.37%	14,147	8.00%

Regulatory Issues

In October 2000, Guaranty and the Bank entered into a written agreement with the Federal Reserve Bank of Richmond ("FRB") and the Bureau of Financial Institutions of the Commonwealth of Virginia ("BFI") with respect to various operating policies and procedures. Various bank operating policies including asset/liability management, liquidity, risk management, loan administration and capital adequacy were rewritten and approved by bank regulators in 2001. Guaranty is restricted from paying future dividends or incurring any debt at the parent company level without prior regulatory approval. In addition, the Bank is prohibited from paying intercompany dividends to Guaranty without prior regulatory approval. Absent this intercompany dividend, Guaranty does not have sufficient resources to make the payments due on its outstanding subordinated debt securities.

Guaranty and the Bank have received regulatory approval for an intercompany dividend in an amount sufficient to make the June 15, 2002, payment due on its subordinated debt securities. While the FRB and the BFI have approved all quarterly dividend payment requests since the written agreement was executed, no assurances can be given that future requests will be approved.

Forward Looking Statements

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

Part II. Other Information

Item 1 Legal Proceedings
Not Applicable

Item 2 Changes in Securities
Not Applicable

Item 3 Defaults Upon Senior Securities
Not Applicable

Item 4 Submission of Matters to a Vote of Security Holders
Not Applicable

Item 5 Other Information
Not Applicable

Item 6 Exhibits and Reports on Form 8-K

(a) Exhibits - None

(b) Reports on Form 8-K - None

SIGNATURES

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

GUARANTY FINANCIAL CORPORATION

Date: May 14, 2002 By: /s/ William E. Doyle, Jr.

William E. Doyle, Jr.
President and Chief Executive Officer

Date: May 14, 2002 By: /s/ Thomas F. Crump

Thomas F. Crump
Senior Vice President and Chief Financial Officer