SUSSEX BANCORP
Form 10QSB
November 14, 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 September 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 November 11,2003 there were 1,725,341 shares of common stock, no par value, outstanding.

SUSSEX BANCORP
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PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

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

ASSETS	September 30, 2003
Cash and due from banks	$ 11,023
Federal funds sold	4,740
Cash and cash equivalents	15,763
Interest bearing time deposits with other banks	3,500
Securities available for sale	75,730

Federal Home Loan Bank Stock, at cost	760
Loans receivable, net of unearned income	129,767
Less: allowance for loan losses	1,652
Net loans receivable	128,115
Premises and equipment, net	4,334
Accrued interest receivable	1,248
Goodwill	1,932
Other assets	3,679
Total Assets	$235,061
LIABILITIES AND STOCKHOLDERS' EQUITY	
Liabilities:	
Deposits:	
Non-interest bearing demand	$ 33,894
Savings and interest bearing demand	115,516
Time of less than $100,000	41,901
Time of $100,000 and over	10,495
Total Deposits	201,806
Borrowings	12,000
Accrued interest payable and other liabilities	2,218
Mandatory redeemable capital debentures	5,000
Total Liabilities	221,024
Stockholders' Equity:	
Common stock, no par value, authorized 5,000,000 shares; issued and outstanding 1,789,457 in 2003 and 1,688,130 in 2002	9,302
Retained earnings	4,604
Accumulated other comprehensive income	131
Total Stockholders' Equity	14,037
Total Liabilities and Stockholders' Equity	$235,061

See Notes to Consolidated Financial Statements

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

	Three Months Ended September 30, 2003	2002
INTEREST INCOME		
Loans receivable, including fees	$2,036	$1,956
Securities:		
Taxable	360	609
Tax-exempt	198	130
Federal funds sold	14	87
Interest bearing deposits	11	31
Total Interest Income	2,619	2,813
INTEREST EXPENSE		
Deposits	479	671
Borrowings	142	148
Mandatory redeemable capital debentures	60	65
Total Interest Expense	681	884
Net Interest Income	1,938	1,929
Provision for Loan Losses	70	75
Net Interest Income after Provision for Loan Losses	1,868	1,854
NON-INTEREST INCOME		
Service fees on deposit accounts	197	195
ATM fees	87	70
Insurance commissions and fees	512	414
Investment brokerage fees	54	56
Net gain on sale of loans held for sale	0	--
Net gain on sale of other real estate owned	0	--
Other	64	59
Total Non-Interest Income	914	794
NON-INTEREST EXPENSE		
Salaries and employee benefits	1,371	1,245
Occupancy, net	154	151
Furniture and equipment	199	199
Stationary and supplies	43	50
Audit and exams	28	35
Advertising and promotion	111	121
Postage and freight	44	42
Amortization of intangible assets	42	33
Other	383	372
Total Non-Interest Expense	2,375	2,248
Income before Income Taxes	407	400
Provision for Income Taxes	91	113
Net Income	$ 316	$ 287

Earnings per share		
Basic	$ 0.18	$ 0.16
Diluted	$ 0.17	$ 0.16

See Notes to Consolidated Financial Statements

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

	Number of Shares Outstanding	Common Stock
	(Dollars in thousands,	
Balance December 31, 2001	1,659,057	$7,732
Comprehensive income:		
Net income	-	-
Change in unrealized gains (losses) on securities available for sale	-	-
Total Comprehensive Income		
Treasury shares purchased	(14,554)	-
Issuance of common stock and exercise of stock options	5,623	38
Issuance of common stock through dividend reinvestment plan	9,313	86
Cash dividends on common stock ($.18 per share)	-	-
Balance September 30, 2002	1,659,439	$7,856
Balance December 31, 2002	1,688,130	$7,869
Comprehensive income:		
Net income	-	-
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	7,037	52
Shares issued through dividend reinvestment plan	11,478	128
Cash dividends on common stock ($.14 per share)	-	-
5% Stock Dividend	85,212	1,278
Balance September 30, 2003	1,789,457	$9,302

See Notes to Consolidated Financial Statements

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

	Treas St
	(Dollars in thous
Balance December 31, 2001	($
Comprehensive income:	
Net income	
Change in unrealized gains (losses) on securities available for sale	
Total Comprehensive Income	
Treasury shares purchased	(
Issuance of common stock and exercise of stock options	
Issuance of common stock through dividend reinvestment plan	
Cash dividends on common stock ($.18 per share)	
Balance September 30, 2002	($
Balance December 31, 2002	
Comprehensive income:	
Net income	
Change in unrealized gains (losses) on securities available for sale	
Total Comprehensive Income	
Treasury shares purchased	
Treasury shares retired	
Issuance of common stock and exercise of stock options	
Shares issued through dividend reinvestment plan	
Cash dividends on common stock ($.14 per share)	
5% Stock Dividend	

Balance September 30, 2003

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See Notes to Consolidated Financial Statements

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

	Nine Months
	2003
	(
Cash Flows from Operating Activities	
Net income	$ 989
Adjustments to reconcile net income to net cash provided by operating activities:	
Provision for loan losses	315
Provision for depreciation and amortization	386
Net amortization of securities premiums and discounts	892
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	(37
Increase in assets:	
Accrued interest receivable	(104
Other assets	(360
Decrease in accrued interest payable and other liabilities	(148
Net Cash Provided by Operating Activities	1,870
Cash Flows from Investing Activities	
Securities available for sale:	
Purchases	(42,634
Maturities, calls and principal repayments	38,014
Net increase in loans	(16,584
Purchases of bank premises and equipment	(86
Purchase 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	(20,950
Cash Flows from Financing Activities	
Net increase in deposits	11,948
Net purchase (redemption) of borrowings	(3,000
Net purchase of debentures	-
Proceeds from the issuance of common stock	52
Purchase of treasury stock	(25
Dividends paid, net of reinvestments	(228
Net Cash Provided by Financing Activities	8,747
Net Decrease in Cash and Cash Equivalents	(10,333
Cash and Cash Equivalents - Beginning	26,096
Cash and Cash Equivalents - Ending	$ 15,763
Supplementary Cash Flows Information	
Interest paid	$ 2,988
Income taxes paid	$ 623
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., ("Tri-State") a full service insurance agency located in Sussex County, New Jersey. All inter-company transactions and balances have been eliminated in consolidation. The Bank operates eight banking offices all 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 nine-month period ended September 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. Stockholders' Equity and Subsequent Event

On October 15, 2003, the Board of Directors declared a 5% common stock dividend payable on November 24, 2003 to shareholders of record as of November 3, 2003. Accordingly, 85,212 shares of common stock will be issued to the Company's stockholders and $1,278,000 will be transferred from retained earnings to common stock. The effect of the stock dividend has been retroactively reflected as of September 30, 2003 on the consolidated balance sheet and the consolidated statement of stockholders' equity. The earnings per share amounts disclosed on the consolidated income statement and related footnote reflect the effect of the stock dividend on the number of outstanding shares for all periods.

3. Earnings per Share

Basic earnings per share 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 as retroactively adjusted for the 5% stock dividend declared October 15, 2003 (dollars in thousands, except per share data):

	Three Months Ended September 30, 2003			Three
	Income (Numerator)	Shares (Denominator)	Per Share Amount	Inco (Numer
Basic earnings per share:				
Net income applicable to common stockholders	$ 316	1,788	$ 0.18	

	Income (Numerator)	Shares (Denominator)	Per Share Amount
Effect of dilutive securities:			
Stock options	-	50	
Deferred common stock payments for purchase of insurance agency	1	34	
Diluted earnings per share:			
Net income applicable to common stock-holders and assumed conversions	$ 317	1,872	$ 0.17

	Nine Months Ended September 30, 2003			Nine
	Income (Numerator)	Shares (Denominator)	Per Share Amount	Inco (Numer
Basic earnings per share:				
Net income applicable to common stockholders	$ 989	1,783	$ 0.55	
Effect of dilutive securities:				
Stock options	-	28		
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	$ 994	1,849	$ 0.54	

4. Comprehensive Income

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

	Three Months Ended September 3	
	2003	2002
	(in Thousands)	
Unrealized holding gains (losses) on available for sale securities	(1,053)	$374
Less: reclassification adjustments for gains included in net income	-	-
Net unrealized gains (losses)	(1,053)	374
Tax effect	(421)	149
Other comprehensive income (loss), net of tax	($632)	$225

5. 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 September 30, 2003			Three M
	Banking and Financial Services	Insurance Services (In Thousands)	Total	Banking Financial Serv
Revenues from external sources	$3,021	$512	$3,533	$3
Income before income taxes	312	95	407	

	Nine Months Ended September 30, 2003			Nine Months
	Banking and Financial Services	Insurance Services (In Thousands)	Total	Banking Financial Serv
Revenues from external sources	$9,331	$1,599	$10,930	$9
Income before income taxes	1,066	254	1,320	1

6. 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 September 30	
	2003	2002
	(In Thousands)	
Net income, as reported	$ 316	$ 287
Total stock-based compensation expense determined under fair value based method for all awards, net of related tax effects	(16)	(8)
Pro forma net income	$ 300	$ 279

Basic earnings per share:		
As reported	$ 0.18	$ 0.16
Pro forma	$ 0.17	$ 0.16
Diluted earnings per share:		
As reported	$ 0.17	$ 0.16
Pro forma	$ 0.16	$ 0.16

7. 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.

8. 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 $1,174,000 of standby letters of credit as of September 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 September 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 December 31, 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 did not 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 Nine Months ended September 30, 2003 and September 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 12 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 $316 thousand for the third quarter of 2003, an increase of $29 thousand from the $287 thousand reported for the same period in 2002. Basic earnings per share, as retroactively adjusted for the 5% stock dividend declared October 15, 2003, increased from $0.16 in the third quarter of 2002 to $0.18 for the third quarter of 2003. Diluted earnings per share were $0.16 in the third quarter of 2002 and increased to $0.17 in the third quarter of 2003.

For the nine months ended September 30, 2003, net income was $989 thousand, an increase of $140 thousand from the $849 thousand reported for the same period in 2002. Basic earnings per share , as retroactively adjusted for the 5% stock dividend declared October 15, 2003, were $0.55 for the nine months ended September 30, 2003 compared to $0.49 for the nine-month period ended September 30, 2002. Diluted earnings per share were $0.54 for the nine months ended September 30, 2003, an increase from $0.47 from the first nine months of 2002.

The results reflect an increase in net interest income , primarily as a result of a substantial decrease in interest expense due to declining market rates of interest, coupled with increases in non-interest income, primarily from our insurance agency operations.

RESULTS OF OPERATIONS

Interest Income. Total interest income decreased $160 thousand, or 0.6%, to $2.7 million for the quarter ended September 30, 2003 from the same period in 2002. This decrease was primarily attributable to a decrease in the average yield of 62 basis points, on a fully taxable equivalent basis, from 5.66% during the third quarter of 2002 to 5.04% in the third quarter of 2003. Average earning assets increased $12.1 million from $200.7 million in the third quarter of 2002 to $212.8 million in the same quarter in 2003. Although the average rate earned on investment securities declined by 149 basis points, the average balance increased by $11.4 million, or 17.6%, to $76.2 million in the third quarter of 2003. Similarly, while the average rate earned in the loan portfolio decreased 78 basis points to 6.33% for the third quarter of 2003 from 7.11% in the third quarter of 2002, the average loan balance increased 17.1% from $109.1 million to $127.7 million from third quarter 2002 to third quarter 2003. The interest earned on other interest bearing assets declined $94 thousand while the average balance in other interest earning assets decreased by $17.9 million, or 67.0%, to $8.8 million from $26.8 million from the third quarter of 2002, primarily reflecting a decline in federal funds sold. The market declines in interest rates exceeded the impact of volume increases in average balances on interest income, resulting in a decrease in interest income for the third quarter of 2003 compared to the third quarter if 2002.

For the nine months ended September 30, 2003, interest income, on a fully taxable equivalent basis, remained stable compared to the first nine months of 2002, at $8.2 million for both nine month periods. During the first nine months of 2003 average interest earning assets increased $18.5 million to $211.3 million from $192.8 million during the same period in 2002. The average balance in the loan portfolio increased $14.7 million, taxable securities increased $14.2 million and tax exempt securities increased $6.1 million, while the average balance of other interest-earning assets decreased $16.4 million during the first nine 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 50 basis point decrease in the average yield on interest earning assets on a fully taxable equivalent basis from 5.70% from the first nine months of 2002 to 5.20% for the same period of 2003.

Interest Expense. The Company's interest expense for the third quarter of 2003 decreased $202 thousand, or 22.9%, to $682 thousand from $884 thousand in the third quarter of 2002. Despite the decline in interest expense, the average balance of interest bearing liabilities increased $8.6 million, or 4.9% to $185.0 million during the third quarter of 2003 from $176.4 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 1.46% for the third quarter of 2003 from 1.99% in the third quarter of 2002. NOW deposit average balances grew $11.0 million, or 31.2%, from $35.2 million during the third quarter 2002 to $46.2 million in the third quarter of 2003. However, the interest expense on NOW deposits decreased $14 thousand from the third quarter of 2002, as the average interest rate paid decreased 31 basis points from 0.77% to 0.46% during the same period. Average savings deposits increased $3.3 million, or 5.3%, while the average rate paid declined 57 basis points from 1.30% in the third quarter of 2002 to 0.73% in the third quarter of 2003. The average balance in time deposits decreased $3.5 million, or 6.3% in the third quarter of 2003 compared to the same period in 2002 as the interest expense on time deposits declined $91 thousand, or 23.4% to $298 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 decreased $892 thousand to $17.3 million in the third quarter of 2003 from $18.2 million in the third 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. The capital debentures bear a floating rate of interest, which averaged 4.77% in the third quarter of 2003, down 94 basis points from 5.71% in the third quarter of 2002.

For the nine months ended September 30, 2003 interest expense decreased $475 thousand, or 17.8%, to $2.2 million from $2.7 million for the same period last year. This decrease was largely due to a decrease in interest expense on time deposits of $415 thousand, or 30.2%, from $1.4

million for the first nine months of 2002 to $958 thousand during the first nine months of 2003. The average balance in time deposit accounts decreased $5.0 million, or 8.7%, over the same nine-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 its 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 $11.9 million, or 36.2%, from $32.9 million during the first nine months of 2002 to $44.8 million in the first nine months of 2003. Savings deposits increased $3.8 million, or 6.2%, from $60.8 million during the first nine months of 2002 to $64.6 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 nine months of 2003. The issuance of $5 million in capital debentures during July of 2002 initially bore an average rate of 5.71% during the first nine months of 2002. The rate on these debentures has decreased to an average rate of 4.92% during the first nine months of 2003. The average rate paid on total interest bearing liabilities decreased 53 basis points from 2.12% in the first nine months of 2002 to 1.59% 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 nine months ended September 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.

(dollars in thousands)	Nine Months Ended September 30, 2003			
Earning Assets:	Average Balanc	Interest (1)	Average Rate (2)	Average Balance
Securities:				
Tax exempt (3)	$17,804	$755	5.67%	$11,734
Taxable	57,378	1,328	3.10%	43,225
Total securities	75,182	2,083	3.70%	54,959
Taxable loans: (net of unearned income)				
Mortgage and construction	75,250	3,822	6.79%	62,108
Commercial	16,993	729	5.74%	12,102
Consumer	29,581	1,457	6.59%	32,906
Total loans receivable (4)	121,824	6,008	6.59%	107,116
Other interest-earning assets	14,263	131	1.22%	30,704
Total earning assets	211,269	$8,222	5.20%	192,779
Non-interest earning assets	21,519			19,158

Allowance for loan losses	(1,526)			(1,255)
Total Assets	$231,263			$210,682
Sources of Funds:				
Interest bearing deposits:				
NOW	$44,786	$190	0.57%	$32,888
Money market	4,044	23	0.76%	4,065
Savings	64,586	403	0.83%	60,787
Time	52,892	958	2.42%	57,932
Total interest bearing deposits	166,308	1,574	1.27%	155,672
Borrowed funds	13,267	437	4.34%	11,245
Capital debentures	5,000	186	4.92%	1,502
Total interest bearing liabilities	184,575	$2,197	1.59%	168,419
Non-interest bearing liabilities:				
Demand deposits	30,475			27,255
Other liabilities	2,287			2,443
Total non-interest bearing liabilities	32,762			29,698
Stockholders' equity	13,926			12,565
Total Liabilities and Stockholders' Equity	$231,263			$210,682
Net Interest Income and Margin (5)		$6,025	3.81%	

(1) Includes loan fee income
(2) Average rates on securities are calculated on amortized costs
(3) Full taxable equivalent basis, using a 39% 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 third quarter of 2003 increased $42 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 14 basis points to 3.77% in the third quarter of 2003 compared to 3.91% the year earlier due to the average rate earned on total earning assets declining 62 basis points compared to the average rate paid on total interest bearing liabilities declining only 53 basis points.

Net interest income for the nine months ended September 30, 2003 increased $484 thousand, or 8.7%, over the same period last year. The net interest margin decreased, on a fully taxable equivalent basis, 3 basis points from 3.84% for the first nine months of 2002 to 3.81% for the first nine months of 2003. Comparing the first nine months of 2002 to the first nine months of 2003, the average rate paid on interest bearing liabilities repriced faster and lower than the average rate earned on interest earning assets, while the volume of average earning assets increased more than the volume of average interest bearing liabilities, resulting in the 3 basis point decline to the net interest margin.

Provision for Loan Losses. For the three months ended September 30, 2003 the provision for loan losses was $70 thousand compared to $75 thousand for the third quarter ended September 30, 2002. The provision for loan losses was $315 thousand for the nine months ended September 30, 2003 as compared to $225 thousand for the same period last year. 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 September 30, 2003. 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.

Non-Interest Income. For the third quarter of 2003, total non-interest income increased $120 thousand, or 15.1%, from the same period in 2002. In the third quarter of 2003 insurance commissions and fees increased $98 thousand, or 23.7%, from $414 thousand reported in the third quarter of 2002 to $512 thousand for the quarter ended September 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 $47 thousand of the third quarter increase and industry-wide insurance premium increases of 10% to 15% account for the balance of the increase. ATM and debit card fees have increased $27 thousand compared to the same period in 2002. This increase is attributable to the growth in the Company's deposits and the increased use of customer's ATM or debit cards.

For the nine months ended September 30, 2003, non-interest income increased $540 thousand, or 22.6%, from the same period in 2002. Insurance commissions and fees increased $323 thousand, a 25.3% increase over the first nine months of 2002. This increase included $85 thousand from the acquisition of the Garrera book of business, with the reminder consisting of increased sales and premium increases. ATM fees increased $64 thousand, or 34.2%, and service charges on deposit accounts increased $59 thousand, or 11.6%, for the nine-month period ending September 30, 2003 over the same period in 2002. Mortgage banker fees, which are included in other income, increased in the first nine months of 2003 to $49 thousand from $14 thousand during the first nine months of 2002. On August 1, 2003 the Company created a new residential mortgage banking division. Mortgage banking fees of $6 thousand from the new banking operations are included in the 2003 year to date number of $49 thousand, reflecting the limited operations conducted in the third quarter. In the first nine 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 nine months of 2002.

Non-Interest Expense. For the quarter ended September 30, 2003, non-interest expense increased $127 thousand from the same period last year. The majority of this increase is attributed to the increase of the Company's salaries and employee benefits of $126 thousand, or 10.1%, from the addition of six full time equivalent employees and a 12% increase in medical insurance premiums which became effective April 1, 2003. Other non-interest expense increases from third quarter 2002 to third quarter 2003 were education and training expenses of $16 thousand due to a new Company commitment to a comprehensive employee training program which began in the fourth quarter of 2002.

For the nine months ended September 30, 2003, non-interest expense increased $723 thousand, to $7.1 million, from the first nine months of 2002. Salaries and employee benefits increased $524 thousand, or 15.1%, 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 nine months of 2002 were professional fees increases of $78 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, education and training increases of $52 thousand for the continuation of the new employee training program and legal expenses increases of $37 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 $77 thousand over the first nine 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 $22 thousand to $91 thousand for the three months ended September 30, 2003 as compared to $113 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 decreased $19 thousand for the nine months ended September 30, 2003 to $331 thousand as compared to $350 thousand for the nine months ended September 30, 2002. These decreases in income taxes resulted primarily due to an increased level of tax-exempt income.

FINANCIAL CONDITION

September 30, 2003 as compared to December 31, 2002

Total assets increased to $235.1 million at September 30, 2003, a $9.2 million increase from total assets of $225.9 million at December 31, 2002. Increases in total assets include increases of $16.0 million in net loans and $3.0 million in securities available for sale, partially offset by a $10.3 million reduction in cash and cash equivalents. Asset increases were financed through an increase in total deposits of $11.9 million from $189.9 million at year-end 2002 to $201.8 million on September 30, 2003, offset by a $3 million decrease in borrowings. Total stockholder's equity increased $357 thousand from $13.7 million at December 31, 2002 to $14.0 million at September 30, 2003.

Total loans at September 30, 2003 increased $16.3 million to $129.8 million from $113.4 million at year-end 2002. During the nine-month period ending September 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 Company has also increased its activity in the loan participation market, both originations and purchases. The balance in non-residential real estate loans increased $13.8 million from $41.0 million at December 31, 2002 to $54.8 million on September 30, 2003 and other loans, which include loans secured by farmland, increased $5.0 million over the same nine-month period. Construction and land development loans have decreased $1.9 million and residential 1-4 family real estate loans have decreased $1.0 million from December 31, 2002 to September 30, 2003. Other minor shifts in ending balances occurred between December 31, 2002 and September 30, 2003 according to loan demand.

Federal funds sold decreased by $12.2 million to $4.7 million at September 30, 2003 from $16.9 million on December 31, 2002. During the first nine months of 2003, these funds were used to fund loan demand and to purchase higher yielding investment securities.

Securities, available for sale, at market value, increased $3.0 million, or 4.0%, from $72.7 million at year-end 2002 to $75.7 million at September 30, 2003. The Company purchased $42.6 million in new securities in the first nine months of 2003 and $38.0 million in available for sale securities matured, were called and were repaid. There was a $718 thousand decrease in unrealized gains in the available for sale portfolio and $892 thousand in net amortization expenses recorded during the first nine months of 2003. There were no held to maturity securities at September 30, 2003 or at December 31, 2002.

Total deposits increased $11.9 million, or 6.3%, to $201.8 million during the first nine months of 2003 from $189.9 million at December 31, 2002. Non -interest bearing deposits increased $7.4 million, or 27.8%, to 16.8% of total deposits at September 30, 2003 from 14.0% of total deposits at December 31, 2002, interest-bearing and savings deposits increased $4.8 million, or 4.3% and total time deposits decreased $219 thousand from December 31, 2002 to September 30, 2003. Business non-interest bearing demand accounts account for $5.0 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 September 30, 2003, non-accrual loans decreased $84 thousand to $1.2 million, 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 September 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:

	September 30, 2003	December 31,
Non-accrual loans	$1,174,000	$1,258
Non-accrual loans to total loans	0.90%	1
Non-performing assets to total assets	0.59%	0
Allowance for loan losses as a % of non-performing loans	140.72%	107
Allowance for possible loan losses to total loans	1.27%	1

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 September 30, 2003, the allowance for loan losses was $1.7 million, an increase of 19.2% from the $1.4 million at year-end 2002. There were $50 thousand in charge offs and $1 thousand in recoveries reported in the first nine months of 2003. The allowance for loan losses as a percentage of total loans was 1.27% at September 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 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.

	September 30, 2003		September 30, 2002	
(Dollars in Thousands)	Change in Net Interest Margin	% Change in Net Interest Margin	Change in Net Interest Margin	% Change in Net Inte Margin
Down 200 basis points	($541)	11.53%	($860)	19.03%
Down 100 basis points	(173)	7.36%	(386)	17.07%
Up 100 basis points	(200)	-8.52%	(5)	-0.24%
Up 200 basis points	(481)	-10.25%	(64)	-1.41%

LIQUIDITY MANAGEMENT

At September 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 September 30, 2003, liquid investments totaled $15.8 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 September 30, 2003, had the ability to borrow up to $17.3 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 September 30, 2003 had borrowings totaling $12 million secured by the pledge of its one to four family mortgages and selected securities. Two short-term borrowings have maturities in October 2003 and July 2004 with interest rates ranging from 2.43 % 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%.

CAPITAL RESOURCES

Total stockholders' equity increased $357 thousand to $14.0 million at September 30, 2003 from $13.7 million at year-end 2002. Activity in stockholder's equity consisted of a net increase in retained earnings of $633 thousand derived from $989 thousand in net income earned during the first nine months of 2003, offset by $356 thousand in payments for cash dividends. Other increases were $52 thousand in stock options exercised, $128 thousand for shares issued through the dividend reinvestment plan, an unrealized loss on securities available for sale, net of income tax, of $431 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 October 7, 2003, the new quarterly rate of interest on the debentures will be 4.8%. 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 September 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 September 30, 2003, for the Company and the Bank, as well as the minimum regulatory requirements.

	Amount	Ratio	Amount	Minimum Ratio
The Company:				
Leverage Capital	$15,997	6.94%	$9,220	4%
Tier 1 - Risk Based	15,997	10.99%	5,823	4%
Total Risk-Based	18,017	12.38%	11,646	8%
The Bank:				
Leverage Capital	15,954	6.93%	9,214	4%
Tier 1 Risk-Based	15,954	10.98%	5,812	4%
Total Risk-Based	17,606	12.12%	11,624	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

Not applicable

Item 5. Other Information

Not applicable

Item 6. Exhibits and Report on form 8-K

(a). Exhibits

Number	Description
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
July 10, 2003	5	Announcement of a $0.07 per share cash dividend

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: