BLACKHAWK BANCORP INC
Form 10QSB
November 13, 2003

FORM 10-QSB
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

[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 0-18599

BLACKHAWK BANCORP, INC.
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

WISCONSIN	39-1659424
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	(I. R. S. EMPLOYER IDENTIFICATION NO.)

400 BROAD STREET
BELOIT, WISCONSIN 53511
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

(608) 364-8911
(REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE)
NOT APPLICABLE
(FORMER NAME, FORMER ADDRESS AND FORMER FISCAL YEAR, IF CHANGED SINCE LAST REPORT)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days.

YES X NO ---

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

CLASS OF COMMON STOCK	OUTSTANDING AT NOVEMBER 7, 2003
$.01 PAR VALUE	2,522,995 SHARES

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BLACKHAWK BANCORP, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED BALANCE SHEETS

	SEPTEMBER 30, 2003
	(Dollars in t
ASSETS	
Cash and due from banks	$ 17,252
Federal funds sold and securities purchased under agreements to resell	9,572
Interest-bearing deposits in banks	3,679
Available-for-sale securities	108,917
Held to maturity securities, at amortized cost	18,691
Loans, less allowance for loan losses of $3,305 and $2,079	

at September 30, 2003 and December 31, 2002, respectively	241,187
Office buildings and equipment, net	9,769
Intangible assets	7,363
Other assets	15,390
Total Assets	$431,820

LIABILITIES AND STOCKHOLDERS' EQUITY

LIABILITIES:	
Deposits:	
Noninterest-bearing	$ 48,423
Interest-bearing	268,757
Total deposits	317,180
Short-term borrowings	18,485
Long-term borrowings	58,596
Company Obligated Mandatorily Redeemable Preferred Securities of subsidiary trust holding solely subordinated debentures	7,000
Other liabilities	4,723
Total Liabilities	405,984
STOCKHOLDERS' EQUITY:	
Preferred stock 1,000,000 shares, $.01 par value per share authorized, none issued or outstanding	--
Common stock 10,000,000 shares, $.01 par value per share authorized, shares issued and outstanding: 2,522,995 at September 30, 2003, 2,507,065 at December 31, 2002	25
Surplus	8,818
Retained earnings	16,073
Accumulated other comprehensive income	920
Total Stockholders' Equity	25,836
Total Liabilities and Stockholders' Equity	$431,820

See Notes to Unaudited Consolidated Financial Statements

BLACKHAWK BANCORP, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF INCOME

	THREE MONTHS ENDED SE 2003 (Dollars in thou except per share
INTEREST INCOME:	
Interest and fees on loans	$2,993
Interest and dividends on securities:	
Taxable	745
Nontaxable	286

Interest on fed funds sold and securities purchased under agreements to resell	5
Interest on interest-bearing deposits in banks	14
Total Interest Income	4,043
INTEREST EXPENSE:	
Interest on deposits	1,180
Interest on short-term borrowings	20
Interest on long-term borrowings	549
Interest on Company Obligated Mandatorily Redeemable Preferred Securities	102
Total Interest Expense	1,851
Net Interest Income	2,192
Provision for loan losses	142
Net Interest Income after Provision for Loan Losses	2,050
NONINTEREST INCOME:	
Service charges on deposit accounts	372
Gain on sale of loans	158
Securities gains, net	50
Other	247
Total Noninterest Income	827
NONINTEREST EXPENSES:	
Salaries and employee benefits	1,322
Occupancy	172
Equipment	202
Data processing services	221
Advertising and marketing	47
Amortization of intangibles	79
Professional fees	92
Office supplies	69
Telephone	79
Transportation and postage	105
Other	281
Total Noninterest Expenses	2,669
Income before Income Taxes	208
Income Taxes (Benefit)	(30)
Net Income	$ 238
Basic Earnings Per Share	$ 0.09
Diluted Earnings per Share	$ 0.09
Dividends Per Share	$ 0.09

See Notes to Unaudited Consolidated Financial Statements

BLACKHAWK BANCORP, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF INCOME

	NINE MONTHS ENDED SEPTE	
	2003	
	(Dollars in thousan except per share da	
INTEREST INCOME:		
Interest and fees on loans	$ 9,261	$
Interest and dividends on securities:		
Taxable	2,602	
Nontaxable	821	
Interest on fed funds sold and securities purchased under agreements to resell	54	
Interest on interest-bearing deposits in banks	31	
Total Interest Income	12,769	
INTEREST EXPENSE:		
Interest on deposits	3,676	
Interest on short-term borrowings	96	
Interest on long-term borrowings	1,584	
Interest on Company Obligated Mandatorily Redeemable Preferred Securities	265	
Total Interest Expense	5,621	
Net Interest Income	7,148	
Provision for loan losses	508	
Net Interest Income after Provision for Loan Losses	6,640	
NONINTEREST INCOME:		
Service charges on deposit accounts	1,072	
Gain on sale of loans	459	
Securities gains, net	475	
Other	739	
Total Noninterest Income	2,745	
NONINTEREST EXPENSES:		
Salaries and employee benefits	4,140	
Occupancy	541	
Equipment	663	
Data processing services	619	
Advertising and marketing	254	
Amortization of intangibles	238	
Professional fees	393	
Office supplies	186	
Telephone	232	
Transportation and postage	317	
Other	805	

Total Noninterest Expenses	8,388	
Income before Income Taxes	997	
Income Taxes	31	
Net Income	$ 966	$
Basic Earnings Per Share	$ 0.38	$
Diluted Earnings per Share	$ 0.38	$
Dividends Per Share	$ 0.27	$

See Notes to Unaudited Consolidated Financial Statements

BLACKHAWK BANCORP, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	NINE MONTHS ENDED SEPTE	
	2003	
	(Dollars in thousa	
Common Stock:		
Balance at beginning of period	$ 25	$
Stock options exercised	--	
Balance at end of period	25	
Surplus:		
Balance at beginning of period	8,698	
Stock options exercised	120	
Sale of treasury stock	--	
Balance at end of period	8,818	
Retained Earnings:		
Balance at beginning of period	15,788	1
Net income	966	
Dividends declared on common stock	(681)	
Balance at end of period	16,073	1
Treasury Stock, at cost:		
Balance at beginning of period	--	
Sale of treasury stock	--	
Balance at end of period	--	
Accumulated other comprehensive income:		
Balance at beginning of period	1,287	

Other comprehensive income (loss):		
Change in net unrealized gains on available-for-sale securities	(457)	
Change in net unrealized gains on interest rate SWAP contract	325	
Reclassification adjustment for securities gains included in net income	(475)	
Income tax effects	240	
Balance at end of period	920	
Total Stockholders' Equity	$25,836	$2

See Notes to Unaudited Consolidated Financial Statements

BLACKHAWK BANCORP, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

	NINE MONTHS ENDED SEPTE	
	2003	
	(Dollars in thousa	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 966	$
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	931	
Provision for loan losses	508	
Gain on sale of loans	(459)	
FHLB stock dividends	(202)	
Amortization of premiums on securities, net	744	
Securities gains, net	(475)	
Decrease (increase) in accrued interest receivable	201	
Decrease in accrued interest payable	(44)	
Decrease (increase) in other assets	(503)	
Decrease in other liabilities	(631)	
Net cash provided by operations before loan originations and sales	1,036	
Origination of loans for sale	(24,385)	(
Proceeds from sale of loans	26,550	
Net cash provided by operating activities	3,201	
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net decrease in interest-bearing deposits in banks	6,184	
Net decrease in federal funds sold and securities purchased under agreements to resell	13,120	
Proceeds from sales of available-for-sale securities	33,631	
Proceeds from maturities and calls of available-for-sale securities	34,096	
Proceeds from maturities and calls of held-to-maturity securities	4,553	
Purchase of available-for-sale securities	(82,773)	(
Purchase of held-to-maturity securities	(284)	
Net decrease (increase) in loans	(11,481)	
Purchase of bank owned life insurance	--	

Net cash used in acquisition	(4,533)	
Proceeds from the sale of office buildings, equipment, and other real estate owned	369	
Purchase of office buildings and equipment, net	(910)	
Net cash provided by (used in) investing activities	(8,028)	

See Notes to Unaudited Consolidated Financial Statements

BLACKHAWK BANCORP, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
(CONTINUED)

	NINE MONTHS ENDED SEPTE	
	2003	
	(Dollars in thousa	
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net decrease in deposits	$(10,141)	$
Dividends paid	(679)	
Proceeds from other borrowings	15,500	
Payments on other borrowings	(300)	(
Net increase in short-term borrowings	5,030	
Proceeds from exercise of stock options	97	
Sale of treasury stock	--	
Net cash provided by (used in) financing activities	9,507	
Net increase (decrease) in cash and due from banks	4,680	
CASH AND DUE FROM BANKS:		
Beginning	12,572	
Ending	$ 17,252	$
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid (refunded) during the period for:		
Interest	$ 5,688	$
Income taxes	$ (21)	$
SUPPLEMENTAL SCHEDULES OF NON-CASH INVESTING ACTIVITIES:		
Change in accumulated other comprehensive income:		
Unrealized gains (losses) on available-for-sale securities, net	$ (581)	$
Unrealized gains (losses) on interest rate SWAP contract, net	$ 214	$
Other assets acquired in settlement of loans	$ 273	$

See Notes to Unaudited Consolidated Financial Statements

BLACKHAWK BANCORP, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
(CONTINUED)

SUPPLEMENTAL SCHEDULES OF NON-CASH INVESTING ACTIVITIES

(CONTINUED):

Acquisition of DunC Corp.

Assets acquired:	
Cash and due from banks	$ 2,686
Federal funds sold	9,572
Interest-bearing deposits in banks	1,391
Available-for-sale securities	11,104
Loans	45,892
Office buildings and equipment, net	2,741
Intangible assets	3,069
Other assets	1,271
Total assets	$77,726
Liabilities assumed:	
Deposits	$64,237
Borrowings	3,631
Other liabilities	1,401
Total liabilities	$69,269
Net assets acquired	$ 8,457
Cash paid	$ 7,223
Cash acquired:	
DunC Corp.	4
First Banc bc	2,686
Total cash received	$ 2,690
Net cash used in acquisition	$ 4,533

See Notes to Unaudited Consolidated Financial Statements

BLACKHAWK BANCORP, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2003

Note 1. General:

The unaudited consolidated financial statements include the accounts of Blackhawk Bancorp, Inc. and its subsidiaries. Effective September 30, 2003, Blackhawk Bancorp, Inc. acquired the assets of DunC Corp and its subsidiary, First Bank bc., in a transaction accounted for as a purchase. The assets and liabilities of those acquired companies have been included in the September 30, 2003 Unaudited Consolidated Balance Sheet of Blackhawk Bancorp, Inc.

In the opinion of management, all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the financial position, results of operation and cash flows for the interim periods have been made. The results of operations for the nine months ended September 30, 2003 are not necessarily indicative of the results to be expected for the entire fiscal year.

The unaudited interim financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and industry practice. Certain information in footnote disclosure normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America and industry practice has been condensed or omitted pursuant to rules and regulations of the Securities and Exchange Commission. The more significant policies used by the Company in preparing and presenting its financial statements are stated in the Corporation's Form 10-KSB. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's December 31, 2002 audited financial statements.

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

Certain reclassifications have been made to the 2002 historical financial statements to conform to the 2003 presentation.

Stock-Based Compensation Plan: At September 30, 2003, the Company had a stock-based director, key officer and employee compensation plan. The Company accounts for this plan 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 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 table on the following page illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of Financial Accounting Standards Board (FASB) Statement No. 123, Accounting for Stock-Based Compensation, to stock-based employee compensation.

(Dollars in thousands, except per share data)	Three Months Ended September 30, 2003	Three Months Ended September 30, 2002
Net income, as reported	$ 238	$ 302
Deduct total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(29)	(19)
PRO FORMA NET INCOME	$ 209	$ 283

Earnings per share:		
Basic:		
As reported	$0.09	$0.12
Pro forma	0.08	0.11
Diluted:		
As reported	0.09	0.12
Pro forma	0.08	0.11

(Dollars in thousands, except per share data)	Nine Months Ended September 30, 2003	2002
Net income, as reported	$ 966	$1,049
Deduct total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(71)	(56)
PRO FORMA NET INCOME	$ 895	$ 993
Earnings per share:		
Basic:		
As reported	$0.38	$ 0.43
Pro forma	0.36	0.40
Diluted:		
As reported	0.38	0.43
Pro forma	0.35	0.40

In determining compensation cost using the fair value method prescribed in Statement No. 123, the value of each grant is estimated at the grant date with the following weighted-average assumptions used for grants: dividend yield of 4 percent; expected price volatility of 25 percent; risk-free interest rates of 4 percent; and expected lives of 10 years.

Note 2. Allowance for Loan Losses

A summary of transactions in the allowance for loan losses is as follows:

	THREE MONTHS ENDED SEPTEMBER 30, (Dollars in thousands) 2003	2002
Balance at beginning of period	$2,342	$2,519
Reserve acquired in merger	889	--
Provision charged to expense	142	422
Loans charged off	105	237
Recoveries	37	2
Balance at end of period	$3,305	$2,706

	NINE MONTHS ENDED SEPTEMBER 30, (Dollars in thousands) 2003	2002
Balance at beginning of period	$2,079	$2,404
Reserve acquired in merger	889	--
Provision charged to expense	508	683
Loans charged off	353	419
Recoveries	182	38
Balance at end of period	$3,305	$2,706

Note 3. Earnings per Share

Presented below are the calculations for basic and diluted earnings per share:

	THREE MONTHS ENDED SEPTEMBER 30, 2003	2002	NIN S 2003
Basic:			
Net income available to common stockholders	$ 238,000	$ 302,000	$ 966,
Weighted average shares outstanding	2,520,443	2,503,832	2,517,
Basic earnings per share	$ 0.09	$ 0.12	$ 0
Diluted:			
Net income available to common stockholders	$ 238,000	$ 302,000	$ 966,
Weighted average shares outstanding	2,520,443	2,503,832	2,517,
Effect of dilutive stock options outstanding	14,126	6,176	14,
Diluted weighted average shares outstanding	2,534,569	2,510,008	2,531,
Diluted earnings per share	$ 0.09	$ 0.12	$ 0

Note 4. Derivative Instrument

During June, 2003, the Company entered into an interest rate swap transaction, which resulted in the Company converting its $7,000,000 of variable rate Company Obligated Mandatorily Redeemable Preferred Securities into fixed rate debt. This swap transaction requires the payment of interest by the Company at a fixed rate equal to 2.47% using an actual/360 day basis. In turn the Company receives a variable rate interest payment based on the 90 day LIBOR rate adjusted quarterly.

Summary information about the interest rate swap at September 30 is as follows:

	2003	2002
	(Dollars in thousands)	
Notional amount	$7,000	--
Weighted average fixed rate	2.51%	--
Weighted average variable rate	1.16%	--
Weighted average maturity	4.25 years	--
Fair value	$325	--

Note 5. Acquisition of DunC Corp.

As more fully described in Item 2 of this report under the caption "Acquisition or Disposition of Assets", Blackhawk Bancorp, Inc. acquired DunC Corp on September 30, 2003 in a transaction accounted for as a purchase. The assets and liabilities of DunC Corp., valued at fair market value, on the date of acquisition, September 30, 2003, were included in the unaudited consolidated balance sheet of Blackhawk Bancorp, Inc. and Subsidiaries at September 30, 2003. Since the transaction was accounted for as a purchased no amounts have been included in the unaudited consolidated statement of income for either of the periods presented.

Note 6. Recent Accounting Developments

The Financial Accounting Standards Board has issued Statement 149, "Amendment of Statement 133 on Derivative Instruments and Hedging". This Statement amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under Statement 133. The Statement is effective for contracts entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003. Implementation of the Statement is not expected to have a material impact on the company's financial statements.

The Financial Accounting Standards Board has issued Statement 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity". This Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity and requires that certain freestanding financial instruments be reported as liabilities in the balance sheet. Depending on the type of financial instrument, it is required to be accounted for at either fair value or the present value of future cash flows determined at each balance sheet date with the change in that value reported as interest expense in the income statement. Prior to the application of Statement No. 150, either those financial instruments were not required to be recognized, or if recognized were reported in the balance sheet as equity and changes in the value of those instruments were normally not recognized in net income. For the Company, the Statement is effective July 1, 2003 and implementation is not expected to have a material impact on the consolidated financial statements.

FIN No. 46 "Consolidation of Variable Interest Entities, an interpretation of Accounting Research Bulletin No. 51." establishes accounting guidance for consolidation of variable interest entities (VIE) that function to support the activities of the primary beneficiary. The primary beneficiary of a VIE entity is the entity that absorbs a majority of the VIE's expected losses, receives a majority of the VIE's expected residual returns, or both, as a result of ownership, controlling interest, contractual relationship or other business relationship with a VIE. Prior to the implementation of FIN 46, VIEs were generally consolidated by an enterprise when the enterprise had a controlling financial interest through ownership of a majority of voting interest in the entity. The provisions of FIN 46 were effective immediately for all arrangements entered into after January 31, 2003. If a VIE existed prior to February 1, 2003, FIN 46 was effective at the beginning of the first interim period beginning after June 15, 2003. However, on October 8, 2003, the Financial Accounting Standards Board (FASB) deferred the implementation date of FIN 46 until the first period ending after December 15, 2003.

The interpretations of FIN 46 and its application to various transaction types and structures are evolving. Management continuously monitors emerging issues related to FIN 46, some of which could potentially impact the Corporation's financial statements. The Corporation currently consolidates its VIE, Blackhawk Statutory Trust I, in its unaudited consolidated financial statements and treats its Trust Preferred Securities as debt.

Note 7. Recent Regulatory Developments

On July 30, 2002, President Bush signed the Sarbanes-Oxley Act of 2002 (the "Act"). This legislation impacts corporate governance of public companies, affecting their officers and directors, their audit committees, their relationships with their accountants and the audit function itself. Certain provisions of the Act became effective on July 30, 2002. Other provisions will become effective as the SEC adopts appropriate rules.

The Act implements a broad range of corporate governance and accounting measures for public companies designed to promote honesty and transparency in corporate America and better protect investors from corporate wrongdoing. The Act includes the creation of an independent accounting oversight board to oversee the audit of public companies and their auditors, provisions restricting non-audit services performed by independent accountants for public companies and additional corporate governance and responsibility provisions.

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

The purpose of Management's discussion and analysis is to provide relevant information regarding the Registrant's financial condition and its results of operations. The information included herein should be read in conjunction with the company's consolidated financial statements and footnotes thereto for the year ended December 31, 2002.

This report contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 with respect to the financial condition, results of operations, plans, objectives, future performance and business of Blackhawk Bancorp, Inc. Statements that are not historical facts, including statements about beliefs and expectations, are forward-looking statements. These statements are based upon beliefs and assumptions of Blackhawk's management and on information currently available to such management. The use of the words "believe", "expect", "anticipate", "plan", "estimate", "may", "will" or similar expressions are forward-looking statements.

Contemplated, projected, forecasted or estimated results in such forward-looking statements involve certain inherent risks and uncertainties. A number of factors - many of which are beyond the ability of the company to control or predict - could cause actual results to differ materially from those described in the forward-looking statements. Factors which could cause such a variance to occur include, but are not limited to: heightened competition; adverse state and federal regulation; failure to obtain new or retain existing customers; ability to attract and retain key executives and personnel; changes in interest rates; unanticipated changes in industry trends; unanticipated changes in credit quality and risk factors, including general economic conditions; success in gaining regulatory approvals when required; changes in the Federal Reserve Board monetary policies; unexpected outcomes of new and existing litigation in which Blackhawk or its subsidiaries, officers, directors or employees is named defendants; technological changes; changes in accounting principles generally accepted in the United States; changes in assumptions or conditions affecting the application of critical accounting policies; and the inability of third party vendors to perform critical services for the company or its customers.

The Company does not undertake, and specifically declines any obligation, to publicly release the results of any revisions which may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

ACQUISITION OR DISPOSITION OF ASSETS

On September 30, 2003 (the "Effective Date"), Blackhawk Bancorp, Inc., (the "Corporation") consummated its acquisition of DunC Corp. ("DunC"), a bank holding company registered under the Bank Holding Company Act of 1956, as amended, and DunC's wholly owned subsidiary, First Bank, bc ("First Bank"), an Illinois state bank.

The Corporation acquired DunC and First Bank pursuant to an Agreement and Plan of Merger dated as of March 17, 2003 (the "Merger Agreement"), between the Corporation, DunC Merger Corporation ("Merger Corp"), a wholly owned subsidiary of the Corporation, and DunC through a series of mergers.

Pursuant to the Merger Agreement, Merger Corp was merged with and into DunC at the close of business on the Effective Date, and DunC became a wholly owned subsidiary of the Corporation. The merger consideration was cash in the aggregate amount of $7,222,941, which was paid to former DunC shareholders. The price paid by the Corporation for the DunC common stock was arrived at through arms-length negotiations.

The terms of the merger of Merger Corp with and into DunC are described more fully in the Merger Agreement filed as Exhibit 2.1 to the Corporation's Form 10-QSB for the quarterly period ended March 31, 2003, which is incorporated herein by reference. The description of the transaction set forth above is qualified in its entirety by the terms set forth in the Merger Agreement.

Immediately following the merger of Merger Corp into DunC, DunC merged with and into the Corporation, and First Bank merged with and into Blackhawk State Bank, a wholly owned subsidiary of the Corporation. As a result of these mergers the Corporation and Blackhawk State Bank were the surviving entities, and DunC and First Bank ceased to exist.

The merger consideration paid to the former shareholders of DunC was funded through a term loan with U.S. Bank National Association, Milwaukee, Wisconsin. The term loan for $7.5 million was entered into in the ordinary course of business and on terms commensurate with prevailing market conditions on September 26, 2003. The term loan matures on September 26,

2008. A copy of the term loan agreement was filed as an exhibit on the Corporation's Current Report on Form 8-K dated September 30, 2003 and is incorporated herein by reference.

The merger was accounted for as a purchase. The assets of the acquired companies (as detailed on page 10 of this report on Form 10-QSB) are included in the September 30, 2003 Unaudited Consolidated Balance Sheet. The results of operations subsequent to the acquisition date will be reflected in future filings.

RESULTS OF OPERATIONS

The company reported net income of $238,000 for the three months ended September 30, 2003, a decrease of $64,000 or 21.2% from the $302,000 reported for the same three month period in 2002. Net income for the nine month period ended September 30, 2003 was $966,000, a decrease of $83,000, or 7.9% from the $1,049,000 reported for the same period in 2002.

Diluted earnings per share were $0.09 and $0.38 for the three and nine months ended September 30, 2003, respectively, compared to $0.12 and $0.43 for the same periods in 2002. This represents a decrease of 25.0% and 11.6% for the three month and nine month periods, respectively.

NET INTEREST INCOME

Net interest income, which is the sum of interest and certain fees generated by earning assets minus interest paid on deposits and other funding sources, is the primary source of the company's earnings. All discussions of interest income amounts and rates are on a tax-equivalent basis, which accounts for income earned on loans and securities that are not fully subject to income taxes as if they were fully subject to income taxes. The following table sets forth the company's consolidated average balances of assets, liabilities and stockholders' equity, interest income and expense on related items, and the company's average rate for the three and nine month periods ended September 30, 2003 and 2002. The tax-equivalent yield calculations assume a Federal Tax Rate of 34%:

AVERAGE BALANCE SHEET WITH RESULTANT INTEREST AND RATES

(yields on a tax-equivalent basis)	Three Months ended September 30, 2003			Three Mo Septembe	
	Average Balance	Interest	Average Rate	Average Balance	Int
INTEREST EARNING ASSETS:					
Interest-bearing deposits in banks	$ 2,548	$ 14	2.18%	$ 987	$
Federal funds sold & securities purchased under agreements to resell	2,047	5	.97%	9,687	
Investment securities:					
Taxable investment securities	92,312	745	3.20%	77,182	
Tax-exempt investment securities	29,560	433	5.81%	19,784	
Total investment securities	121,872	1,178	3.83%	96,966	1
Loans	192,758	2,994	6.16%	193,773	3

TOTAL EARNING ASSETS	$319,225	$4,191	5.21%	$301,413	$4
Allowance for loan losses	(2,402)			(2,491)	
Cash and due from banks	11,287			10,569	
Other assets	21,093			17,013	
TOTAL ASSETS	$349,203			$326,504	
INTEREST BEARING LIABILITIES:					
Interest bearing checking accounts	$ 36,396	$ 62	.68%	$ 32,461	$
Savings deposits	54,793	93	.67%	53,901	
Time deposits	130,867	1,025	3.11%	123,716	1
Total interest bearing deposits	222,056	1,180	2.11%	210,078	1
Short-term borrowings	11,254	20	.71%	18,405	
Long-term borrowings	48,388	549	4.50%	39,442	
Trust preferred securities	7,000	102	5.78%	-0-	
TOTAL INTEREST-BEARING LIABILITIES	$288,698	$1,851	2.54%	$267,925	$2
NET INTEREST SPREAD			2.66%		
Noninterest bearing deposits	32,998			30,641	
Other liabilities	1,809			2,217	
Total liabilities	323,505			300,783	
Stockholders' equity	25,698			25,721	
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$349,203			$326,504	
NET INTEREST MARGIN		$2,340	2.91%		$2

AVERAGE BALANCE SHEET WITH RESULTANT INTEREST AND RATES

(yields on a tax-equivalent basis)	Nine Months ended September 30, 2003			Nine Mon Septembe	
	Average Balance	Interest	Average Rate	Average Balance	Int
INTEREST EARNING ASSETS:					
Interest-bearing deposits in banks	$ 2,035	$ 31	2.04%	$ 2,880	$
Federal funds sold & securities purchased under					

agreements to resell	4,053	54	1.78%	7,345	
Investment securities:					
Taxable investment securities	91,702	2,602	3.79%	66,734	
Tax-exempt investment securities	27,658	1,242	6.00%	19,564	
Total investment securities	119,360	3,844	4.31%	86,298	
Loans	186,262	9,262	6.65%	197,863	1
TOTAL EARNING ASSETS	$311,710	$13,191	5.66%	$294,386	$1
Allowance for loan losses	(2,276)			(2,509)	
Cash and due from banks	11,004			10,070	
Other assets	21,372			17,153	
TOTAL ASSETS	$341,810			$319,100	
INTEREST BEARING LIABILITIES:					
Interest bearing checking accounts	$ 37,800	$ 224	.79%	$ 32,255	$
Savings deposits	53,953	305	.76%	53,820	
Time deposits	125,995	3,147	3.34%	122,201	
Total interest bearing deposits	217,748	3,676	2.26%	208,276	
Short-term borrowings	12,384	96	1.04%	13,053	
Long-term borrowings	44,448	1,584	4.76%	41,035	
Trust preferred securities	7,000	265	5.06%	-0-	
TOTAL INTEREST-BEARING LIABILITIES	$281,580	$ 5,621	2.67%	$262,364	$
NET INTEREST SPREAD			2.99%		
Noninterest bearing deposits	32,445			29,725	
Other liabilities	1,966			2,162	
Total liabilities	315,991			294,251	
Stockholders' equity	25,819			24,849	
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$341,810			$319,100	
NET INTEREST MARGIN		$ 7,570	3.25%		$

Net interest income decreased by $517,000, or 18.1%, to $2,340,000 for the quarter ended September 30, 2003, compared to $2,857,000 for the comparable period in 2002. On a year to date basis net interest income decreased by $876,000, or 10.4%, to $7,570,000 compared to $8,446,000 for the first nine months of 2002. These decreases are primarily due to decreases in yields on interest earning assets, which were only partially offset with decreases in costs of interest bearing liabilities. The net interest margin, which is the tax equivalent net interest income divided by average interest earning assets was 2.91% and 3.25% for the three and nine month periods ended September 30, 2003. The third quarter net interest margin represents an 85 basis point decrease compared to the 2002 third quarter net interest margin of 3.76%. The year to date net interest margin of 3.25% represents a 59 basis point decrease compared to the 3.84% net interest margin realized for the same period in 2002.

For the three months ended September 30, 2003, total interest income decreased by $747,000, or 15.1%, to $4,191,000 compared to $4,938,000 for the same period in 2002. The decrease in interest income is due to a 129 basis point decrease in the yield on average earning assets to 5.21% for the third quarter of 2003, compared to 6.50% for the same period in 2002. The decrease in the yield on average earning assets for the third quarter of 2003 compared to the third quarter of 2002 is offset by a $17,812,000 increase in average earning assets. For the nine months ended September 30, 2003, total interest income decreased by $1,658,000, or 11.2%, to $13,191,000 compared to $14,849,000 for the same period in 2002. The decrease in interest income is due to a 108 basis point decrease in the yield on average earning assets to 5.66% compared to 6.74% for the same period in 2002 partially offset by a 5.9% increase in average earning assets. The decrease in yield on average earning assets for the three months ended September 30, 2003 reflects the investment of available liquidity into lower yielding investment securities and the continued re-pricing of loans and investments in this historically low interest rate environment.

Interest income on loans decreased 17.0% to $2,994,000 for the third quarter of 2003 compared to $3,609,000 for the same period in 2002. This decrease primarily is due to lower rates earned on the bank's loans due to continued repricing and the sustained low interest rate environment. Average loans outstanding for the three months ended September 30, 2003 decreased .5% compared to the same period in 2002. Interest and fees on loans decreased 17.2% to $9,262,000 for the nine months ended September 30, 2003 compared to $11,192,000 in same period of 2002. This decrease was the result of an $11,601,000 or 5.9% decrease in average loans outstanding and a 91 basis point decrease in yield on the portfolio. The decrease in average loans outstanding for the nine month period ended September 30, 2003 compared to the same period in 2002 is largely attributable to the refinancing activity in the residential real estate market, weak commercial and consumer loan demand and competitive pricing pressure for quality credits.

Interest income on taxable securities deincreased by $201,000 or 21.2% in the third quarter of 2003 to $745,000 compared to $946,000 for the same period in 2002. The average balances of taxable investment securities increased 19.6% to $92,312,000 for the quarter ended September 30, 2003 compared to $77,182,000 for the same period in the prior year. However, the yield on average taxable investment securities decreased 166 basis points to 3.20% for the third quarter of 2003 compared to 4.86% for the third quarter of 2002. Interest income on taxable securities increased by $43,000, or 1.7%, in the first nine months of 2003 to $2,602,000 from $2,559,000 for the same period in 2002. Average balances of taxable investment securities increased 37.4% to $91,702,000 for the nine months ended September 30, 2003 compared to $66,734,000 for the same period in the prior year. The increase in average balances outstanding was offset by a decrease of 134 basis points in average yield to 3.79% for the first nine months of 2003 compared to 5.13% for the first nine months of 2002. The decrease in the yield on taxable investments for the three and nine months ended September 30, 2003 compared to the same periods a year ago is primarily due to the investment of proceeds from the maturity and sale of investments and additional liquidity into the investment portfolio during the historically low interest rate environment. The yield was further impacted by accelerated amortization of purchase premium on mortgage-backed securities and collateralized mortgage obligations due to increased prepayment speeds on the underlying collateral.

Tax exempt investment securities increased $9,776,000, or 49.4% to an average balance of $29,560,000 for the three months ended September 30, 2003 compared to $19,784,000 for the same period in 2002. Interest income on tax exempt securities increased $115,000 or 36.2% to $433,000 for the third quarter of 2003 compared to $318,000 for the third quarter of 2002. Average tax exempt securities increased to $27,658,000 for the nine months ended September 30, 2003 compared to $19,564,000 for the same period in 2002 and their average tax equivalent yield decreased from 6.49% for the nine months ended September 30, 2002 to 6.00% for the same period in 2003.

Interest from fed funds sold and securities purchased under agreements to resell decreased to $5,000 and $54,000 for the three and nine month periods ended September 30, 2003, respectively, compared to $59,000 and $109,000 during the same periods in 2002. The quarterly and year to date decreases in interest on fed funds sold and securities purchased under agreements to resell were due to lower market rates and lower average balances outstanding.

Total interest expense decreased by $230,000, or 11.1%, to $1,851,000 for the three months ended September 30, 2003 compared to $2,081,000 for the same period in 2002. For the nine months ended September 30, 2003 total interest expense decreased by $782,000, or 12.2%, to $5,621,000 compared to $6,403,000 for the same period in 2002. The decrease in total interest expense is the result of the aforementioned lower interest rate environment offset by higher average balances outstanding.

While interest paid on deposits decreased $279,000, or 19.1% to $1,180,000 during the three months ended September 30, 2003 compared to $1,459,000 for the same period in 2002, average interest bearing deposits increased $11,978,000 quarter over quarter. Year to date interest paid on deposits decreased $891,000, or 19.5% to $3,676,000 compared to $4,567,000 for the same period in 2002 while average total interest bearing deposits increased by $9,472,000.

Interest on short-term borrowings decreased $69,000 to $20,000 for the three months ended September 30, 2003 compared to $89,000 for the same period in 2002. For the nine months ended September 30, 2003 interest on short-term borrowings decreased $88,000 to $96,000 compared to $184,000 for the same period in 2002. Both decreases are the result of lower average balances outstanding in 2003 coupled with the lower interest rate environment in 2003 compared to 2002. They also reflect the liquidation of the holding company's bank line of credit during December 2002 coincident with the issuance of the company's Trust Preferred Securities.

Interest expense on long-term borrowings increased $16,000 to $549,000 for the three months ended September 30, 2003 compared to $533,000 for the third quarter of 2002. The increase is primarily the result of additional Federal Home Loan Bank advances in 2003, at lower market interest rates, offset by the pay-off of the bank debt of Blackhawk Bancorp, Inc. during December, 2002 co-incident with the issuance of the company's Trust Preferred Securities. Interest expense on long-term borrowings decreased $68,000 to $1,584,000 for the nine months ended September 30, 2003 compared to $1,652,000 for the third quarter of 2002 primarily from the liquidation of the holding company debt in December 2002 offset by additional interest, at lower market rates, on additional Federal Home Loan Bank advances outstanding in 2003.

PROVISION FOR LOAN LOSSES

The provision for loan losses (provision) is an amount added to the allowance for loan losses (allowance) to provide for the known and estimated amount of loans that will not be collected. Actual loan losses are charged against (reduce) the allowance when management believes that the collection of principal will not occur. Subsequent recoveries of amounts previously charged to the allowance, if any, are credited to (increase) the allowance. Management determines the appropriate provision based upon a number of criteria, including a detailed evaluation of certain credits, historical performance, economic conditions and overall quality of the loan portfolio. The provision was $142,000 in the third quarter of 2003, a decrease of $280,000 or 66.4% from the $422,000 in the third quarter of 2002. The bank provided an additional provision of $300,000 during the third quarter of 2002 to adequately value its loan portfolio for problem loans identified during the quarter. For the first nine months of 2003, the provision was $508,000 compared to $683,000 during the same time period a year ago.

Activity in the allowance for loan losses is detailed in footnote 2 to the unaudited consolidated financial statements. Charge-offs, net of recoveries for the third quarter of 2003 decreased by $167,000 to net charge-offs of $68,000 compared to net charge-offs of $235,000 for the third quarter of 2002. Year to date net charge-offs decreased $210,000 or 55.1% to $171,000 compared to $381,000 for the first nine months of 2002.

The ratio of the allowance to total loans was 1.35% at September 30, 2003 compared to 1.10% at December 31, 2002. The allowance for loan losses totaled $3,305,000 at September 30, 2003 and included $889,000, which was acquired as part of the DunC Corp. and First Bank, bc acquisition.

NONINTEREST INCOME

Total noninterest income increased $126,000, or 18.0%, to $827,000 for the three months ended September 30, 2003 compared to $701,000 for the same period in 2002. Year to date total noninterest income increased $532,000, or 24.0%, to $2,745,000 compared to $2,213,000 for the same period in 2002.

Service charges on deposit accounts totaled $372,000 for the quarter ended September 30, 2003 compared to $396,000 for the third quarter of 2002. The decrease is primarily due to lower overdraft fees collected which decreased by $22,000 or 8.6% to $235,000 for the quarter ended September 30, 2003 compared to $257,000 for the third quarter of 2002. Year to date service charges on deposits decreased $70,000, or 6.1%, to $1,072,000 compared to $1,142,000 in the prior year primarily due to lower levels of overdraft fees collected for the nine months ended September 30, 2003.

Gain on the sale of mortgage loans increased $63,000 or 66.3% to $158,000 for the third quarter of 2003 compared to the $95,000 of gains recognized during the third quarter of 2002. The increase was primarily due to higher volumes sold during the third quarter of 2003. In the third quarter of 2003, $9,842,000 of loans were sold to the secondary market compared to $6,242,000 for the same period in 2002. Year to date gain on sale of mortgage loans increased $238,000 or 107.7% to $459,000 compared to $221,000 for the same period in 2002. The increase is due to a higher volume of loans sold and higher margins. The average gain in 2003 was 1.73% on $26,550,000 in loans sold to the secondary market compared to an average gain of 1.20% on the $18,468,000 of loans sold in the same period in 2002. The level of gains realized is dependent on market interest rates which impacts the level of home loan refinancings. Should market interest rates increase from their current 45-year historical lows, the amount of loans sold to the secondary market and the level of gains realized is anticipated to decrease.

The Company recognized $50,000 in securities gains in the third quarter of 2003. No gains were recognized in the third quarter of 2002. Year to date the company has realized $475,000 in securities gains, a $246,000 or 107.4% increase over the $229,000 realized for the nine months ended September 30, 2002.

Other noninterest income increased $37,000 or 17.6% to $247,000 for the quarter ended September 30, 2003 compared to $210,000 for the third quarter of 2002. The increase is primarily due to additional income on the bank's investment in bank owned life insurance. The increase in the cash surrender value of life insurance increased by $68,000 in the third quarter of 2003 compared to the third quarter of 2002. The bank invested $5,000,000 in bank owned life insurance on September 30, 2002. Year to date other noninterest income increased by $118,000 or 19.0% to $739,000 for the nine months ended September 30, 2003 from $621,000 for the nine months ended September 30, 2002. The year to date increase is due to an increase in cash surrender value of bank owned life insurance of $203,000 offset by a 32.9% decrease in brokerage and annuity commissions realized in 2003 from $130,000 in 2002 to $87,000 in 2003.

NONINTEREST EXPENSES

Total operating expenses increased $29,000, or 1.1%, to $2,669,000 for the three months ended September 30, 2003 compared to $2,640,000 for the same period in 2002. The third quarter of 2002 included a reversal of $157,000 in accrued vacation as a result of a change in the company's vacation policy. Excluding this non-recurring item, operating expenses decreased by $128,000 for the quarter. The decrease in operating expenses, net of the non-recurring item, reflects senior management's efforts to control discretionary spending to offset lower net interest margin. For the first nine months of 2002 total operating expenses increased $128,000, or 1.5%, to $8,388,000 compared to $8,260,000 for the same period in 2002. Adjusting for the one time year to date impact on the 2002 change in vacation policy of $145,000, operating expenses decreased by $17,000 year over year.

Salaries and employee benefits for 2002 included the one time adjustment, due to the change in the company's vacation policy, of $157,000 and $145,000 for the three and nine months ended September 30, 2003. Excluding this adjustment, salaries and employee benefits decreased $68,000 or 4.9% to $1,322,000 for the quarter ended September 30, 2003, compared to $1,390,000 for the third quarter of 2002. For the first nine months of 2002 total salaries and employee benefits increased $31,000 or 0.8% to $4,140,000 compared to $4,109,000 for the same period in 2002.

Occupancy expenses for the three months ended September 30, 2003 decreased to $172,000 from $193,000 for the third quarter of 2002 primarily due to lower maintenance costs and the closure of the Wal-Mart branch. Occupancy expenses for the nine months ended September 30, 2003 decreased to $541,000 compared to $641,000 for the same period in 2002 primarily as a result of the one time charge in 2002 of $75,000 due to the closure of the company's Wal-Mart branch and the reduction in rent expense for the closed branch.

Furniture and equipment expenses decreased $23,000 or 10.2% to $202,000 for the quarter ended September 30, 2003 compared to $225,000 for the same quarter in 2002 primarily due to lower depreciation on computer equipment. For the first nine months of 2002 furniture and equipment expense increased $9,000, or 1.4%, to $663,000 compared to $654,000 for the same period in 2002.

Data processing costs increased $37,000, or 20.1%, to $221,000 for the quarter ended September 30, 2003 and $49,000, or 8.6%, to $663,000 for the nine months ended September 30, 2003. These increases reflect increases in core processing costs and the outsourcing of certain network administration and support functions midway through 2003.

Advertising and marketing costs decreased $46,000, or 49.5% to $47,000 for the third quarter of 2003 compared to $93,000 for the same period in 2002. Year to date advertising and marketing costs decreased $2,000, or 0.8% to

254,000 from $256,000. The third quarter decrease is primarily due to the timing of expenses as a number of major marketing campaigns occurred during the second quarter of 2003.

Transportation and postage increased $4,000 or 4.0% to $105,000 for the third quarter of 2003 compared to $101,000 for the third quarter of 2002. For the first nine months of 2003 transportation and postage increased $35,000 or 12.4% to $317,000 compared to $282,000 for the same period in 2002. The increase is primarily due to additional costs from an expansion of the bank's courier program in 2003 and increased communication with customers regarding the acquisition of DunC Corp. and First Bank, bc..

Other noninterest expenses increased $4,000 or 1.4% to $281,000 for the three months ended September 30, 2003 compared to $277,000 for the same period a year ago. For the first nine months of 2003 other noninterest expenses decreased $29,000 or 3.5% to $805,000 compared to $834,000 for the same period in 2002. Other noninterest expenses in 2002 included $117,000 of charges to accrue severance payments for executive officers that left the company in 2002 partially offset by an $87,000 credit from adjustment of stale reconciling items.

Income taxes decreased $115,000, or 135.3%, to a tax benefit of $30,000 for the three months ended September 30, 2003 from income taxes of $85,000 for the same period in 2002. For the nine months ended September 30, 2003 income taxes decreased $310,000, or 90.9%, to $31,000 from $341,000 for the same period in 2002. The decrease reflects greater tax efficiency brought about by an increase in non-taxable interest from the municipal bond portfolio and the purchase of bank owned life insurance on September 30, 2002 and the lower level of pre-tax income in 2003.

BALANCE SHEET ANALYSIS

OVERVIEW

Total assets increased to $431,820,000 at September 30, 2003, including $77,726,000 in assets acquired from First Bank, compared to assets of $352,377,000 at December 31, 2002, an increase of 22.5%. The December 31, 2002 balance sheet included short-term year-end deposits of $18,600,000, which were invested in federal funds sold and interest bearing deposits in banks at December 31, 2002. Excluding these deposits, total assets increased 29.4% from December 31, 2002 to September 30, 2003.

LOANS

Gross loans increased $56,113,000, or 29.8%, to $244,492,000 on September 30, 2003, including gross loans of $46,781,000 received in the First Bank acquisition, compared to $188,379,000 on December 31, 2002. The composition of loans is shown in the following table:

				As a % of Total Lo	
	September 30, 2003	December 31, 2002	Change in Balance	September 30, 2003	Decem 20
	(Dollars in millions)				
Residential Real Estate	$100.9	$71.8	$29.1	41.3%	38
Commercial Real Estate	$ 70.5	$59.0	$11.5	28.8%	31
Construction and Land Development	$ 12.3	$ 6.4	$ 5.9	5.0%	3
Commercial	$ 37.5	$28.3	$ 9.2	15.3%	15

Consumer	$ 21.3	$22.3	($ 1.0)	8.7%	11
Other	$ 2.0	$ 0.6	$ 1.4	0.9%	0

The historically low interest rate environment has led to substantial prepayments on the company's 1-4 family residential real estate loan portfolio. To offset this loan run-off, the bank has retained new adjustable and fixed rate mortgages with lives of 15 years or less. This has lead to an increase of $15,900,000 or 22.1% in residential real estate loans, exclusive of the First Bank acquisition, for the nine months ended September 30, 2003. This increase has partially offset decreases, exclusive of the First Bank acquisition, of $3,800,000 in Commercial and Commercial Real Estate loans and $4,800,000 in Consumer loans over the same period. In addition, the company's focus on relationship banking has resulted in the subsidiary bank not pursuing certain "transactions" that may have resulted in increased loan balances, but offered no opportunity to form other relationships with the client.

NON-PERFORMING LOANS

Non-performing loans includes loans which have been categorized by management as non-accruing because collection of interest is not assured, and loans which are past-due ninety days or more as to interest and/or principal payments.

The following summarizes information concerning non-performing loans:

(Dollars in thousands)	SEPTEMBER 30, 2003	DECEMBER 31, 2002
Non-accruing loans	$3,668	$2,560
Past due 90 days or more and still accruing	154	26
Total non-performing loans	$3,822	$2,586
Restructured loans performing in accordance with modified terms	$ 389	$ 418

ASSET QUALITY

The allowance for loan losses was $3,305,000 or 1.35% of total loans at September 30, 2003 compared to $2,079,000 or 1.10% of total loans at December 31, 2002 and includes $889,000 acquired in the First Bank acquisition. As of September 30, 2003, non-performing loans and restructured loans performing in accordance with modified terms totaled $4,211,000 compared to $3,004,000 at December 31, 2002. The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes that the collectibility of the principal is unlikely. The allowance for loan losses is adequate to cover probable credit losses relating to specifically identified loans, as well as probable credit losses inherent in the balance of the loan portfolio. In accordance with FASB Statements 5 and 114, the allowance is provided for losses that have been incurred as of the balance sheet date. The allowance is based on past events and current economic conditions, and does not include the effects of expected losses on specific loans or groups of loans that are related to future events or expected changes in economic conditions. Management reviews a calculation of the allowance for loan losses on a quarterly basis. While management uses the best information available to make its evaluation, future adjustments to the allowance may be necessary if there are significant changes in economic conditions.

In addition, various regulatory agencies periodically review the allowance for loan losses. These agencies may require the bank to make additions to the allowance for loan losses based on their judgments of collectibility based on information available to them at the time of their examination. The policy of the Company is to place a loan on non-accrual status if: (a) payment in full of interest and principal is not expected, or (b) principal or interest has been in default for a period of 90 days or more, unless the obligation is both in the process of collection and well secured. Well secured is defined as collateral with sufficient market value to repay principal and all accrued interest. A debt is in the process of collection if collection of the debt is proceeding in due course either through legal action, including judgement enforcement procedures, or in appropriate circumstances, through collection efforts not involving legal action which are reasonably expected to result in repayment of the debt or in its restoration to current status.

At September 30, 2003 the allowance for loan losses to total non-performing and restructured loans equaled 78.5% compared to 69.2% at December 31, 2002. Total nonperforming and restructured loans increased by $1,207,000;$446,000 due to the First Bank acquisition and the balance as the result of two large loans. One is a commercial real estate loan and the other is a single family residence. Both loans are in foreclosure.

SHORT-TERM INVESTMENTS

Fed funds sold and securities purchased under agreements to resell decreased $3,548,000 to $9,572,000 at September 30, 2003 compared to $13,120,000 at December 31, 2002. The decrease reflects the liquidation of short-term year-end investments on January 2, 2003 associated with the December 31, 2002 year-end deposits of $18,600,000 offset by $9,572,000 of fed funds sold acquired in the First Bank acquisition.

INVESTMENT SECURITIES

Securities available for sale increased $25,020,000, or 29.8%, to $108,917,000 at September 30, 2003 compared to $83,897,000 at December 31, 2002. $11,104,000 of the increase represents securities acquired in the First Bank acquisition. The balance of the increase in investments in securities available for sale resulted from the redeployment of short-term investments and cash flows from held to maturity securities.

DEPOSITS

Total deposits increased $54,983,000 to $318,068,000 at September 30, 2003 compared to $263,085,000 at December 31, 2002. As noted above, the Company's December 31, 2002 financial statements reflect short-term year-end interest-bearing deposits of $18,600,000. The Company assumed $13,899,000 of noninterest-bearing deposits and $50,338,000 of interest bearing deposits from First Bank bc. Excluding the short-term year-end deposits and deposits of $64,237,000 assumed in the First Bank acquisition, total deposits increased 3.8% from December 31, 2002. Excluding the First Bank bc. and short-term year-end deposits, non-interest bearing deposits decreased by $749,000 and interest bearing deposits increased by $10,095,000 at September 30, 2003 compared to December 31, 2002.

BORROWINGS

Short-term borrowings increased $5,031,000 to $18,485,000 at September 30, 2003 from $13,454,000 at year-end. The increase is due to $9,594,000 of fed funds purchased at September 30, 2003 offset by lower outstanding balances of repurchase agreements with commercial customers.

Long-term borrowings at September 30, 2003 total $57,731,000 and consist of a $7,500,000 commercial bank loan and term advances from the Federal Home Loan

Bank ("FHLB"). The FHLB advances were $50,231,000 at September 30, 2003 compared to $38,900,000 at December 31, 2002 and include $3,631,000 of borrowings assumed in the First Bank acquisition. The increase reflects an additional $8,000,000 in FHLB advances net of a $300,000 repayment invested into securities during 2003 and the $7,500,000 term loan used to finance the First Bank acquisition.

STOCKHOLDERS' EQUITY

Total stockholders' equity increased $38,000 to $25,836,000 at September 30, 2003 compared to $25,798,000 at December 31, 2002. During the first nine months of 2003 additional paid in capital increased by $120,000 from stock options exercised. Accumulated other comprehensive income, which is comprised of the adjustment of securities available for sale to market value, net of tax, and the fair value of Blackhawk Bancorp, Inc.' s interest rate SWAP contract, net of tax, was $920,000 at September 30, 2003 compared to $1,287,000 at December 31, 2002. In addition the company declared three quarterly dividends of $0.09 per share on its common stock, which totaled $681,000.

The Company is subject to certain regulatory capital requirements and continues to remain in compliance with the requirements. The following table shows the company's capital ratios and regulatory requirements.

	September 30, 2003	December 31, 2002	Regulatory Requirements
Total Capital (To Risk-Weighted Assets)	10.7%	13.9%	8.0%
Tier I Capital (To Risk-Weighted Assets)	9.5%	12.9%	4.0%
Tier I Capital (To Average Assets)	5.9%	8.3%	4.0%

The decreases in the capital ratios at September 30, 2003 compared to December 31, 2002 were due to the First Bank acquisition, which increased average assets and risk-weighted assets by $73,516,000 and $50,692,000 respectively.

The Company's subsidiary bank meets regulatory capital requirements to be considered well capitalized.

ASSET/LIABILITY MANAGEMENT

Asset/liability management is the process of identifying, measuring and managing the risk to the Company's earnings and capital resulting from the movements in interest rates. It is the Company's objective to protect earnings and capital while achieving liquidity, profitability and strategic goals.

The Company focuses its measure of interest rate risk on the effect a shift in interest rates would have on earnings rather than on the amount of assets and/or liabilities subject to repricing in a given time period. Since not all assets or liabilities move at the same rate and at the same time, a determination must be made as to how each interest earning asset and each interest bearing liability adjusts with each change in the base rate. The Company develops, evaluates and amends its assumptions on an ongoing basis and analyzes its earnings exposure quarterly.

In addition to the effect on earnings, quarterly evaluation is made to determine the change in the economic value of the equity with various changes in interest rates. This determination indicates how much the value of the assets and the value of the liabilities change with a specified change in interest rates. The net difference between the economic values of the assets and liabilities results in an economic value of equity.

During June 2003, the Company entered into an interest rate SWAP agreement related to the company obligated mandatorily redeemable preferred securities. This SWAP is utilized to manage variable interest rate exposure and is designated as a highly effective cash flow hedge. The differential to be paid or received on the SWAP agreement is accrued as interest rates change and is recognized over the life of the agreement in interest expense. The SWAP agreement expires in December 2007 and essentially fixes the rate to be paid at 5.72%. The notional amount is $7,000,000. Included in other comprehensive income is a gain of $325,000, less $111,000 of deferred income tax, relating to the fair market value of the SWAP agreement as of September 30, 2003. Risk management results for the nine months ended September 30, 2003 related to the balance sheet hedging of the company obligated mandatorily redeemable preferred securities indicate that the hedge was 100% effective and that there was no component of the derivative instrument's gain or loss which was excluded from the assessment of hedge effectiveness.

LIQUIDITY

Liquidity, as it relates to the subsidiary bank, is a measure of its ability to fund loans and withdrawals of deposits in a cost-effective manner. The Bank's principal sources of funds are deposits, scheduled amortization and prepayment of loan principal, maturities of investment securities, short-term borrowings and income from operations. Additional sources include purchasing fed funds, sale of securities, sale of loans, borrowing from both the Federal Reserve Bank and Federal Home Loan Bank, and dividends paid by Nevahawk, a wholly owned subsidiary of the Bank.

The liquidity needs of the Company generally consist of payment of dividends to its Stockholders, payments of principal and interest on borrowed funds and subordinated debentures, and a limited amount of expenses. The sources of funds to provide this liquidity are issuance of capital stock and dividends from its subsidiary bank. Certain restrictions are imposed upon the Bank, which could limit its ability to pay dividends if it did not have net earnings or adequate capital in the future. The Company maintains adequate liquidity to pay its expenses.

The following table summarizes The Company's significant contractual obligations and other potential funding needs at September 30, 2003 (in thousands):

Year Ended September 30,	Time Deposits	Long-term debt(1)	Operating