

## LETTER TO OUR SHAREHOLDERS

Dear Shareholders:

The year 2003 was an exceptionally challenging one for our Company as we continue to move from our residential mortgage lending past into a more profitable commercial banking environment. As we reflect on 2003, we want to share with you some thoughts regarding the true strengths and values that our Company has built and will continue to build for many years to come.

Carrollton Bancorp continues to be a safe and sound financial institution with strong levels of capital. The Company's year-end total capital ratio was 15.51%, our Tier 1 risk-based capital ratio was 13.75% and our leverage capital ratio was 10.35%. All remain substantially above federal regulatory standards for a well capitalized financial services institution.

The commitment to the Company's business strategy set forth in 2001 continues to position the Company for sustained profitability in the years to come. 2003 was not a strong profitable year for your Company. Net income for 2003 was \$924,714. There were nonrecurring expenses reducing profitability in 2003 with the largest being related to a conversion of the Company's data processing and delivery systems (approximately \$350,000). This planned conversion will enhance the Company's ability to better serve our commercial clients while increasing the Company's capabilities to better serve all of our clients. The Company's high cost of funds also adversely affected results for 2003. The re-pricing of \$30.0 million in high cost deposits, which occurred in the third quarter of 2003, will position the Company to take advantage of an increased net interest margin in 2004, while the company continues to grow its profitable commercial lending portfolio. The interest expense incurred on these high cost deposits in 2003 was \$1,144,000 which will not be a recurring expense in 2004. The net result is a positive re-pricing position on deposits, which the Company will benefit from in 2004.

Carrollton Bancorp will continue to evolve and remain true to our ideas of conservative management, a strong commitment to quality service, and a disciplined approach to growth. As planned, growth in the Company's commercial lending sector continues to be strong. The Company has formed a talented group of Associates to grow the commercial lending sector of your Company. Since 2001, the Company has seen double digit growth in our commercial lending portfolio while sustaining the high asset quality that has come to be expected. Commercial loans, including commercial real estate loans, increased 13.5% in 2003 from \$122,953,000 to \$139,560,000. The continued focus on the footprint outlined in our Strategic Plan to build this Company into a strong commercial bank hasn't changed. Our strategies are to create improved value for our clients and from that process create greater profitability for the Bank.

The Company's overall loan portfolio decreased 2.9%, resulting from the low interest rate environment and the Company's commitment not to purchase "commodity" type loans. The decrease can be seen in the Company's residential loan portfolio where a 27.6% decrease was experienced in 2003. The Company has enhanced its ability to generate residential real estate loans (home equities and secured second mortgages) within our branch network and expects improvements within this loan portfolio category.

During 2003, the Company made a significant change in its delivery systems and information systems. We do not attempt to be a technological leader, but we want to be a very close follower. The Company closely follows the technological breakthroughs our larger counterparts implement and if the Company believes it will benefit our clients, we will replicate it and try to do better. The Company offers a strong core of electronic delivery systems and will continue to enhance them to better serve our clients.

The Company reactivated Carrollton Mortgage Services, Inc. (CMSI) in 2003. Carrollton Mortgage Services, Inc. is a full service mortgage subsidiary of Carrollton Bank, offering mortgage products that will be originated and sold in the secondary market. Carrollton Mortgage Services, Inc. became fully operational in the second half of 2003, reflecting fees and gains on mortgage activities before expenses of \$665,948.

Carrollton Financial Services, Inc. (CFS), the Company's financial services arm, continues to be affected by market conditions. Carrollton Financial Services, Inc. ended 2003 with external fee income of \$597,247 compared to \$670,952 in 2002, an 11% decrease. The Company will continue to license well qualified Associates enabling them to offer financial services products which will enhance the fee income of Carrollton Financial Services, Inc.

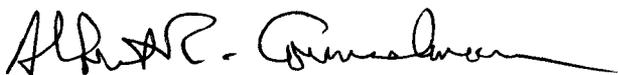
The Company continues to have a substantial commitment in Automated Teller Machines (ATMs). Currently, the Company has 155 ATMs with 144 deployed in Wal-Marts and Sam's Clubs. The Company in 2001 took an aggressive stance in accelerating the depreciation of its ATM network. Automated Teller Machine depreciation expense in 2003 was \$762,000. The ATMs will be fully depreciated in September of 2004. The ATMs transaction fees, along with other fees and commissions, resulted in an increase in other fees and commissions (electronic banking) of 14% in 2003.

After three (3) years of positioning the Company to grow and restructuring our balance sheet, it is time to grow. The Company is very pleased to announce the anticipated opening of a new branch located near the intersection of Conowingo Road and East-West Highway in Harford County, Maryland. The anticipated opening will occur in the second half of 2004. We are very excited and energized about the growth opportunities this new location will offer to your Company.

As was stated in this letter, 2003 was an exceptionally challenging year for the Company. We have overcome many obstacles and believe we are positioned to grow in the typical commercial banking way. The Company understands enhanced profitability should only increase shareholder value and we are committed to doing so. We believe our shareholders can see the investment benefits in Carrollton Bancorp. In 2003, an investment in Carrollton Bancorp stock has significantly outperformed the Standard and Poor's 500 Index. In 2003, the Company's total return to shareholders before dividend was over 31.5%, while the S&P 500 Index before dividend was 26.1%.

The opening sentence of your Company's Mission Statement reads "Carrollton Bank will create long term value for its customers and shareholders by providing superior financial products and services to our community at fair and competitive prices." The Company firmly believes in this statement and firmly believes that our key purpose is to create improved rewards to shareholders. The Board of Directors and all Associates of Carrollton Bancorp, the Bank, and its subsidiaries are committed to building shareholder value for the future.

Sincerely,



Albert R. Counselman  
Chairman of the Board



Robert A. Altieri  
President and Chief Executive Officer

## SELECTED FINANCIAL DATA

	2003	2002	2001	2000	1999
<b>CONSOLIDATED INCOME</b>					
<b>STATEMENT DATA:</b>					
Interest income . . . . .	\$ 15,935,691	\$ 18,985,364	\$ 23,832,624	\$ 26,726,048	\$ 22,255,896
Interest expense . . . . .	6,639,734	8,692,320	12,872,355	15,921,684	10,953,649
Net interest income . . . . .	9,295,957	10,293,044	10,960,269	10,804,364	11,302,247
Provision for loan losses . . . . .	243,000	526,000	550,000	448,000	597,840
Net interest income after provision for loan losses . . . . .	9,052,957	9,767,044	10,410,269	10,356,364	10,704,407
Noninterest income . . . . .	8,268,612	7,534,802	7,156,444	7,913,046	10,721,487
Noninterest expense . . . . .	16,058,355	14,536,958	14,817,504	15,945,347	17,864,554
Income before income taxes . . . . .	1,263,214	2,764,888	2,749,209	2,324,063	3,561,340
Income taxes . . . . .	338,500	847,630	816,132	576,531	840,664
Net income . . . . .	\$ 924,714	\$ 1,917,258	\$ 1,933,077	\$ 1,747,532	\$ 2,720,676
<b>CONSOLIDATED BALANCE SHEET</b>					
<b>DATA, AT YEAR END</b>					
Assets . . . . .	\$302,409,975	\$324,221,615	\$356,907,181	\$387,658,811	\$375,331,442
Gross loans . . . . .	199,296,561	205,220,126	220,177,983	276,367,035	257,447,335
Deposits . . . . .	207,056,100	230,264,108	265,528,720	292,024,141	262,449,865
Shareholders' equity . . . . .	34,124,882	33,691,079	32,458,383	30,292,083	29,694,656
<b>PER SHARE DATA: (a)</b>					
Number of shares of Common					
Stock outstanding, at year-end . . . . .	2,828,078	2,821,757	2,836,317	2,843,120	2,915,749
Net income:					
Basic . . . . .	\$ 0.33	\$ 0.68	\$ 0.68	\$ 0.61	\$ 0.96
Diluted . . . . .	0.32	0.68	0.68	0.61	0.96
Cash dividends declared . . . . .	0.360	0.342	0.342	0.337	0.292
Book value, at year end . . . . .	12.07	11.94	11.44	10.65	10.18
<b>Performance and Capital Ratios:</b>					
Return on average assets . . . . .	0.29%	0.57%	0.52%	0.46%	0.81%
Return on average shareholders' equity . . . . .	2.71%	5.70%	6.05%	5.91%	8.80%
Net yield on interest earning assets (b) . . . . .	3.36%	3.47%	3.32%	3.22%	4.01%
Average shareholders' equity to average total assets . . . . .	10.83%	9.99%	8.52%	7.81%	9.21%
Year-end capital to year-end risk-weighted assets:					
Tier 1 . . . . .	13.75%	13.57%	12.88%	10.99%	11.96%
Total . . . . .	15.51%	15.07%	14.26%	12.13%	13.12%
Year-end Tier 1 leverage ratio . . . . .	10.35%	9.54%	8.61%	7.74%	8.38%
Cash dividend declared to net income . . . . .	109.96%	50.80%	50.43%	55.58%	31.77%
<b>ASSETS QUALITY RATIOS:</b>					
Allowance for loan losses, at year-end to:					
Gross loans . . . . .	1.83%	1.74%	1.52%	1.09%	1.10%
Nonperforming, restructured and past-due loans . . . . .	151.37	111.68	276.13	119.19	201.30
Net charge-offs to average gross loans . . . . .	0.09	0.13	0.10	0.09	0.07
Nonperforming assets as a percent of period-end loans and foreclosed real estate . . . . .	1.26	1.67	0.55	0.92	0.54

(a) Per share amounts and common shares outstanding have been adjusted to retroactively reflect the effect of a 5% stock dividend declared by the Board of Directors on October 24, 2002.

(b) This ratio is presented on a fully taxable equivalent basis, using regular income tax rates.

**CARROLLTON BANCORP**  
**344 North Charles Street, Suite 300**  
**Baltimore, Maryland 21201**

**NOTICE OF ANNUAL MEETING OF SHAREHOLDERS**  
**TO BE HELD ON APRIL 20, 2004**

**TO THE SHAREHOLDERS OF CARROLLTON BANCORP:**

The Annual Meeting of Shareholders of Carrollton Bancorp, a Maryland corporation (the "Company"), will be held at 344 North Charles Street, Baltimore, Maryland on April 20, 2004 at 10:00 a.m., prevailing local time, for the following purposes:

1. To elect four directors for a three-year term ending in 2007, and until their respective successors are duly elected and qualify.
2. To ratify the appointment of Rowles & Company, LLP as independent public accountants to audit the financial statements of the Company for 2004.
3. To vote on the amendment to the 1998 Long Term Incentive Plan to increase the number of shares available for issuance.
4. To act upon any other matter which may properly come before the meeting or any adjournment thereof.

The close of business on March 1, 2004, has been fixed by the Board of Directors as the date for determining shareholders of record entitled to receive notice of and to vote at the Annual Meeting.

Your attention is directed to the enclosed Proxy Statement and annual report of the Company for the fiscal year ended December 31, 2003.

Please sign, date and mail the accompanying proxy in the enclosed, self-addressed, stamped envelope, whether or not you expect to attend the meeting in person. You may withdraw your proxy at the meeting should you be present and desire to vote your shares in person. Your cooperation is respectfully requested.

By Order of the Board of Directors



D. Doreen Smith  
Secretary

Baltimore, Maryland  
March 19, 2004

**WHETHER OR NOT YOU PLAN TO ATTEND THE MEETING IN PERSON, IT IS IMPORTANT THAT YOUR SHARES BE REPRESENTED AND VOTED. ACCORDINGLY, PLEASE DATE, SIGN AND RETURN THE ENCLOSED PROXY PROMPTLY.**

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**CARROLLTON BANCORP**  
**344 North Charles Street, Suite 300**  
**Baltimore, Maryland 21201**

**PROXY STATEMENT**  
**ANNUAL MEETING OF SHAREHOLDERS**

**APRIL 20, 2004**

**SOLICITATION AND REVOCATION OF PROXIES**

This Proxy Statement (the "Proxy Statement") is being furnished to the shareholders of Carrollton Bancorp (the "Company") in connection with the solicitation of proxies by the Board of Directors of the Company for use at the Annual Meeting of Shareholders, and any adjournments thereof, to be held at 344 North Charles Street, Baltimore, Maryland at 10:00 a.m. prevailing local time, on Tuesday, April 20, 2004. Our principal executive offices are located at 344 North Charles Street, Baltimore, Maryland 21201. This Proxy Statement is being sent to the shareholders of the Company on or about March 19, 2004.

The Board of Directors has selected David P. Hessler, Ben F. Mason, and Howard S. Klein and each of them, to act as proxies with full power of substitution. A proxy may be revoked at any time prior to its exercise by giving written notice of revocation to the Company, by executing and delivering a substitute proxy to the Company, or by attending the Annual Meeting and voting in person. If no instructions are specified in the proxy, it is the intention of the persons named therein to vote **FOR** the election of the nominees named herein as directors of the Company, **FOR** the ratification of Rowles and Company, LLP as independent public accountants to audit the financial statements of the Company for 2004, and **FOR** the amendment to the 1998 Long Term Incentive Plan to increase the number of shares available for issuance.

Shareholders of the Company are requested to complete, date and sign the accompanying form of proxy and return it promptly to the Company in the enclosed envelope. If a proxy is properly executed and returned in time for voting, it will be voted as indicated thereon.

The Company does not know of any matter to be presented at the Annual Meeting except as described herein. If any other matters are properly brought before the Annual Meeting, the persons named in the enclosed proxy intend to vote the proxy according to their best judgment.

The Company will bear the costs of the solicitation of proxies, including the reimbursement of banks, brokers and other fiduciaries for expenses in forwarding proxy solicitation materials to beneficial owners. Such expenses are estimated not to exceed \$5,000. Solicitations may be made by mail, telegraph or personally by directors, officers or employees of the Company, none of whom will receive additional compensation for performing such services.

## VOTING SECURITIES

On March 1, 2004, the Company had outstanding 2,828,078 shares of Common Stock, \$1.00 par value per share. Each share of Common Stock entitles the holder thereof to one vote on each matter to be voted upon at the Annual Meeting. Neither the Company's Charter nor its Bylaws provides for cumulative voting rights.

The close of business on March 1, 2004 has been fixed by the Board of Directors as the record date for determining the shareholders of the Company entitled to receive notice of and to vote at the Annual Meeting.

## PROPOSAL 1: ELECTION OF DIRECTORS

The Company's Board of Directors is divided into three classes. Each year the directors in one class are elected to serve for a term of three years, and until their respective successors are duly elected and qualify. The Shareholders will vote at this Annual Meeting for the election of four directors for the three-year term expiring at the Annual Meeting of Shareholders in 2007.

The proxies solicited hereby, unless directed to the contrary, will be voted FOR the election as directors of all four nominees listed in the following tables. In order to be elected, a plurality of the shares voted at a meeting at which a quorum is present is necessary for the election of a director. Each nominee has consented to serve as a director, if elected.

Your Company's Board of Directors unanimously recommends a vote FOR the election of each of the nominees named below as directors of the Company.

In the event that any of the nominees should be unable to serve, the persons named in the proxy will vote for such substitute nominee or nominees as they, in their sole discretion, shall determine. The Board of Directors has no reason to believe that any nominee named herein will be unable to serve.

The following material contains information concerning the nominees for election and those directors whose terms continue beyond the date of the Annual Meeting.

### NOMINEES FOR DIRECTOR FOR TERM EXPIRING IN 2007

**Robert J. Aumiller** – Mr. Aumiller, age 55, currently is serving as a director of Carrollton Bank ("the Bank"), the principal subsidiary of the Company, and the Company beginning with his appointment in 2001. He has been the Executive Vice President and General Counsel of MacKenzie Commercial Real Estate Services, LLC involved in

brokerage and real estate development of various commercial real estate projects, since 1983. (2)

**Ben F. Mason** – Mr. Mason, age 66, currently is serving as a director of the Bank and the Company beginning with his appointment in 2001. He has been the Executive Director of the Baltimore City Chamber of Commerce, a member business association that promotes business development within Baltimore City, since 1993. (2) (4)

**Charles E. Moore, Jr.** – Mr. Moore, age 54, currently is serving as a director of the Bank and the Company beginning with his appointment in 2001. He has been the Co-Founder, Director, President and CFO of TelAtlantic, a consolidation of rural telephone companies across the United States, since 1999. (1) (2) (3) (4)

**John Paul Rogers** – Mr. Rogers, age 68, has served as director of the Bank since 1970 and of the Company since its inception in 1990.

Mr. Rogers has been Chairman of the Bank since February 1994. He was a partner of the law firm of Rogers, Moore and Rogers, counsel of the Bank, from 1970 until 1992. Mr. Rogers was senior title officer of The Security Title Guarantee Corporation of Baltimore from May 1991 until December 1992, having served as President from March 1989 until May 1991, and as Executive Vice President from March 1970 until March 1989. He is the brother of William C. Rogers, Jr., a director of the Bank and the Company.

## DIRECTORS CONTINUING IN OFFICE

### DIRECTORS WHOSE TERMS EXPIRE IN 2005

**Steven K. Breeden** – Mr. Breeden, age 45, has served as a director of the Bank, since June 1994, and of the Company since October 1995. Mr. Breeden is currently a managing member of Security Development LLC and related real estate and development companies, a position he has held since 1980. (2) (3) (4)

**Harold I. Hackerman** – Mr. Hackerman, age 52, has served as a director of the Bank since February 2002 and of the Company since February 2002. Since 1984, Mr. Hackerman has been Vice President of Ellin & Tucker, a certified public accounting firm, and has provided audit, accounting and consulting services since 1973. (1) (2) (4) (5)

**Howard S. Klein** – Mr. Klein, age 45, has served as a director of the Bank since March 1999 and of the Company since April 1999. Mr. Klein has been Vice President and General Counsel for Klein's Super Markets, a family-operated chain of six full serve supermarkets and related development and operating companies since 1987. (1) (4)

## DIRECTORS WHOSE TERMS EXPIRE IN 2006

**Albert R. Counselman** – Mr. Counselman, age 55, has served as a director of the Bank since April 1985, and of the Company since its inception in 1990. Mr. Counselman was elected Chairman of the Board of the Company in January 2002. He has been President of Riggs, Counselman, Michaels & Downes, Inc., an insurance brokerage firm, since September 1987, and served in various executive positions with that firm from 1972 to September 1987.

**John P. Hauswald** – Mr. Hauswald, age 81, has served as a director of the Bank since 1964 and of the Company since its inception in 1990. He was, until his retirement in October 1989, President of The Hauswald Bakery. (4)

**David P. Hessler** – Mr. Hessler, age 47, has served as a director of the Bank since March 1999, and the Company since May 1999. He has been President and CEO of Eastern Sales & Engineering, an electrical contracting and service maintenance firm, since 1987 and was Vice President from 1986 to 1987. Mr. Hessler has been Vice President of Advanced Petroleum Equipment, a distributorship, since its inception in 1998. (1)(3)(4)

**William C. Rogers, Jr.** – Mr. Rogers, age 77, has served as a director of the Bank since 1955 and of the Company since its inception in 1990. He has been a partner in the law firm of Rogers, Moore and Rogers, counsel to the Bank, since 1950. He has been Chairman of the Board of The Security Title Guarantee Corporation of Baltimore since 1989 and a director since 1952, and was President from 1970 until March 1989. Mr. Rogers is President of Maryland Mortgage Company where he has been a director since 1953. He is also President of Moreland Memorial Park Cemetery, Inc. where he has been a director since 1959. He is the brother of John Paul Rogers, a director of the Bank and the Company.

The Board of Directors of the Company met 4 times and the Board of Directors of the Bank met 12 times during the year ended December 31, 2003. The Board of Directors of the Bank meets regularly 12 times each year. No director attended fewer than 75% of the total number of meetings of both Boards and committees to which they were assigned during the year ended December 31, 2003.

- 
- (1) Member of the Audit Committee
  - (2) Member of the Compensation Committee
  - (3) Member of the Nominating Committee
  - (4) Independent Director
  - (5) Financial expert for Audit Committee

As of the date of this Proxy Statement, the Board of Directors has standing audit, nominating and compensation committees.

The Audit Committee held 13 meetings during 2003. Its current members are Messrs. Hackerman, Hessler, Klein and Moore. Only non-employee directors are eligible to serve on the Audit Committee. The duties of the Audit Committee include reviewing the quarterly and annual financial statements and regulatory filings of the Company and Bank and the scope of the independent annual audit and internal audits. It also reviews the independent accountant's letter to management concerning the effectiveness of the Company's internal financial and accounting controls and management's response to that letter. In addition, the Committee reviews and recommends to the Board the firm to be engaged as the Company's independent accountants. The Committee also approves all insider loans. The Committee may also examine and consider other matters relating to the financial affairs of the Company as it determines appropriate.

The Compensation Committee met four times during 2003. Its current members are Messrs. Aumiller, Breeden, Hackerman, Mason and Moore. The purpose of the Compensation Committee is to review and approve major compensation and benefit policies of the Company and the Bank. In addition, the committee recommends to the Board the compensation to be paid to all officers, Senior Vice President and above, of the Bank.

Directors who are not employees of the Bank receive a monthly fee of \$900 for Board meetings, and between \$75 and \$150 per committee meeting attended. The Chairman of the Board of the Bank receives a monthly fee of \$1,100. Directors do not receive additional fees for their service as directors of the Company.

## OTHER EXECUTIVE OFFICERS AND DIRECTORS OF THE BANK

Certain information regarding significant employees of the Bank other than those previously mentioned is set forth below.

**Robert A. Altieri** – Mr. Altieri, age 42, has been President and Chief Executive Officer of both the Bank and Company since his appointment in February 2001. Mr. Altieri previously was the Senior Vice President—Lending of the Bank since June 1994, and Vice President—Commercial Lending since September 1991.

**Edward R. Bootey** – Mr. Bootey, age 57, has been Senior Vice President—Automation & Technology since October, 1995, and was Senior Vice President—Operations of the Bank from June 1994 to

October 1995. Mr. Bootey previously served as Vice President—Operations from January 1991. He served as Assistant Vice President—Operations from December 1987 until January 1991.

**John A. Giovanazi** – Mr. Giovanazi, age 46, has been Senior Vice President and Chief Lending Officer since his appointment in February 2001. Mr. Giovanazi previously was Vice President of Commercial Lending since August 1996. Prior to joining Carrollton Bank, he was a Vice President, Commercial Lending, with Citizens Bank of Maryland, from 1992 to 1996.

**Robert F. Hickey** – Mr. Hickey, age 42, has been Senior Vice President—Branch Administration since December 2003. Prior to joining Carrollton Bank, Mr. Hickey was an Account Executive for Chase Manhattan Mortgage from 2000 to 2003. He served as President of Carrollton Mortgage Services, Inc. from 1997 to 2000.

**Gary M. Jewell** – Mr. Jewell, age 57, has been Senior Vice President—Electronic Banking since July 1998. He was previously Senior Vice President and Retail Delivery Group Manager from March 1996 to July 1998. Prior to joining the Bank, Mr. Jewell was Director of Product Management and Point of Sale Services for the MOST EFT network in Reston, Virginia from March 1995 to March 1996 and prior to that Director/Manager of Merchant Services for the Farmers and Mechanics National Bank from 1993 to March 1995.

**Randall M. Robey** – Mr. Robey, age 46, has been Executive Vice President and Chief Financial Officer of both the Bank and Company, since November 2000. Previously he had been the Senior Vice President and Chief Financial Officer and Treasurer since October 1999. Prior to joining the Bank, Mr. Robey was Vice President of Financial Services of Mercantile Bank & Trust in Baltimore, Maryland from June 1998 to October 1999, and prior to that Senior Vice President and Chief Financial Officer of Annapolis Bank & Trust from March of 1989 to June 1998.

#### **CODE OF ETHICS**

A Code of Ethics is in existence for the Chief Executive Officer, Chief Financial Officer and Bank Controller positions. There have been no exceptions to the Code of Ethics; any exceptions are required to be reported to the Audit Committee.

#### **SECTION 16 (A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE**

Section 16(a) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), requires the Company’s directors and executive officers, and persons who own more than 10% of a registered class of the Company’s equity securities (“10% Holders”), to file with the Securities and Exchange Commission initial reports of ownership and reports of changes in ownership of common stock and other equity securities of the Company. Directors, executive officers and 10% Holders are required by regulations under the Exchange Act to furnish the Company with copies of all of the Section 16(a) reports which they file. Based solely upon a review of copies of Forms 3 and 4 furnished to the Company during its fiscal year 2003 and copies of Form 5 furnished to the Company with respect to its fiscal year 2003, and any written representations made by the reporting persons to the Company, the Company believes that its directors, executive officers and 10% Holders complied with the filing requirements under Section 16(a) of the Exchange Act, except that Mr. Aumiller did not file a Form 4 on a timely basis to report the purchase of 105 shares of stock.

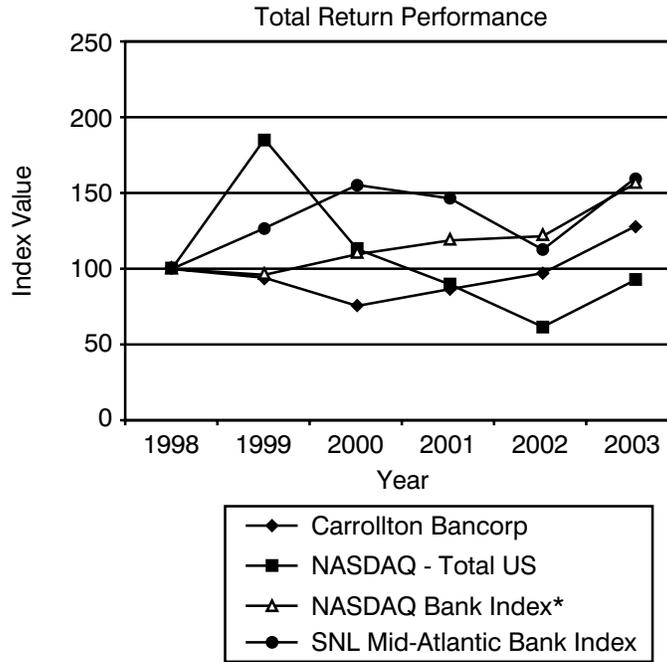
#### **STOCK PERFORMANCE TABLE**

The Company is required by the SEC to provide a five-year comparison of the cumulative total Shareholder return on our Common Stock compared with that of a broad equity market index, and either a published industry index or a constructed peer group index of the Company.

The following chart compares the cumulative Shareholder return on the Company’s Common Stock from December 31, 1998 to December 31, 2003 with the cumulative total of the NASDAQ Composite (U.S.), the NASDAQ Bank and SNL Mid-Atlantic Indices. The comparison assumes \$100 was invested on December 31, 1998 in the Company’s Common Stock and in each of the foregoing indices. It also assumes reinvestment of any dividends.

The Company does not make, nor does it endorse, any predictions as to future stock performance.

CARROLLTON BANCORP STOCK PERFORMANCE



Index	Period Ending					
	12/31/98	12/31/99	12/31/00	12/31/01	12/31/02	12/31/03
Carrollton Bancorp . . . . .	100.00	94.10	75.66	86.61	97.29	128.33
NASDAQ — Total US . . . . .	100.00	185.95	113.19	89.65	61.67	92.90
NASDAQ Bank Index* . . . . .	100.00	96.15	109.84	118.92	121.74	156.62
SNL Mid-Atlantic Bank Index . . . . .	100.00	127.05	155.70	146.73	112.85	160.45

\*Source: CRSP, Center for Research in Security Prices, Graduate School of Business, The University of Chicago 2004. Used with permission. All rights reserved. crsp.com.

**SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**

The following table sets forth, as of March 1, 2004, certain information concerning shares of the Common Stock of the Company beneficially owned by (i) the

executive officers of the Company and Bank; (ii) all directors and nominees for directors of the Company and the Bank; (iii) all directors and executive officers of the Company and the Bank as a group; and (iv) other significant shareholders.

<i>Beneficial Owner(1)(21)</i>	<i>Amount and Nature of Beneficial Ownership</i>	<i>Percent of Class</i>
<b>EXECUTIVE OFFICERS:</b>		
Chief Executive Officer: Robert A. Altieri	26,773(2)	*
Chief Financial Officer: Randall M. Robey	10,850(3)	*
Senior Vice President—Bank: Edward R. Bootey	21,325(4)	*
Senior Vice President—Bank: John A. Giovanazi	4,515(5)	*
Senior Vice President—Bank: Robert F. Hickey	390	*
Senior Vice President—Bank: Gary M. Jewell	16,800(6)	*
<b>DIRECTORS:</b>		
Robert J. Aumiller	3,150(7)	*
Steven K. Breeden	12,516(8)	*
Albert R. Counselman	39,807(9)	1.41%
Harold I. Hackerman	2,625(10)	*
John P. Hauswald	16,072(11)	*
David P. Hessler	3,990(12)	*
Howard S. Klein	9,567(13)	*
Ben F. Mason	69,619(14)	2.46%
Charles E. Moore, Jr.	4,668(15)	*
John Paul Rogers	206,992(16)	7.32%
William C. Rogers, Jr.	274,226(17)(18)(19)	9.70%
All Directors and Executive Officers of the Company as a Group (17 persons)	579,706(21)	20.50%
<b>OTHER SIGNIFICANT SHAREHOLDER:</b>		
Patricia A. Rogers	192,062(20)	6.79%

\* Less than 1%

- (1) Unless otherwise indicated, the named person has sole voting and investment power with respect to all shares.
- (2) Includes 1,050 shares owned jointly by Mr. Altieri and his wife, 173 shares Mr. Altieri holds as trustee for minor children under the Maryland Uniform Gifts to Minors Act, and 25,550 fully vested options to purchase shares at an exercise price of between \$10.94 and \$17.79 per share.
- (3) Includes 100 shares owned jointly by Mr. Robey and his wife and 10,750 fully vested options to purchase shares at an exercise price of between \$10.94 and \$15.48 per share.
- (4) Includes 2,425 shares owned jointly by Mr. Bootey and his wife and 18,900 fully vested options to purchase shares at an exercise price of between \$10.94 and \$17.79 per share.
- (5) Includes 4,515 fully vested options to purchase shares at an exercise price of between \$10.94 and \$15.42 per share.
- (6) Includes 14,700 fully vested options to purchase shares at an exercise price of between \$10.94 and \$17.79 per share.
- (7) Includes 2,205 shares owned jointly by Mr. Aumiller and his wife and 840 fully vested options to purchase shares at an exercise price of between \$9.71 and \$14.50 per share.
- (8) Includes 3,777 shares owned jointly by Mr. Breeden and his wife and 3,780 fully vested options to

- purchase shares at an exercise price of between \$9.71 and \$18.10 per share.
- (9) Includes 3,780 fully vested options to purchase shares at an exercise price of between \$9.71 and \$18.10 per share, but excludes 7,982 shares owned by Mr. Counselman's wife.
- (10) Includes 1,470 shares owned jointly by Mr. Hackerman and his wife, and 1,050 fully vested options to purchase shares at an exercise price of between \$12.11 and \$14.50 per share.
- (11) Includes 210 shares owned jointly by Mr. Hauswald and his wife and 3,570 fully vested options to purchase shares at an exercise price of between \$9.71 and \$18.10 per share.
- (12) Includes 1,470 shares owned jointly by Mr. Hessler and his wife and 2,520 fully vested options to purchase shares at an exercise price of between \$9.71 and \$15.42 per share.
- (13) Includes 1,680 shares owned by Colgate Investments, LLP, of which Mr. Klein is partner and 2,079 shares Mr. Klein holds as trustee for minor children under the Maryland Uniform Gifts to Minors Act. Also includes 2,520 fully vested options to purchase shares at an exercise price of between \$9.71 and \$15.36 per share.
- (14) Includes 1,890 fully vested options to purchase shares at an exercise price of between \$9.71 and \$14.50 per share. Also includes 67,099 shares owned by The Security Title Guarantee Corporation of Baltimore of which Mr. Mason is a Director.

- (15) Includes 840 fully vested options to purchase shares at an exercise price of between \$9.71 and \$14.50 per share, but excludes 17,320 shares owned by Mr. Moore's wife.
- (16) Includes 3,780 fully vested options to purchase shares at an exercise price of between \$9.71 and \$18.10 per share. Also includes 67,099 shares owned by The Security Title Guarantee Corporation of Baltimore and 9,981 shares owned by Maryland Mortgage Company of which Mr. Rogers is a principal shareholder.
- (17) Includes 67,099 shares owned by The Security Title Guarantee Corporation of Baltimore of which William C. Rogers, Jr. is Chairman, as well as a Director. Includes 3,360 fully vested options to purchase shares at an exercise price of between \$9.71 and \$18.10 per share.
- (18) Includes 6,818 shares owned by the Moreland Memorial Park Cemetery Bronze Perpetual Care Trust Agreement, Inc., 6,168 shares owned by Moreland Memorial Park Perpetual Care, 34,034 shares owned by Moreland Memorial Park Perpetual Care Trust, 3,597 shares owned by Moreland Memorial Park, Inc. Bronze Marker Perpetual Care Trust Fund, 6,168 shares owned by Moreland Memorial Park Cemetery, Inc. Perpetual Care Trust Agreement, and 9,981 shares owned by Maryland Mortgage Company of which William C. Rogers, Jr. is President as well as a Director.
- (19) Includes 137,001 shares owned jointly by Mr. Rogers and his wife. Excludes 12,251 shares owned by Mr. Roger's wife.
- (20) Includes 67,099 shares owned by The Security Title Guarantee Corporation of Baltimore and 9,981 shares owned by Maryland Mortgage Company of which Mrs. Rogers is a principal shareholder.
- (21) All directors, executive officers and other significant shareholders may be contacted at the Company's corporate offices by addressing correspondence to the appropriate person, care of Carrollton Bancorp, 344 North Charles Street, Suite 300, Baltimore, Maryland 21201.

## PRINCIPAL HOLDERS OF VOTING SECURITIES

The following table sets forth information with respect to the ownership of shares of Common Stock of the Company by the only persons believed by management to be the beneficial owners of more than five percent of the Company's outstanding Common Stock. The information is based on the most recent Schedule 13-G filed by such persons with the Securities and Exchange Commission.

<i>Name and Address of Beneficial Owner</i>	<i>Amount and Nature of Beneficial Ownership</i>	<i>Percentage of Common Stock Outstanding</i>
John Paul Rogers 46 C Queen Anne Way Chester, MD 21619	206,992(a)	7.3%
William C. Rogers, Jr. 6 South Calvert Street Baltimore, MD 21201	274,226(b)	9.7%
Patricia A. Rogers P.O. Box 246 Gibson Island, MD 21056	192,062(c)	6.8%

- (a) A Schedule 13-G filed on February 12, 2004, states that John Paul Rogers has sole voting and dispositive power over 126,132 shares. Also includes 67,099 shares owned by The Security Title Guarantee Corporation of Baltimore, and 9,981 shares owned by Maryland Mortgage Company of which Mr. Rogers is a principal shareholder.
- (b) A Schedule 13-G dated February 12, 2004 states that William C. Rogers, Jr. has sole voting and dispositive power over 4,704 shares, and shared voting and dispositive power over 274,226 shares. Also includes 67,099 shares owned by the Security Title Guarantee Corporation of Baltimore of which Mr. Rogers is chairman, as well as a director; 9,981 shares owned by Maryland Mortgage Company of which Mr. Rogers is president as well as a director; and 56,785 shares owned by Moreland Memorial Park Cemetery, Inc. of which Mr. Rogers is a trustee.
- (c) A Schedule 13-G dated February 12, 2004 states that Patricia A. Rogers has sole voting and dispositive power over 114,982 shares. Also includes 67,099 shares owned by The Security Title Guarantee Corporation of Baltimore, and 9,981 shares owned by Maryland Mortgage Company of which Mrs. Rogers is a principal shareholder.

## REPORT OF THE COMPENSATION COMMITTEE

### OVERALL POLICY

The Board of Directors of the Company establishes the overall goals and objectives of, and the policies to be followed in pursuing these goals and objectives, including the selection of necessary key management personnel, and the evaluating of the performance of those personnel. The major responsibility for assisting in satisfying the compensatory aspect of the overall supervisory duty of the Board rests with the Compensation Committee. The membership of the Compensation Committees (collectively the "Committee") of the Company and the Bank is identical, composed of independent nonemployee Directors of both institutions who do not participate in any executive compensation plan.

In order to achieve the overall goals and objectives of the Company, and recognizing the interest of the shareholders in that achievement, the Committee has developed and maintains an executive compensation plan based on a philosophy that links executive compensation to individual and corporate performance, and return to shareholders. This philosophy is intended to enable the Company to attract and retain highly motivated executive personnel of outstanding ability and initiative, and to create an identity of interests between executives and the Company's shareholders. The Company's executive compensation plan consists of basic cash compensation, the opportunity for annual incentive compensation based on corporate performance, and continuing stock based compensation.

The Committee administers the provisions of the Company's incentive cash compensation plan and its stock based plans. In addition, the Committee is authorized to make recommendations to the Boards of the Company and the Bank with respect to basic salaries, supplemental pension, deferred compensation, employment and similar agreements affecting their executive officers, and performs such

other functions as may be delegated to it by the Boards.

The Committee takes various factors into consideration when establishing and reviewing executive compensation. There follows an explanation of general principles governing basic cash compensation, annual incentive compensation based on corporate earnings performance, stock based compensation, and the factors considered in establishing basic cash compensation for 2003.

#### **BASIC CASH COMPENSATION**

The Committee, in determining basic cash compensation of the executive officers of the Company, considers corporate profitability, financial condition, capital adequacy, return on assets and other factors. The Committee also considers the performance and compensation levels of other banking institutions as more fully set forth under the caption "2003 Compensation". The Committee does not consider these factors by any formula and does not assign specific weight to any given factor. Instead, the Committee applies its collective business judgment to reach a consensus on compensation fair to the Company, its shareholders and its executive officers.

#### **STOCK BASED COMPENSATION**

The 1998 Long-Term Incentive Plan, previously approved by the shareholders, was designed to create a common interest between key employees, non-employee board members and shareholders on a long-term basis, encouraging participants to maintain and increase their proprietary interests as shareholders in the Company with the opportunity to benefit from the long-term performance of the Company.

From 1998 through 2003, the Committee granted, under the 1998 Long-Term Incentive Plan, options for a total of 272,115 shares of Common Stock to directors and key employees of the Company and the Bank. The exercise price of the stock options equals the market price of the Common Stock on the date of grant and the options have a ten year life. Options are not performance-based and become exercisable in equal annual installments over three years.

#### **2003 COMPENSATION**

The Committee, in determining the 2003 basic cash compensation of the executive officers of the Company, considered the factors described in this Report.

Robert A. Altieri serves as President and Chief Executive Officer of the Company and President and Chief Executive Officer of the Bank and, as such, had the ultimate management responsibility for the strategic direction, performance, operating results and financial condition of the Company and its subsidiaries, and the carrying out of corporate policies and procedures. Randall M. Robey is Executive Vice President and Chief Financial Officer

of the Company and the Bank; Edward R. Bootey is Senior Vice President—Operations of the Bank; Robert F. Hickey is Senior Vice President—Branch Administration of the Bank; John A. Giovanazi is Senior Vice President—Lending of the Bank; Gary M. Jewell is Senior Vice President—Electronic Banking of the Bank.

The Committee was aware of 2003 earnings of the Company. The Committee further reviewed profitability and capital strength ratios (return on assets, net interest margin, efficiency ratio, equity to assets and return on equity) and loan loss performance ratios (period-end non-performing assets to loans and foreclosed real estate, net charge-offs to average loans and period-end allowance for loan losses to non-performing loans) as compared to comparable information for peer banking companies with assets from \$250 to \$500 million, considered by an independent analyst as the Company's peer group. The Committee compared similar ratios showing profitability, capital adequacy, reserve strength, and asset quality with those of the peer institutions as prepared by that financial analyst. The Committee was aware of the strategic plan of improving profitability and the factors that influence management's ability to accomplish strategic goals under the plan in the current economic environment in its assessment of management's performance.

The Committee compared the proposed compensation of Mr. Altieri with independent studies published in 2002 reflecting compensation information for 2001 of the peer group commercial banking institutions participating in the study and with the compensation of executive officers of banking institutions, based on proxy information covering institutions comparable to the Company in terms of criteria including the nature and quality of operations, or geographic proximity. This group included financial institutions having high returns on assets, capital significantly in excess of that required by current federal regulations, and located within a 100 mile radius of Baltimore so as to include companies operating in a comparable economic climate. No target was established in the comparison with this group of institutions.

The Committee concluded that the Company's profitability is below comparisons while capital strength ratios continued to be strong, and that loan loss ratios were favorable, both standing alone and in comparison to the banking companies constituting the peer group. Based on the Committees review and its evaluation of the qualifications, experience and responsibilities of Mr. Altieri and the other members of executive management, and of the importance of the continued services for transitional and other purposes, the Committee approved the compensation and other arrangements with Mr. Altieri, Mr. Robey, Mr. Bootey, Mr. Giovanazi and Mr. Jewell as described in the Summary Compensation Table in this Proxy Statement.

Section 162(m) of the Internal Revenue Code provides for non-deductibility, in certain cases, of compensation paid to certain executives in excess of \$1 million per year. The Company does not have a policy limiting compensation to amounts deductible under Section 162(m). The annual incentive plan and the Omnibus Stock Plans have been approved by the shareholders and are designed to be qualified performance-based plans so that Section 162(m) limits would not apply to plan benefits. Section 162(m) limits would apply to salary, bonuses in excess of bonuses under the annual incentive compensation plan and certain amounts included under "Other Annual Compensation" and "All Other Compensation" in the Summary Compensation Table.

#### The Compensation Committee

Ben F. Mason, Chair  
 Robert J. Aumiller  
 Steven K. Breeden  
 Harold I. Hackerman  
 Charles E. Moore, Jr.

Note: Albert R. Counselman served as a member of the Compensation Committee until November 2003. Steven K. Breeden and Robert J. Aumiller were appointed to the Compensation Committee in January 2004.

#### COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

In 2003, the Company and the Bank had banking and other relationships, in the ordinary course of business, with a number of its Directors and companies associated with them. The Company purchased insurance from Riggs, Counselman, Michaels & Downes, Inc. of which Mr. Counselman is President. The insurance coverage purchased was made on substantially the same terms, as those prevailing at the time, for comparable transactions with others. Management believes the terms of the insurance coverage obtained through Riggs, Counselman, Michaels & Downes, Inc. were at least as favorable to the Company as could have been obtained elsewhere.

Outstanding loans exist to Mr. Breeden, Mr. Moore and their related companies which were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with others not considered outsiders, and did not involve more than the normal risk of collectibility or present other unfavorable features.

#### EXECUTIVE COMPENSATION

The following table sets forth the compensation paid or allocated for services rendered to the

Company in all capacities during the years ended December 31, 2003, 2002, and 2001 to the chief executive officer of the Company, as well as other members of Executive Management whose compensation exceeded \$100,000 in 2003.

#### SUMMARY COMPENSATION TABLE

Name and Principal Position	Year	Salary	Long-Term Incentive Plan	
			Stock Options Grants (Shares)	Bonus
Robert A. Altieri President and Chief Executive Officer	2003	\$180,600	0	\$ 0
	2002	\$184,515	8,400	\$ 0
	2001	\$172,943	10,500	\$ 0
Randall M. Robey Executive Vice President and Chief Financial Officer	2003	\$125,648	0	\$ 0
	2002	\$127,109	5,250	\$ 0
	2001	\$119,682	7,350	\$ 0
Gary M. Jewell Senior Vice President	2003	\$ 99,757	0	\$20,566
	2002	\$ 97,576	3,150	\$14,524
	2001	\$ 90,392	3,150	\$ 9,135
John A. Giovanazi Senior Vice President	2003	\$109,865	0	\$ 0
	2002	\$106,933	3,150	\$ 0
	2001	\$ 88,418	3,150	\$ 0
Edward R. Bootey Senior Vice President	2003	\$100,286	0	\$ 0
	2002	\$ 96,908	3,150	\$ 0
	2001	\$ 83,384	3,150	\$ 0

The Company had no employment agreements, termination of employment, or change-in-control agreements or understandings with any of its directors, executive officers or any other party whatsoever.

#### LONG-TERM INCENTIVE PLAN

The 1998 Long-Term Incentive Plan, (the "Plan") which was approved at the 1998 Annual Meeting of Shareholders, authorizes the granting of awards in the form of options, stock appreciation rights, restricted stock, performance awards, phantom shares, bonus shares or cash awards. Any executive or other employee of the Company, its subsidiaries, affiliated entities and non-employee Directors of the Company shall be eligible to receive awards under the Plan. Non-employee Directors of subsidiaries or affiliated entities of the Company will not be eligible to participate in the Plan.

The Plan provides for 210,000 shares of the Company's Common Stock to be issued as awards under the Plan, either directly or upon exercise of an option. The Plan provides for appropriate adjustments in the number of shares subject to the Plan in the event of a stock dividend, stock split, reverse stock split or other similar changes in the Company's common stock or in the event of a merger, consolidation or certain other types of recapitalizations affecting the Company.

### OPTION GRANTS IN 2003

The following table contains information concerning the grant of stock options under the Long-Term Incentive Plan to the Chief Executive Officer and other members of Executive Management whose compensation exceeded \$100,000.

Name	Options Granted (Number of Shares)	% of Total Options Granted to Employees in year	Exercise or Base Price	Expiration Date	Potential Realizable Value at Assumed Annual Rates of Stock Appreciation for Option Term	
					5%	10%
Robert A. Altieri	0	0%	\$ 0.00	—	\$ 0	\$ 0
Randall M. Robey	0	0%	\$ 0.00	—	\$ 0	\$ 0
Edward R. Bootey	0	0%	\$ 0.00	—	\$ 0	\$ 0
John A. Giovanazi	0	0%	\$ 0.00	—	\$ 0	\$ 0
Gary M. Jewell	0	0%	\$ 0.00	—	\$ 0	\$ 0

A total of 9,930 incentive stock options were granted in 2003 under the 1998 Long-Term Incentive Plan to directors and employees. Of that total, 6,930 incentive stock options were granted to directors at an exercise price of \$14.50. The options granted to directors vest over a three-year period and expire, if not exercised, in 2013. There were no grants in 2003 for restricted stock, stock appreciation rights, performance grants, phantom shares, bonus shares or cash awards.

### CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

During the past year the Company has had banking transactions in the ordinary course of its business with: (i) its directors and nominees for directors; (ii) its executive officers; (iii) its 5% or greater shareholders; (iv) members of the immediate family of its directors, nominees for directors or executive officers and 5% shareholders; and (v) the associates of such persons on substantially the same terms, including interest rates, collateral, and repayment terms on loans, as those prevailing at the same time for comparable transactions with others. The extensions of credit by the Company to these persons have not had and do not currently involve more than the normal risk of collectibility or present other unfavorable features. At December 31, 2003, the balance of loans outstanding to directors, executive officers, owners of 5% or more of the outstanding Common Stock, and their associates, including loans guaranteed by such persons, aggregated \$3,209,200 which represented approximately 9.4% of the Company's equity capital accounts.

William C. Rogers, Jr., a director of both the Company and the Bank, is a partner of the law firm of Rogers, Moore and Rogers, which performs legal

services for the Company, the Bank, and Bank subsidiaries (Carrollton Financial Services, Inc., Carrollton Mortgage Services, Inc., and Carrollton Community Development Corporation). Management believes that the terms of these transactions, which totaled \$259,502 in 2003, were at least as favorable to the Company as could have been obtained elsewhere.

Albert R. Counselman, a director of both the Company and the Bank, is President and Chief Executive Officer of Riggs, Counselman, Michaels & Downes, Inc., an insurance brokerage firm through which the Company, the Bank, and Bank subsidiaries place various insurance policies. The Company and the Bank paid total premiums for insurance policies placed by Riggs, Counselman, Michaels & Downes, Inc in 2003 of \$244,721. Related commissions on these policies amounted to \$32,528 in 2003. Management believes that the terms of these transactions were at least as favorable to the Company as could have been obtained elsewhere.

Robert J. Aumiller, a director of both the Company and the Bank is Executive Vice President of MacKenzie Real Estate Services, a brokerage and real estate development firm, through which the Company and the Bank paid for commercial real estate services of \$100,949 in 2003 for appraisal and property management services provided by MacKenzie Commercial Real Estate Services. Management believes these terms were as favorable as could have been obtained elsewhere.

David P. Hessler, a director of both the Company and the Bank, is the President and Chief Executive Officer of Eastern Sales and Services, a firm which performs electrical services for the Company, the Bank, and Bank subsidiaries. Management believes that the terms of these transactions, which totaled

\$3,341 in 2003, were at least as favorable as could have been obtained elsewhere.

#### **VOTING PROCEDURES**

Generally, each proposal submitted to the Company shareholders for a vote is deemed approved if a majority of the shareholders present, in person or by proxy, at a meeting at which a quorum is present, votes in favor of the proposal. The presence of a majority, in person or by proxy, of shareholders entitled to cast votes at the meeting constitutes a quorum. A shareholder is entitled to one vote for each share owned.

Shareholder votes are tabulated by the Company's Registrar and Transfer Agent. Proxies received by the Company, if such proxy is properly executed and delivered, will be voted in accordance with the voting specifications made on such proxy. Proxies received by the Company on which no voting specification has been made by the shareholder will be voted "for" all items discussed in the Proxy Statement, in the manner stated on the proxy card. Shareholders who execute and deliver proxies retain the right to revoke them by notice delivered to the Company Secretary at any time before such proxies are voted.

The vote of a plurality of all of the votes cast at a meeting at which a quorum is present is necessary for the election of a director. For purposes of the election of directors, abstentions and broker non-votes will not be counted as votes cast and will have no effect on the result of the vote, although they will count toward the presence of a quorum.

#### **SUBMISSION OF MATTERS TO A VOTE OF SHAREHOLDERS**

There have been no matters submitted to a vote of the Company's shareholders since its 2003 Annual Shareholders' Meeting held on April 22, 2003.

#### **SHAREHOLDER PROPOSALS FOR THE 2005 ANNUAL MEETING**

Proposals of shareholders to be presented at the 2005 Annual Meeting of the Company must be received at the Company's principal executive offices prior to November 19, 2004 in order to be included in the proxy statement for such meeting. In order to curtail controversy as to compliance with this requirement, shareholders are urged to submit proposals to the Secretary of the Company by Certified Mail—Return Receipt Requested.

If a shareholder intends to submit a proposal at the 2005 Annual Meeting of the Company that is not eligible for inclusion in the proxy statement and proxy, the shareholder must do so no later than February 4, 2005.

#### **PROPOSAL 2: RATIFICATION OF INDEPENDENT PUBLIC ACCOUNTANTS**

The Company's Board of Directors has selected the firm of Rowles & Company, LLP, certified public accounts, as independent auditors for the Company for the fiscal year 2004 and seeks ratification of such selection by the shareholders of the Company. Rowles & Company, LLP has served as independent auditors for the Company since 1955. No qualified opinions have been issued during such engagement. A representative of Rowles & Company, LLP will be present at the 2004 Annual Shareholders' Meeting.

A majority of votes cast at the meeting is required at this meeting for approval of this proposal. Abstentions and broker non-votes will have no effect on the vote for this proposal.

Your Company's Board of Directors unanimously recommends a vote "FOR" the ratification of the appointment of Rowles & Company, LLP as independent public accountants for fiscal year 2004.

#### **AUDIT COMMITTEE REPORT**

The Audit Committee has adopted a written charter which is included in this document. The members of the Audit Committee are independent as such term is defined in Rule 4200(a)(15) of the National Association of Securities Dealers' listing standards. The Audit Committee has (1) reviewed and discussed the Company's audited financial statements with Company management and representatives of Rowles & Company, LLP, the Company's independent auditors; (2) discussed with Rowles & Company, LLP all matters required to be discussed by SAS No. 61, as modified or supplemented; and (3) has received the written disclosures and the letter from Rowles & Company, LLP required by Independence Standards Board Standard No. 1, as modified or supplemented and has discussed with Rowles & Company, LLP the independence of Rowles & Company, LLP. Based on its review and discussions, the Audit Committee recommended to the Board of Directors that the audited financial statements for the year ended December 31, 2003 be included in the Company's Annual Report on Form 10-K for the last fiscal year.

Audit Committee:

By: Harold I. Hackerman  
David P. Hessler  
Howard S. Klein  
Charles E. Moore, Jr.

Note: Albert R. Counselman served as a member of the Audit Committee until November 2003.

### PROPOSAL 3: AMENDMENT OF THE 1998 LONG TERM INCENTIVE PLAN TO INCREASE THE NUMBER OF SHARES AVAILABLE FOR ISSUANCE.

The shareholders are being asked to approve an amendment to the Company's 1998 Long-Term Incentive Plan in order to increase the number of shares of common stock reserved for issuance under the plan, and the number of shares of common stock for which options may be granted by 90,000, to an aggregate of 300,000.

The purpose of the Incentive Plan is to advance the interests of the Company by enabling it to attract and retain outstanding key management employees and non-employee directors, and to provide an incentive to and encourage stock ownership in the Company by those employees and directors responsible for the policies and operations of the Company. By encouraging such stock ownership, the Company seeks to attract, retain and motivate the best available personnel for positions of substantial responsibility and to provide additional incentive to key employees and directors of the Company and its subsidiaries to promote the success of the business as measured by the value of its shares, and to increase the commonality of interests among key employees, directors and other shareholders. The principal features of the Incentive Plan are described above under the caption "Report Of The Compensation Committee-Stock Based Compensation." Except as proposed to be amended hereby, the provisions of the Incentive Plan, as currently in effect, will continue in full force and effect. The exercise price of the stock options equals the market price of the Common Stock on the date of grant and the options have a ten year life. Options are not performance-based and become exercisable in equal annual installments over three years.

#### REASONS FOR THE AMENDMENT

Since adoption of the Incentive Plan, awards for an aggregate of 272,115 shares have been granted to directors, officers and employees of the Company and the Bank or reserved for future issuance in accordance with the terms of outstanding awards. As of March 2, 2004 only 29,130 shares remain available for issuance under the Incentive Plan. The Board of Directors feels that this number of shares is inadequate to permit the Company to appropriately compensate employees, officers and directors in coming years. If the amendment to the Incentive Plan is approved, an aggregate of 119,130 shares will be available for issuance upon the exercise of future options grants.

The Board of Directors believes that the availability of a stock based compensation program is necessary in order to attract and retain high caliber

directors, officers and employees in key positions. The Board of Directors also believes that such a plan is necessary to align the interests of such persons with the interests of the Company's shareholders, which will increase their incentive to improve the Company's performance. As such, the Board of Directors believes that the authorization of additional shares for issuance under the Incentive Plan is necessary in order to permit the Company's continued growth and profitability.

If the amendment to the Incentive Plan is approved, the total number of shares subject to issuance under outstanding and future awards pursuant to the Incentive Plan will be 300,000 or 10.61% of the outstanding common stock, and 9.41% of the common stock assuming the exercise of all options.

#### NEW PLAN BENEFITS

Approximately 136 employees and 11 Directors are currently eligible to participate in the Incentive Plan. The number of shares that may be granted to executive officers and non-executive officers is undeterminable at this time, as such grants are subject to the discretion of the Committee.

#### FEDERAL INCOME TAX CONSEQUENCES

The following discussion is a general summary of the material federal income tax consequences to participants in the Plan. The discussion is based on the Internal Revenue Code, regulations thereunder, rulings and decisions now in effect, all of which are subject to change. The summary does not discuss all aspects of federal income taxation that may be relevant to a particular participant in light of such participant's personal investment circumstances. Also, state and local income taxes are not discussed and may vary from locality to locality.

*Non-Qualified Stock Options.* Currently, an optionee who is granted a non-qualified stock option will not realize taxable income at the time the option is granted. In general, an optionee will be subject to tax for the year of exercise on an amount of ordinary income equal to the excess of the fair market value of the shares over the option price. The Company will be entitled to an income tax deduction equal to the amount of ordinary income recognized by the optionee with respect to the exercised non-qualified stock option. The deduction will, in general, be allowed for the taxable year in which such ordinary income is recognized by the optionee.

*Incentive Options.* No taxable income is recognized by the optionee at the time of the option grant, and no taxable income is generally recognized at the time the option is exercised. The optionee will, however, recognize taxable income in the year in which the purchased shares are sold or

otherwise made the subject of a taxable disposition. For Federal income tax purposes, dispositions are divided into two categories: (i) qualifying and (ii) disqualifying. A qualifying disposition occurs if the sale or other disposition is made after the optionee has held the shares for more than two years after the option grant date and more than one year is not met, then a disqualifying disposition will result.

If the optionee makes a disqualifying disposition of the purchased shares, then the Company will be entitled to an income tax deduction, for the taxable year in which such disposition occurs, equal to the excess of (i) fair market value of such share on the option exercise date over (ii) the exercise price paid for the shares. In no other instance will the Company be allowed a deduction with respect to the optionee's disposition of the purchase shares.

**Stock Appreciation Rights.** An optionee who is granted a stock appreciation right will recognize ordinary income in the year of exercise equal to the amount of the appreciated distribution. The Company will be entitled to an income tax deduction equal to such distribution for the taxable year in which the ordinary income is recognized by the optionee.

**Restricted Stock.** Recipients of Shares of restricted Stock that are not "transferable" and are subject to "substantial risk of forfeiture" at the time of grant will not be subject to federal income taxes until lapse or release of the restrictions on the shares, unless the recipient files a specific election under the Code to be taxed at the time of the grant. The recipients income and the Company's tax deduction will be equal to the fair market value of the shares on the date of lapse or release of such restrictions (or on the date of grant if such election is made) less any purchase price.

**Performance Awards.** Upon receipt of the shares or cash underlying a performance award, the recipient will be taxed at ordinary income tax rates on the amount of cash received and/or the current fair market value of stock received. The Company will be entitled to an income tax deduction equal to the distribution for the taxable year in which the ordinary income is recognized by the recipient.

**Bonus Shares and Cash Awards.** A recipient of bonus shares and/or cash awards will be taxed at ordinary income tax rates on the amount of cash received and/or the current fair market value of stock received after the exercise date. If either of these two holding periods Company will be entitled to an income tax deduction equal to the distribution for the taxable year in which the ordinary income is recognized by the recipient.

A majority of affirmative votes cast at the meeting on the proposal to amend the Incentive Plan is required for the approval of the amendment to the Incentive Plan. Abstention and broker non-votes will have no effect on the vote for approval on the amendment to the Incentive Plan.

Your Company's Board of Directors unanimously recommends a vote "FOR" the approval of the amendment to the Incentive Plan.

<i>Plan Category</i>	<i>(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights</i>	<i>(b) Weighted- average exercise price of outstanding options, warrants and rights</i>	<i>(c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))</i>
1998 Long Term Incentive Plan approved by security holders	174,785	\$13.88	29,130

## THE AUDIT COMMITTEE CHARTER

### PURPOSE

The Audit Committee is appointed by the Board of Directors (the "Board") to assist the Board in monitoring (1) the integrity of the financial statements of Carrollton Bancorp, Inc. (the "Company"), (2) the independent auditor's qualifications and independence, and (3) the performance of the Company's internal audit function and independent auditors, and (4) the compliance by the Company with legal and regulatory requirements.

The primary responsibility of the Audit Committee is to oversee the accounting and financial reporting processes of the Company and the audits of the financial statements of the Company on behalf of the Board and report the results of its activities to the Board. Management is responsible for preparing the Company's financial statements and related disclosures and the Company's independent auditors are responsible for auditing those financial statements. It is not the duty of the Audit Committee to plan or conduct audits or to determine that the Company's financial statements are complete and accurate and in accordance with generally accepted accounting principles ("GAAP"). It shall be the duty of the Audit Committee to assist the Board in the oversight of the Company's legal and regulatory requirements.

## COMMITTEE MEMBERSHIP

The Audit Committee shall consist of no fewer than three and no more than five members, each of whom shall be a non-employee director of the Company. Each member of the Audit Committee shall meet the independence and experience requirements of the listing standards of NASDAQ, Section 10A(m)(3) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") and the rules and regulations of the Securities and Exchange Commission ("SEC"), and all other applicable legal requirements, including the requirement that at least one member of the Audit Committee be an "audit committee financial expert" within the meaning of rules promulgated by the SEC under the Sarbanes-Oxley Act of 2002. Each member of the Audit Committee must be able to read and understand fundamental financial statements, including a balance sheet, income statement and cash flow statement. A majority of the members of the Committee shall constitute a quorum.

Audit Committee members shall be appointed and may be replaced by the Board.

The Audit Committee may request any officer or employee of the Company or the Company's outside counsel or independent auditor to attend a meeting of the Committee or to meet with any members of, or consultants to, the Committee without the consent of management or the Board. The Audit Committee shall meet with management, the internal auditors and the independent auditor in separate executive sessions at least quarterly. The Audit Committee shall make regular reports to the Board. The Audit Committee shall review and reassess the adequacy of this Charter annually and recommend any proposed changes to the Policy Committee and to the Board for approval. The Audit Committee shall annually review the Audit Committee's own performance and present such review to the Board.

## STATEMENT OF POLICY

The Audit Committee shall provide assistance to the Board in fulfilling its responsibility to the shareholders, potential shareholders, the investment community and others relating to the Company's corporate accounting and financial reporting processes, the systems of internal accounting and financial controls, the internal audit function, and the annual independent audit of the Company's financial statements.

In carrying out its responsibilities, the Audit Committee believes its policies and procedures should remain flexible, in order to best react to changing circumstances and conditions.

The Committee, and each member of the Committee in his or her capacity as such, shall be entitled to rely, in good faith, on information, opinions, reports or statements, or other information prepared or presented to them by (i) officers and other employees of the Company or Carrollton Bank, whom such member believes to be reliable and competent in the matters presented, (ii) counsel, public accountants or other persons as to matters which the member believes to be within the professional competence of such person.

## COMMITTEE AUTHORITY AND RESPONSIBILITIES

- Responsibilities Relating to Retention of Public Accounting Firms – The Committee shall have the sole authority and be directly responsible for the appointment, compensation, oversight of the work, evaluation and termination of any accounting firm employed by the Company (including resolving disagreements between management and the auditor regarding financial reporting) for the purpose of preparing or issuing an audit report and related work. The accounting firm shall report directly to the Committee.
- Pre-approval of Services – All auditing services (which may entail providing comfort letters in connection with securities underwritings) and all non-audit services, provided to the Company by the Company's auditors, subject to exception set forth below, shall be pre-approved by the Committee pursuant to such processes as are determined to be advisable. Pre-approval shall include blanket pre-approval of non-prohibited services for limited dollar amounts which the Committee, in its business judgment, does not believe possess the potential for abuse or conflict.
- Exception – The pre-approval requirement set forth above, shall not be applicable with respect to the provision of non-audit services, if:
  - i. the aggregate amount of all such non-audit services provided to the Company constitutes not more than 5 percent of the total amount of revenues paid by the Company to its auditor during the fiscal year in which the non-audit services are provided;
  - ii. such services were not recognized by the Company at the time of the engagement to be non-audit services; and
  - iii. such services are promptly brought to the attention of the Committee and approved prior to the completion of the audit by the

Committee or by one or more members of the Committee who are members of the Board of Directors to whom authority to grant such approvals has been delegated by the Committee.

- Delegation – The Committee may delegate to one or more designated members of the Audit Committee the authority to grant required pre-approvals. The decisions of any member to whom authority is delegated under this paragraph to pre-approve an activity under this subsection shall be presented to the full Audit Committee at its next scheduled meetings.
- Complaints – The Committee shall establish procedures to facilitate:
  - i. the receipt, retention, and treatment of complaints received by the Company from third parties regarding accounting, internal accounting controls, or auditing matters; and
  - ii. the confidential, anonymous submission by employees of the Company or others of concerns regarding questionable accounting or auditing matters.

#### FINANCIAL STATEMENT AND DISCLOSURE MATTERS

The Audit Committee, to the extent it deems necessary or appropriate, shall:

- Review and discuss with management and the independent auditor the annual audited financial statements, including disclosures made in management’s discussion and analysis of financial condition and results of operation, and recommend to the Board whether the audited financial statements should be included in the Company’s Form 10-K.
- Review and discuss with management and the independent auditor the Company’s quarterly financial statements, including the disclosures made in management’s discussion and analysis of financial condition and results of operations prior to the filing of the Company’s Form 10-Q, including the results of the independent auditors’ reviews of the quarterly financial statements.
- Discuss with management and the independent auditor significant financial reporting issues and judgments made in connection with the preparation of the Company’s financial statements, including (i) any significant changes in the Company’s selection or application of accounting principles, (ii) any major

issues as to the adequacy of the Company’s internal controls, (iii) the development, selection and disclosure of critical accounting estimates, (iv) analyses of the effect of alternative assumptions, estimates or GAAP methods on the Company’s financial statements, (v) analyses and disclosure of financial trends, and (vi) presentation of the financial statements and notes thereto.

- Review and discuss reports from the independent auditors on (i) all critical accounting policies and practices to be used; (ii) all alternative treatments of financial information within GAAP that have been discussed with management officials of the Company, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the independent auditors; and (iii) other material written communications between the independent auditors and management of the Company, such as any management letter or schedule of unadjusted differences.
- Discuss with management the Company’s earnings press releases, including the use of “pro forma,” “adjusted” or other non-GAAP information, as well as financial information and earnings guidance provided to analysts and rating agencies.
- Discuss with management and the independent auditor the effect of accounting initiatives as well as off-balance sheet structures on the Company’s financial statements.
- Discuss with management, the internal auditors and the legal/compliance department the effect of regulatory initiatives on the Company’s financial statements.
- Discuss with management the Company’s major financial risk exposures and the steps management has taken to monitor and control such exposures, including the Company’s risk assessment and risk management policies.
- Discuss with the independent auditor the matters required to be discussed by Statement on Auditing Standards No. 61 relating to the conduct of the audit including:
  - i. The adoption of, or changes to, the Company’s significant auditing and accounting principles and practices.
  - ii. The management letter provided by the independent auditor and the Company’s response to that letter.

- iii. Any difficulties encountered in the course of the audit work, including any restrictions on the scope of activities or access to requested information, or personnel and any significant disagreements with management.
- Review disclosures made to the Audit Committee by the Company's chief executive officer and chief financial officer during the certification process for the Form 10-K and Form 10-Q about any significant deficiencies in the design or operation of internal controls or material weaknesses therein and any fraud involving management or other employees who have a significant role in the Company's internal controls.
- Review and sign the call report prior to its filing.

#### **OVERSIGHT OF THE COMPANY'S RELATIONSHIP WITH THE INDEPENDENT AUDITOR**

- Review the experience and qualifications of the senior members of the independent auditor team.
- Obtain and review a written report from the independent auditor at least annually regarding (i) the independent auditor's internal quality-control procedures, (ii) any material issues raised by the most recent quality-control review, or peer review, of the firm, or by any inquiry or investigation by governmental or professional authorities within the preceding five years concerning one or more independent audits carried out by the firm (iii) any steps taken to deal with any such issues, and (iv) all relationships, both direct and indirect, between the independent auditor and the Company. Evaluate the qualifications, performance and independence of the independent auditor, including considering whether the auditor's quality controls are adequate and the provision of non-audit services is compatible with maintaining the auditor's independence, and taking into account the opinions of management and the internal auditor. The Audit Committee shall present its conclusions to the Board and, if so determined by the Audit Committee, recommend that the Board take additional action to satisfy itself of the qualifications, performance and independence of the auditor.
- Ensure the rotation of the lead (or coordinating) audit partner having primary responsibility for the audit and the audit partner

responsible for reviewing the audit as required by law. Consider whether, in order to assure continuing auditor independence, it is appropriate to adopt a policy of rotating the lead audit partner or even the independent auditing firm itself on a regular basis.

- Recommend to the Board policies for the Company's hiring of employees or former employees of the independent auditor who were engaged on the Company's account.
- Discuss with the independent auditor issues on which the independent auditor communicated with its national office regarding auditing or accounting issues.
- Meet with the independent auditor prior to the audit to discuss the planning and staffing of the audit.

#### **OVERSIGHT OF THE COMPANY'S INTERNAL AUDIT FUNCTION**

- Review the appointment and replacement of the senior internal auditing executive.
- Review the significant reports to management prepared by the internal auditing department and management's responses.
- Discuss with the independent auditor and management the internal audit department responsibilities, budget and staffing and any recommended changes in the planned scope of the internal audit.

#### **COMPLIANCE OVERSIGHT**

- Obtain from the independent auditor such assurance as it deems adequate that such auditor has fulfilled its responsibilities under Section 10A(b) of the Exchange Act.
- Obtain reports from management, the Company's senior internal auditing executive and the regulatory compliance and legal/compliance department relating to the Company's conformity with applicable legal and regulatory requirements. Review reports and disclosures of insider and affiliated party transactions.
- Review with management, the Company's internal auditors and the Company's legal/compliance department compliance with laws and regulations. Advise the Board with respect to the Company's compliance with applicable laws and regulations.
- Review with the appropriate officers and/or the Company's legal counsel, pending material litigation and compliance matters.

- The Committee will address and take action, as it deems necessary or appropriate, with respect to any issues regarding the provisions of the Company's Code of Ethics to the extent the issue relates to accounting and disclosure and regulations of the SEC, the NASDAQ or other bank regulatory authority, and to the extent such misrepresentation or omission relates to financial statements or related financial information.
- The Committee will address and take any action, as it deems necessary or appropriate, with respect to any issues relating to inquiries or investigations regarding the quality of financial reports filed by the Company with the SEC or otherwise distributed to the public.

#### **MISCELLANEOUS POWERS AND RESPONSIBILITIES**

- The Committee shall have the power to investigate any matter brought to its attention within the scope of its duties, with the power to retain outside counsel for this purpose if, in its judgment, that is appropriate.
- The Committee shall have the responsibility to submit the minutes of all meetings of the Audit Committee to the Board of Directors.
- The Committee shall have the responsibility of reviewing and assessing the adequacy of this Charter at least annually.
- The Audit Committee shall have the responsibility to prepare the report required to be included in the Company's annual proxy statement by the rules of the Securities and Exchange Commission.
- The Committee shall have the power to access the Company's counsel without the approval of management, as it determines necessary to carry out its duties.
- The Audit Committee shall also have the authority without the consent of management or the Board, to the extent it deems necessary or appropriate, to retain special independent legal, accounting or other consultants to advise the Committee in connection with fulfilling its obligations hereunder. The Company shall provide for appropriate funding, as determined by the Audit Committee, for payment of compensation to the independent auditor for the purpose of preparing or issuing an audit report or performing other

audit, review or attest services for the Company and to any advisors employed by the Audit Committee.

- The Committee shall have the responsibility of discussing with management and the independent auditor any significant or material correspondence with regulators or governmental agencies, including all examination reports received from the various supervisory authorities, and any employee complaints or published reports that raise material issues regarding the Company's financial statements or accounting policies and review management's replies to such correspondence, complaints, or reports.
- The Committee shall have the responsibility to discuss with the Company's General Counsel legal matters that may have a material impact on the financial statements or the Company's compliance policies.
- The Committee shall make provision to examine all dealings between the Company or Bank and members of the Committee and to examine or have examined all dealings between the Company or Bank and any company by whom a Committee member may be employed.
- The Committee will monitor management's oversight of the controls required to ensure accurate financial reporting.
- The Committee will monitor management and auditors' assessment of internal control functions.

#### **COMPENSATION**

Audit Committee members are prohibited from receiving, directly or indirectly, any consulting, advisory or compensatory fee from the Company or any of the Company's subsidiaries, other than in the member's capacity as a member of the Board or Committee.

#### **MEETINGS**

The Audit Committee shall meet as often as it determines, but not less frequently than quarterly. The Audit Committee may form and delegate authority to Committee members when appropriate, including specifically the pre-approval of non-audit services and the review of earnings releases, and earnings guidance.

Minutes of each meeting will be maintained by the Committee.

## AUDIT FEES

The estimated fees billed or to be billed by Rowles & Company, LLP for professional services rendered for the audit of the Company's annual financial statement for the year ended December 31, 2003 and the review of the financial statements included in the Company's Forms 10-Q and 10-K for that year are \$70,379.

## AUDIT RELATED FEES

The aggregate fees billed for audit related services rendered by Rowles & Company, LLP for the year ended December 31, 2003 were \$11,379.

## ALL OTHER FEES

The aggregate fees billed for services rendered by Rowles & Company, LLP for the year ended December 31, 2003, other than the services described above under "Audit Fees" and "Audit Related Fees," were \$9,260. For 2003, these fees represent fees for income tax return preparation and advice.

The Audit Committee has determined that the provision of the services covered in "All Other Fees" is compatible with maintaining Rowles & Company, LLP's independence.

## FINANCIAL INFORMATION SYSTEMS DESIGN AND IMPLEMENTATION FEES

During the year ended December 31, 2003, Rowles & Company, LLP did not render to the Company any professional services with regard to financial information systems design and implementation described in paragraph (c)(4)(ii) of Rule 2-01 of Regulation S-X.

## NOMINATING/CORPORATE GOVERNANCE COMMITTEE CHARTER

### PURPOSE

The Nominating/Corporate Governance Committee (the "Committee") is appointed by the Board of Directors (the "Board") of Carrollton Bancorp (the "Company") (1) to assist the Board, on an annual basis, by identifying individuals qualified to become Board members, and to recommend to the Board the director nominees for the next annual meeting of shareholders; (2) to assist the Board in the event of any vacancy on the Board by identifying individuals qualified to become Board members, and to recommend to the Board qualified individuals to fill any such vacancy; (3) develop and recommend to the Board a set of corporate governance guidelines applicable to the Company; and (4) take a leadership role in shaping the corporate governance of the Company.

## COMMITTEE MEMBERSHIP

The Committee shall consist of no fewer than three members, each of whom shall be a non-employee director of the Company. Each member of the Committee shall meet the independence definition standards of NASDAQ and all other applicable legal requirements. The Committee will also consider the absence or presence of material relationships with the Company that might impact independence. The Committee shall report to the Board. Members shall be appointed and removed by the Board. A majority of the members of the Committee shall constitute a quorum.

## COMMITTEE AUTHORITY AND RESPONSIBILITIES

1. The Committee shall have the responsibility to develop and recommend criteria for the selection of new directors to the Board, including, but not limited to, diversity, age, skills, experience, time availability (including the number of other boards he or she sits on) in the context of the needs of the Board and the Company and such other criteria as the Committee shall determine to be relevant at the time. The Committee shall have the power to apply such criteria in connection with the identification of individuals to be board members, as well as to apply the standards for independence imposed by the Company's listing agreement with NASDAQ and all applicable federal laws in connection with such identification process.
2. When vacancies occur or otherwise at the direction of the Board, the Committee shall actively seek individuals whom the Committee determines meet such criteria and standards for recommendation to the Board.
3. The Committee shall have the sole authority to retain and terminate any search firm to be used to identify director candidates and shall have sole authority to approve the search firm's fees and other retention terms, at the Company's expense.
4. The Committee shall recommend to the Board, on an annual basis, nominees for elections of directors for the next annual meeting of shareholders.
5. The Committee may form and delegate authority to subcommittees or members when appropriate.
6. The Committee shall review the function of the Board and management and shall make recommendations to the Board from time to time as to changes that the Committee believes to be desirable to the size of the Board or to the

- manner in which the board directs the management of the business and affairs of the Company.
7. The Committee shall approve and recommend to the Board a set of corporate governance guidelines applicable to the Company prepared by management or counsel to the Company and, at least once a year, shall review and reevaluate the adequacy of those corporate governance guidelines and recommend any proposed changes to the Board for approval.
  8. The Committee shall approve and recommend to the Board a code of ethics and business principles (the "Code of Ethics") applicable to the Company prepared by management or counsel to the Company and, at least once a year, shall review and reevaluate the adequacy of the Code of Ethics and recommend any proposed changes to the Board for approval.
  9. The Committee shall make regular reports to the Board, including copies of the minutes of its meetings.
  10. The Committee shall review and reassess the adequacy of this Charter annually and recommend any proposed changes to the Board for approval. The Committee shall annually review its own performance and present such review to the Board.
  11. The Committee, and each member of the Committee in his or her capacities as such, shall be entitled to rely, in good faith, on information, opinions, reports or statements, or other information prepared or presented to them by (i) officers and other employees of the Company or Carrollton Bank, whom such member believes to be reliable and competent in the matters presented, (ii) counsel, public accountants or other persons as to matters which the member believes to be within the professional competence of such person.
  12. Review conflicts of interest or potential conflicts of interest of Directors, senior executives and consider waivers or other action related thereto. Any waiver granted must be reported to the shareholders.
  13. Review breaches of the Company's Code of Ethics for Directors and executive officers and consider waivers or other action related thereto. Any waiver granted must be reported to the shareholders.
  14. Make provision to assure that the independent Directors meet at regularly scheduled executive sessions without management or non-independent Directors being present.
  15. Make provisions for the annual continuing education of the Company directors.
  16. If requested by the Compensation Committee, to participate in the oversight of the annual evaluation process for the Board and management.
  17. The Committee shall perform such other duties and responsibilities and shall have such other authority as may be assigned or delegated to it from time to time by the Board.

The Nominating Committee  
David P. Hessler  
Steven K. Breeden  
Charles E. Moore, Jr.

The Nominating Committee Charter can be found on the Carrollton Bank website at [www.carrolltonbank.com](http://www.carrolltonbank.com).

#### ANNUAL REPORT

The Annual Report of the Company for the year 2003 is included herein. Copies of the report will also be available at the Annual Meeting on April 20, 2004.

A COPY OF THE COMPANY'S ANNUAL REPORT TO THE SECURITIES AND EXCHANGE COMMISSION ON FORM 10-K FOR THE PERIOD ENDED DECEMBER 31, 2003, INCLUDING FINANCIAL STATEMENTS AND THE SCHEDULES THERETO WILL BE FURNISHED BY MANAGEMENT TO ANY BENEFICIAL OWNER OF ITS SECURITIES WITHOUT CHARGE UPON RECEIPT OF A WRITTEN REQUEST FROM SUCH PERSON. REQUESTS IN WRITING SHOULD BE DIRECTED TO RANDALL M. ROBESY, TREASURER, CARROLLTON BANCORP, 344 NORTH CHARLES STREET, SUITE 300, BALTIMORE, MARYLAND 21201-4301. EACH REQUEST MUST SET FORTH A GOOD FAITH REPRESENTATION THAT, AS OF MARCH 1, 2004, THE RECORD DATE FOR THE ANNUAL MEETING, THE PERSON MAKING THE REQUEST WAS A BENEFICIAL OWNER OF SECURITIES ENTITLED TO VOTE AT SUCH MEETING.

**OTHER MATTERS**

The management of the Company knows of no matters to be presented for action at the meeting other than those mentioned above; however, if any other matters properly come before the meeting, it is intended that the persons named in the accompanying proxy will vote on such other matters in accordance with their judgment of the best interest of the Company.

By Order of the Board of Directors

A handwritten signature in cursive script that reads "D. Doreen Smith".

D. Doreen Smith  
Secretary

Baltimore, Maryland  
March 19, 2004

U.S. SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549  
FORM 10-K

Annual report under Section 13 or 15(d) of the Securities Exchange Act of 1934 (Fee required)

For the fiscal year ended December 31, 2003

Commission file number: 0-23090

Carrollton Bancorp  
(Name of Issuer in Its Charter)

<u>Maryland</u> (State or Other Jurisdiction of Incorporation or Organization)	<u>52-1660951</u> (I.R.S. Employer Identification No.)
<u>344 North Charles Street, Suite 300 Baltimore, Maryland</u> (Address of Principal Executive Offices)	<u>21201-4301</u> (Zip Code)
<u>(410) 536-4600</u> (Issuer's Telephone Number)	

Securities registered under Section 12(b) of the Exchange Act:

Title of Each Class	Name of Each Exchange on Which Registered
<u>None</u>	<u>None</u>

Securities registered under Section 12(g) of the Exchange Act:

Common Stock  
(Title of Class)

Check whether the issuer: (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for past 90 days.

Yes  No

Indicate by checkmark if disclosure of delinquent filers in response to Item 405 of Regulation S-K is not contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by checkmark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes  No

As of February 27, 2004, the aggregate market value of the voting stock held by non-directors and executive officers: \$40,538,147.

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: 2,828,078 shares as of March 5, 2004.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement to shareholders in connection with the 2004 Annual Meeting of Shareholders scheduled to be held on April 20, 2004 are incorporated by reference into Part III.

## PART I

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### ITEM 1: DESCRIPTION OF BUSINESS

**General.** – Carrollton Bancorp (the “Company”) is a bank holding company registered under the Bank Holding Company Act of 1956, as amended, and was organized on January 11, 1990. Carrollton Bank (the “Bank”) is a commercial bank and the principal subsidiary of the Company. The Bank was chartered by an act of the General Assembly of Maryland (Chapter 727) approved April 10, 1900. The Bank is engaged in a general commercial and retail banking business.

**Service Area.** – The service area for the Bank is defined principally by geographic area. The Bank’s ten branches are located in Baltimore City, Baltimore County, Anne Arundel County, and Howard County, Maryland. The Bank attracts deposits and generates loan activity throughout this area primarily through its branch network. In addition, the Bank has made loans in Harford County, Howard County and Prince George’s County, Maryland, and in southern Pennsylvania. The Bank also has deposit customers who live in Harford County, Howard County, and Montgomery County, Maryland. The Bank operates a network of ATMs in Maryland, Virginia, and West Virginia. The Bank sponsors national retailers in various electronic networks operating as regional switches for electronic transactions throughout the country.

**Description of Services.** – The Bank provides a broad range of consumer and commercial banking products and services to individuals, businesses, professionals and governments. The services and products have been designed in such a manner as to appeal to consumers and business principals.

The following is a partial listing of the types of services and products that the Bank offers:

- Commercial loans for businesses, including those for working capital purposes, equipment purchases and accounts receivable and inventory financing.
- Commercial and residential real estate loans for acquisition, refinancing and construction.
- Consumer loans including automobile loans, home equity loans and lines of credit.
- Loans guaranteed by the United States Small Business Administration.
- Money market deposits, demand deposits, NOW accounts and certificates of deposit.
- Letters of credit and remittance services.
- Credit and debit card services.
- Merchant credit card deposit servicing.

- Brokerage services for stocks, bonds, mutual funds and annuities.
- A 24-hour ATM network.
- After-hours depository services.
- Safe deposit boxes.
- Point of Sale (POS) services.
- Other services, such as direct deposit, traveler’s checks and IRAs.

Customer service hours for the Bank are fully competitive with other institutions in the market area. The Bank also acts as a reseller of services purchased from third party vendors for customers requiring services not offered directly by the Bank.

**Lending Activities.** – The Bank makes various types of loans to borrowers based on, among other things, an evaluation of the borrowers’ net asset value, cash flow, security and ability to repay. Loans to consumers include home equity lines of credit, home improvement loans, overdraft lines of credit, and installment loans for automobiles, boats and recreational vehicles. The Bank also makes loans secured by deposit accounts and common stocks. The Bank’s commercial loan product line includes first mortgage loans, time and demand loans, lines and letters of credit, and asset based financing. The Notes to the Consolidated Financial Statements contained in Part II, Item 8 report the classification by type of loan for the whole portfolio.

First and second residential mortgage loans, made principally through a subsidiary of the Bank, Carrollton Mortgage Services Inc., (“CMSI”) enable customers to purchase or refinance residential properties. These loans are secured by liens on the residential property. All first mortgage loans with a loan to value greater than 80% have private mortgage insurance coverage equal to or greater than the amount required under the Federal National Mortgage Association guidelines. Residential loans are considered low risk based on the type of collateral (residential property) and the underwriting standards used. The Bank experienced losses of \$8,709 and recoveries of \$0 on residential mortgage loans in 2003. The Bank experienced losses of \$0 and recoveries of \$0 on residential mortgage loans in 2002. The Bank experienced \$50,460 in losses in 2001 and \$20,574 in recoveries in 2001. There were \$375,896 of residential mortgage loans delinquent more than 90 days at December 31, 2003. There are no discernible delinquency or loss trends relating to residential mortgage loans known to management.

Home equity lines of credit are typically second mortgage loans (sometimes first mortgages) secured by the borrower’s primary residence structured as a revolving borrowing line with a maximum loan amount. Customers write checks to access the line. Generally, the Bank has a second lien on the property behind the first mortgage lien holder. The Bank has a number of different equity loan

products that it offers. Borrowers can choose between fixed rate loans or loans tied to the prime rate with margins ranging from 0% to 1.5%. The Bank will finance up to 90% of the value of the home in combination with the first mortgage loan balance, depending on the rate and program. As with first mortgage residential loans, borrowers are required to meet certain income to debt ratios. The Bank maintains in its portfolio loans financed under a program that financed up to 125% of the value of the home, subject to stricter income and debt ratios, with a maximum loan amount of \$25,000. Home equity loans carry a higher level of risk than first mortgage residential loans because of the second lien position on the property, and because a higher loan to value ratio is used in the underwriting of the loan. However, the overall risk of loss on home equity loans is also considered low due to the underlying values of the collateral. The Bank experienced losses on home equity loans during 2003 of \$8,189 and recoveries of \$0. The Bank experienced losses on home equity loans during 2002 of \$160,591 and recoveries of \$67,705. There were losses of \$67,122 and recoveries of \$2,228 in 2001. There were \$283,806 of home equity loans delinquent more than 90 days at December 31, 2003. There are no discernible delinquency or loss trends relating to home equity loans known to management.

Commercial and investment mortgage loans are first mortgage loans made to individuals or to businesses to finance acquisitions of plant or earning assets, such as rental property. These loans are secured by a first mortgage lien on the commercial property, and may be further secured by other property or other assets depending on the value of the mortgaged property. In most instances, these loans are guaranteed personally by the principals. The Bank typically looks for cash flow from the business at least equal to 100% coverage of the business debt service, and to income-producing property to be self-supporting, generally, with a minimum debt service coverage ratio of 120% to 125%. Commercial mortgage loans carry more risk than residential real estate loans. Commercial mortgage loans tend to be larger in size, and the properties tend to exhibit more fluctuation in value. The repayment of the loan is primarily dependent on the success of the business itself, or the tenants in the case of income producing property. Economic cycles can affect the success of a business. The Bank experienced net losses of \$0, \$112,718, and \$0 on commercial mortgage loans during 2003, 2002, and 2001, respectively. There were \$899,081 of commercial mortgage loans past due more than 90 days at December 31, 2003. There are no known discernible delinquency or loss trends relating to commercial mortgage loans.

Construction and land development loans are loans to finance the acquisition and development of parcels of land and to construct residential housing or commercial property. The Bank typically will

finance 70% to 75% of the discounted future value of these projects, or 80% of value or 90% of cost, whichever is less, on a single-family detached home. The loan is collateralized by the project or real estate itself, and other assets or guarantees of the principals in most cases. Repayment to the Bank is anticipated from the proceeds of sale of the final units, or permanent mortgage financing on a residential construction loan for a single borrower. These types of loans carry a higher degree of risk than a commercial mortgage loan. Interest rates, buyer preferences, and desired locations are all subject to change during the period from the time of the loan commitment to final delivery of the final unit, all of which can change the economics of the project. In addition, real estate developers to whom these loans are typically made are subject to the business risk of operating a business in a competitive environment. The Bank did not experience any losses or recoveries on construction and land development loans during 2003, 2002, or 2001. There were no construction and land development loans past due more than 90 days at December 31, 2003. There are no discernible delinquency or loss trends relating to construction and land development loans known to management.

Time and demand loans and lines of credit are loans to businesses for relatively short periods of time, usually not more than one year. These loans are made for any valid business purpose. These loans may be secured by assets of the borrower or guarantor, but may be unsecured based on the personal guarantee of the principal. If secured, loans may be made for up to 100% of the value of the collateral. Time and demand loans and lines of credit are more risky than secured commercial real estate lending transactions. The businesses to which these loans are made are subject to normal business risk, and cash flows of the business may be subject to economic cycles. In addition, the value of the collateral may fluctuate, or the collateral may be used for other purposes if not subject to Uniform Commercial Code filings. If guaranteed by the principal, the net worth and assets of the principal may be dissipated by demands of the business, or due to other factors. The Bank had losses of \$200,173 and recoveries of \$58,034 on time and demand loans in 2003. The Bank had losses of \$21,904 and recoveries of \$2,475 on time and demand loans in 2002 and recoveries of \$17,269 in 2001. There were \$789,262 of time and demand and line of credit loans delinquent more than 90 days at December 31, 2003. There are no discernible delinquency or loss trends relating to time and demand loans or lines of credit known to management.

Home improvement loans are loans made to borrowers to complete improvements to their homes including such projects as room additions, swimming pool installations or new roofs. Home improvement loans include those made directly to customers and those made indirectly or originated

through an approved home improvement dealer. The Bank makes unsecured home improvement loans to a maximum amount of \$15,000. Any loan above that limit is secured by a deed of trust. Borrowers are required to own their home, and to meet certain income and debt ratio requirements. The Bank also reviews the credit history of all applicants. Because they are unsecured or secured by a deed of trust, these loans are more risky than first mortgage residential lending. This risk is mitigated somewhat based on the fact that the loans are used to improve the borrower's home, typically a borrower's most significant asset. In addition, the income-to-debt-ratio requirement helps determine the borrower's current ability to repay the loan. The Bank had charge-offs of home improvement loans of approximately \$3,170, \$24,472, and \$30,251 in 2003, 2002, and 2001. There were recoveries of \$21,922, \$10,912, and \$11,388 in 2003, 2002, and 2001. There were no home improvement loans delinquent more than 90 days at December 31, 2003. There are no discernible loss or delinquency trends relating to home improvement loans known to management.

The remainder of the consumer loan portfolio is composed of installment loans for automobiles, boats and recreational vehicles, overdraft protection lines, and loans secured by deposit accounts or stocks. The largest portion of this group is installment loans for automobiles and other vehicles. The Bank will finance 90% of the cost of a new car purchase, or the maximum loan amount as determined by the National Automobile Dealers Association (NADA) publication for used cars. The Bank will finance 85% of the cost of a new boat or RV, or the maximum loan amount determined by the NADA Boat/RV Guide for used Boats and RVs. These loans are secured by the vehicle purchased. Borrowers must meet certain income and debt ratio requirements, and a credit review is performed on each applicant. These types of loans are subject to the risk that the value of the vehicle will decline faster than the amount due on the loan. However, the income-to-debt ratio requirement helps determine the borrower's current ability to repay. The Bank had losses on automobile loans in 2003, 2002, and 2001 of \$0, \$0, and \$21,933, respectively, and recoveries of \$369, \$1,400, and \$208 in 2003, 2002 and 2001, respectively. There were no automobile or other vehicle loans past due more than 90 days at December 31, 2003. There are no discernible delinquency or loss trends relating to automobile or other vehicle loans known to management.

Overdraft lines and other personal loans are unsecured lending arrangements. These loans or lines of credit are made to allow customers to easily make purchases of consumer goods. If the lines are handled as agreed, they will typically be automatically renewed each year. Because they are unsecured, these loans carry a higher level of risk than secured lending transactions. The Bank attempts to mitigate significant risk by establishing

fairly low credit limits. Net charge-offs in 2003, 2002, and 2001 were approximately \$34,000, \$59,000, and \$114,000, respectively. There were \$67,533 of overdraft loans and other personal loans past due more than 90 days at December 31, 2003. There are no discernible delinquency or loss trends relating to overdraft lines and other personal loans known to management.

Loans secured by savings accounts and stock and bond certificates are secured lending arrangements. The Bank will advance funds for up to 95% of balances in savings or certificate of deposit accounts. The Bank will advance funds up to 60% of the market value of actively traded stock certificates and bonds or 50% of the market value of listed but not actively traded stocks and bonds. Loans secured by stocks and bonds are subject to margin calls to maintain the loan to value ratio. Collateral is not released until the loan is repaid, and the borrower is generally required to pay interest monthly. There were no losses on loans secured by savings accounts or stock and bond certificates during 2003, 2002, or 2001. There were no loans secured by savings accounts or stock and bond certificates past due more than 90 days at December 31, 2003. There are no discernible delinquency or loss trends relating to loans secured by savings accounts or stock and bond certificates known to management.

Reference is also made to Note 4 of the Notes to Consolidated Financial Statements included in this Report for the composition of the loan portfolio by type of loan. This Note indicates the relative size of the various types of loans to the portfolio in total. Reference is made to the Statistical Disclosures in this Report for an allocation of the allowance for loan losses by type of loan, which also indicates management's assessment of the degree of risk that each type of loan carries.

The Bank is the principal originator of the loans it makes, at this time. In prior periods, residential mortgage loans and home equity loans and lines of credit were predominantly purchased from a network of brokers or other types of originators with whom the Bank does business. The Bank has sold some loans in the secondary market and therefore derives a small amount of noninterest income from serviced loans. These income amounts are not significant to the amounts of noninterest income derived from other sources.

Reference is made to Note 4 of the Notes to Consolidated Financial Statements which contains the amounts of nonaccrual, restructured, and delinquent loans at December 31, 2003.

Carrollton Mortgage Services, Inc. (CMSI), a 100% owned subsidiary of Carrollton Bank originates and sells residential mortgage loans. CMSI originates adjustable and fixed-rate residential mortgage loans at terms and conditions and with documentation that permit their sale in the secondary mortgage market. CMSI's practice is to immediately sell substantially all residential

mortgage loans in the secondary market with servicing released.

Carrollton Community Development Corporation (CCDC), a 96.4% owned subsidiary of Carrollton Bank, was established in 1995 for the purpose of promoting, developing, and improving the housing and economic conditions of people in Maryland with particular emphasis in the Metropolitan Baltimore area. CCDC promotes through loans, investments, and other transactions, efforts to increase housing for low and moderate-income individuals.

**Investment Activities.** – The Company maintains a portfolio of investment securities to provide liquidity and income. The current portfolio amounts to about 21% of total assets, and is invested primarily in U.S. government agency securities, state and municipal bonds, corporate bonds, and mortgage-backed securities with maturities varying from 2004 to 2033, as well as equity securities. Reference is made to Note 3 of the Notes to Consolidated Financial Statements included in this Report and Statistical Disclosures for additional information concerning the investment portfolio.

**Deposit Services.** – The Bank offers a wide range of both personal and commercial types of deposit accounts and services as a means of gathering funds. Deposit accounts available include noninterest-bearing demand checking, interest-bearing checking (NOW accounts), savings, money market, certificates of deposit, and individual retirement accounts. Deposit accounts carry varying fee structures depending on the level of services desired by the customer. Interest rates vary depending on the balance in the account maintained by the customer. Commercial deposit customers may also choose an overnight investment account which automatically invests excess balances available in demand accounts on a daily basis in repurchase agreements. The Bank's customer base for deposits is primarily retail in nature. The Bank also offers certificates of deposit over \$100,000 to its retail and commercial customers. The Bank has used deposit brokers in the past and may do so in the future to meet liquidity needs. The balance of accounts over \$100,000 is not significant, and these accounts are offered principally as accommodations to existing customers.

Reference is also made to Note 8 of the Notes to Consolidated Financial Statements included in this Report for additional information concerning deposits of the Bank.

**Brokerage Activities.** – Carrollton Financial Services, Inc., a 100% owned subsidiary of the Bank, provides full service brokerage services for stocks, bonds, mutual funds and annuities. For 2003, commission income totaled \$793,572 and net income was \$176,694.

**Sources of Business.** – The major focus of the Bank's marketing efforts is on individual consumers

and on small to medium-sized businesses and professionals in the Bank's service area. The Bank's ability to generate deposits, loans and service income is dependent upon the growth of its market and the development and execution of a marketing strategy. Marketing primarily involves the print, television and radio media, and sponsorships of various prominent events in the Bank's market area. Direct mail is used on a sporadic basis, and direct calling on business customers is performed by branch and commercial lending personnel. The Bank's customers also promote the Bank through word of mouth referral. In its marketing efforts, the Bank emphasizes the advantages of dealing with a locally-owned institution that provides personalized service and is sensitive to the particular needs of consumers and businesses.

**Competition.** – The Bank faces strong competition in all areas of its operations. This competition comes from entities operating in Baltimore City, Baltimore County, Anne Arundel County and Carroll County, and includes branches of some of the largest banks in Maryland. Its most direct competition for deposits historically has come from other commercial banks, savings banks, savings and loan associations and credit unions. The Bank also competes for deposits with money market funds, mutual funds and corporate and government securities. The Bank competes with the same banking entities for loans, as well as mortgage banking companies and other institutional lenders. The competition for loans varies from time to time depending on certain factors, including, among others, the general availability of lendable funds and credit, general and local economic conditions, current interest rate levels, conditions in the mortgage market and other factors which are not readily predictable. Some of the Bank's competitors have greater assets and operating capacity than the Bank.

**Asset Management.** – The Bank makes available several types of loan services to its customers as described above, depending on customer needs. Recent emphasis has been made on originating short-term (one year or less), variable rate commercial loans and variable rate home equity lines of credit, with the balance of its funds invested in consumer/installment loans and real estate loans, both commercial and residential. In addition, a portion of the Bank's assets is invested in high-grade securities and other investments in order to provide income, liquidity and safety. Such investments include U.S. government agency securities, corporate bonds, mortgage-backed securities and collateralized mortgage obligations, as well as advances of federal funds to other member banks of the Federal Reserve System. Subject to the effects of taxes, the Bank also invests in tax-exempt state and municipal securities with a minimum rating of "A" by a recognized ratings agency. The Bank's primary source of funds is customer deposits.

The risk of non-repayment (or deferred payment) of loans is inherent in the business of commercial banking, regardless of the type of loan or borrower. The Bank's efforts to expand its loan portfolio to small and medium-sized businesses may result in the Bank undertaking certain lending risks which are somewhat different from those involved in loans made to larger businesses. The Bank's management evaluates all loan applications and seeks to minimize the exposure to credit risks through the use of thorough loan application, approval and monitoring procedures. However, there can be no assurance that such procedures significantly reduce all risks.

**Employees.** – As of December 31, 2003, the Bank and its subsidiaries had 136 full time equivalent employees, 38 of whom were officers. Each officer generally has responsibility for one or more loan, banking, customer contact, operations, or subsidiary functions. Non-officer employees are employed in a variety of administrative capacities. Management does not anticipate any inordinate difficulty in recruiting and training such additional officers and employees as it may need in the future. Management believes that relations with its employees are good.

#### CRITICAL ACCOUNTING POLICIES

The Company's financial condition and results of operations are sensitive to accounting measurements and estimates of matters that are inherently uncertain. When applying accounting policies in areas that are subjective in nature, management must use its best judgment to arrive at the carrying value of certain assets. One of the most critical accounting policies applied is related to the valuation of the loan portfolio.

A variety of estimates impact carrying value of the loan portfolio including the calculation of the allowance for loan losses, valuation of underlying collateral and the timing of loan charge-offs.

The allowance for loan losses is one of the most difficult and subjective judgments. The allowance is established and maintained at a level that management believes is adequate to cover losses resulting from the inability of borrowers to make required payments on loans. Estimates for loan losses are arrived at by analyzing risks associated with specific loans and the loan portfolio. Current trends in delinquencies and charge-offs, the views of Bank regulators, changes in the size and composition of the loan portfolio and peer comparisons are also factors. The analysis also requires consideration of the economic climate and direction and change in the interest rate environment, which may impact a borrower's ability to pay, legislation impacting the banking industry and economic conditions specific to the Bank's service area. Because the calculation of the allowance for loan losses relies on estimates and judgments relating to inherently uncertain events, results may differ from our estimates.

#### SUPERVISION AND REGULATION

**Supervision and Regulation of the Company.** – As a bank holding company, the Company is subject to the Bank Holding Company Act of 1956, as amended (the "BHCA"). The BHCA is administered by the Board of Governors of the Federal Reserve System (the "Board of Governors"), and the Company is required to file with the Board of Governors such reports and information as may be required pursuant to the BHCA. The Board of Governors also may examine the Corporation and any of its nonbank subsidiaries. The BHCA requires every bank holding company to obtain the prior approval of the Board of Governors before: (i) it or any of its subsidiaries (other than a bank) acquires substantially all of the assets of any bank; (ii) it acquires ownership or control of any voting shares of any bank if after such acquisition it would own or control, directly or indirectly, more than five percent of the voting shares of such bank; or (iii) it merges or consolidates with any other bank holding company.

Under the BHCA, a bank holding company is generally prohibited from engaging in, or acquiring direct or indirect control of more than five percent of the voting shares of any company engaged in non-banking activities. A major exception to this prohibition is for activities the Board of Governors finds, by order or regulation, to be so closely related to banking or managing or controlling banks. Some of the activities that the Board of Governors has determined by regulation to be properly incident to the business of a bank holding company are: making or servicing loans and certain types of leases; engaging in certain investment advisory and discount brokerage activities; performing certain data processing services; acting in certain circumstances as a fiduciary or as an investment or financial advisor; ownership of certain types of savings associations; engaging in certain insurance activities; and making investments in certain corporations or projects designed primarily to promote community welfare.

Certain provisions of the Federal Deposit Insurance Corporation Improvements Act of 1991 ("FDICIA") also may impact the operations of the Company. FDICIA requires that the Board of Governors adopt regulations establishing safety and soundness standards for bank holding companies relating to: (i) internal controls, information systems and internal audit systems; (ii) loan documentation; (iii) credit underwriting; (iv) interest rate exposure; (v) asset growth; and (vi) compensation and benefit standards for officers, directors, employees and principal shareholders. FDICIA also requires any bank holding company which controls an undercapitalized insured bank to act as a "source of strength" to such bank. Finally, FDICIA permits the appropriate federal bank regulatory agency to require a bank holding company to divest itself of a bank subsidiary in certain circumstances.

The Company is an “affiliate” of the Bank under the Federal Reserve Act, which imposes certain restrictions on: (i) loans by the Bank to the Company; (ii) investments in the stock or securities of the Company; and (iii) the Bank taking stock or securities of the Company as collateral for loans by it to a borrower.

The Company also is an affiliate of the Bank under the Maryland Financial Institutions Article of the Annotated Code of Maryland (the “Financial Institutions Article”). As such, the Commissioner of Financial Regulation for the State of Maryland (the “Commissioner”) has the same authority to examine the business of the Company that it has to examine the business of the Bank.

**Supervision and Regulation of the Bank.** – The Bank is the only direct subsidiary of the Company. The Bank operates as a banking institution incorporated under the laws of the State of Maryland and is subject to examination by the Commissioner. The Bank is not a member of the Federal Reserve System (an “insured nonmember bank”) and as such, its primary federal regulator is the Federal Deposit Insurance Corporation (the “FDIC”). Deposits in the Bank are insured by the FDIC. The Commissioner and the FDIC regulate or monitor all areas of the Bank’s operations, including reserves, loans, loans to directors, officers or principal shareholders, loans to one borrower, capital, investments, borrowings, deposits, mergers, issuance of securities, payment of dividends, interest rates payable on deposits, interest rates or fees chargeable on loans, establishment of branches, corporate reorganizations and maintenance of books and records.

**Examinations.** – Pursuant to FDICIA, and subsequent amendments thereto, examinations of insured nonmember banks having assets of \$250,000,000 or more must be conducted no less frequently than every 12 months. The Bank is subject to assessments by the FDIC to cover the costs of such examinations. As a result of such examinations, the FDIC may revalue assets of the Bank and require establishment of specific reserves in amounts equal to the difference between such revaluation and the book value of the assets.

**Safety and Soundness.** – The FDIC is authorized to promulgate regulations to ensure the safe and sound operations of insured nonmember banks and may impose various requirements and restrictions on the activities of insured nonmember banks. Additionally, under FDICIA, the FDIC was required to prescribe safety and soundness regulations relating to: (i) internal controls, information systems, and internal audit systems; (ii) loan documentation; (iii) credit underwriting; (iv) interest rate exposure; (v) asset growth; and (vi) compensation and benefit standards for officers, directors, employees and principal shareholders.

**Loans and Deposit Products.** – Interest and certain other charges collected or contracted for by

the Bank are subject to state usury and consumer protection laws and certain federal laws concerning interest rates. The Bank’s loan operations are also subject to certain federal laws applicable to credit transactions, such as the Truth-in-Lending Act (governing disclosures of credit terms to consumer borrowers), the Equal Credit Opportunity Act (prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit), the Fair Credit Reporting Act (governing the use of information from and provision of information to credit reporting agencies and others), the Fair Debt Collection Practices Act (governing the manner in which consumer debts may be collected), and the rules and regulations of the various federal agencies charged with the responsibility of implementing such federal laws. The deposit operations of the Bank also are subject to the Electronic Funds Transfer Act (governing automatic deposits to and withdrawals from deposit accounts and customers’ rights and liabilities arising from the use of automated teller machines and other electronic banking services), the Truth-in-Savings Act (governing disclosures of terms applicable to deposit accounts), the Expedited Funds Availability Act (governing the availability of certain funds deposited into transaction accounts), and the rules and regulations of the Board of Governors implementing such acts.

Pursuant to FDICIA, the FDIC has adopted regulations prescribing standards for extensions of credit by insured nonmember banks secured by liens on or interests in real estate and made for the purpose of financing the construction of a building or other improvements to real estate. The FDIC regulations require insured nonmember banks to establish and maintain written internal real estate lending policies consistent with safe and sound banking practices and appropriate to the size of the bank. These policies must include loan portfolio diversification standards, prudent underwriting standards (including clear and measurable loan-to-value limits), loan administration procedures, and documentation, approval and reporting requirements to monitor compliance with the policies. Finally, the regulations require insured nonmember banks to monitor conditions in its real estate market to ensure that its lending policies continue to be appropriately based on current market conditions.

**Capital Requirements.** – Under regulations promulgated by the FDIC, insured nonmember banks currently are required to maintain “core” or “tier 1” capital of at least 4% (5% to be “well-capitalized”) of total assets (the “Leverage Ratio”). Tier 1 capital consists of: (i) common shareholders’ equity, noncumulative perpetual preferred stock and minority interests in consolidated subsidiaries; (ii) minus intangible assets (other than certain purchased mortgage and credit card servicing rights); (iii) minus certain losses, and minus investments in certain securities subsidiaries.

In addition, each insured nonmember bank also must maintain a “tier 1 risk-based capital ratio” of 4% (6% to be “well-capitalized”). The “tier 1 risk-based capital ratio” is defined in FDIC regulations as the ratio of tier 1 capital to risk-weighted assets. A bank’s total risk-weighted assets are determined by: (i) converting each of its off-balance sheet items to a balance sheet credit equivalent amount; (ii) assigning each balance sheet asset and the credit equivalent amount of each off-balance sheet item to one of the five risk categories established in the FDIC’s regulations; and (iii) multiplying the amounts in each category by the risk factor assigned to that category. The sum of the resulting amounts constitutes total risk-weighted assets.

Each insured nonmember bank is required to maintain a “total risk-based capital ratio” of at least 8% (10% to be “well-capitalized”). The “total risk-based capital ratio” is defined in FDIC regulations as the ratio of total qualifying capital to risk-weighted assets (as defined above). Total capital, for purposes of the risk-based capital requirement, consists of the sum of tier 1 capital (as defined for purposes of the Leverage Ratio) and supplementary capital. Supplementary capital includes such items as cumulative perpetual preferred stock, long-term and intermediate-term preferred stock, term subordinated debt and general valuation loan and lease loss allowances (but only in an amount of up to 1.25% of total risk-weighted assets). The maximum amount of supplementary capital that may be counted towards satisfaction of the total capital requirement is limited to 100% of core capital. Additionally, term subordinated debt and intermediate-term preferred stock may only be included in supplementary capital up to 50% of tier 1 capital.

Capital requirements higher than the generally applicable minimum requirements may be established for a particular insured nonmember bank if the FDIC determines that the bank’s capital is or may become inadequate in view of its particular circumstances. Individual minimum capital requirements may be imposed where a bank is receiving special supervisory attention, has a high degree of exposure to interest rate risk, or poses other safety or soundness concerns. Deficient capital may result in the suspension of an institution’s deposit insurance.

**Prompt Corrective Action.** – Under FDIC regulations, any insured nonmember bank that receives notice from the FDIC that it is undercapitalized, must file a capital restoration plan with the FDIC addressing, among other things, the manner in which the bank will increase its capital to comply with all applicable capital standards. Under the prompt corrective action regulation adopted by the FDIC, an institution will be considered “well capitalized” if the institution has a total risk-based capital ratio of 10% or greater, a tier 1 risk-based capital ratio of 6% or

greater, and a leverage ratio of 5% or greater (provided the institution is not subject to an order, written agreement, capital directive or prompt corrective action to meet and maintain a specified capital level for any capital measure). At December 31, 2003, the Company and Bank were considered “well-capitalized.”

**Brokered and Other Deposits.** – Under applicable FDIC regulations, only well-capitalized depository institutions may solicit, accept, renew or roll over any brokered deposit. Adequately-capitalized depository institutions may accept, renew or roll over brokered deposits only after obtaining a waiver from the FDIC. Adequately-capitalized institutions are subject to limits on rates of interest they may pay on brokered deposits. Undercapitalized institutions are subject to limits on rates of interest they may pay on deposits in general. As of December 31, 2003, the Bank had \$0 in brokered deposits.

**Limitation on Bank Activities.** – The scope of activities in which an insured nonmember bank may engage and the permissible investments which an insured nonmember bank may make are subject to federal and Maryland law. An insured nonmember bank may engage only in those activities, and make only those investments, as are permissible for national banks. National banks generally are permitted to engage in certain enumerated banking functions and all such activities as are incidental thereto. Further, national banks and, as a result of FDICIA, insured nonmember banks are severely limited as to the types of debt and equity securities in which such banks may invest.

**Transactions with Affiliates.** – Transactions engaged in by an insured nonmember bank or one of its subsidiaries with affiliates of such bank are subject to the affiliate transactions restrictions contained in Section 23A and 23B of the Federal Reserve Act in the same manner and to the same extent as such restrictions apply to transactions engaged in by a Federal Reserve System member bank or one of its subsidiaries with affiliates of that member bank. Section 23A of the Federal Reserve Act imposes both quantitative and qualitative restrictions on transactions engaged in by a member bank or one of its subsidiaries with an affiliate. Section 23B of the Federal Reserve Act requires, among other things, that all transactions with affiliates be on terms substantially the same, or at least as favorable to the member bank or the subsidiary, as the terms that would apply, or would be offered in, a comparable transaction with an unaffiliated party.

Loans made by an insured nonmember bank to its directors, executive officers and principal shareholders, to the directors, executive officers and principal shareholders of its affiliates, or to the related interests of any of the foregoing (collectively, “insiders”) must comply with Maryland law and the requirements of Sections 22(g) and

22(h) of the Federal Reserve Act and certain of the regulations of the Board of Governors, except to the extent more stringent requirements are established by the FDIC. Among other things, Sections 22(g) and 22(h) of the Federal Reserve Act require that all loans to insiders be made on substantially the same terms as those prevailing at the time for comparable transactions with unaffiliated borrowers and not involve more than the normal risk of repayment or present other unfavorable features. Maryland law further requires that such loans, with limited exceptions, be approved by the board of directors or executive committee and be reviewed every six months by the board. Additionally, the aggregate amount of loans or extensions of credit outstanding to any insider may not exceed the loans to one borrower limitation applicable to national banks. Further, FDICIA limits the aggregate amount of loans or extensions of credit outstanding to all insiders to 100% of the amount of unimpaired capital and unimpaired surplus of the institution.

**Regulatory Restrictions on the Payment of Dividends by the Bank to the Company.** – FDICIA restricts the ability of federally-insured banks to pay any dividend (other than a dividend in the form of additional shares, or options to purchase additional shares) if, after paying the dividend, the bank would be undercapitalized.

**Community Reinvestment.** – The Community Reinvestment Act (the “CRA”) and the regulations of the FDIC require each insured nonmember bank to delineate its local community, adopt a CRA statement listing the local community and the types of credit the bank is prepared to extend in that community and to make its CRA statement available for public inspection. The FDIC periodically evaluates performance and compliance with the CRA statement. The failure to adequately perform community reinvestment activities could result in the denial of applications to acquire banking and non-banking institutions, establish branches, obtain deposit insurance for newly-chartered banks, or to relocate the main office or a branch office of a bank.

**Deposit Insurance.** – The Bank’s deposits are insured by the FDIC through the Bank Insurance Fund (the “BIF”) up to a maximum of \$100,000 for each insured depositor. The insurance premium payable by each BIF member is based on the institution’s assessment base (generally total deposit accounts subject to certain adjustments). The premiums are paid in quarterly assessments. The FDIC promulgated regulations establishing a risk-based assessment system commencing in 1993.

Deposit insurance may be terminated by the FDIC after notice and hearing, upon a finding by the FDIC that an insured nonmember bank has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, rule, regulation, order or condition imposed by, or

written agreement with, the FDIC. Additionally, the FDIC may temporarily suspend insurance on new deposits received by an insured nonmember bank that has no tangible capital and no goodwill includible in core capital.

**Income Taxes.** – The Company and its subsidiaries are required to file annual income tax returns with both the Internal Revenue Service (the “IRS”) and the taxing authorities in any state in which they are qualified to do business. Because the Bank is under \$500 million in asset size, it is permitted to use the reserve method of tax accounting for determining bad debt deductions for income tax purposes. At December 31, 2003, the Bank had a tax bad debt reserve of \$609 thousand and a book bad debt reserve of \$3.7 million. The Bank has provided a deferred tax asset on its books for the difference between its tax and book bad debt reserves. If the Bank were to grow to a size of \$500 million or greater, it would be required to recapture its tax bad debt reserve over a four year period and pay taxes on that amount. For financial accounting purposes, the payment of these taxes would be offset by an increase in the deferred tax asset related to the difference between tax and book bad debt reserves, potentially subject to a total deferred tax asset limitation based on reasonable recovery under current accounting literature.

Although the Company currently pays income taxes based on current marginal rates, the Bank has a portfolio of state and municipal securities which earn interest that is not taxed for federal income tax purposes. For that reason, the Bank may be subject to the Alternative Minimum Tax (“AMT”) provisions of the Internal Revenue Code. The AMT provisions in general limit the benefit available from investing in tax free obligations, and require companies to pay the higher of taxes computed at 34% of income less the tax free income, or 20% of total income. Any amounts paid under the AMT are carried over and are available as a credit in future years.

**Securities Laws.** – The Company and certain of its directors, officers and shareholders are subject to the Securities Act of 1934 and a broad range of both federal and state securities laws including the obligation to file annual, quarterly and other periodic reports with the appropriate authorities, soliciting proxies and conducting shareholders’ meetings in accordance with the 1934 Act’s proxy rules, and complying with the reporting and “short-swing” profit recovery provisions imposed by 1934 Act Section 16.

**Monetary Policies.** – Banking is a business that depends on interest rate differentials. In general, the differences between the interest paid by a bank on its deposits and other borrowings, the interest received by the bank on loans extended to its customers, and securities held in its investment portfolio constitute the major portion of a bank’s earnings. Consequently, the earnings growth of the

Bank is influenced by economic conditions, both domestic and foreign, and also on the monetary and fiscal policies of the United States and its agencies, particularly the Federal Reserve Board, which regulates the supply of money through various means. The nature and timing of changes in such policies and their impact on the Bank cannot be predicted. This instrument of monetary policy may cause volatile fluctuations in short term interest rates, and can have a direct, adverse effect on the operating results of financial institutions. Consequently, Federal Reserve monetary policies have had a significant effect on the operating results of commercial banks in the past and are expected to continue to do so in the future.

During the last several years, federal legislation and actions by various federal regulatory authorities have significantly increased competition among commercial banks, savings and loan associations, savings banks, and other financial institutions through, among other things, the elimination of virtually all rate ceilings on interest-bearing deposits.

#### **ITEM 2: DESCRIPTION OF PROPERTY**

Both the Bank's main branch and certain of the Company's executive and administrative offices are located in the Bank's headquarters building which it owns in downtown Baltimore, Maryland. The Bank owns buildings for three of its other branch office locations as well. The Bank leases space for the remaining six branches, two of its CMSI locations, and for its operations center which primarily houses support functions. As a result of the sale of one of the Bank's branches in 2002, it remains responsible for a lease of the facility, currently subleased by the acquiring bank, which expires in 2005. Current lease terms expire in 2004 through 2013 and contain renewal options ranging from 3 to 23 years.

The Bank has purchased the furniture and fixtures required for its headquarters, operations center and branch network. The Bank has purchased the computer/teller equipment in its branch network and the equipment used for administrative functions.

#### **ITEM 3: LEGAL PROCEEDINGS**

A proper person plaintiff, Charles A. Allen, filed a negligence lawsuit against Carrollton Bank on October 24, 2002 in the Circuit Court of Baltimore City. The case was also filed against an employee of the Bank, the FDIC, and an employee of the FDIC. Counsel for the Bank filed an answer to Mr. Allen's complaint on December 20, 2002 to protect the Bank's interest. Mr. Allen sought damages of the Bank in excess of \$50,000,000.

Counsel for the Bank filed a motion for summary judgment in the court in October of 2003. The plaintiff Allen did not respond to the Bank's motion. The court granted the Bank's motion and dismissed Mr. Allen's lawsuit against the Bank.

In a separate action, Carrollton Bank has been sued for damages by the personal representative of a deceased customer, in the Circuit Court for Anne Arundel County, Maryland. The complaint alleges causes of action against the Bank for negligence, breach of contract and breach of fiduciary duty and seeks damages of \$132,000. Counsel for the Bank has filed an Answer and Cross/Claim in the case to protect the Bank's interest.

In December of 2003, the Bank filed a motion for summary judgment in the case seeking a dismissal of the lawsuit filed against the Bank. The plaintiff also filed motions for summary judgment. On February 4, 2004, the court denied all of the summary judgment motions filed by all parties in the case. A pre-trial conference is scheduled in the case for April 6, 2004. The Bank will likely re-file its summary judgment motion once again to seek dismissal of the case against it prior to a full trial on the merits.

It does not appear to counsel that the Bank has any material liability exposure in this case. Counsel has advised the Bank's insurance carrier of the lawsuit. Counsel feels the claims made in the lawsuit are "covered claims," under the Bank's insurance policy, for which defense costs and indemnity are available to the Bank.

#### **ITEM 4: SUBMISSION OF MATTERS TO A VOTE OF SECURITY-HOLDERS**

Not applicable.

## PART II

### ITEM 5: MARKET FOR COMMON EQUITY AND RELATED SHAREHOLDER MATTERS

#### TRADING AND DIVIDENDS

As of December 31, 2003, there were 455 shareholders of record of the Company. Since May 1994, the Company's Common Stock has traded on the NASDAQ National Market Tier of The NASDAQ Stock Market under the symbol "CRRB." Currently, there are two broker-dealers who make a market in the Common Stock.

The table below sets forth the high and low sales price for each quarter in the last two years, and cash dividends paid per share.

Period	Price per Share (a)				Cash Dividends Paid per Share(a)	
	2003		2002		2003	2002
	High	Low	High	Low		
1st Quarter	\$15.55	\$12.82	\$12.02	\$11.20	\$0.09	\$0.085
2nd Quarter	17.99	14.15	12.88	11.35	\$0.09	0.086
3rd Quarter	18.10	16.03	13.11	11.84	\$0.09	0.085
4th Quarter	18.40	17.49	14.25	11.70	\$0.09	0.086

(a) Per share amounts have been adjusted to retroactively reflect the effect of the 5% stock dividend in October of 2002.

The following table provides information about the Company's outstanding options, warrants and rights under equity compensation plans:

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	174,785	\$13.88	29,130
Equity compensation plans not approved by security holders	—	—	—
Total	174,785	\$13.88	29,130

### ITEM 6: SELECTED FINANCIAL DATA

The following information should be read in conjunction with the Audited Consolidated Financial Statements contained in Item 8 of this document and Management's Discussion and Analysis of Financial Condition and Results of Operations. The following information contained herein is presented to help the reader gain additional insight to information and discussion presented in the Audited Consolidated Financial Statements and in Management's Discussion and Analysis.

The ability of the Company to pay dividends in the future will be dependent on the earnings, if any, financial condition and business of the Company, as well as other relevant factors, such as regulatory requirements. No assurance can be given either that the Company's future earnings, if any, will be sufficient to enable it to pay dividends, or that if such earnings are sufficient, that the Company will not decide to retain such earnings for general working capital and other funding needs. In addition, the Company is highly dependent on dividends received from the Bank to enable it to pay dividends to shareholders. No assurance can be given that the Bank will continue to generate sufficient earnings to enable it to pay dividends to the Company, or that it will continue to meet regulatory capital requirements which, if not met, could prohibit payment of dividends to the Company.

### ITEM 6A: DISTRIBUTION OF ASSETS, LIABILITIES, AND SHAREHOLDERS' EQUITY; INTEREST RATES AND INTEREST DIFFERENTIAL

#### AVERAGE BALANCES, INTEREST AND YIELDS

The following chart contains average balance sheet information for 2003, 2002, and 2001, and indicates the related interest income or expense and calculated yield. Nonaccruing loans are included in the average balance amounts of the applicable portfolio, but only the amount of interest actually recorded as income on nonaccrual loans is included in the interest income column.

2003 AVERAGE BALANCES, INTEREST, AND YIELDS

2003

	<i>Average balance</i>	<i>Interest</i>	<i>Yield</i>
<b>ASSETS</b>			
Federal funds sold and Federal Home Loan Bank deposit	\$ 18,044,257	\$ 198,427	1.10%
Federal Home Loan Bank stock	2,352,030	90,075	3.83
Investment securities			
U.S. government agency	39,007,166	1,170,484	3.00
State and municipal	5,064,139	323,561	6.39
Mortgage-backed securities	12,605,968	676,216	5.36
Corporate bonds	7,504,350	453,741	6.05
Other	3,765,420	248,647	6.60
	<u>67,947,043</u>	<u>2,872,649</u>	<u>4.23</u>
Loans			
Demand and time	36,937,606	2,362,358	6.40
Residential mortgage	66,966,298	4,373,550	6.53
Commercial mortgage and construction	85,645,620	5,687,390	6.64
Installment	2,745,494	271,251	9.88
Lease financing	4,201,261	356,616	8.49
	<u>196,496,279</u>	<u>13,051,165</u>	<u>6.64</u>
Total interest-earning assets	284,839,609	16,212,316	5.69
Noninterest-bearing cash	19,662,376		
Premises and equipment	5,173,405		
Other assets	6,062,058		
Allowance for loan losses	(3,692,349)		
Unrealized gains on available for sale securities, net	3,306,853		
	<u>\$315,351,952</u>	<u>\$16,212,316</u>	
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
Interest-bearing deposits			
Savings and NOW	\$ 72,624,598	\$ 231,024	0.32%
Money market	28,266,591	267,744	0.95
Other time	77,496,371	2,970,271	3.83
	<u>178,387,560</u>	<u>3,469,039</u>	<u>1.94</u>
Borrowed funds	58,234,600	3,170,695	5.44
Total interest-bearing liabilities	236,622,160	6,639,734	2.81
Noninterest-bearing deposits	42,449,945		
Other liabilities	2,132,959		
Shareholders' equity	34,146,888		
Total liabilities and shareholders' equity	<u>\$315,351,952</u>	<u>\$ 6,639,734</u>	
<b>NET YIELD ON INTEREST-EARNING ASSETS</b>	<u>\$284,839,609</u>	<u>\$ 9,572,582</u>	<u>3.36%</u>

*Interest on investments and loans is presented on a fully taxable equivalent basis, using regular income tax rates.*

2002 AVERAGE BALANCES, INTEREST, AND YIELDS

2002

	<i>Average balance</i>	<i>Interest</i>	<i>Yield</i>
<b>ASSETS</b>			
Federal funds sold and Federal Home Loan Bank deposit	\$ 10,563,830	\$ 166,183	1.57%
Federal Home Loan Bank stock	3,060,959	163,132	5.33
Investment securities			
U.S. Treasury	700,723	12,587	1.80
U.S. government agency	43,244,998	1,993,200	4.61
State and municipal	5,577,528	362,950	6.51
Mortgage-backed securities	19,122,373	1,068,841	5.59
Corporate bonds	7,682,596	466,665	6.07
Other	4,111,271	285,749	6.95
	<u>80,439,489</u>	<u>4,189,992</u>	<u>5.21</u>
Loans			
Demand and time	35,702,734	2,408,240	6.75
Residential mortgage	98,056,690	6,460,935	6.59
Commercial mortgage and construction	75,290,582	5,428,237	7.21
Installment	3,737,614	367,749	9.84
Lease financing	2,985,485	261,238	8.75
	<u>215,773,105</u>	<u>14,926,399</u>	<u>6.92</u>
Total interest-earning assets	309,837,383	19,445,706	6.28
Noninterest-bearing cash	17,385,072		
Premises and equipment	6,394,921		
Other assets	4,058,345		
Allowance for loan losses	(3,530,286)		
Unrealized gains on available for sale securities, net	2,551,816		
	<u>\$336,697,251</u>	<u>\$19,445,706</u>	
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
Interest-bearing deposits			
Savings and NOW	\$ 76,375,342	\$ 422,165	0.55%
Money market	31,474,273	461,295	1.47
Other time	93,558,972	4,612,898	4.93
	<u>201,408,587</u>	<u>5,496,358</u>	<u>2.73</u>
Borrowed funds	57,578,163	3,195,963	5.55
Total interest-bearing liabilities	258,986,750	8,692,321	3.36
Noninterest-bearing deposits	42,139,426		
Other liabilities	1,919,529		
Shareholders' equity	33,651,546		
Total liabilities and shareholders' equity	<u>\$336,697,251</u>	<u>\$ 8,692,321</u>	
<b>NET YIELD ON INTEREST-EARNING ASSETS</b>	<u>\$309,837,383</u>	<u>\$10,753,385</u>	<u>3.47%</u>

*Interest on investments and loans is presented on a fully taxable equivalent basis, using regular income tax rates.*

2001 AVERAGE BALANCES, INTEREST, AND YIELDS

2001

	<i>Average balance</i>	<i>Interest</i>	<i>Yield</i>
<b>ASSETS</b>			
Federal funds sold and Federal Home Loan Bank deposit	\$ 10,562,893	\$ 422,569	4.00%
Federal Home Loan Bank stock	3,250,000	222,599	6.85
Investment securities			
U.S. Treasury	157,969	10,202	6.46
U.S. government agency	58,176,745	3,231,072	5.55
State and municipal	6,097,110	392,332	6.43
Mortgage-backed securities	19,120,539	1,127,965	5.90
Corporate bonds	6,443,265	388,839	6.03
Other	3,987,982	300,270	7.53
	<u>93,983,610</u>	<u>5,450,680</u>	<u>5.80</u>
Loans			
Demand and time	31,224,350	2,623,454	8.40
Residential mortgage	145,005,914	10,681,143	7.37
Commercial mortgage and construction	54,797,755	4,272,029	7.80
Installment	4,918,974	505,711	10.28
Lease financing	1,586,061	142,246	8.97
	<u>237,533,054</u>	<u>18,224,583</u>	<u>7.67</u>
Total interest-earning assets	345,329,557	24,320,431	7.04
Noninterest-bearing cash	18,742,938		
Premises and equipment	7,554,159		
Other assets	5,295,745		
Allowance for loan losses	(3,146,369)		
Unrealized gains on available for sale securities, net	1,405,193		
	<u>\$375,181,223</u>	<u>\$24,320,431</u>	
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
Interest-bearing deposits			
Savings and NOW	\$ 83,980,457	\$ 1,161,384	1.38%
Money market	42,466,305	1,384,639	3.26
Other time	115,777,381	6,799,716	5.87
	<u>242,224,143</u>	<u>9,345,739</u>	<u>3.86</u>
Borrowed funds	59,638,438	3,526,616	5.91
Total interest-bearing liabilities	301,862,581	12,872,355	4.26
Noninterest-bearing deposits	38,867,266		
Other liabilities	2,491,767		
Shareholders' equity	31,959,609		
Total liabilities and shareholders' equity	<u>\$375,181,223</u>	<u>\$12,872,355</u>	
<b>NET YIELD ON INTEREST-EARNING ASSETS</b>	<u>\$345,329,557</u>	<u>\$11,448,076</u>	<u>3.32%</u>

*Interest on investments and loans is presented on a fully taxable equivalent basis, using regular income tax rates.*

## RATE AND VOLUME VARIANCE

The following chart shows the changes in interest income and interest expense for the last two years resulting from changes in volume and changes in rates.

	2003 Compared to 2002			2002 Compared to 2001		
	<i>Change Due to Variance In</i>			<i>Change Due to Variance In</i>		
	<i>Rates</i>	<i>Volume</i>	<i>Total</i>	<i>Rates</i>	<i>Volume</i>	<i>Total</i>
<b>INTEREST EARNED ON</b>						
Federal funds sold and Federal Home Loan Bank deposit	\$ (85,433)	\$ 117,677	\$ 32,244	\$ (256,423)	\$ 37	\$ (256,386)
Federal Home Loan Bank stock	(35,275)	(37,782)	(73,057)	(46,519)	(12,948)	(59,467)
<b>INVESTMENT SECURITIES</b>						
U.S. Treasury	—	(12,587)	(12,587)	(32,667)	35,052	2,385
U.S. government agency	(627,391)	(195,325)	(822,716)	(408,579)	(829,293)	(1,237,872)
State and municipal	(5,981)	(33,408)	(39,389)	4,052	(33,434)	(29,382)
Mortgage-backed securities	(28,392)	(364,233)	(392,625)	(59,232)	108	(59,124)
Corporate bonds	(2,097)	(10,827)	(12,924)	3,035	74,791	77,826
Other	(13,064)	(24,038)	(37,102)	(23,804)	9,283	(14,521)
	<u>(676,925)</u>	<u>(640,418)</u>	<u>(1,317,343)</u>	<u>(517,195)</u>	<u>(743,493)</u>	<u>(1,260,688)</u>
<b>LOANS</b>						
Demand and time	(129,177)	83,295	(45,882)	(591,486)	376,272	(215,214)
Residential mortgage	(38,846)	(2,048,539)	(2,087,385)	(761,926)	(3,458,282)	(4,220,208)
Commercial mortgage and construction	(487,415)	746,568	259,153	(441,411)	1,597,619	1,156,208
Installment and credit card	1,118	(97,616)	(96,498)	(16,508)	(121,454)	(137,962)
Lease financing	(11,006)	106,384	95,378	(6,515)	125,507	118,992
	<u>(665,326)</u>	<u>(1,209,908)</u>	<u>(1,875,234)</u>	<u>(1,817,846)</u>	<u>(1,480,338)</u>	<u>(3,298,184)</u>
<b>TOTAL INTEREST EARNED</b>	<u>(1,462,959)</u>	<u>(1,770,431)</u>	<u>(3,233,390)</u>	<u>(2,637,983)</u>	<u>(2,236,742)</u>	<u>(4,874,725)</u>
<b>INTEREST EXPENSE ON DEPOSITS</b>						
Savings and NOW	(170,409)	(20,732)	(191,141)	(634,046)	(105,173)	(739,219)
Money market	(146,538)	(47,013)	(193,551)	(564,942)	(358,402)	(923,344)
Other time	(850,665)	(791,962)	(1,642,627)	(881,910)	(1,304,908)	(2,186,818)
Borrowed funds	(61,705)	36,437	(25,268)	(208,822)	(121,831)	(330,653)
<b>TOTAL INTEREST EXPENSE</b>	<u>(1,229,317)</u>	<u>(823,270)</u>	<u>(2,052,587)</u>	<u>(2,289,720)</u>	<u>(1,890,314)</u>	<u>(4,180,034)</u>
<b>NET INTEREST INCOME</b>	<u>\$ (233,642)</u>	<u>\$ (947,161)</u>	<u>\$ (1,180,803)</u>	<u>\$ (348,263)</u>	<u>\$ (346,428)</u>	<u>\$ (649,691)</u>

*Interest on investments and loans is presented on a fully taxable equivalent basis, using regular income tax rates.*

## ITEM 6B: INVESTMENT PORTFOLIO

### AMORTIZED COST OF INVESTMENTS

Reference is made to Note 3 of Notes to Consolidated Financial Statements for the amortized cost of investments at the end of 2003 and 2002. The amortized cost of investments at the end of 2001 was as follows:

#### AVAILABLE FOR SALE

U.S. Government agency	\$ 64,711,849
Mortgage-backed securities	19,758,761
State and municipal Corporate bonds	5,891,946
	<u>7,739,978</u>
	98,102,534
Equity securities	<u>4,299,478</u>
	<u>\$102,402,012</u>

#### HELD TO MATURITY

Foreign bonds	<u>\$ 25,000</u>
---------------	------------------

Note: Investments classified as available for sale are carried at market value whereas investments classified as held to maturity are carried at amortized cost.

### MATURITY AND WEIGHTED AVERAGE YIELDS

The following charts show the maturity distribution for amortized cost and weighted average yields of debt securities in the Company's investment portfolio at December 31, 2003. Separate charts are presented for securities classified as available for sale and held to maturity. Because the amortized cost is shown and not market value, the totals of the available for sale securities will not agree with the amount shown on the Consolidated Balance Sheet for 2003 in Part II, Item 8.

#### MATURITY DISTRIBUTION—AMORTIZED COST

DESCRIPTION	<i>Available for Sale</i>			
	<i>&lt; 1 year</i>	<i>1 to 5 years</i>	<i>5 to 10 years</i>	<i>&gt; 10 years</i>
U.S. Government agency	\$1,999,003	\$32,537,815	\$ —	\$ —
Mortgage-backed securities (1)	1,323	205,103	1,831,517	7,048,419
State and municipal	508,451	1,188,271	3,344,814	—
Corporate bonds	3,520,944	3,057,871	—	—
	<u>\$6,029,721</u>	<u>\$36,989,060</u>	<u>\$5,176,331</u>	<u>\$7,048,419</u>

DESCRIPTION	<i>Held to Maturity</i>			
	<i>&lt; 1 year</i>	<i>1 to 5 years</i>	<i>5 to 10 years</i>	<i>&gt; 10 years</i>
Foreign	<u>\$25,000</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

(1) Mortgage-backed securities are included in the maturity distribution table based on the average life of the security using anticipated prepayment rates.

## WEIGHTED AVERAGE YIELD

DESCRIPTION	<i>Available for Sale</i>			
	<i>&lt; 1 year</i>	<i>1 to 5 years</i>	<i>5 to 10 years</i>	<i>&gt; 10 years</i>
U.S. Government agency	5.00%	2.15%	—%	—%
Mortgage-backed securities	7.01%	6.19%	5.70%	6.17%
State and municipal (1)	2.49%	6.69%	6.31%	—%
Corporate bonds	5.68%	6.03%	—%	—%
	<u>5.19%</u>	<u>2.64%</u>	<u>6.10%</u>	<u>6.17%</u>

DESCRIPTION	<i>Held to Maturity</i>			
	<i>&lt; 1 year</i>	<i>1 to 5 years</i>	<i>5 to 10 years</i>	<i>&gt; 10 years</i>
Foreign	5.50%	—%	—%	—%

(1) Yields on state and municipal obligations are computed on a tax equivalent basis using a 34% federal income tax rate.

## ITEM 6C: LOAN PORTFOLIO

### CLASSIFICATION OF LOANS

Reference is made to Note 4 of Notes to Consolidated Financial Statements for the classification of loans at the end of 2003 and 2002. In addition to that information, the following information concerning loans is presented.

	<i>2001</i>	<i>2000</i>	<i>1999</i>
Real Estate:			
Residential	\$117,617,158	\$188,658,857	\$176,291,571
Commercial	52,675,033	45,963,998	37,091,072
Construction and land development	10,116,583	4,958,938	5,575,105
Demand and time	33,982,346	28,981,256	28,514,699
Lease financing	1,328,828	2,242,679	3,150,917
Installment	4,458,035	5,561,307	6,823,971
	<u>220,177,983</u>	<u>276,367,035</u>	<u>257,447,335</u>
Allowance for loan losses	3,338,807	3,024,290	2,836,291
Loans, net	<u>\$216,839,176</u>	<u>\$273,342,745</u>	<u>\$254,611,044</u>

### MATURITIES AND INTEREST RATE SENSITIVITIES

The maturities and sensitivities to changes in interest rates for commercial demand and time loans and real estate—construction loans at December 31, 2003 is presented below:

	<i>One year or less</i>	<i>Contractually Due</i>			
		<i>After one year through five years</i>		<i>After five years</i>	
		<i>Variable</i>	<i>Fixed</i>	<i>Variable</i>	<i>Fixed</i>
Construction and land development	\$11,702,402	\$ 292,939	\$ 2,363,046	\$938,588	\$978,853
Commercial demand and time	22,656,660	2,586,386	10,466,187	177,125	92,275

## RISK ELEMENTS

Reference is made to Note 4 of Notes to Consolidated Financial Statements for nonaccrual, past due and restructured loans at the end of 2003, 2002, and 2001. In addition to that information, the following information concerning risk elements is presented.

	2000	1999
Nonaccrual	\$ 622,392	\$240,569
Restructured	633,302	330,987
	<u>\$1,255,694</u>	<u>\$571,556</u>
Accruing loans past due more than 90 days	<u>\$1,281,706</u>	<u>\$837,198</u>

There are no other interest-bearing assets that would be required to be reported under this section if such assets were loans.

## ITEM 6D: SUMMARY OF LOAN LOSS EXPERIENCE

The following charts show the level of loan losses recorded by the Company for the past five years, management's allocation of the allowance for loan losses by type of loan as of the end of each year, and other statistical information. The allocation of the allowance reflects management's analysis of economic risk potential by type of loan, and is not intended as a forecast of loan losses.

### ANALYSIS OF THE ALLOWANCE FOR LOAN LOSSES

<i>Description</i>	<i>Years ended December 31</i>				
	<i>2003</i>	<i>2002</i>	<i>2001</i>	<i>2000</i>	<i>1999</i>
Balance at beginning of year	\$3,578,762	\$3,338,807	\$3,024,290	\$2,836,291	\$2,387,732
Charge-offs					
Commercial	200,173	21,904	—	30,015	148,636
Lease financing	—	—	—	—	31,677
Real estate:					
Residential	16,898	160,591	117,582	201,187	44,000
Commercial	—	112,718	—	—	—
Construction	—	—	—	—	—
Installment	47,957	85,393	184,559	153,197	78,512
	<u>265,028</u>	<u>380,606</u>	<u>302,141</u>	<u>384,399</u>	<u>302,825</u>
Recoveries					
Commercial	58,034	2,475	17,269	51,115	105,227
Lease financing	—	—	—	—	4,065
Real estate:					
Residential	—	67,705	22,802	30,317	12,000
Commercial	—	—	—	—	—
Construction	—	—	—	—	—
Installment	33,477	24,381	26,587	42,966	32,252
	<u>91,511</u>	<u>94,561</u>	<u>66,658</u>	<u>124,398</u>	<u>153,544</u>
Net charge-offs	<u>173,517</u>	<u>286,045</u>	<u>235,483</u>	<u>260,001</u>	<u>149,281</u>
Provision charged to operations	<u>243,000</u>	<u>526,000</u>	<u>550,000</u>	<u>448,000</u>	<u>597,840</u>
Balance at end of the year	<u>\$3,648,245</u>	<u>\$3,578,762</u>	<u>\$3,338,807</u>	<u>\$3,024,290</u>	<u>\$2,836,291</u>
Ratio of net charge-offs to average loans outstanding	.09%	.13%	.10%	.09%	.07%

The provision charged to operations for 2003, 2002, and 2001 is discussed in the section on Management's Discussion and Analysis of Financial Condition and Results of Operations. The Company's provisions in 2000 and 1999 related to the level of net losses incurred and to loan portfolio growth in each year.

## ALLOCATION OF THE ALLOWANCE FOR LOAN LOSSES

*Allocated Amount of the Allowance—Years Ended December 31*

PORTFOLIO	2003	2002	2001	2000	1999
Commercial and lease financing	\$1,226,447	\$ 733,560	\$ 607,323	\$ 910,445	\$ 565,474
Real estate:					
Residential	831,173	754,979	707,061	763,017	434,500
Commercial	1,041,834	876,243	775,321	349,594	356,711
Construction	—	—	—	—	—
Installment	133,865	94,162	173,166	207,061	341,190
Unallocated	414,926	1,119,818	1,075,936	794,173	1,138,416
	<u>\$3,648,245</u>	<u>\$3,578,762</u>	<u>\$3,338,807</u>	<u>\$3,024,290</u>	<u>\$2,836,291</u>

*Percent of Loans in Each Category to Total Loans—Years Ended December 31*

Portfolio	2003	2002	2001	2000	1999
Commercial and lease financing	20.2%	17.9%	16.0%	10.5%	12.2%
Real estate:					
Residential	28.9	38.8	53.5	70.0	68.8
Commercial	41.6	38.2	23.9	17.0	15.7
Construction	8.2	3.8	4.6	0.3	0.7
Installment	1.1	1.3	2.0	2.2	2.6
	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

### ITEM 6E: DEPOSITS

Reference is made to the tables for Average Balances, Interest and Yields under Item 6A of this section. Reference is made to Note 8 of Notes to Consolidated Financial Statements for additional information concerning deposits.

### ITEM 6F: RETURN ON EQUITY AND ASSETS

DESCRIPTION	2003	2002	2001
Return on average assets	0.29%	0.57%	0.52%
Return on average equity	2.71%	5.70%	6.05%
Dividend payout ratio	109.96%	50.80%	50.43%
Average equity to average assets	10.83%	9.99%	8.52%

### ITEM 6G: SHORT-TERM BORROWINGS

Reference is made to Note 9 of Notes to Consolidated Financial Statements for a description of the general terms of short-term borrowings, and for information related to repurchase agreements.

Other short-term borrowings, consisting of Notes Payable-U.S. Treasury, are as follows.

OTHER SHORT-TERM BORROWINGS:	2003	2002	2001
Total outstanding at period-end	\$2,025,339	\$2,045,237	\$ 657,726
Average amount outstanding during period	910,061	838,491	519,746
Maximum amount outstanding at any period-end	2,032,502	2,119,117	1,412,045
Weighted average interest rate at period-end	.73%	1.21%	1.74%
Weighted average interest rate for the period	1.04%	1.40%	4.16%

### ITEM 6H: LONG-TERM BORROWINGS

Reference is made to Note 9 of Notes to Consolidated Financial Statements for a description of the general terms of long-term borrowings.

## ITEM 7: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### EARNINGS 2003 COMPARED TO 2002

#### SUMMARY

Carrollton Bancorp reported net income for 2003 of \$925,000, or \$0.33 per share, representing a 51.8% decrease from 2002 net income of \$1,917,000, or \$0.68 per share. Included in the 2003 results was a \$486,000 gain on the sale of securities. The loan portfolio decreased 2.9% to \$199,297,000 as a result of loan payoffs and refinancing in 2003. The loan portfolio contraction, as well as the lower interest rates, contributed to a decrease in interest income from 2002. Noninterest income from fees increased by 14.1% compared to 2002. Fees generated by the ATM network of 155 machines and income from national point of sale sponsorships grew during 2003. Commissions from brokerage operations of \$597,000 were an 11% decrease compared to \$671,000 in 2002. In 2003, the Company reactivated CMSI and as a result, generated mortgage banking revenue of \$666,000.

#### NET INTEREST INCOME

Net interest income is the principal source of earnings for a banking company. It represents the difference between the interest income earned on loans and other investments, and the interest paid on deposits and borrowed funds. For analysis, net interest income is measured on a fully taxable equivalent basis. To determine the taxable equivalent basis, an adjustment is made to income from state and municipal securities, dividends from equity stocks which achieve a dividend exclusion, and to certain loans which are tax exempt.

In 2003, net interest income on a taxable equivalent basis decreased by \$1.2 million to \$9.6 million as a result of decreases in both the volume and yields on earning assets. On average, the loan portfolio decreased 8.9% from 2002 while the investment portfolio decreased by 15.5%. The yield on the loan portfolio decreased from 6.92% in 2002 to 6.64% in 2003. Changes in loan portfolio mix, the prime rate changes, and a very competitive loan market caused the loan yield to decline. The yield on investment securities also declined to 4.23% in 2003 from 5.21% in 2002. The reduction in the loan and investment portfolios and decreased yields, caused total interest income on a tax equivalent basis to fall from \$19.5 million in 2002 to \$16.2 million in 2003.

Interest expense decreased \$2.1 million to \$6.6 million in 2003 from \$8.7 million in 2002. Interest expense decreased due to a decrease in both interest bearing liabilities and rates. Interest expense on deposits decreased in 2003 from 2002

due to decreased cost of interest-bearing deposits, from 2.73% in 2002 to 1.94% in 2003. The table for Rate and Volume Variance Analysis included in this report shows the decrease in interest expense resulted from decreased volume and rate on deposits and borrowings. The decline in interest bearing liabilities corresponded with a decline in the loan portfolio.

#### PROVISION FOR LOAN LOSSES

The provision for loan losses was \$243,000 for 2003 compared to \$526,000 for 2002. Nonaccrual, restructured, and delinquent loans over 90 days to total loans decreased to 1.21% at the end of 2003 compared to 1.56% in 2002. This decrease was due to the 2003 change in status of certain loans that were on nonaccrual in 2002, but had performed for a sufficient amount of time in 2003 to warrant their change in status to performing. The ratio of loan losses to average loans decreased in 2003 to 0.09% compared to 0.13% for 2002.

On a monthly basis, management reviews all loan portfolios to determine trends and monitor asset quality. For consumer loan portfolios, this review generally consists of reviewing delinquency levels on an aggregate basis with timely follow-up on accounts that become delinquent. In commercial loan portfolios, delinquency information is monitored and periodic reviews of business and property leasing operations are performed on an individual loan basis to determine potential collection and repayment problems.

#### NONINTEREST INCOME

For 2003, noninterest income excluding securities gains, gains on branch divestitures, and gains or losses on loan sales increased by 7.2% compared to 2002. Brokerage commissions decreased \$74,000 or 11.0% in 2003 due to the economic slowdown and investor concerns over the stock market. Electronic Banking fee income increased \$456,000 primarily due to the growth of national point of sale sponsorships and increased ATM traffic. The Company reactivated its mortgage banking subsidiary in 2003. Noninterest income for 2003 includes \$666,000 in mortgage banking revenue.

Net securities gains in 2003 were \$486,000 compared to \$210,000 in 2002.

At December 31, 2003, the Company serviced loans for others totaling \$3,423,249.

#### NONINTEREST EXPENSES

In 2003, noninterest expenses increased by \$1.5 million or 10.5%. Salaries and benefits increased by \$1.2 million, or 19.7%. Full time equivalent staff increased from 116 positions at the end of 2002 to 136 positions at December 31, 2003 mostly due to increased personnel at the Company's

mortgage banking subsidiary. Occupancy expenses increased \$21,000 to \$1,453,000 in 2003, due to additional locations for the Company's mortgage-banking operations. This increase was slightly offset by reimbursement from the Company's insurance carrier in excess of costs to repair flood damage at the Company's main headquarters. Furniture and equipment expense decreased by \$275,000, mostly due to decreased depreciation in 2003. Other operating expenses increased \$539,000, or 11.3%. A significant portion of this increase is due to increased operations at the mortgage-banking subsidiary. In addition, the Bank incurred significant costs in the 2003 conversion of its main processing systems.

#### **INCOME TAX PROVISION**

For 2003, the effective tax rate for the Company decreased to 26.8% compared to 30.7% for 2002.

#### **FINANCIAL CONDITION**

##### **SUMMARY**

Total assets of the Company decreased by 6.7% to \$302.4 million at December 31, 2003 versus \$324.2 million at the end of 2002. Investment securities decreased 20.7% to \$62.5 million at December 31, 2003. Total loans declined 2.9% to \$199.3 million at December 31, 2003 compared to \$205.2 million at the end of 2002. Interest earning assets decreased to \$270.2 million but were 89.4% of total assets at December 31, 2003.

##### **INVESTMENT SECURITIES**

Securities decreased to \$62.5 million at December 31, 2003 from \$78.8 million at December 31, 2002. The portfolio consists primarily of U.S. Government agency securities, mortgage-backed securities, corporate bonds, state and municipal obligations, and equity securities. The income from state and municipal obligations is exempt from federal income tax. Certain agency securities are exempt from state income taxes. The Company uses its investment portfolio as a source of both liquidity and earnings.

The Company reinvested the proceeds of the loan payoffs during the year into the investment portfolio, structured in a manner as to provide liquidity for funding future loan growth, as well as for the runoff of higher cost funding sources. These transactions were principally undertaken to increase liquidity and reduce interest rate risk.

##### **LOANS**

Total loans decreased \$5.9 million or 2.9% from 2002 to \$199.3 million at December 31, 2003. The decrease in loans was primarily in real estate lending, due to the heavy volume of refinancing. Commercial loans equaled 70% of total loans at the end of the year and amounted to \$139.6 million.

Consumer loans amounted to \$59.7 million and were 30% of total loans.

##### **ALLOWANCE FOR LOAN LOSSES**

At December 31, 2003, the allowance for loan losses was \$3.7 million, a 1.9% increase from the end of 2002. The ratio of the allowance to total loans was 1.83% at December 31, 2003 and 1.74% at December 31, 2002. The ratio of net loan losses to average loans outstanding for 2003 was .09% compared to 0.13% for 2002. The ratio of nonaccrual loans, restructured loans, and loans delinquent more than 90 days to total loans decreased to 1.21% at December 31, 2003 from 1.56% at the end of 2002. The ratio of real estate secured loans to total loans decreased to 78.6% at the end of 2003 from 80.7% at the end of 2002.

An allowance for loan losses is maintained to absorb losses in the existing loan portfolio. The allowance is a function of specific loan allowances, general loan allowances based on historical loan loss experience and current trends, and allowances based on general economic conditions that affect the collectibility of the loan portfolio. These can include, but are not limited to exposure to an industry experiencing problems, changes in the nature or volume of the portfolio and delinquency and nonaccrual trends. The portfolio review and calculation of the allowance is performed by management on a continuing basis.

All loan reserves are subject to regulatory examinations and determination as to the appropriateness of the methodology and adequacy on an annual basis.

The specific allowance is based on regular analysis of the loan portfolio and is determined by analysis of collateral value, cash flow and guarantor capacity, as applicable. The specific allowance was \$134,190 and \$1,312,020 as of December 31, 2003 and 2002, respectively.

The general allowance is calculated using internal loan grading results and appropriate allowance factors on approximately 10 classes of loans. This process is reviewed on a regular basis. The allowance factors may be revised whenever necessary to address current credit quality trends or risks associated with particular loan types. Historic trend analysis is utilized to obtain the factors to be applied. The general allowance was \$3,099,129 and \$1,146,924 as of December 31, 2003 and 2002, respectively.

Allocation of a portion of the allowance does not preclude its availability to absorb losses in other categories. An unallocated reserve is maintained to recognize the imprecision in estimating and

measuring loss when evaluating the allowance for individual loans or pools of loans.

During the years ended December 31, 2000 through 2003, the unallocated portion of the allowance for loan losses has fluctuated with the specific and general allowances so that the total allowance for loan losses would be at a level that management believes is the best estimate of possible future loan losses at the balance sheet date. The specific allowance may fluctuate from period to period if the balance of what management considers problem loans changes. The general allowance will fluctuate with changes in the mix of the Company's loan portfolio, economic conditions, or specific industry conditions. The requirements of the Company's federal regulators are a consideration in determining the required total allowance.

Management believes that it has adequately assessed the risk of loss in the loan portfolios based on a subjective evaluation and has provided an allowance which is appropriate based on that assessment. Because the allowance is an estimate based on current conditions, any change in the economic conditions of the Company's market area or change within a borrower's business could result in a revised evaluation, which could alter the Company's earnings.

#### FUNDING SOURCES

Total deposits at December 31, 2003 decreased by \$23.2 million to \$207.1 million from the end of 2002. Interest bearing accounts decreased by \$24.4 million and noninterest bearing deposits increased by \$1.2 million. Overall deposit contraction is a result of the Company's efforts to reduce interest rate risk on its balance sheet. The Company made a concerted effort to reduce the level of high-yield deposits.

Advances from the Federal Home Loan Bank remained at the same level of \$45 million at the end of 2003 compared to the end of 2002. Borrowings for federal funds purchased, securities sold under agreements to repurchase and notes payable to the US Treasury increased by \$396,000 from December 31, 2002 to 2003.

#### CAPITAL

At December 31, 2003, shareholders' equity was \$34.1 million, an increase of \$434,000 from 2002. A part of the increase in Shareholders' equity was due to a \$449,000 fair market value adjustment of the investment portfolio as required by Statement No. 115 of the Financial Accounting Standards Board. The Company paid shareholders dividends totaling \$1,017,000, and net income for 2003 was \$925,000. In addition, proceeds from the exercise of stock options were \$77,000 in 2003. Shareholders'

equity amounted to 11.3% of total assets at December 31, 2003 compared to 10.4% at the end of 2002.

Bank holding companies and banks are required by the Federal Reserve and FDIC to maintain minimum levels of Tier 1 (or Core) and Tier 2 capital measured as a percentage of assets on a risk-weighted basis. Capital is primarily represented by shareholders' equity, adjusted for the allowance for loan losses and certain issues of preferred stock, convertible securities, and subordinated debt, depending on the capital level being measured. Assets and certain off-balance sheet transactions are assigned to one of five different risk-weighting factors for purposes of determining the risk-adjusted asset base. The minimum levels of Tier 1 and Tier 2 capital to risk-adjusted assets are 4% and 8%, respectively, under the regulations.

In addition, the Federal Reserve and the FDIC require that bank holding companies and banks maintain a minimum level of Tier 1 (or Core) capital to average total assets excluding intangibles for the current quarter. This measure is known as the leverage ratio. The current regulatory minimum for the leverage ratio for institutions to be considered adequately capitalized is 4%, but could be required to be maintained at a higher level based on the regulator's assessment of an institution's risk profile. The following chart shows the regulatory capital levels for the Company and Bank at December 31, 2003 and 2002. The Company's subsidiary bank also exceeded the FDIC required minimum capital levels at those dates by a substantial margin. Based on the levels of capital, the Company and the Bank are well capitalized.

Ratio	Minimum	At December 31			
		Carrollton Bancorp 2003	Carrollton Bancorp 2002	Carrollton Bank 2003	Carrollton Bank 2002
Leverage Ratio	4%	10.35%	9.54%	9.75%	8.87%
Risk-based Capital:					
Tier 1 (Core)	4%	13.75%	13.57%	12.86%	12.66%
Tier 2 (Total)	8%	15.51%	15.07%	14.12%	13.92%

#### LIQUIDITY

Liquidity management ensures that funds are available when required to meet deposit withdrawals, loan commitments, and operating expenses. These funds are supplied by deposits, loan repayments, security maturities, and can be raised by liquidating assets or through additional borrowings. Securities

classified as available for sale can be liquidated or pledged to secure borrowed funds to provide necessary liquidity. In addition, the Company has unsecured lines of credit outstanding under which it could borrow \$7 million, and has borrowing capacity with the Federal Home Loan Bank of \$76 million, which is collateralized by a security interest in the Company's residential first mortgage and commercial real estate loans, as well as pledged investment securities.

At December 31, 2003, the Company had outstanding loan commitments and unused lines of credit totaling \$108.2 million. Of this total, management places a high probability for funding within 1 year on approximately \$41.1 million. The remaining amount is mainly unused home equity lines of credit on which management places a low probability for required funding.

### **INTEREST RATE RISK**

The level of income of a financial institution can be affected by the repricing characteristics of its assets and liabilities due to changes in interest rates. This is referred to as interest rate risk. Financial institutions allocate significant time and resources to managing interest rate risk because of the impact that interest rate changes can have on the net interest margin and earnings. Management continues to seek reasonable ways to reduce its exposure to interest rate shifts. A static gap analysis is used by the Company as one tool to monitor interest rate risk. A static gap analysis measures the difference, or the gap, between the amount of assets and liabilities repricing within a given time period. The Company also performs rate shock analyses which estimate changes in the net interest margin for parallel rising and falling interest rate environments. Management also calculates and monitors other ratios on a monthly basis that provide additional information relating to certain aspects of asset/liability management. This information, together with information about forecasted future interest rate trends, is used to manage the Company's asset and liability positions. Management uses this information as a factor in decisions made about maturities for investment of cash flows, classification of investment securities

purchases as available for sale or held to maturity, emphasis of variable rate or fixed rate loans and short or longer term deposit products in marketing campaigns, and deposit account pricing to alter asset and liability repricing characteristics.

At December 31, 2003, the Company was in an asset sensitive position amounting to 11.4% of assets within a one-year time horizon. This is within the targets as established by the Asset/Liability Management Policy approved by the Board of Directors. Although the Company was at a positive asset/liability position at December 31, 2003, the Company can experience significant volatility in its asset/liability position by virtue of its funding of longer term mortgage loans with relatively short repricing borrowings while it works to sell the loans. Management continues to work to structure borrowing terms that more closely match asset repricing characteristics, keeping in mind the overall balance sheet strategy of the Company. Theoretically, a liability sensitive position is preferable in a falling interest rate climate since more liabilities will reprice downward as interest rates fall than will assets, and an asset sensitive position is preferable in a rising rate environment.

The following chart shows the static gap position for interest sensitive assets and liabilities of the Company as of December 31, 2003. The chart is as of a point in time, and reflects only the contractual terms of the loan or deposit accounts in assigning assets and liabilities to the various repricing periods except that deposit accounts with no contractual maturity, such as money market, NOW and savings accounts, have been allocated evenly over a five-year period. In addition, the maturities of investments shown in the gap table will differ from contractual maturities due to anticipated calls of certain securities based on current interest rates. While this chart indicates the opportunity to reprice assets and liabilities within certain time frames, it does not reflect the fact that interest rate changes occur in disproportionate increments for various assets and liabilities.

Period from December 31, 2003 in which assets and liabilities repriced

(\$'s in 000's)	0 to 90 days	91 to 365 days	1 to 2 years	2 to 5 years	> 5 year
<b>ASSETS:</b>					
Short term investments	\$ 7,589	\$ —	\$ —	\$ —	\$ —
Securities	9,677	14,220	22,412	5,956	12,469
Loans	74,791	11,534	11,029	56,926	47,259
	<u>\$92,057</u>	<u>\$ 25,754</u>	<u>\$33,441</u>	<u>\$ 62,882</u>	<u>\$59,728</u>
<b>LIABILITIES:</b>					
Deposits	\$21,180	\$ 48,194	\$26,771	\$ 68,426	\$ —
Borrowings	13,977	—	—	5,000	40,000
	<u>\$35,157</u>	<u>\$ 48,194</u>	<u>\$26,771</u>	<u>\$ 73,426</u>	<u>\$40,000</u>
Gap position:					
Period	\$56,900	\$(22,440)	\$ 6,670	\$(10,544)	\$19,728
% of Assets	18.8%	(7.4)%	2.2%	(3.5)%	6.5%
Cumulative	\$56,900	\$ 34,460	\$41,130	\$ 30,586	\$50,314
% of Assets	18.8%	11.4%	13.6%	10.1%	16.6%
Cumulative risk sensitive assets to risk sensitive liabilities	2.62%	1.41%	1.37%	1.17%	1.23%

#### OFF-BALANCE SHEET ARRANGEMENTS

The Company enters into off-balance sheet arrangements in the normal course of business. These arrangements consist primarily of commitments to extend credit, lines of credit and letters of credit. In addition, the Company has certain operating lease obligations.

Credit commitments are agreements to lend to a customer as long as there is no violation of any condition to the contract. Loan commitments generally have interest rates fixed at current market amounts, fixed expiration dates, and may require payment of a fee. Lines of credit generally have variable interest rates. Such lines do not represent future cash requirements because it is unlikely that all customers will draw upon their lines in full at any time. Letters of credit are commitments issued 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 borrower is the contract amount of the commitment. Loan commitments, lines of credit, and letters of credit are made on the same terms, including collateral, as outstanding loans. The Company is not aware of any accounting loss it would incur by funding its commitments.

Outstanding loan commitments, unused lines of credit and letters of credit were as follows at December 31, 2003:

Loan commitments	\$33,624,154
Unused lines of credit	\$74,600,420
Letters of credit	\$ 2,795,649

The Company leases various branch and general office facilities to conduct its operations. The leases have remaining terms which range from a period of one year to 11 years. Most leases contain renewal options which are generally exercisable at increased rates. Some of the leases provide for increases in the rental rates at specified times during the lease terms, prior to the expiration dates.

The following table shows information relating to the Company's off-balance sheet obligations at December 31, 2003 (dollars in thousands):

Contractual Obligations	Total	Less	One to	Three	More
		than 1 year	three years	to five years	than five years
Operating lease obligations	\$2,616	\$547	\$864	\$596	\$609

## NEW ACCOUNTING PRONOUNCEMENTS

FASB Statement No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*, amends Statement 133 by (1) clarifying under what circumstances a contract with an initial net investment meets the characteristic of a derivative, (2) clarifying when a derivative contains a financing component, (3) amending the definition of an underlying, (4) amending certain other existing pronouncements. This Statement is effective for contracts entered into or modified after June 30, 2003 with certain exceptions.

FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*, establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify the following financial instruments as a liability or an asset in some circumstances.

This statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003.

FASB Statement No. 132, *Employers' Disclosures about Pensions and Other Postretirement Benefits—an amendment of FASB Statements No. 87, 88, and 106*, was revised in 2003 requiring additional disclosures, including information describing the types of plan assets, investment strategy, measurement date(s), plan obligations, cash flows, and components of net periodic benefit cost recognized during interim periods. This Statement is effective for financial statements with fiscal years ending after December 15, 2003, with interim-period disclosures required by this Statement effective for interim periods beginning after December 15, 2003. Certain disclosure provisions of the Statement are effective for fiscal years ending after June 15, 2004.

FASB Interpretation No. 46, *Consolidation of Variable Interest Entities, An Interpretation of ARB No. 51*, requires consolidation of variable interest entities by the primary beneficiary. This interpretation is effective for the first interim period or fiscal year beginning after June 15, 2003, for variable interest entities created before February 1, 2003. For entities created after January 31, 2003, the effective date was immediate.

AICPA Statement of Position (SOP) 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer*, prohibits the "carrying over" of valuation allowances in loans and securities acquired in a transfer. At transfer, the assets are to be recorded at the total cash flows expected to be collected. The SOP is effective for loans acquired in fiscal years beginning after December 15, 2004.

Management does not expect these statements to have any material effect on the Company's financial position or results of operation.

## EARNINGS 2002 COMPARED TO 2001

### SUMMARY

Carrollton Bancorp reported net income for 2002 of \$1,917,000, or \$0.68 per share, representing a 0.8% decrease from 2001 net income of \$1,933,000, or \$0.68 per share. Included in the 2002 results was a \$210,000 gain on the sale of securities, and a \$688,000 gain on the sale of a branch, as part of the Company's plan to address asset/liability sensitivity. The loan portfolio decreased 7% to \$205,220,000 as a result of home equity payoffs in 2002 and loan refinancing. The loan portfolio contraction, as well as the lower interest rates, contributed to a decrease in interest income over 2001. Noninterest income from fees decreased by 8% compared to 2001. Fees generated by the ATM network of 152 machines and income from national point of sale sponsorships grew during 2002. Commissions from brokerage operations of \$671,000 were a 34% decrease compared to \$1,016,000 in 2001.

### NET INTEREST INCOME

Net interest income is the principal source of earnings for a banking company. It represents the difference between the interest income earned on loans and other investments, and the interest paid on deposits and borrowed funds. For analysis, net interest income is measured on a fully taxable equivalent basis. To determine the taxable equivalent basis, an adjustment is made to income from investments in state and municipal securities which achieve a federal or state tax benefit, to dividends from equity stocks which achieve a dividend exclusion, and to certain loans which are tax exempt.

In 2002, net interest income on a taxable equivalent basis decreased by \$695,000 to \$10.8 million as a result of decreases in the yields on earning assets. On average, the loan portfolio decreased 9% from 2001 while the investment portfolio decreased by 14%. The yield on the loan portfolio decreased from 7.67% in 2001 to 6.92% in 2002. Changes in loan portfolio mix, the prime rate changes, and a very competitive loan market caused the loan yield to decline. The yield on investment securities also declined to 5.21% in 2002 from 5.80% in 2001. The reduction in the loan and investment portfolios and decreased yields caused total interest income on a tax equivalent basis to fall from \$24.3 million in 2001 to \$19.4 million in 2002.

Interest expense decreased \$4.2 million to \$8.7 million in 2002 from \$12.9 million in 2001. Interest expense decreased due to a decrease in both interest bearing liabilities and rates. Interest expense on deposits decreased in 2002 from 2001 due to decreased cost of interest-bearing deposits, which decreased from 3.86% in 2001 to 2.73% in 2002. The table for Rate and Volume Variance Analysis included in this report shows the decrease

in interest expense resulted from decreased volume and rate on deposits and borrowings. The decline in interest bearing liabilities corresponded with a decline in the loan portfolio.

#### PROVISION FOR LOAN LOSSES

The provision for loan losses was \$526,000 for 2002 compared to \$550,000 for 2001. Nonaccrual, restructured, and delinquent loans over 90 days to total loans increased to 1.56% at the end of 2002 compared to 0.55% in 2001. This increase was due to increased delinquencies. As of December 31, 2002, there was an increase of loan delinquencies of \$1,196,970. The ratio of loan losses to average loans increased in 2002 to 0.13% compared to 0.10% for 2001.

On a monthly basis, management reviews all loan portfolios to determine trends and monitor asset quality. For consumer loan portfolios, this review generally consists of reviewing delinquency levels on an aggregate basis with timely follow-up on accounts that become delinquent. In commercial loan portfolios, delinquency information is monitored and periodic reviews of business and property leasing operations are performed on an individual loan basis to determine potential collection and repayment problems.

#### NONINTEREST INCOME

For 2002, noninterest income excluding securities gains, gains on branch divestitures, and gains or losses on loan sales decreased by 10.5% compared to 2001. Brokerage commissions decreased \$345,000 or 34% in 2002 due to the economic slowdown and investor concerns over the stock market. ATM fee income declined \$410,000 primarily due to the discontinuation of the Target relationship in July of 2001, and a reduced average number of active ATM machines. Other fees and commissions decreased by \$405,000 from 2001.

Net securities gains in 2002 were \$210,000 compared to losses of \$3,000 in 2001. The Company also had a gain of \$688,000 as a result of the divestiture of one of its branches.

The Company did not sell any loans during 2002. At December 31, 2002, the Company serviced loans for others totaling \$7,448,000.

#### NONINTEREST EXPENSES

In 2002, noninterest expenses decreased by \$281,000 or 2%. Salaries and benefits decreased by \$59,000, or 1%. In certain areas of the Company, staff reductions occurred through attrition and the positions were eliminated. Full time equivalent staff decreased from 136 positions at the end of 2001 to 116 positions at December 31, 2002. Occupancy expenses decreased \$152,000 to \$1,395,000 in 2002, due to the branch divestiture and the sale of a building no longer being utilized. Furniture and equipment expense increased by \$284,000 in 2002 in part as a result of Management's decision to accelerate the depreciation on its ATMs in 2001. Other operating expenses decreased \$353,000, or

7%. A significant portion of this decrease relates to ATM transactions costs.

#### INCOME TAX PROVISION

For 2002, the effective tax rate for the Company increased to 31% compared to 30% for 2001.

#### FINANCIAL CONDITION

##### SUMMARY

Total assets of the Company decreased by 9% to \$324.2 million at December 31, 2002 versus \$356.9 million at the end of 2001. Investment securities decreased to \$78.8 million at December 31, 2002. Total loans declined 7% to \$205.2 million at December 31, 2002 compared to \$220.2 million at the end of 2001. Interest earning assets decreased to \$297.6 million but were 91.8% of total assets at December 31, 2002.

##### INVESTMENT SECURITIES

Securities decreased to \$78.8 million at December 31, 2002 from \$104.5 million at December 31, 2001. The portfolio consists primarily of U.S. Government agency securities, mortgage-backed securities, corporate bonds, and state and municipal obligations. The income from state and municipal obligations is exempt from federal income tax. Certain agency securities are exempt from state income taxes. The Company uses its investment portfolio as a source of both liquidity and earnings.

The Company reinvested the proceeds of the loan payoffs during the year into the investment portfolio, structured in a manner as to provide liquidity for funding future loan growth, as well as for the runoff of higher cost funding sources. These transactions were principally undertaken to increase liquidity and reduce interest rate risk.

##### LOANS

Total loans decreased \$15.0 million or 7% from 2001 to \$205.2 million at December 31, 2002. The decrease in loans was primarily in real estate lending, due to the heavy volume of refinancing. Commercial loans equaled 60% of total loans at the end of the year and amounted to \$123 million. Consumer loans amounted to \$82 million and were 40% of total loans.

##### ALLOWANCE FOR LOAN LOSSES

At December 31, 2002, the allowance for loan losses was \$3.6 million, a 7% increase from the end of 2001. The ratio of the allowance to total loans was 1.74% at December 31, 2002 and 1.51% at December 31, 2001. The ratio of net loan losses to average loans outstanding for 2002 was 0.13% compared to 0.10% for 2001. The ratio of nonaccrual loans, restructured loans, and loans delinquent more than 90 days to total loans increased to 1.56% at December 31, 2002 from 0.55% at the end of 2001. The ratio of real estate secured loans to total loans decreased to 81% at the end of 2002 from 82% at the end of 2001.

An allowance for loan losses is maintained to absorb losses in the existing loan portfolio. The allowance is a function of specific loan allowances, general loan allowances based on historical loan loss experience and current trends, and allowances based on general economic conditions that affect the collectibility of the loan portfolio. These can include, but are not limited to exposure to an industry experiencing problems, changes in the nature or volume of the portfolio and delinquency and nonaccrual trends. The portfolio review and calculation of the allowance is performed by management on a continuing basis.

All loan reserves are subject to regulatory examinations and determination as to the appropriateness of the methodology and adequacy on an annual basis.

The specific allowance is based on regular analysis of the loan portfolio and is determined by analysis of collateral value, cash flow and guarantor capacity, as applicable. The specific allowance was \$1,312,020 and \$1,126,700 as of December 31, 2002 and 2001, respectively.

The general allowance is calculated using internal loan grading results and appropriate allowance factors on approximately 10 classes of loans. This process is reviewed on a regular basis. The allowance factors may be revised whenever necessary to address current credit quality trends or risks associated with particular loan types. Historic trend analysis is utilized to obtain the factors to be applied. The general allowance was \$1,150,239 and \$1,136,171 as of December 31, 2002 and 2001, respectively.

Allocation of a portion of the allowance does not preclude its availability to absorb losses in other categories. An unallocated reserve is maintained to recognize the imprecision in estimating and measuring loss when evaluating the allowance for individual loans or pools of loans.

During the years ended December 31, 1999 through 2002, the unallocated portion of the allowance for loan losses has fluctuated with the specific and general allowances so that the total allowance for loan losses would be at a level that management believes is the best estimate of possible future loan losses at the balance sheet date. The specific allowance may fluctuate from period to period if the balance of what management considers problem loans changes. The general allowance will fluctuate with changes in the mix of the Company's loan portfolio, economic conditions, or specific industry conditions. The requirements of the Company's federal regulators are a consideration in determining the required total allowance.

Management believes that it has adequately assessed the risk of loss in the loan portfolios based on a subjective evaluation and has provided an allowance which is appropriate based on that assessment. Because the allowance is an estimate based on current conditions, any change in the economic conditions of the Company's market area

or change within a borrower's business could result in a revised evaluation, which could alter the Company's earnings.

## FUNDING SOURCES

Total deposits at December 31, 2002 decreased by \$35.3 million to \$230.3 million from the end of 2001. Interest bearing accounts decreased by \$36.5 million and noninterest bearing deposits increased by \$1.3 million. Overall deposit contraction is a result of the Company's efforts to reduce interest rate risk on its balance sheet, including the sale of its Liberty Road branch. The Company made a concerted effort to reduce the level of high-yield deposits.

Advances from the Federal Home Loan Bank remained at the same level of \$45 million at the end of 2002 compared to the end of 2001. Borrowings for federal funds purchased, securities sold under agreements to repurchase and notes payable to the US Treasury increased by \$1.7 million from December 31, 2001 to 2002.

## CAPITAL

At December 31, 2002, shareholders' equity was \$33.7 million, an increase of \$1.2 million from 2001. The increase in Shareholders' equity was largely due to a \$489,000 fair market value adjustment of the investment portfolio as required by Statement No. 115 of the Financial Accounting Standards Board. The Company paid shareholders dividends totaling \$974,000, and net income for 2002 was \$1.9 million. In addition, the Company purchased and retired common stock for \$199,000 in 2002. Shareholders' equity amounted to 10% of total assets at December 31, 2002 compared to 9% at the end of 2001.

Bank holding companies and banks are required by the Federal Reserve and FDIC to maintain minimum levels of Tier 1 (or Core) and Tier 2 capital measured as a percentage of assets on a risk-weighted basis. Capital is primarily represented by shareholders' equity, adjusted for the allowance for loan losses and certain issues of preferred stock, convertible securities, and subordinated debt, depending on the capital level being measured. Assets and certain off-balance sheet transactions are assigned to one of five different risk-weighting factors for purposes of determining the risk-adjusted asset base. The minimum levels of Tier 1 and Tier 2 capital to risk-adjusted assets are 4% and 8%, respectively, under the regulations.

In addition, the Federal Reserve and the FDIC require that bank holding companies and banks maintain a minimum level of Tier 1 (or Core) capital to average total assets excluding intangibles for the current quarter. This measure is known as the leverage ratio. The current regulatory minimum for the leverage ratio for institutions to be considered adequately capitalized is 4%, but could be required to be maintained at a higher level based on the regulator's assessment of an institution's risk profile. The following chart shows the regulatory

capital levels for the Company and Bank at December 31, 2002 and 2001. The Company's subsidiary bank also exceeded the FDIC required minimum capital levels at those dates by a substantial margin. Based on the levels of capital, the Company and the Bank are well capitalized.

<i>Ratio</i>	<i>Minimum</i>	At December 31			
		Carrollton Bancorp		Carrollton Bank	
		2002	2001	2002	2001
Leverage Ratio	4%	9.54%	8.61%	8.87%	7.63%
Risk-based Capital:					
Tier 1 (Core)	4%	13.57%	12.88%	12.66%	11.37%
Tier 2					
(Total)	8%	15.07%	14.26%	13.92%	12.62%

## LIQUIDITY

Liquidity management ensures that funds are available when required to meet deposit withdrawals, loan commitments, and operating expenses. These funds are supplied by deposits, loan repayments, security maturities, and can be raised by liquidating assets or through additional borrowings. Securities classified as available for sale can be liquidated or pledged to secure borrowed funds to provide necessary liquidity. In addition, the Company has unsecured lines of credit outstanding under which it could borrow \$7 million, and has borrowing capacity with the Federal Home Loan Bank of \$52 million, which is collateralized by a security interest in the Company's residential first mortgage and commercial real estate loans, as well as pledged investment securities.

At December 31, 2002, the Company had outstanding loan commitments and unused lines of credit totaling \$86.3 million. Of this total, management places a high probability for funding within 1 year on approximately \$20.0 million. The remaining amount is mainly unused home equity lines of credit on which management places a low probability for required funding.

## INTEREST RATE RISK

The level of income of a financial institution can be affected by the repricing characteristics of its assets and liabilities due to changes in interest rates. This is referred to as interest rate risk. Financial institutions allocate significant time and resources to managing interest rate risk because of the impact that interest rate changes can have on the net interest margin and earnings. Management continues to seek reasonable ways to reduce its exposure to interest rate shifts. A static gap analysis is used by the Company as one tool to monitor interest rate risk. A static gap analysis measures the difference, or the gap, between the amount of assets

and liabilities repricing within a given time period. The Company also performs rate shock analyses which estimate changes in the net interest margin for parallel rising and falling interest rate environments. Management also calculates and monitors other ratios on a monthly basis that provide additional information relating to certain aspects of asset/liability management. This information, together with information about forecasted future interest rate trends, is used to manage the Company's asset and liability positions. Management uses this information as a factor in decisions made about maturities for investment of cash flows, classification of investment securities purchases as available for sale or held to maturity, emphasis of variable rate or fixed rate loans and short or longer term deposit products in marketing campaigns, and deposit account pricing to alter asset and liability repricing characteristics.

At December 31, 2002, the Company was in an asset sensitive position amounting to 10.9% of assets within a one-year time horizon. This is within the targets as established by the Asset/Liability Management Policy approved by the Board of Directors. Although the Company was at a positive asset/liability position at December 31, 2002, the Company can experience significant volatility in its asset/liability position by virtue of its funding of longer term mortgage loans with relatively short repricing borrowings while it works to sell the loans. Management continues to work to structure borrowing terms that more closely match asset repricing characteristics, keeping in mind the overall balance sheet strategy of the Company. Theoretically, a liability sensitive position is preferable in a falling interest rate climate since more liabilities will reprice downward as interest rates fall than will assets, and an asset sensitive position is preferable in a rising rate environment.

The following chart shows the static gap position for interest sensitive assets and liabilities of the Company as of December 31, 2002. The chart is as of a point in time, and reflects only the contractual terms of the loan or deposit accounts in assigning assets and liabilities to the various repricing periods except that deposit accounts with no contractual maturity, such as money market, NOW and savings accounts, have been allocated evenly over a five-year period. In addition, the maturities of investments shown in the gap table will differ from contractual maturities due to anticipated calls of certain securities based on current interest rates. While this chart indicates the opportunity to reprice assets and liabilities within certain time frames, it does not reflect the fact that interest rate changes occur in disproportionate increments for various assets and liabilities.

Period from December 31, 2002 in which assets and liabilities reprice

(\$'s in 000's)	0 to 90 days	91 to 365 days	1 to 2 years	2 to 5 years	> 5 year
<b>ASSETS</b>					
Short term investments	\$ 11,067	\$ —	\$ —	\$ —	\$ —
Securities	27,588	12,313	6,586	15,553	19,271
Loans	86,245	13,400	16,267	53,373	35,935
	<u>\$124,900</u>	<u>\$ 25,713</u>	<u>\$ 22,853</u>	<u>\$ 68,926</u>	<u>\$55,206</u>
<b>LIABILITIES:</b>					
Deposits	\$ 20,877	\$ 75,686	\$ 26,627	\$ 65,705	\$ 110
Borrowings	18,580	—	—	40,000	—
	<u>\$ 39,457</u>	<u>\$ 75,686</u>	<u>\$ 26,627</u>	<u>\$105,705</u>	<u>\$ 110</u>
Gap position:					
Period	\$ 85,443	\$(49,973)	\$ (3,774)	\$ (36,779)	\$55,096
% of Assets	26.4%	(15.4)%	(1.2)%	(11.3)%	17.0%
Cumulative	\$ 85,443	\$ 35,470	\$ 31,696	\$ (5,083)	\$50,013
% of Assets	26.4%	10.9%	9.8%	(1.6)%	15.4%
Cumulative risk sensitive assets to risk sensitive liabilities	3.17%	1.31%	1.22%	0.98%	1.20%

#### ITEM 7: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

For information regarding the market risk of the Company's financial instruments, see "Management's Discussion and Analysis—Interest Rate Risk" in Item 7.

ITEM 8: FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA  
REPORT OF INDEPENDENT AUDITORS

To the Board of Directors and Shareholders  
Carrollton Bancorp and Subsidiary  
Baltimore, Maryland

We have audited the accompanying consolidated balance sheets of Carrollton Bancorp and Subsidiary as of December 31, 2003 and 2002, and the related consolidated statements of income, changes in shareholders' equity, and cash flows for the three years ended December 31, 2003. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Carrollton Bancorp and Subsidiary as of December 31, 2003 and 2002, and the results of their operations and their cash flows for the three years ended December 31, 2003, in conformity with accounting principles generally accepted in the United States of America.

Rowles & Company, LLP

A handwritten signature in cursive script that reads "Rowles & Company LLP".

Baltimore, Maryland  
February 24, 2004

## CONSOLIDATED BALANCE SHEETS

December 31,

	2003	2002
<b>ASSETS</b>		
Cash and due from banks	\$ 19,711,633	\$ 20,332,373
Federal funds sold and Federal Home Loan Bank deposit	7,589,293	11,067,383
Federal Home Loan Bank stock, at cost	2,250,000	2,500,000
Investment securities		
Available for sale	62,458,957	78,786,147
Held to maturity	25,000	25,000
Loans held for sale	2,241,583	—
Loans, less allowance for loan losses of \$3,648,245 and \$3,578,762	195,648,316	201,641,364
Premises and equipment	5,079,551	5,610,715
Accrued interest receivable	1,421,554	1,747,994
Foreclosed real estate	100,000	218,654
Prepaid income taxes	33,910	152,591
Other assets	5,850,178	2,139,394
	<u>\$302,409,975</u>	<u>\$324,221,615</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Deposits		
Noninterest-bearing	\$ 42,484,836	\$ 41,259,140
Interest-bearing	164,571,264	189,004,968
Total deposits	207,056,100	230,264,108
Federal funds purchased and securities sold under agreement to repurchase	11,951,594	11,535,372
Notes payable — U.S. Treasury	2,025,339	2,045,237
Advances from the Federal Home Loan Bank	45,000,000	45,000,000
Accrued interest payable	451,055	513,358
Deferred income taxes	286,475	257,680
Other liabilities	1,514,530	914,781
	<u>268,285,093</u>	<u>290,530,536</u>
Shareholders' equity		
Common stock, par \$1.00 per share; authorized 10,000,000 shares; issued and outstanding 2,828,078 in 2003 and 2,821,757 in 2002	2,828,078	2,821,757
Surplus	18,682,387	18,617,608
Retained earnings	10,427,425	10,513,874
Accumulated other comprehensive income	2,186,992	1,737,840
	<u>34,124,882</u>	<u>33,691,079</u>
	<u>\$302,409,975</u>	<u>\$324,221,615</u>

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

## CONSOLIDATED STATEMENTS OF INCOME

Years Ended December 31,

	2003	2002	2001
<b>INTEREST INCOME</b>			
Interest and fees on loans	\$13,034,872	\$14,907,165	\$18,183,405
Interest and dividends on securities			
Taxable interest income	2,331,880	3,381,602	4,591,732
Nontaxable interest income	218,645	244,340	268,330
Dividends	125,539	121,388	128,333
Interest on federal funds sold and other interest income	224,755	330,869	660,824
Total interest income	<u>15,935,691</u>	<u>18,985,364</u>	<u>23,832,624</u>
<b>INTEREST EXPENSE</b>			
Deposits	3,469,039	5,496,357	9,345,738
Borrowings	3,170,695	3,195,963	3,526,617
Total interest expense	<u>6,639,734</u>	<u>8,692,320</u>	<u>12,872,355</u>
Net interest income	9,295,957	10,293,044	10,960,269
<b>PROVISION FOR LOAN LOSSES</b>	<u>243,000</u>	<u>526,000</u>	<u>550,000</u>
Net interest income after provision for loan losses	<u>9,052,957</u>	<u>9,767,044</u>	<u>10,410,269</u>
<b>NONINTEREST INCOME</b>			
Service charges on deposit accounts	987,582	1,118,349	1,145,622
Brokerage commissions	597,247	670,952	1,015,720
Mortgage banking fees and gains	665,948	—	—
Other fees and commissions	5,531,726	4,847,738	5,252,236
Gains (losses) on security sales	486,109	209,880	(2,725)
Gain on branch divestiture	—	687,883	—
Losses on loan sales	—	—	(254,409)
Total noninterest income	<u>8,268,612</u>	<u>7,534,802</u>	<u>7,156,444</u>
<b>NONINTEREST EXPENSES</b>			
Salaries	5,996,496	5,118,713	5,272,330
Employee benefits	1,499,002	1,140,614	1,046,493
Occupancy	1,452,624	1,431,978	1,557,845
Furniture and equipment	1,784,787	2,059,447	1,775,507
Other operating expenses	5,325,446	4,786,206	5,165,329
Total noninterest expenses	<u>16,058,355</u>	<u>14,536,958</u>	<u>14,817,504</u>
Income before income taxes	1,263,214	2,764,888	2,749,209
<b>INCOME TAXES</b>	<u>338,500</u>	<u>847,630</u>	<u>816,132</u>
<b>NET INCOME</b>	<u>\$ 924,714</u>	<u>\$ 1,917,258</u>	<u>\$ 1,933,077</u>
<b>NET INCOME PER SHARE—BASIC</b>	<u>\$ 0.33</u>	<u>\$ 0.68</u>	<u>\$ 0.68</u>
<b>NET INCOME PER SHARE—DILUTED</b>	<u>\$ 0.32</u>	<u>\$ 0.68</u>	<u>\$ 0.68</u>

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

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

	<i>Common Stock</i>			<i>Retained Earnings</i>	<i>Accumulated Other</i>	<i>Comprehensive Income</i>
	<i>Shares</i>	<i>Par Value</i>	<i>Surplus</i>		<i>Comprehensive Income</i>	
<b>BALANCE, DECEMBER 31, 2000</b>	2,707,733	\$2,707,733	\$17,090,011	\$10,532,211	\$ (37,872)	
Net Income		—	—	1,933,077	—	\$1,933,077
Changes in net unrealized gains (losses) on available for sale securities, net of tax		—	—	—	1,287,051	<u>1,287,051</u>
Comprehensive Income						<u>\$3,220,128</u>
Shares acquired and cancelled	(6,479)	(6,479)	(72,565)	—	—	
Cash dividends, \$0.342		—	—	(974,784)	—	
<b>BALANCE, DECEMBER 31, 2001</b>	2,701,254	2,701,254	17,017,446	11,490,504	1,249,179	
Net Income		—	—	1,917,258	—	\$1,917,258
Changes in net unrealized gains (losses) on available for sale securities, net of tax		—	—	—	488,661	<u>488,661</u>
Comprehensive Income						<u>\$2,405,919</u>
Shares acquired and cancelled	(14,044)	(14,044)	(185,277)	—	—	
Stock dividend, 5%	134,547	134,547	1,785,439	(1,919,986)	—	
Cash dividends, \$0.342		—	—	(973,902)	—	
<b>BALANCE, DECEMBER 31, 2002</b>	2,821,757	2,821,757	18,617,608	10,513,874	1,737,840	
Net Income		—	—	924,714	—	\$ 924,714
Changes in net unrealized gains (losses) on available for sale securities, net of tax		—	—	—	449,152	<u>449,152</u>
Comprehensive Income						<u>\$1,373,866</u>
Stock options exercised	6,715	6,715	70,007	—	—	
Adjustment to 2002 stock dividend	(394)	(394)	(5,228)	5,622	—	
Cash dividends, \$0.36		—	—	(1,016,785)	—	
<b>BALANCE, DECEMBER 31, 2003</b>	<u>2,828,078</u>	<u>\$2,828,078</u>	<u>\$18,682,387</u>	<u>\$10,427,425</u>	<u>\$2,186,992</u>	

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

# CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended December 31,

	2003	2002	2001
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Interest received	\$ 16,262,131	\$ 19,727,578	\$ 24,351,974
Fees and commissions received	7,468,463	6,616,085	6,972,424
Interest paid	(6,702,037)	(8,729,715)	(13,019,872)
Cash paid to suppliers and employees	(18,569,724)	(12,764,619)	(13,329,307)
Proceeds from sale of loans held for sale	30,933,244	—	1,126,288
Origination of loans held for sale, net of principal reduction	(31,842,931)	—	165,541
Income taxes paid	(191,024)	(1,568,808)	(803,760)
	<u>(2,641,878)</u>	<u>3,280,521</u>	<u>5,463,288</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Proceeds from maturities of securities held to maturity	—	—	25,000
Proceeds from sales of securities available for sale	1,724,217	600,596	3,298,320
Proceeds from maturities of securities available for sale	115,149,964	136,088,554	156,221,001
Proceeds from redemption of Federal Home Loan Bank stock	250,000	750,000	—
Purchase of securities available for sale	(100,048,513)	(110,281,342)	(191,938,361)
Loans made, net of principal collected	5,637,979	3,282,936	2,612,239
Purchase of loans, net of principal collected	—	11,617,770	17,791,957
Proceeds from sale of loans	—	—	35,294,964
Purchase of premises and equipment	(923,640)	(367,160)	(668,039)
Proceeds from sale of premises and equipment	269,198	212,984	13,841
Purchase of foreclosed real estate	—	(145,191)	—
Net proceeds from branch divestiture	—	687,883	—
Proceeds from sale of foreclosed real estate	235,590	50,779	—
	<u>22,294,795</u>	<u>42,497,809</u>	<u>22,650,922</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Net decrease in time deposits	(26,481,138)	(12,942,713)	(25,043,765)
Net increase (decrease) in other deposits	3,273,130	(22,321,899)	(1,451,656)
Net increase (decrease) in other borrowed funds	396,324	1,690,054	(6,466,823)
Common stock repurchase and retirement	—	(199,321)	(79,044)
Stock options exercised	76,722	—	—
Dividends paid	(1,016,785)	(973,902)	(974,784)
	<u>(23,751,747)</u>	<u>(34,747,781)</u>	<u>(34,016,072)</u>
Net increase (decrease) in cash and cash equivalents	(4,098,830)	11,030,549	(5,901,862)
Cash and cash equivalents at beginning of year	31,399,756	20,369,207	26,271,069
Cash and cash equivalents at end of year	<u>\$ 27,300,926</u>	<u>\$ 31,399,756</u>	<u>\$ 20,369,207</u>
<b>RECONCILIATION OF NET INCOME TO NET CASH PROVIDED (USED)</b>			
<b>BY OPERATING ACTIVITIES</b>			
Net income	\$ 924,714	\$ 1,917,258	\$ 1,933,077
<b>ADJUSTMENTS TO RECONCILE NET INCOME TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES</b>			
Provision for loan losses	243,000	526,000	550,000
Depreciation and amortization	1,440,603	1,650,548	1,598,037
Deferred income taxes	(253,808)	(192,177)	(157,515)
Amortization of premiums and discounts	436,783	249,218	158,190
(Gains) losses on disposal of securities	(486,109)	(209,880)	2,725
Loans held for sale made, net of principal sold	(1,575,635)	—	1,291,829
(Gains) losses on sale of loans	(665,948)	—	254,409
Gain on branch divestiture	—	(687,883)	—
(Gains) losses on sale and write-down of premises and equipment	(90,006)	(72,984)	25,307
(Gains) losses on sale of foreclosed real estate	(14,309)	7,898	—
Write-down of foreclosed real estate	9,442	—	—
(Increase) decrease in			
Accrued interest receivable	326,440	492,996	361,161
Prepaid income taxes	118,681	(152,591)	—
Other assets	(3,875,775)	115,485	(262,391)
Increase (decrease) in			
Accrued interest payable	(62,303)	(37,395)	(147,517)
Income taxes payable	—	(280,785)	197,393
Other liabilities	882,352	(45,187)	(341,417)
	<u>\$ (2,641,878)</u>	<u>\$ 3,280,521</u>	<u>\$ 5,463,288</u>
<b>NONCASH INVESTING ACTIVITY</b>			
Transfer of loans to foreclosed real estate	<u>\$ 112,069</u>	<u>\$ 132,140</u>	<u>\$ —</u>

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

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies reflected in the financial statements conform to generally accepted accounting principles and to general practices within the banking industry. Management makes estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of commitments and contingent liabilities at the date of the financial statements and revenues and expenses during the year. Actual results could differ from those estimates.

**Business** – The Company provides commercial banking and brokerage services to businesses and individuals in Baltimore and surrounding areas of central Maryland, and also makes residential mortgage loans in Virginia, Pennsylvania and Delaware.

**Principles Of Consolidation** – The consolidated financial statements include the accounts of Carrollton Bancorp (the Company) and its subsidiary Carrollton Bank (the Bank). Intercompany balances and transactions have been eliminated.

The Parent Only financial statements of the Company account for the Bank using the equity method of accounting.

**Cash Equivalents** – For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, and federal funds sold. Generally, federal funds are purchased and sold for one-day periods.

**Investment Securities** – Investment securities are classified as either available for sale or held to maturity. The Company does not currently conduct short-term purchase and sale transactions of investment securities which would be classified as trading securities.

The Company classifies investments as available for sale based principally on the Company's asset/liability position and potential liquidity needs. These securities are available for sale in response to changes in market interest rates or in the event the Company needs funds to meet loan demand or deposit withdrawals. Securities classified as available for sale are carried at market value. The unrealized gain or loss, net of taxes, related to securities classified as available for sale is reflected as a component of shareholders' equity. Gains or losses on securities sales are determined by the specific-identification method.

The remaining securities in the investment portfolio are classified as held to maturity. These securities are carried at amortized cost. The Company has the ability and the intent to hold these securities to maturity. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of securities.

**Loans Held for Sale** – Loans held for sale are carried at the lower of aggregate cost or market value. Market value is determined based on outstanding investor commitments or, in the absence of such commitments, based on current investor yield requirements. Gains and losses on loan sales are determined using the specific-identification method.

**Loans and Allowance For Loan Losses** – Loans are stated at face value, plus deferred origination costs, less unearned discount, deferred origination fees, and the allowance for loan losses. Interest on loans is credited to income based on the principal amounts outstanding. Origination fees and costs are deferred and amortized to income over the estimated terms of the loans. Accrual of interest is discontinued generally when the collection of principal or interest reaches 90 days past due, or earlier if collection becomes uncertain based upon the financial weakness of the borrower or the realizable value of the collateral. Management may grant a waiver from nonaccrual status for a 90 day past due loan that is well secured or in the process of collection. Nonaccrual loans are returned to accrual status when all past due principal and interest has been collected, and the remainder of the loan is judged to be fully collectible. Loans are considered impaired when, based on current information, management considers it unlikely that the collection of principal and interest payments will be made according to contractual terms. Generally, loans are not reviewed for impairment until the accrual of interest has been discontinued. If collection of principal is evaluated as doubtful, all payments are applied to principal.

The Company measures impaired loans (1) at the observable market price; (2) at the present value of expected cash flows discounted at the loan's effective interest rate; or (3) at the fair value of the collateral if the loan is collateral dependent. If the measure of the impaired loan is less than the recorded investment in the loan, an impairment is recognized through a valuation allowance and corresponding provision for loan losses.

The allowance for loan losses represents an estimate which, in management's judgment, will be adequate to absorb probable losses on existing loans and other extensions of credit that may become uncollectible. Management's judgment in determining the adequacy of the allowance is based on evaluations of the collectibility of loans. These evaluations take into consideration such factors as historical loss experience, changes in the nature and volume of the loan portfolio, current economic conditions that may affect the borrowers' ability to pay, overall portfolio quality, and review of specific problem areas. Actual loan performance may differ from estimates used by management.

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**  
(Continued)

**Premises and Equipment** – Premises and equipment are recorded at cost less accumulated depreciation and amortization. Depreciation and amortization are computed over the estimated useful lives using the straight-line method. Leasehold improvements are amortized over the terms of the leases or the estimated useful lives of the improvements, whichever is shorter.

**Foreclosed Real Estate** – Real estate acquired through foreclosure is recorded at the lower of cost or fair market value on the date acquired. Losses incurred at the time of acquisition of the property are charged to the allowance for loan losses. Subsequent reductions in the estimated carrying value of the property and other expenses of owning the property are included in noninterest expense.

**Intangible Assets** – A deposit intangible asset of \$1,847,700, relating to a branch acquisition, is being amortized using the straight-line method over 15 years. The remaining unamortized balance at December 31, 2003 and 2002 was \$800,633 and \$923,813, respectively. Amortization expense was \$123,180 for 2003, 2002, and 2001.

The Company capitalizes the value of loan servicing retained on loan sales, and amortizes the value over the estimated life of the portfolio of loans serviced.

Intangible assets are included in other assets on the Consolidated Balance Sheets. Management evaluates intangible assets for impairment quarterly.

**Income Taxes** – The provision for income taxes includes taxes payable for the current year and deferred income taxes. The Company recognizes

deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse.

**Per Share Data** – Basic net income per common share is determined by dividing net income by the weighted average shares of common stock outstanding giving retroactive effect to any stock dividends and splits declared. Diluted earnings per share is determined by adjusting average shares of common stock outstanding by the potentially dilutive effects of stock options outstanding. The dilutive effects of stock options are computed using the treasury stock method.

**Comprehensive Income** – Comprehensive income includes net income and the unrealized gain (loss) on investment securities available for sale, net of income taxes.

**Stock options** – The Company uses the intrinsic value method to account for stock based compensation plans. Because the option price of stock options granted was equal to the market price of the common stock at the date of grant for all options granted, no compensation expense related to the options was recognized. If the Company had applied a fair value based method to recognize compensation cost for the options granted, net income and net income per share would have been changed to the following pro forma amounts for the years ended December 31, 2003, 2002, and 2001.

	2003	2002	2001
Net Income:			
As Reported	\$924,714	\$1,917,258	\$1,933,077
Additional compensation net of related income tax	(22,727)	(41,824)	(54,530)
Pro forma	<u>\$901,987</u>	<u>\$1,875,434</u>	<u>\$1,878,547</u>
Basic Earnings Per Share:			
As Reported	\$ 0.33	\$ 0.68	\$ 0.68
Pro forma	\$ 0.32	\$ 0.66	\$ 0.66
Diluted Earnings Per Share:			
As reported	\$ 0.32	\$ 0.68	\$ 0.68
Pro forma	\$ 0.32	\$ 0.66	\$ 0.66

The value of each option is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions used for grants during the years ended December 31, 2003, 2002, and 2001.

	2003	2002	2001
Dividend yield	2.48% to 2.84%	2.84% to 2.97%	3.13% to 3.53%
Expected volatility	20.88%	19.55%	23.52%
Risk free rate	4.25% to 4.67%	4.70% to 5.56%	5.18% to 5.67%
Estimated life	10 years	10 years	10 years

## 2. RESTRICTIONS ON CASH AND DUE FROM BANKS

Banks are required to carry cash reserves with the Federal Reserve Bank or maintain cash on hand of specified percentages of deposit balances. The Bank's normal amount of cash on hand, which averaged \$20 million and \$17 million during 2003 and 2002, respectively, is sufficient to satisfy the reserve requirements.

In order to cover the costs of services provided by correspondent banks, the Company maintains compensating balances at these correspondent banks, or pays fees in the event the credit earned on balances is not sufficient to cover activity charges. During 2003 and 2002, the Company maintained average compensating balances of approximately \$1,000,000 which was maintained at the Federal Reserve Bank.

## 3. INVESTMENT SECURITIES

Investment securities are summarized as follows:

	<i>Amortized cost</i>	<i>Unrealized gains</i>	<i>Unrealized losses</i>	<i>Fair value</i>
December 31, 2003				
<b>AVAILABLE FOR SALE</b>				
U.S. government agency	\$34,536,818	\$ 70,616	\$ 41,149	\$34,566,285
Mortgage-backed securities	9,086,362	541,905	—	9,628,267
State and municipal	5,041,536	159,588	3,408	5,197,716
Corporate bonds	6,578,815	241,525	—	6,820,340
	<u>55,243,531</u>	<u>1,013,634</u>	<u>44,557</u>	<u>56,212,608</u>
Equity securities	3,652,390	2,996,026	402,067	6,246,349
	<u>\$58,895,921</u>	<u>\$4,009,660</u>	<u>\$446,624</u>	<u>\$62,458,957</u>
<b>HELD TO MATURITY</b>				
Foreign Bond	<u>\$ 25,000</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 25,000</u>
	<i>Amortized cost</i>	<i>Unrealized gains</i>	<i>Unrealized losses</i>	<i>Fair value</i>
December 31, 2002				
<b>AVAILABLE FOR SALE</b>				
U.S. government agency	\$44,699,756	\$ 406,539	\$239,962	\$44,866,333
Mortgage-backed securities	16,243,917	764,811	—	17,008,728
State and municipal	5,307,488	140,168	1,396	5,446,260
Corporate bonds	7,664,442	298,363	—	7,962,805
	<u>73,915,603</u>	<u>1,609,881</u>	<u>241,358</u>	<u>75,284,126</u>
Equity securities	2,039,262	1,593,832	131,073	3,502,021
	<u>\$75,954,865</u>	<u>\$3,203,713</u>	<u>\$372,431</u>	<u>\$78,786,147</u>
<b>HELD TO MATURITY</b>				
Foreign Bond	<u>\$ 25,000</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 25,000</u>

### 3. INVESTMENT SECURITIES (Continued)

Information related to unrealized losses in the portfolio follows:

	December 31, 2003					
	Less than 12 months		12 months or longer		Total	
	<i>Fair Value</i>	<i>Unrealized Losses</i>	<i>Fair Value</i>	<i>Unrealized Losses</i>	<i>Fair Value</i>	<i>Unrealized Losses</i>
U.S. government agency	\$15,081,250	\$41,149	\$ —	\$ —	\$15,081,250	\$ 41,149
Mortgage-backed securities	—	—	—	—	—	—
State and municipal	455,322	3,408	—	—	455,322	3,408
Corporate bonds	—	—	—	—	—	—
Equity securities	—	—	1,937,392	402,067	1,937,392	402,067
	<u>\$15,536,572</u>	<u>\$44,557</u>	<u>\$1,937,392</u>	<u>\$402,067</u>	<u>\$17,473,964</u>	<u>\$446,624</u>

	December 31, 2002					
	Less than 12 months		12 months or longer		Total	
	<i>Fair Value</i>	<i>Unrealized Losses</i>	<i>Fair Value</i>	<i>Unrealized Losses</i>	<i>Fair Value</i>	<i>Unrealized Losses</i>
U.S. government agency	\$15,121,146	\$236,107	\$ 496,145	\$ 3,855	\$15,617,291	\$239,962
Mortgage-backed securities	—	—	—	—	—	—
State and municipal	—	—	308,601	1,396	308,601	1,396
Corporate bonds	—	—	—	—	—	—
Equity securities	—	—	340,893	131,073	340,893	131,073
	<u>\$15,121,146</u>	<u>\$236,107</u>	<u>\$1,145,639</u>	<u>\$136,324</u>	<u>\$16,266,785</u>	<u>\$372,431</u>

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

At December 31, 2003, four marketable equity securities have unrealized losses with aggregate depreciation of 17% from the Company's cost basis. No credit issues have been identified that cause management to believe the declines in market value are other than temporary. In analyzing the issuer's financial condition, management considers industry analysis reports, financial performance and projected target prices of investment analysts within a one-year time frame. Unrealized losses on

marketable equity securities that are in excess of 50% of cost, and that have been sustained for more than 24 months, are generally recognized by management as being other than temporary and charged to earnings, unless evidence exists to support a realizable value equal to or greater than the Company's carrying value of the investment.

All unrealized losses on U.S. government agency and state and municipal securities as of December 31, 2003 are considered to be temporary losses, because each security will be redeemed at face value at, or prior to maturity. In most cases, the temporary impairment in value is caused by market interest rate fluctuations.

Contractual maturities of debt securities at December 31, 2003 and 2002 are shown below. Actual maturities may differ from contractual maturities because borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

### 3. INVESTMENT SECURITIES (Continued)

<i>Maturing</i>	December 31, 2003			
	Available for sale		Held to maturity	
	<i>Amortized Cost</i>	<i>Fair value</i>	<i>Amortized cost</i>	<i>Fair value</i>
Within one year	\$ 6,028,398	\$ 6,136,303	\$25,000	\$25,000
Over one to five years	36,783,957	36,988,559	—	—
Over five to ten years	3,344,814	3,459,479	—	—
Mortgage-backed securities	9,086,362	9,628,267	—	—
	<u>\$55,243,531</u>	<u>\$56,212,608</u>	<u>\$25,000</u>	<u>\$25,000</u>

<i>Maturing</i>	December 31, 2002			
	Available for sale		Held to maturity	
	<i>Amortized Cost</i>	<i>Fair Value</i>	<i>Amortized Cost</i>	<i>Fair Value</i>
Within one year	\$30,104,361	\$30,321,241	\$ —	\$ —
Over one to five years	21,682,267	22,178,209	25,000	25,000
Over five to ten years	2,504,836	2,595,737	—	—
Over ten years	3,380,222	3,180,211	—	—
Mortgage-backed securities	16,243,917	17,008,728	—	—
	<u>\$73,915,603</u>	<u>\$75,284,126</u>	<u>\$25,000</u>	<u>\$25,000</u>

At December 31, 2003 and 2002, securities with an amortized cost of \$30,077,878 (Market value of \$30,610,239), and \$24,968,799 (market value of \$25,773,673), respectively, were pledged as collateral for government deposits, securities sold under repurchase agreements, and advances from the Federal Home Loan Bank.

In 2003, 2002, and 2001, the Company realized gross gains on sales of securities of \$486,109, \$209,880, and \$0, respectively, and losses of \$0, \$0, and \$2,725, respectively. Income taxes on net security gains were \$187,735, \$81,056, and \$(1,052) in 2003, 2002, and 2001, respectively.

### 4. LOANS

Major classifications of loans at December 31 are as follows:

	2003	2002
Real estate		
Residential	\$ 57,586,028	\$ 79,520,154
Commercial	82,856,038	78,500,418
Construction and land development	16,275,828	7,664,367
Demand and time	35,978,633	32,444,790
Lease financing	4,449,408	4,343,539
Installment	2,150,626	2,746,858
	<u>199,296,561</u>	<u>205,220,126</u>
Allowance for loan losses	3,648,245	3,578,762
Loans, net	<u>\$195,648,316</u>	<u>\$201,641,364</u>

The Bank makes loans to customers located in Maryland, Virginia, Pennsylvania and Delaware. Although the loan portfolio is diversified, its performance will be influenced by the regional economy.

The maturity and rate repricing distribution of the loan portfolio at December 31 is as follows:

Repricing or maturing within one year	\$ 79,048,922	\$ 99,240,344
Maturing over one to five years	64,465,542	69,640,641
Maturing over five years	55,782,097	36,339,141
	<u>\$199,296,561</u>	<u>\$205,220,126</u>

#### 4. LOANS (Continued)

Loan balances have been adjusted by the following deferred amounts as of December 31:

	2003	2002
Deferred origination costs and premiums	\$ 466,708	\$ 825,007
Deferred origination fees and unearned discounts	<u>(537,019)</u>	<u>(692,981)</u>
Net deferred costs (fees)	<u>\$ (70,311)</u>	<u>\$ 132,026</u>

Transactions in the allowance for loan losses for the years ended December 31 were as follows:

	2003	2002	2001
Beginning balance	\$3,578,762	\$3,338,807	\$3,024,290
Provision charged to operations	243,000	526,000	550,000
Recoveries	<u>91,511</u>	<u>94,561</u>	<u>66,658</u>
	3,913,273	3,959,368	3,640,948
Loans charged off	<u>265,028</u>	<u>380,606</u>	<u>302,141</u>
Ending balance	<u>\$3,648,245</u>	<u>\$3,578,762</u>	<u>\$3,338,807</u>

At December 31, 2003, 2002, and 2001, the accrual of interest has been discontinued on loans of \$712,116, \$734,879, and \$387,037, respectively. The amount of interest income that would have been recorded in 2003, 2002, and 2001 on non-accrual loans if those loans had been handled in accordance with their contractual terms totaled \$54,857, \$30,938, and \$16,109, respectively. The amount of interest income actually recorded on nonaccrual loans totaled \$30,660, \$22,878, and \$1,239 for 2003, 2002, and 2001, respectively.

At December 31, 2003, 2002, and 2001, the Company had one impaired loan to the same borrower amounting to \$661,974, \$568,969, and \$598,644, respectively, which was classified as impaired because it had been restructured to accept interest only payments for a period of time. The average balance of impaired loans amounted to

\$615,021, \$576,577, and \$616,358 in 2003, 2002, and 2001, respectively. During 2003, 2002, and 2001, the Company received total payments on impaired loans of \$34,650, \$85,189, and \$99,868, respectively. Of these amounts, \$34,650, \$54,614, and \$65,210 were recorded as interest income for 2003, 2002, and 2001, respectively. The remainder was applied to reduce principal.

There is no specific allowance for this loan since the fair value of the collateral securing the loan is considered adequate to cover all principal and interest due. The Company also continues to accrue interest on this loan due to the adequacy of the collateral value.

Amounts past due 90 days or more, excluding restructured and nonaccrual loans as of December 31 are as follows:

	2003	2002	2001
Mortgage	\$ 637,137	\$ 498,029	\$ 108,596
Demand and time	<u>398,881</u>	<u>1,402,634</u>	<u>114,863</u>
	<u>\$1,036,018</u>	<u>\$1,900,663</u>	<u>\$ 223,459</u>

Total loans past due 90 days or more were \$2,410,108, \$2,282,176, and \$1,085,206 at December 31, 2003, 2002, and 2001 respectively.

The Company continues to accrue interest on these loans since the fair value of the collateral is considered adequate to assure collection of all

principal and interest amounts due and the loan is in the process of collection.

Loans with a balance of \$49,827,528 and \$55,638,248 were pledged as collateral to the Federal Home Loan Bank of Atlanta as of December 31, 2003 and 2002, respectively.

## 5. CREDIT COMMITMENTS

Outstanding loan commitments, unused lines of credit, and letters of credit were as follows as of December 31:

	2003	2002	2001
<b>LOAN COMMITMENTS</b>			
Mortgage loans	\$ 9,744,958	\$ —	\$ —
Construction and land development	4,290,726	6,899,380	10,275,089
Commercial loans	19,588,470	9,448,509	17,608,000
Installment loans	—	—	579,682
	<u>\$33,624,154</u>	<u>\$16,347,889</u>	<u>\$28,462,771</u>
<b>UNUSED LINES OF CREDIT</b>			
Home equity lines	\$48,536,491	\$46,945,198	\$54,798,129
Commercial lines	24,667,060	22,608,235	10,057,019
Unsecured consumer lines	1,396,869	369,182	525,714
	<u>\$74,600,420</u>	<u>\$69,922,615</u>	<u>\$65,380,862</u>
<b>LETTERS OF CREDIT</b>	<u>\$ 2,795,649</u>	<u>\$ 3,166,123</u>	<u>\$ 2,871,588</u>

Loan commitments and lines of credit are agreements to lend to a customer as long as there is no violation of any condition to the contract. Loan commitments generally have interest rates fixed at current market amounts, fixed expiration dates, and may require payment of a fee. Lines of credit generally have variable interest rates. Such lines do not represent future cash requirements because it is unlikely that all customers will draw upon their lines in full at any time. Letters of credit are commitments issued 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 borrower is the contract amount of the commitment. Loan commitments, lines of credit, and letters of credit are made on the same terms, including collateral, as

outstanding loans. The Company is not aware of any accounting loss it would incur by funding the above commitments.

## 6. RELATED PARTY TRANSACTIONS

The Company's executive officers and directors, or other entities to which they are related, enter into loan transactions with the Bank in the ordinary course of business. The terms of these transactions are similar to the terms provided to other borrowers entering into similar loan transactions and do not involve more than normal risk of collectibility. During the years ended December 31, 2003, 2002 and 2001, transactions in related party loans were as follows:

	2003	2002	2001
Beginning balance	\$ 4,421,030	\$ 5,264,386	\$ 1,915,984
Additions	648,991	1,184,451	664,183
Repayments	(1,860,821)	(2,027,807)	(179,367)
Changes in executive officers and directors	—	—	2,863,586
Ending balance	<u>\$ 3,209,200</u>	<u>\$ 4,421,030</u>	<u>\$ 5,264,386</u>

A director of the Company is a partner in a law firm that provides legal services to the Company and the Bank. During the years ended December 31, 2003, 2002, and 2001, amounts paid to the law firm in connection with those services were \$259,502, \$224,138, and \$173,737, respectively.

A director of the Company is President of an insurance brokerage through which the Company and the Bank place various insurance policies. During the years ended December 31, 2003, 2002, and 2001, amounts paid to the insurance brokerage for insurance premiums were \$244,721, \$153,656, and \$249,889, respectively. Related commissions

amounted to \$32,528, \$17,724, and \$22,582 during the years ended December 31, 2003, 2002, and 2001, respectively.

A director of the Company is President of an electrical company through which the Company and the Bank contracted for electrical services amounting to \$3,341 in 2003, \$4,623 in 2002 and \$26,730 in 2001.

A director of the Company is the Executive Vice President for a commercial real estate services company, through which the Company and the Bank contracted for appraisal and management services amounting to \$100,949 in 2003, \$3,744 in 2002 and \$5,021 in 2001.

## 7. PREMISES AND EQUIPMENT

A summary of premises and equipment is as follows as of December 31:

	2003	2002
Land and improvements	\$ 909,544	\$ 946,520
Buildings	2,730,050	2,528,767
Leasehold improvements	2,146,153	2,144,953
Equipment and fixtures	7,821,438	9,523,157
	<u>13,607,185</u>	<u>15,143,397</u>
Accumulated depreciation and amortization	8,527,634	9,532,682
	<u>\$ 5,079,551</u>	<u>\$ 5,610,715</u>

Depreciation and amortization of premises and equipment was \$1,275,612, \$1,481,612, and \$1,365,767 for 2003, 2002, and 2001 respectively. Amortization of intangible assets, excluding amortization of deposit premiums, was \$41,811, \$45,756, and \$109,090 for 2003, 2002, and 2001, respectively.

During the year ended December 31, 2002, the Company sold its Baltimore Street property for \$200,000. The Bank also sold deposits, along with all assets located within its Liberty Road branch.

## 8. DEPOSITS

Major classifications of interest-bearing deposits are as follows as of December 31:

	2003	2002
NOW and Super NOW	\$ 37,515,591	\$ 35,614,170
Money market	27,957,320	27,395,072
Savings	36,754,460	37,170,695
Certificates of deposit of \$100,000 or more	9,225,093	20,488,159
Other time deposits	53,118,800	68,336,872
	<u>\$164,571,264</u>	<u>\$189,004,968</u>

Interest expense associated with certificates of deposit of \$100,000 or more was \$868,347, \$1,198,018, and \$1,910,347 for the years ended December 31, 2003, 2002, and 2001, respectively.

Time deposits mature as follows:

	December 31,	
	2003	2002
Maturing within one year	\$48,928,167	\$76,527,192
Maturing over one to two years	6,325,619	6,590,866
Maturing over two to three years	3,365,557	2,439,505
Maturing over three to four years	2,054,149	1,141,742
Maturing over four to five years	1,670,401	2,015,844
Maturing over five years	—	109,882
	<u>\$62,343,893</u>	<u>\$88,825,031</u>

## 9. BORROWED FUNDS

Federal funds purchased and securities sold under agreements to repurchase represent transactions with customers for correspondent or commercial account cash management services, and borrowings by the Company under lines of credit with other institutions. The transactions with customers are overnight borrowing arrangements with interest rates discounted from the federal funds sold rate. Securities underlying the customer repurchase agreements are maintained in the Company's control. Additional information is as follows:

	<i>2003</i>	<i>2002</i>	<i>2001</i>
Total outstanding at year end	\$11,951,594	\$11,535,372	\$11,232,829
Average amount outstanding during year	12,324,539	11,739,672	14,110,473
Maximum amount outstanding at any month end	14,733,180	12,939,282	14,765,870
Weighted average interest rate at year end	1.22%	0.82%	0.83%
Weighted average interest rate for the year	0.71%	0.92%	2.91%

Notes payable – U.S. Treasury are Federal Treasury Tax and Loan deposits accepted by the Bank from its customers to be remitted to the Federal Reserve Bank on a periodic basis. The Company pays interest on these deposits at a slight discount to the federal funds rate. The average balances of the notes were \$910,061 and \$838,491 during 2003 and 2002, respectively.

Advances from the Federal Home Loan Bank (FHLB) of Atlanta amounted to \$45,000,000 at December 31, 2003 and 2002. Advances averaged \$45,000,000 and \$45,008,219 for 2003 and 2002, respectively, with weighted average costs of 6.83% for 2003 and 2002. At both December 31, 2003 and

2002, the advances carried a weighted average interest rate of 6.74%, and matured at dates ranging from March 26, 2008 to May 24, 2010. The Bank has a total secured line of \$76 million with the FHLB for which the Bank granted the FHLB a security interest in certain residential first mortgage loans and commercial mortgage loans, as well as pledged investment securities (see notes 3 and 4).

The Company borrows under available unsecured federal funds lines of credit of \$7 million with other institutions. There was no balance outstanding under these lines at December 31, 2003 and 2002. These lines bear interest at the current federal funds rate of the correspondent bank.

## 10. OTHER OPERATING EXPENSES

Other operating expenses include the following for the years ended December 31:

	<i>2003</i>	<i>2002</i>	<i>2001</i>
ATM services	\$1,458,647	\$1,474,497	\$1,539,670
Data processing services	1,025,536	809,215	725,179
Professional services	573,684	406,946	519,136
Telephone	221,363	240,999	288,710
Postage and freight	208,914	176,675	163,929
Printing, stationery, and supplies	193,616	217,188	147,118
Marketing	187,172	85,849	190,787
Liability insurance	181,657	135,656	140,230
Directors' fees	139,950	141,150	149,775
Deposit premium amortization	123,180	123,180	123,180
Software amortization	41,811	45,756	109,090
Other	969,916	929,095	1,068,525
	<u>\$5,325,446</u>	<u>\$4,786,206</u>	<u>\$5,165,329</u>

## 11. STOCK OPTIONS

The Company adopted a stock option incentive plan in 1998, which provides for the granting of common stock options to directors and key employees. These stock option awards contain a serial feature whereby one third of the options granted vest and can be exercised after each year. Option prices are equal to the estimated fair market value of the common stock at the date of the grant. Options expire ten years after the date of grant if not exercised.

Information with respect to options outstanding is as follows for the years ended December 31:

	2003		2002		2001	
	Shares	Option Price Range	Shares	Option Price Range	Shares	Option Price Range
Outstanding at beginning of year	179,025		162,434		114,134	
Granted	9,930	\$14.50 to \$17.75	39,690	\$12.11 to \$12.67	48,300	\$9.71 to \$10.94
Exercised	(6,085)	\$9.71 to \$13.45	—		—	
Expired/Canceled	(8,085)	\$10.94 to \$18.10	(23,099)	\$9.71 to \$18.10	—	
Outstanding at end of year	<u>174,785</u>	\$9.71 to \$18.10	<u>179,025</u>	\$9.71 to \$18.10	<u>162,434</u>	\$9.71 to \$18.10
Exercisable at December 31	<u>137,580</u>		<u>100,135</u>		<u>82,761</u>	

## 12. NET INCOME PER SHARE

The calculation of net income per common share as restated giving retroactive effect to any stock dividends and splits is as follows for the years ended December 31:

	2003	2002	2001
<b>BASIC:</b>			
Net income (applicable to common stock)	\$ 924,714	\$1,917,258	\$1,933,077
Average common shares outstanding	2,825,077	2,832,265	2,842,523
Basic net income per share	\$ 0.33	\$ 0.68	\$ 0.68
<b>DILUTED:</b>			
Net income (applicable to common stock)	\$ 924,714	\$1,917,258	\$1,933,077
Average common shares outstanding	2,825,077	2,832,265	2,842,523
Stock option adjustment	27,810	5,093	952
Average common shares outstanding-diluted	<u>2,852,887</u>	<u>2,837,358</u>	<u>2,843,475</u>
Diluted net income per share	<u>\$ 0.32</u>	<u>\$ 0.68</u>	<u>\$ 0.68</u>

## 13. COMPREHENSIVE INCOME

Comprehensive income is defined as net income plus transactions and other occurrences which are the result of nonowner changes in equity. For the Company, nonowner equity changes are comprised of unrealized gains or losses on available for sale securities that will be accumulated with net income in determining comprehensive income. Presented below is a reconciliation of net income to comprehensive income for the years ended December 31:

	2003	2002	2001
Net Income	\$ 924,714	\$1,917,258	\$1,933,077
Other comprehensive income:			
Unrealized holding gains during the period	1,217,864	1,006,004	2,094,132
Less: Adjustment for security (gains) losses	(486,109)	(209,880)	2,725
Other comprehensive income before tax	731,755	796,124	2,096,857
Income taxes on comprehensive income	(282,603)	(307,463)	(809,806)
Other comprehensive income after tax	<u>449,152</u>	<u>488,661</u>	<u>1,287,051</u>
Comprehensive income	<u>\$1,373,866</u>	<u>\$2,405,919</u>	<u>\$3,220,128</u>

#### 14. CAPITAL STANDARDS

The Federal Reserve Board and the Federal Deposit Insurance Corporation (FDIC) have adopted risk-based capital standards for banking organizations. These standards require ratios of capital to assets for minimum capital adequacy and to be classified as well capitalized under prompt corrective action provisions. As of December 31, 2003 and 2002, the capital ratios and minimum capital requirements are as follows.

	Actual		Minimum Capital Adequacy		To be Well Capitalized	
	<i>Amount</i>	<i>Ratio</i>	<i>Amount</i>	<i>Ratio</i>	<i>Amount</i>	<i>Ratio</i>
<b>DECEMBER 31, 2003</b>						
Total Capital (to risk-weighted assets)						
Consolidated	\$34,998,000	15.51%	\$18,049,000	8.0%	\$22,562,000	10.0%
Carrollton Bank	31,581,000	14.12%	17,895,000	8.0%	22,368,000	10.0%
Tier 1 Capital (to risk-weighted assets)						
Consolidated	31,014,000	13.75%	9,025,000	4.0%	13,537,000	6.0%
Carrollton Bank	28,774,000	12.86%	8,947,000	4.0%	13,421,000	6.0%
Tier 1 Capital (to average assets)						
Consolidated	31,014,000	10.35%	11,983,000	4.0%	14,979,000	5.0%
Carrollton Bank	28,774,000	9.75%	11,799,000	4.0%	14,749,000	5.0%
<b>DECEMBER 31, 2002</b>						
Total Capital (to risk-weighted assets)						
Consolidated	\$34,342,000	15.07%	\$18,233,000	8.0%	\$22,791,000	10.0%
Carrollton Bank	31,306,000	13.92%	17,998,000	8.0%	22,497,000	10.0%
Tier 1 Capital (to risk-weighted assets)						
Consolidated	30,929,000	13.57%	9,116,000	4.0%	13,675,000	6.0%
Carrollton Bank	28,484,000	12.66%	8,999,000	4.0%	13,498,000	6.0%
Tier 1 Capital (to average assets)						
Consolidated	30,929,000	9.54%	12,968,000	4.0%	16,210,000	5.0%
Carrollton Bank	28,484,000	8.87%	12,843,000	4.0%	16,054,000	5.0%

Tier 1 capital consists of common stock, surplus, and retained earnings. Total capital includes a limited amount of the allowance for loan losses. In calculating risk-weighted assets, specified risk percentages are applied to each category of asset and off-balance sheet items.

Failure to meet the capital requirements could affect the Company's ability to pay dividends and accept deposits and may significantly affect the operations of the Company.

As of December 31, 2003, the most recent notification from the Federal Reserve and the FDIC categorized the Company and the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the Company's or Bank's category.

## 15. RETIREMENT PLANS

The Company has a defined benefit pension plan covering substantially all of the employees. Benefits are based on years of service and the employee's highest average rate of earnings for the three

consecutive years during the last five full years before retirement. The Company's funding policy is to contribute annually the amount recommended by the Plan's independent actuarial consultants. Assets of the plan are held in a trust fund managed by an insurance company.

The following table sets forth the financial status of the plan as of and for the year ended December 31:

	2003	2002	2001
<b>CHANGE IN BENEFIT OBLIGATION:</b>			
Benefit obligation at beginning of year	\$8,201,071	\$7,225,216	\$6,759,948
Service cost	434,987	391,125	387,560
Interest cost	544,400	496,375	473,302
Actuarial gain	21,234	409,288	(103,963)
Benefits paid	(381,109)	(320,933)	(291,631)
Benefit obligation at end of year	<u>8,820,583</u>	<u>8,201,071</u>	<u>7,225,216</u>
<b>CHANGE IN PLAN ASSETS:</b>			
Fair value of plan assets at beginning of year	6,161,247	6,735,251	6,990,732
Actual return on plan assets	1,152,983	(581,876)	(255,939)
Employer contribution	466,625	328,805	292,089
Benefits paid	(381,109)	(320,933)	(291,631)
Fair value of plan assets at end of year	<u>7,399,746</u>	<u>6,161,247</u>	<u>6,735,251</u>
Funded status	(1,420,837)	(2,039,824)	(489,965)
Unrecognized net actuarial loss	1,537,550	2,244,035	675,944
Unrecognized prior service cost	73,501	126,928	149,625
Prepaid benefit cost	<u>\$ 190,214</u>	<u>\$ 331,139</u>	<u>\$ 335,604</u>
<b>ASSUMPTIONS USED IN MEASURING THE PROJECTED BENEFIT OBLIGATION WERE AS FOLLOWS FOR THE YEARS ENDED DECEMBER 31:</b>			
Discount rates	6.25%	6.75%	7.25%
Rates of increase in compensation levels	4.25%	5.50%	5.50%
Long-term rate of return on assets	8.00%	9.00%	9.00%
<b>NET PENSION EXPENSE INCLUDES THE FOLLOWING COMPONENTS:</b>			
Service cost	\$ 434,987	\$ 391,125	\$ 387,560
Interest cost	544,400	496,375	473,302
Estimated return on assets	(538,297)	(605,295)	(630,194)
Net amortization and deferral	166,460	51,065	51,065
Net pension expense	<u>\$ 607,550</u>	<u>\$ 333,270</u>	<u>\$ 281,733</u>
<b>ACCUMULATED BENEFIT OBLIGATION AT YEAR END</b>	<u>\$7,089,425</u>	<u>\$6,180,465</u>	<u>\$5,393,853</u>
<b>ALLOCATION OF ASSETS</b>			
Domestic equity-large cap growth fund	\$1,291,449		
Domestic equity-large cap value	1,445,766		
Domestic equity-small cap growth fund	414,398		
Domestic equity-small cap value fund	209,622		
Fixed income-guaranteed fund	4,038,511		
	<u>\$7,399,746</u>		

## 15. RETIREMENT PLANS *(Continued)*

The Plan's investment strategy is predicated on its investment objectives and the risk and return expectations of asset classes appropriate for the Plan. Investment objectives have been established by considering the Plan's liquidity needs and time horizon and the fiduciary standards under ERISA. The asset allocation strategy is developed to meet the Plan's long term needs in a manner designed to control volatility and to reflect the Company's risk tolerance.

In determining the long-term rate of return on pension plan assets assumption, the target asset allocation is first reviewed. An expected long-term rate of return is assumed for each asset class, and an underlying inflation rate assumption is also made. The effects of asset diversification and periodic fund rebalancing are also considered.

The Company estimates it will contribute approximately \$400,000 to the Plan for 2004.

The Company has a contributory thrift plan qualifying under Section 401(k) of the Internal Revenue Code. Employees with one year of service are eligible for participation in the plan. The Company's contributions to this plan, included in employee benefit expenses, were \$70,678, \$88,866, and \$89,125 for 2003, 2002, and 2001, respectively.

## 16. CONTINGENCIES

Carrollton Bank has been sued for damages by the personal representative of a deceased customer, in the Circuit court for Anne Arundel County, Maryland. The complaint alleges causes of action against the Bank for negligence, breach of contract and breach of fiduciary duty and seeks damages of \$132,000. Counsel for the Bank has filed an Answer and Cross/Claim in the case to protect the Bank's interest.

In December of 2003, Carrollton Bank filed a motion for summary judgment in the case seeking a dismissal of the lawsuit filed against the Bank. The plaintiff also filed motions for summary judgment. On February 4, 2004, the court denied all of the summary judgment motions filed by all parties in the case. A pre-trial conference is scheduled in the case for April 6, 2004. Carrollton Bank will likely re-file its summary judgment motion, once again to seek dismissal of the case against it prior to a full trial on the merits.

The Company is involved in various other legal actions arising from normal business activities. Management believes that the ultimate liability or risk of loss resulting from these actions will not materially affect the Company's financial position.

## 17. INCOME TAXES

The components of income tax expense are as follows for the years ended December 31:

	2003	2002	2001
<b>CURRENT</b>			
Federal	\$577,840	\$ 988,868	\$908,494
State	14,468	50,939	65,153
	<u>592,308</u>	<u>1,039,807</u>	<u>973,647</u>
<b>DEFERRED</b>	<u>(253,808)</u>	<u>(192,177)</u>	<u>(157,515)</u>
	<u>\$338,500</u>	<u>\$ 847,630</u>	<u>\$816,132</u>

The components of the deferred tax benefits were as follows for the years ended December 31:

Provision for loan losses	\$ (26,244)	\$(125,757)	\$(121,621)
Deferred origination costs	(39,382)	(112,822)	(95,921)
Deferred compensation plan	4,099	892	(9,404)
Depreciation	(136,195)	(29,292)	15,705
Discount accretion	(1,661)	3,246	(2,951)
Retirement benefits	(54,425)	(1,724)	4,540
Write-down of building	—	73,280	—
Early retirement benefits	—	—	52,137
	<u>\$(253,808)</u>	<u>\$(192,177)</u>	<u>\$(157,515)</u>

The components of the net deferred tax liability were as follows for the years ended December 31:

<b>DEFERRED TAX ASSETS</b>			
Allowance for loan losses	\$1,173,227	\$1,146,983	\$1,054,312
Deferred compensation plan	209,793	213,892	214,784
Allowance for loss on building	—	—	73,280
	<u>1,383,020</u>	<u>1,360,875</u>	<u>1,342,376</u>
<b>DEFERRED TAX LIABILITIES</b>			
Accrued retirement benefits	74,562	128,987	130,711
Deferred origination costs	125,090	164,472	277,304
Unrealized gains on available for sale investment securities	1,376,044	1,093,441	785,978
Depreciation	85,808	222,003	477,832
Discount accretion	5,972	7,633	4,387
FHLB Stock dividends	2,019	2,019	2,019
	<u>1,669,495</u>	<u>1,618,555</u>	<u>1,678,231</u>
<b>NET DEFERRED TAX LIABILITY</b>	<u>\$ (286,475)</u>	<u>\$ (257,680)</u>	<u>\$ (335,855)</u>

The differences between the federal income tax rate of 34 percent and the effective tax rate for the Company are reconciled as follows:

	2003	2002	2001
Statutory federal income tax rate	34.0%	34.0%	34.0%
<b>INCREASE (DECREASE) RESULTING FROM:</b>			
Tax-exempt income	(20.1)	(11.1)	(13.2)
State income taxes, net of federal income tax benefit	1.2	1.8	1.3
Other	<u>11.7</u>	<u>6.0</u>	<u>7.6</u>
	<u>26.8%</u>	<u>30.7%</u>	<u>29.7%</u>

## 18. LEASE COMMITMENTS

The Company leases various branch and general office facilities to conduct its operations. The leases have remaining terms which range from a period of 1 year to 11 years. Most leases contain renewal options which are generally exercisable at increased rates. Some of the leases provide for increases in the rental rates at specified times during the lease terms, prior to the expiration dates.

The leases generally provide for payment of property taxes, insurance, and maintenance costs by the Company. The total rental expense for all real property leases amounted to \$615,032, \$569,703, and \$642,218 for 2003, 2002, and 2001, respectively.

Lease obligations will require minimum rent payments as follows:

<i>Period</i>	<i>Minimum rentals</i>
2004	\$ 547,182
2005	487,950
2006	375,674
2007	334,759
2008	261,545
Remaining years	609,308
	<u>\$2,616,418</u>

## 19. PARENT COMPANY FINANCIAL INFORMATION

The balance sheets for 2003 and 2002 and statements of income and cash flows for Carrollton Bancorp (Parent Only) for 2003, 2002, and 2001, are presented below:

### BALANCE SHEETS

	December 31,	
	2003	2002
<b>ASSETS</b>		
Cash	\$ 52,999	\$ 10,075
Interest bearing deposits in subsidiary	570,547	413,856
Investment in subsidiary	30,314,976	30,482,806
Investment securities available for sale	4,746,989	3,502,020
Other assets	26,401	—
	<u>\$35,711,912</u>	<u>\$34,408,757</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Liabilities	\$ 1,587,030	\$ 717,678
<b>SHAREHOLDERS' EQUITY</b>		
Common Stock	2,828,078	2,821,757
Surplus	18,682,387	18,617,608
Retained earnings	10,427,425	10,513,874
Accumulated other comprehensive income	2,186,992	1,737,840
	<u>34,124,882</u>	<u>33,691,079</u>
	<u>\$35,711,912</u>	<u>\$34,408,757</u>

19. PARENT COMPANY FINANCIAL INFORMATION (Continued)

STATEMENTS OF INCOME

	Years ended December 31,		
	2003	2002	2001
<b>INCOME</b>			
Dividends from subsidiary	\$258,840	\$ 235,309	\$ 235,309
Interest and dividends	157,236	128,866	142,874
Security gains (losses)	462,778	209,880	(2,725)
	<u>878,854</u>	<u>574,055</u>	<u>375,458</u>
<b>EXPENSES</b>			
	<u>86,855</u>	<u>92,624</u>	<u>22,034</u>
Income before income taxes and equity in undistributed net income of subsidiary	791,999	481,431	353,424
Income tax expense	171,968	62,236	10,922
	<u>620,031</u>	<u>419,195</u>	<u>342,502</u>
Equity in undistributed net income of subsidiary	304,683	1,498,063	1,590,575
<b>NET INCOME</b>	<u>\$924,714</u>	<u>\$1,917,258</u>	<u>\$1,933,077</u>

STATEMENTS OF CASH FLOWS

	Years ended December 31,		
	2003	2002	2001
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Cash dividends from subsidiary	\$ 258,840	\$ 235,309	\$ 235,309
Interest and dividends received	130,835	128,866	128,333
Cash paid to suppliers	(116,795)	(101,239)	(32,206)
Income taxes paid, net of cash received from subsidiaries	147,417	8,942	(25,256)
	<u>420,297</u>	<u>271,878</u>	<u>306,180</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Net (increase) decrease in interest-bearing deposits	(156,691)	59,038	398,884
Proceeds from sales of securities available for sale	719,381	600,596	48,318
	<u>562,690</u>	<u>659,634</u>	<u>447,202</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Dividends paid	(1,016,785)	(973,902)	(974,784)
Common stock repurchase and retirement	—	(199,321)	(79,044)
Stock options exercised	76,722	—	—
	<u>(940,063)</u>	<u>(1,173,223)</u>	<u>(1,053,828)</u>
Net (decrease) increase in cash	42,924	(241,711)	(300,446)
Cash at beginning of year	10,075	251,786	552,232
Cash at end of year	<u>\$ 52,999</u>	<u>\$ 10,075</u>	<u>\$ 251,786</u>
<b>RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES</b>			
Net income	\$ 924,714	\$ 1,917,258	\$ 1,933,077
<b>ADJUSTMENTS TO RECONCILE NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES</b>			
Equity in undistributed income of subsidiary	(304,683)	(1,498,063)	(1,590,575)
Security (gains) losses	(462,778)	(209,880)	2,725
Decrease (increase) in accounts receivable	(26,401)	—	28,175
Increase (decrease) in accounts payable	289,445	62,563	(67,222)
	<u>\$ 420,297</u>	<u>\$ 271,878</u>	<u>\$ 306,180</u>

## 20. FAIR VALUE OF FINANCIAL INSTRUMENTS

The estimated fair values of the Company's financial instruments are summarized below. The fair values of a significant portion of these financial instruments are estimates derived using present value techniques prescribed by the FASB and may not be indicative of the net realizable or liquidation values. Also, the calculation of estimated fair values is based on market conditions at a specific point in time and may not reflect current or future fair values.

	December 31, 2003		December 31, 2002	
	<i>Carrying amount</i>	<i>Fair value</i>	<i>Carrying amount</i>	<i>Fair value</i>
<b>FINANCIAL ASSETS</b>				
Cash and cash equivalents	\$ 27,300,926	\$ 27,300,926	\$ 31,399,756	\$ 31,399,756
Investment securities (total)	62,483,957	62,483,957	78,811,147	78,811,147
Federal Home Loan Bank stock	2,250,000	2,250,000	2,500,000	2,500,000
Loans held for sale	2,241,583	2,326,387	—	—
Loans, net	195,648,316	217,381,629	201,641,364	212,964,037
Accrued interest receivable	1,421,554	1,421,554	1,747,994	1,747,994
<b>FINANCIAL LIABILITIES</b>				
Noninterest-bearing deposits	\$ 42,484,836	\$ 42,484,836	\$ 41,259,140	\$ 41,259,140
Interest-bearing deposits	164,571,264	165,649,405	189,004,968	192,572,059
Federal funds purchased	3,507,348	3,507,348	1,853,261	1,853,261
Securities sold under agreements to repurchase	8,444,246	8,444,246	9,682,111	9,682,111
Notes payable-U.S. Treasury	2,025,339	2,025,339	2,045,237	2,045,237
Advances from the Federal Home Loan Bank	45,000,000	55,430,707	45,000,000	54,145,886
Accrued interest payable	451,055	451,055	513,358	513,358

The fair values of U.S. Treasury and government agency securities, corporate bonds, mortgage-backed securities, and listed equity securities are determined using market quotations. For state and municipal securities, the fair values are estimated using a matrix that considers yield to maturity, credit quality, and marketability.

The fair value of fixed-term loans is estimated to be the present value of scheduled payments, and anticipated prepayments in the case of residential mortgages, discounted using interest rates currently in effect for loans of the same class and term. The fair value of variable-rate loans is estimated to equal the carrying amount. The valuations of fixed-term and variable-rate loans are adjusted for possible loan losses.

The fair value of interest-bearing checking, savings, and money market deposit accounts is equal to the carrying amount. The fair value of fixed-maturity time deposits is estimated based on interest rates currently offered for deposits of similar remaining maturities.

Generally, the Company charges fees for commitments to extend credit. Interest rates on commitments to extend credit are normally committed for periods of less than one month. Fees charged on standby letters of credit are deemed to be immaterial and these guarantees are expected to be settled at face amount or expire unused. It is impractical to assign any fair value to these commitments.

## 21. SEGMENT INFORMATION

The Company has reportable segments that are strategic business units offering complimentary products and services to the core business of banking. The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The Company provides the accounting for all segments and charges a management fee for this service to the other segments. The Company has also lent money to various segments with terms similar to those offered third parties.

The Commercial/Retail Bank segment provides full service retail and business banking services, including lending and deposit services, investment activities and other customary services associated with a bank.

The Electronic Banking segment provides off-site ATM services, national point of sale transaction originations, home banking, and debit card transaction processing.

The Brokerage segment provides full service brokerage services for stocks, bonds, mutual funds and annuities.

The Mortgage Unit segment provides residential mortgage lending products and services.

21. SEGMENT INFORMATION (Continued)

Segment information for the Company for 2003 is as follows:

	<i>Commercial/ Retail Bank</i>	<i>Electronic Banking</i>	<i>Brokerage</i>	<i>Mortgage Unit</i>	<i>Segment Totals</i>	<i>Eliminations</i>	<i>Consolidated</i>
Interest income	\$ 15,065,256	\$ —	\$ 3,962	\$ 579,609	\$ 15,648,827	\$ 286,864	\$ 15,935,691
Interest expense	(5,901,928)	(177,442)	—	(273,500)	(6,352,870)	(286,864)	(6,639,734)
Net interest income	9,163,328	(177,442)	3,962	306,109	9,295,957	—	9,295,957
Provision for loan losses	(231,000)	—	—	(12,000)	(243,000)	—	(243,000)
Noninterest income	2,076,622	4,734,112	793,572	664,306	8,268,612	—	8,268,612
Intersegment income	100,724	—	—	—	100,724	(100,724)	—
Noninterest expenses	(10,944,649)	(3,821,983)	(509,665)	(882,782)	(16,159,079)	100,724	(16,058,355)
Income before income taxes	165,025	734,687	287,869	75,633	1,263,214	—	1,263,214
Income taxes	85,622	(283,736)	(111,175)	(29,211)	(338,500)	—	(338,500)
Net income	\$ 250,647	\$ 450,951	\$ 176,694	\$ 46,422	\$ 924,714	\$ —	\$ 924,714
Segment assets	\$296,158,289	\$ 6,571,225	\$ 340,094	\$5,383,870	\$308,453,478	\$(6,043,503)	\$302,409,975
Expenditures for segment purchases of premises, equipment and software	\$ 787,225	\$ 74,423	\$ —	\$ 61,992	\$ 923,640	\$ —	\$ 923,640

A reconciliation of total segment assets to consolidated total assets follows as of December 31, 2003:

Total segment assets	\$308,453,478
Elimination of intersegment loans	(4,518,191)
Elimination of intersegment deposit accounts	(1,525,312)
	<u>\$302,409,975</u>

Segment information for the Company for 2002 is as follows:

	<i>Commercial/ Retail Bank</i>	<i>Electronic Banking</i>	<i>Brokerage</i>	<i>Mortgage Unit</i>	<i>Segment Totals</i>	<i>Eliminations</i>	<i>Consolidated</i>
Interest income	\$ 16,880,426	\$ —	\$ 3,826	\$ 1,285,642	\$ 18,169,894	\$ 815,470	\$ 18,985,364
Interest expense	(6,797,663)	(278,423)	—	(800,764)	(7,876,850)	(815,470)	(8,692,320)
Net interest income	10,082,763	(278,423)	3,826	484,878	10,293,044	—	10,293,044
Provision for loan losses	(502,000)	—	—	(24,000)	(526,000)	—	(526,000)
Noninterest income	2,640,874	4,222,976	670,952	—	7,534,802	—	7,534,802
Intersegment income	65,119	—	—	—	65,119	(65,119)	—
Noninterest expenses	(10,372,136)	(3,621,027)	(535,204)	(73,710)	(14,602,077)	65,119	(14,536,958)
Income before income taxes	1,914,620	323,526	139,574	387,168	2,764,888	—	2,764,888
Income taxes	(519,487)	(124,946)	(53,673)	(149,524)	(847,630)	—	(847,630)
Net income	\$ 1,395,133	\$ 198,580	\$ 85,901	\$ 237,644	\$ 1,917,258	\$ —	\$ 1,917,258
Segment assets	\$311,072,820	\$12,714,617	\$ 237,172	\$12,279,240	\$336,303,849	\$(12,082,234)	\$324,221,615
Expenditures for segment purchases of premises, equipment and software	\$ 305,036	\$ 62,124	\$ —	\$ —	\$ 367,160	\$ —	\$ 367,160

21. SEGMENT INFORMATION (Continued)

A reconciliation of total segment assets to consolidated total assets follows as of December 31, 2002:

Total segment assets	\$336,303,849
Elimination of intersegment loans	(11,072,112)
Elimination of intersegment deposit accounts	(1,010,122)
	<u>\$324,221,615</u>

Segment information for the Company for 2001 is as follows:

	<i>Commercial/ Retail Bank</i>	<i>Electronic Banking</i>	<i>Brokerage</i>	<i>Mortgage Unit</i>	<i>Segment Totals</i>	<i>Eliminations</i>	<i>Consolidated</i>
Interest income	\$ 19,122,477	\$ —	\$ 12,015	\$ 2,599,228	\$ 21,733,720	\$ 2,098,904	\$ 23,832,624
Interest expense	(8,394,419)	(311,599)	—	(2,067,433)	(10,773,451)	(2,098,904)	(12,872,355)
Net interest income	10,728,058	(311,599)	12,015	531,795	10,960,269	—	10,960,269
Provision for loan losses	(502,000)	—	—	(48,000)	(550,000)	—	(550,000)
Noninterest income	1,708,480	4,686,653	1,015,720	(254,409)	7,156,444	—	7,156,444
Intersegment income	67,285	—	—	—	67,285	(67,285)	—
Noninterest expenses	(10,457,180)	(3,678,429)	(648,380)	(100,800)	(14,884,789)	67,285	(14,817,504)
Income before income taxes	1,544,643	696,625	379,355	128,586	2,749,209	—	2,749,209
Income taxes	(353,432)	(269,037)	(144,003)	(49,660)	(816,132)	—	(816,132)
Net income	<u>\$ 1,191,211</u>	<u>\$ 427,588</u>	<u>\$ 235,352</u>	<u>\$ 78,926</u>	<u>\$ 1,933,077</u>	<u>\$ —</u>	<u>\$ 1,933,077</u>
Segment assets	\$345,072,034	\$11,245,455	\$ 569,059	\$22,773,491	\$379,660,039	\$(22,752,858)	\$356,907,181
Expenditures for segment purchases of premises, equipment and software	\$ 552,223	\$ 76,206	\$ 39,610	\$ —	\$ 668,039	\$ —	\$ 668,039

A reconciliation of total segment assets to consolidated total assets follows as of December 31, 2001:

Total segment assets	\$379,660,039
Elimination of intersegment loans	(21,346,400)
Elimination of intersegment deposit accounts	(1,406,458)
	<u>\$356,907,181</u>

## 22. CONSOLIDATED QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

Year Ended December 31, 2003

	<i>First Quarter</i>	<i>Second Quarter</i>	<i>Third Quarter</i>	<i>Fourth Quarter</i>
Interest income	\$4,241,869	\$4,060,277	\$3,865,703	\$3,767,842
Interest expense	(1,943,872)	(1,926,524)	(1,452,690)	(1,316,648)
Net interest income	2,297,997	2,133,753	2,413,013	2,451,194
Provision for loan losses	(121,500)	(121,500)	—	—
Security gains	154,118	192,879	115,781	23,331
Other income	1,759,179	1,982,259	2,192,819	1,848,246
Operating expenses	(3,532,988)	(3,833,056)	(4,222,518)	(4,469,793)
Income (loss) before taxes	556,806	354,335	499,095	(147,022)
Income taxes	(207,561)	(89,574)	(133,742)	92,377
Net income (loss)	<u>\$ 349,245</u>	<u>\$ 264,761</u>	<u>\$ 365,353</u>	<u>\$ (54,645)</u>
Earnings (loss) per share	<u>\$ 0.12</u>	<u>\$ 0.09</u>	<u>\$ 0.13</u>	<u>\$ (0.01)</u>
Cash dividends per share	<u>\$ 0.09</u>	<u>\$ 0.09</u>	<u>\$ 0.09</u>	<u>\$ 0.09</u>
Market prices: high	<u>\$ 15.55</u>	<u>\$ 17.99</u>	<u>\$ 18.10</u>	<u>\$ 18.40</u>
low	<u>\$ 12.82</u>	<u>\$ 14.15</u>	<u>\$ 16.03</u>	<u>\$ 17.49</u>

Year Ended December 31, 2002

	<i>First Quarter</i>	<i>Second Quarter</i>	<i>Third Quarter</i>	<i>Fourth Quarter</i>
Interest income	\$4,913,172	\$4,824,517	\$4,773,938	\$4,473,737
Interest expense	(2,345,141)	(2,175,561)	(2,126,511)	(2,045,107)
Net interest income	2,568,031	2,648,956	2,647,427	2,428,630
Provision for loan losses	(131,500)	(131,500)	(131,500)	(131,500)
Security gains	103,005	—	106,875	—
Gain on branch divestiture	—	687,883	—	—
Other income	1,524,190	1,816,697	1,743,196	1,552,956
Operating expenses	(3,605,742)	(3,696,614)	(3,680,708)	(3,553,894)
Income before income taxes	457,984	1,325,422	685,290	296,192
Income taxes	(132,462)	(439,327)	(218,304)	(57,537)
Net income	<u>\$ 325,522</u>	<u>\$ 886,095</u>	<u>\$ 466,986</u>	<u>\$ 238,655</u>
Earnings per share	<u>\$ 0.11</u>	<u>\$ 0.31</u>	<u>\$ 0.16</u>	<u>\$ 0.10</u>
Cash dividends per share	<u>\$ 0.085</u>	<u>\$ 0.086</u>	<u>\$ 0.085</u>	<u>\$ 0.086</u>
Market prices: high	<u>\$ 12.02</u>	<u>\$ 12.88</u>	<u>\$ 13.11</u>	<u>\$ 14.25</u>
low	<u>\$ 11.20</u>	<u>\$ 11.35</u>	<u>\$ 11.84</u>	<u>\$ 11.70</u>

## ITEM 9: CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS

At no time whatsoever during the Company's two most recent fiscal years or any subsequent interim period, has an independent accountant who was previously engaged as the principal accountant to audit the Company's financial statements, or an independent accountant who was previously engaged to audit a significant subsidiary and on whom the principal accountant expressed reliance in its report, resigned, declined to stand for reelection or been dismissed.

## PART III

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### ITEM 10: DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS; COMPLIANCE WITH SECTION 16(A) OF THE EXCHANGE ACT

There is hereby incorporated by reference into this Item 10 the information appearing under the captions "Election of Directors," "Other Executive Officers and Directors of the Bank" and "Section 16(a) Beneficial Ownership Reporting Compliance" in the Company's definitive Proxy Statement relating to its Annual meeting of Shareholders to be held on April 20, 2004.

### ITEM 11: EXECUTIVE COMPENSATION

There is hereby incorporated by reference into this Item 11 the information appearing under the captions "Executive Compensation" and "Long-Term Incentive Plan" in the Company's definitive Proxy Statement relating to its Annual Meeting of Shareholders to be held on April 20, 2004.

### ITEM 12: SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

There is hereby incorporated by reference into this Item 12 the information appearing under the caption "Security Ownership of Certain Beneficial Owners and Management" in the Company's definitive Proxy Statement relating to its Annual Meeting of Shareholders to be held on April 20, 2004.

### ITEM 13: CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

There is hereby incorporated by reference into this Item 13 the information appearing under the caption "Certain Relationships and Related Transactions" in the Company's definitive Proxy Statement relating to its Annual meeting of Shareholders to be held on April 20, 2004.

### ITEM 14: CONTROLS AND PROCEDURES

Within 90 days prior to the date of this report, we carried out an evaluation, under the supervision and with the participation of our principal executive officer and principal financial officer, of

the effectiveness of the design and operation of our disclosure controls and procedures. Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information required to be included in our periodic SEC reports. The design of any system of controls is based in part upon certain assumption about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote.

In addition, we reviewed our internal controls, and there have been no significant changes in our internal controls or other factors that could significantly affect those controls subsequent to the date of their last evaluation.

## PART IV

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### ITEM 15: EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

#### a) List of Exhibits:

<i>Exhibit Number</i>	<i>Description</i>
3(i)	Articles of Incorporation of Carrollton Bancorp*
3(ii)	By-Laws of Carrollton Bancorp*
10.1	Lease dated January 24, 1989 by and between Hill Management Services, Inc. and The Carrollton Bank of Baltimore.*
10.2	Lease dated July 21, 1989 by and between Hill Management Services, Inc. and The Carrollton Bank of Baltimore.*
10.3	Lease dated October 30, 1959 between Arbutus Shopping Plaza, Inc. and The Carrollton Bank of Baltimore, as amended.*
10.4	Lease dated August 3, 1976 between Arbutus Shopping Plaza, Inc. and The Carrollton Bank of Baltimore.*
10.5	Lease dated May 20, 1971 by and between Home Mutual Life Insurance Company and The Carrollton Bank of Baltimore.*
10.6	Lease dated April 17, 1974 by and between Liberty Plaza Enterprises, Inc. and The Carrollton Bank of Baltimore.*
10.7	Lease dated July 19, 1988 by and between Northway Limited Partnership and The Carrollton Bank of Baltimore.*
10.8	Lease dated August 11, 1994 by and between Kensington Associates Limited Partnership and Carrollton Bank.**
10.9	Lease dated October 11, 1994 by and between Ridgeview Associates Limited Partnership and Carrollton Bank.**
21.1	Subsidiaries of Carrollton Bancorp
23.0	Consent of Accountant

- 31(a) Certification of Robert A. Altieri, President and Chief Executive Officer
- 31(b) Certification of Randall M. Robey, Executive Vice President and Chief Financial Officer
- 32(a) Certification of Robert A. Altieri, President and Chief Executive Officer
- 32(b) Certification of Randall M. Robey, Executive Vice President and Chief Financial Officer

- \* Incorporated by reference from Registration Statement dated January 12, 1990 on SEC Form S-4 (1933 Act File No.: 33-33027).
- \*\* Incorporated by reference from Annual Report on Form 10-KSB for the fiscal year ended December 31, 1994 (1934 Act File No.:0-23090).

b) Reports on Form 8-K:

Notice of press release related to earnings for the quarter ended June 30, 2003 filed on August 11, 2003

Notice of press release related to earnings for the quarter ended September 30, 2003 filed on October 30, 2003

**SIGNATURES**

In accordance with Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**CARROLLTON BANCORP**

March 19, 2004 By: /s/ Robert A. Altieri  
 Robert A. Altieri  
 President and Chief Executive Officer

In accordance with the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacity and on the dates indicated.

**PRINCIPAL EXECUTIVE OFFICER**

March 19, 2004 By: /s/ Robert A. Altieri  
 Robert A. Altieri  
 President and Chief Executive Officer

**PRINCIPAL FINANCIAL AND ACCOUNTING OFFICER**

March 19, 2004 By: /s/ Randall M. Robey  
 Randall M. Robey  
 Executive Vice President and Treasurer

*Board of Directors*

March 19, 2004 /s/ Robert J. Aumiller  
 Robert J. Aumiller  
 Director

March 19, 2004 /s/ Steven K. Breeden  
 Steven K. Breeden  
 Director

March 19, 2004 /s/ Albert R. Counselman  
 Albert R. Counselman  
 Director

March 19, 2004 /s/ Harold I. Hackerman  
 Harold I. Hackerman  
 Director

March 19, 2004 /s/ John P. Hauswald  
 John P. Hauswald  
 Director

March 19, 2004 /s/ David P. Hessler  
 David P. Hessler  
 Director

March 19, 2004 /s/ Howard S. Klein  
 Howard S. Klein  
 Director

March 19, 2004 /s/ Ben F. Mason  
 Ben F. Mason  
 Director

March 19, 2004 /s/ Charles E. Moore, Jr.  
 Charles E. Moore, Jr.  
 Director

March 19, 2004 /s/ John Paul Rogers  
 John Paul Rogers  
 Director

March 19, 2004 /s/ William C. Rogers, Jr.  
 William C. Rogers, Jr.  
 Director

## EXHIBIT INDEX

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\*\* Incorporated by reference from Annual Report on Form 10-KSB for the fiscal year ended December 31, 1994 (1934 Act File No.: 0-23090).

**EXHIBIT 21.1**

Subsidiaries of Carrollton Bancorp

Carrollton Bancorp

Carrollton Bank

Carrollton Financial Services, Inc.

Carrollton Community Development Corp.

Carrollton Mortgage Services, Inc.

Subsidiaries are indicated by indentation. All subsidiaries are 100% owned, except for Carrollton Community Development Corp. which is 96.4% owned.

**EXHIBIT 23**

**CONSENT OF INDEPENDENT PUBLIC ACCOUNTANT**

Carrollton Bancorp  
Baltimore, Maryland

As independent public accountants, we hereby consent to the incorporation of our report dated February 24, 2004 on the consolidated financial statements of Carrollton Bancorp and Subsidiary included in this Form 10-K into Carrollton Bancorp's previously filed registration statement on Form S-8, File No. 333-82915.

Baltimore, Maryland  
February 24, 2004

## EXHIBIT 31.1

### CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Carrollton Bancorp (the "Company") on Form 10-K for the period ending December 31, 2003, as filed with the Securities and Exchange Commission and which this Certification is an exhibit (the "Report"), the undersigned hereby certifies, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, that:

- (1) I have reviewed this annual report on Form 10-K of Carrollton Bancorp;
- (2) Based on my knowledge, the report does not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which the statements were made, not misleading with respect to the period covered by this annual report;
- (3) Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in the annual report;
- (4) The registrant's other certifying officers and I:
  - (a) are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the issuer;
  - (b) have designed such disclosures, controls and procedures to ensure that material information is made known to them, particularly during the period in which this annual report is being prepared;
  - (c) have evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the evaluation date); and
  - (d) have presented within the report our conclusions as to the effectiveness of the disclosure controls and procedures based on the required evaluation as of that date;
- (5) The registrant's other certifying officers and I have disclosed to the registrant's auditors and the registrant's audit committee of the board of directors:
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal controls which could adversely affect the issuers ability to record, process, summarize and report financial data and have identified for the issuer's auditors any material weaknesses in internal controls; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the issuer's internal controls; and
- (6) The registrant's other certifying officers and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

/s/ ROBERT A. ALTIERI

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Robert A. Altieri  
*President and Chief Executive Officer*

Date: March 4, 2004

## EXHIBIT 31.2

### CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Carrollton Bancorp (the "Company") on Form 10-K for the period ending December 31, 2003, as filed with the Securities and Exchange Commission and which this Certification is an exhibit (the "Report"), the undersigned hereby certifies, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, that:

- (1) I have reviewed this annual report on Form 10-K of Carrollton Bancorp;
- (2) Based on my knowledge, the report does not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which the statements were made, not misleading with respect to the period covered by this annual report;
- (3) Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in the annual report;
- (4) The registrant's other certifying officers and I:
  - (a) are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the issuer;
  - (b) have designed such disclosures, controls and procedures to ensure that material information is made known to them, particularly during the period in which this annual report is being prepared;
  - (c) have evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the evaluation date); and
  - (d) have presented within the report our conclusions as to the effectiveness of the disclosure controls and procedures based on the required evaluation as of that date;
- (5) The registrant's other certifying officers and I have disclosed to the registrant's auditors and the registrant's audit committee of the board of directors:
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal controls which could adversely affect the issuers ability to record, process, summarize and report financial data and have identified for the issuer's auditors any material weaknesses in internal controls; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the issuer's internal controls; and
- (6) The registrant's other certifying officers and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

/s/ RANDALL M. ROBESY

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Randall M. Robesey  
*Treasurer*

Date: March 4, 2004

## EXHIBIT 32.1

### CERTIFICATION OF CHIEF EXECUTIVE OFFICER

In connection with the Form 10-K of Carrollton Bancorp for the year ended December 31, 2003, I, Robert A. Altieri, President and Chief Executive Officer of Carrollton Bancorp, hereby certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes/Oxley Act of 2002, to the best of my knowledge and belief, that:

- (1) such Form 10-K for the year ended December 31, 2003, fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) the information contained in such Form 10-K for the year ended December 31, 2003, fairly presents, in all material respects, the financial conditions and results of operations of Carrollton Bancorp.

/s/ Robert A. Altieri

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Robert A. Altieri  
*President and Chief Executive Officer*

## EXHIBIT 32.2

### CERTIFICATION OF CHIEF FINANCIAL OFFICER

In connection with the Form 10-K of Carrollton Bancorp for the year ended December 31, 2003, I, Randall M. Robey, Executive Vice President and Chief Financial Officer of Carrollton Bancorp, hereby certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes/Oxley Act of 2002, to the best of my knowledge and belief, that:

- (1) such Form 10-K for the year ended December 31, 2003, fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) the information contained in such Form 10-K for the year ended December 31, 2003, fairly presents, in all material respects, the financial conditions and results of operations of Carrollton Bancorp.

/s/ Randall M. Robey

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Randall M. Robey  
*Executive Vice President and Chief Financial Officer*

## DIRECTORS AND OFFICERS

### DIRECTORS

Robert J. Aumiller  
*Executive Vice President*  
*MacKenzie Commercial Real Estate Services*

Steven K. Breeden  
*Managing Member*  
*Security Development, LLC*

Albert R. Counselman  
*President and Chief Executive Officer*  
*Riggs, Counselman, Michaels & Downes, Inc.*

Harold I. Hackerman  
*Vice President*  
*Ellin & Tucker, Chartered*

John P. Hauswald  
*Retired Business Owner*

David P. Hessler  
*President and CEO*  
*Eastern Sales and Engineering Co.*

Howard S. Klein  
*Vice President and General Counsel*  
*Klein's Super Markets*

Ben F. Mason  
*Executive Director*  
*Baltimore Chamber of Commerce*

Charles E. Moore, Jr.  
*President and CFO*  
*TelAtlantic Communications, Inc.*

John Paul Rogers  
*Attorney*

William C. Rogers, Jr.  
*Attorney*

William McCallister  
*Director Emeritus*

### OFFICERS

CARROLLTON BANCORP  
Albert R. Counselman  
*Chairman of the Board*  
Robert A. Altieri  
*President and Chief Executive Officer*  
D. Doreen Smith—*Vice President and Secretary*  
Randall M. Robey—*Treasurer and Executive Vice President*

CARROLLTON BANK  
John Paul Rogers  
*Chairman of the Board*  
Robert A. Altieri  
*President and Chief Executive Officer*  
Randall M. Robey—*Executive Vice President and Chief Financial Officer*  
D. Doreen Smith—*Vice President and Secretary*  
Senior Vice Presidents:  
Edward R. Bootey—*Operations*  
John A. Giovanazi—*Lending*  
Robert F. Hickey—*Branch Administration*  
Gary M. Jewell—*Electronic Banking*  
Vice Presidents:  
Michael Camiel—*Credit*  
Leroy J. Cummins—*Audit*  
Stephen G. Hyman—*Commercial Lending*  
Lola Stokes—*Compliance*  
George Mazurkevich—*Commercial Lending*  
Robert J. Morales—*Operations*  
Joyce F. Murphy—*Electronic Banking*  
W. Stephen Pindell—*Commercial Lending*  
William M. Rash—*Branch Administration*  
Nancy Isaac-Simering—*Branches*  
Harry P. Schultheis—*Commercial lending*  
William Sherman—*Commercial Lending*  
Samuel A. Sparks—*Finance*  
Eunice W. Taylor—*Electronic Banking*  
Lois A. Ward—*Human Resources*  
Victor Zubar—*MIS*  
Assistant Vice Presidents:  
William Brown—*Data Processing*  
Allyson Cwiek—*Executive*  
Patricia Harris—*Financial Sales & Service*  
Cindi Joynes—*Finance*  
Lori Ratzburg—*Credit*  
Donna Smith—*Customer Service*  
Robert J. Tolson—*Loan Servicing*  
Karen D. Trimp—*Training*

CARROLLTON FINANCIAL SERVICES, INC.  
Brian J. Culloty  
*Chairman of the Board and President*  
Teresa M. Bracci  
*Vice President and Secretary*

CARROLLTON MORTGAGE SERVICES, INC.  
Robert A. Altieri  
*President*  
Lance T. Tearnan  
*Vice President*  
Randall M. Robey  
*Treasurer*  
John A. Giovanazi  
*Director*

CARROLLTON COMMUNITY DEVELOPMENT CORPORATION  
John A. Giovanazi  
*President*

## SHAREHOLDER INFORMATION

### BUSINESS SUMMARY

Carrollton Bancorp (the Company) is a bank holding company registered under the Bank Holding Company Act of 1956, and was organized on January 11, 1990. Carrollton Bank is a Maryland State chartered commercial bank and the principal subsidiary of the Company. The Bank was incorporated under the laws of the State of Maryland in 1903 and is engaged in a general commercial and retail banking business. Carrollton Financial Services, Inc., a subsidiary of the Bank, provides full service brokerage services for stocks, bonds, mutual funds and annuities. Carrollton Mortgage Services, Inc., also a subsidiary of the Bank, is a residential mortgage lender.

The Bank operates 10 full service branch offices in Baltimore County, Baltimore City, and Anne Arundel County, Maryland. The Bank offers a wide range of both personal and commercial deposit and loan services.

The Bank and its subsidiaries currently have 136 full time equivalent employees. Management considers its relationship with its employees to be good.

The Bank faces strong competition in its market area. Its most direct competition for deposits comes from other commercial banks, savings banks, savings and loan associations and credit unions. It also competes for deposits with brokerage houses, mutual funds and, to a lesser extent, the securities markets. The Bank also competes with the same banking entities for loans, as well as with mortgage banking companies and other institutional lenders. Some of the Bank's competitors have assets and operating capacity which exceed that of the Bank.

The Company is subject to regulation and examination by the Federal Reserve Board, and is required to file periodic reports and any additional information that the Federal Reserve Board may require. The Bank is subject to supervision, regulation and examination by the Department of Labor, Licensing and Regulation of the State of Maryland and the Federal Deposit Insurance Corporation.

### CORPORATE HEADQUARTERS:

344 North Charles Street, Suite 300  
Baltimore, Maryland 21201  
Phone: (410) 536-4600  
Internet: [www.carrolltonbank.com](http://www.carrolltonbank.com)

### INVESTMENT SUBSIDIARY:

Carrollton Financial Services, Inc.  
The Avenue at White Marsh  
8157A Honeygo Blvd.  
White Marsh, Maryland 21236  
Phone: (410) 242-6418  
(800) 851-0851

### MORTGAGE SUBSIDIARY:

Carrollton Mortgage Services, Inc.  
344 North Charles Street  
Baltimore, Maryland 21201

### ANNUAL MEETING NOTICE:

The annual meeting of shareholders of Carrollton Bancorp will be held on Tuesday, April 20, 2004 at 10 a.m. at the Corporate Headquarters, 344 North Charles Street, Baltimore, Maryland.

### STOCK LISTING:

The common stock of Carrollton Bancorp trades on the NASDAQ National Market tier of The NASDAQ Stock Market under the symbol "CRRB". There were 455 record holders of stock at December 31, 2003.

### TRANSFER AGENT AND REGISTRAR:

American Stock Transfer & Trust Company  
59 Maiden Lane  
New York, New York 10038  
Phone: (800) 937-5449  
(212) 936-5100  
Internet: [www.amstock.com](http://www.amstock.com)

### INDEPENDENT ACCOUNTANTS:

Rowles & Company, LLP  
101 E. Chesapeake Avenue, Suite 300  
Baltimore, Maryland 21286

During 2003 and 2002, there were no disagreements with the Company's accountants on accounting matters or financial disclosure.

### ADDITIONAL INFORMATION:

The Company files an annual report with the Securities and Exchange Commission on Form 10-K. Any shareholder may obtain a copy, without charge, upon request to the Company's Treasurer.

### ANALYSTS, INVESTORS, AND OTHERS SEEKING FINANCIAL INFORMATION ABOUT THE COMPANY ARE INVITED TO CONTACT:

Randall M. Robey  
Treasurer  
Carrollton Bancorp  
344 North Charles Street  
Baltimore, Maryland 21201  
Phone: (410) 536-7308

## NOTES

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