



2002 Annual Report

Selected Consolidated Financial Data



Selected Financial Condition Data:

	At March 31,				
	2002	2001	2000	1999	1998
	(In Thousands)				
Total assets	\$263,374	\$270,176	\$243,077	\$200,810	\$183,894
Loans receivable, net	219,434	210,550	189,701	171,414	162,471
Investment securities and other earning assets ⁽¹⁾	29,704	44,421	38,074	17,020	8,976
Real estate owned, net	794	451	823	352	303
Deposits	204,535	174,307	158,568	153,015	138,164
Advances and other borrowed money	28,951	67,422	57,000	19,000	18,000
Stockholders' equity	26,695	25,805	25,394	26,384	25,515

Selected Operations Data:

	At March 31,				
	2002	2001	2000	1999	1998
	(In Thousands)				
Total interest income	\$18,941	\$20,047	\$16,154	\$14,258	\$13,949
Total interest expense	9,057	11,914	8,715	7,332	7,316
Net interest income	9,884	8,133	7,439	6,926	6,633
Provision for loan losses	373	320	283	360	498
Net interest income after provision for loan losses	9,511	7,813	7,156	6,566	6,135
Service charges and fees on loans	3,287	2,821	2,382	1,328	757
Gain on sale of securities	-	-	601	1,225	-
Other noninterest income ⁽²⁾	95	78	213	85	9
Noninterest expenses	9,163	8,241	8,258	6,028	4,017
Income before income taxes	3,730	2,471	2,094	3,176	2,884
Income taxes	1,123	728	770	1,328	1,079
Net income	<u>\$ 2,607</u>	<u>\$ 1,743</u>	<u>\$ 1,324</u>	<u>\$ 1,848</u>	<u>\$ 1,805</u>
	2002	2001	2000	1999	1998

Other Data:

Average interest-earning assets to average interest-bearing liabilities	108.18%	107.04%	107.30%	111.43%	111.47%
Average interest rate spread during year	3.66	2.96	3.30	3.45	3.42
Non-performing assets to total assets	.36	.43	.52	.76	.51
Return on assets (ratio of net income to average total assets)	1.03	.68	.60	.96	1.03
Return on equity (ratio of net income to average total equity)	10.01	6.81	5.11	7.12	7.39
Equity-to-assets ratio (ratio of average equity to average assets)	10.27	9.97	11.66	13.52	13.89

Per Share Data:

Net income-diluted	\$1.14	\$.72	\$.52	\$.71	\$.70
Book value	11.84	10.99	10.11	10.26	9.97
Dividends	.32	.32	.32	.31	.28
Dividend payout ratio	28.08%	44.75%	61.90%	43.11%	39.60%
Number of full-service offices	7	6	6	5	4

(1) Includes federal funds sold, securities purchased under resale agreements and overnight deposits.

(2) Other income includes customer service fees and commissions, gain or loss on disposal of property and other items.



Dear Stockholder:

This past year has been an unprecedented one for Community Financial Corporation. Your Corporation achieved record earnings for the year in addition to positive growth in deposits and loans. As you review the enclosed annual report we hope that you will share our pride for the accomplishments of this past year and our enthusiasm for the Corporation's continued success in the future. We were particularly pleased with our financial results for fiscal year 2002 considering the economic environment and the tragic impact of September 11th. The Community family joins together to pay tribute to those victims and heroes of the tragedy, and to our men and women in uniform who so unselfishly give of themselves to protect the freedoms that we hold so dear.

Net income for fiscal year 2002 was \$2.6 million compared to \$1.7 million in the prior year, a 53% increase. Diluted earnings per share for 2002 were \$1.14 compared to \$0.72 in the prior year, a 58% increase. The increase in net income and diluted earnings per share were primarily attributable to increases in both net interest income and fee income of \$1.75 million and \$480,000 respectively.

For the year, your Bank has enjoyed record loan production in excess of \$112 million. Accompanied with this high level of production was a record level of payoffs, as a result of the declining interest rate environment during the year. Despite this record level of payoffs, our loan portfolio increased by \$9.3 million or 4.3% to end the year at \$223.8 million. Deposits for the year increased by \$30.2 million or 17.3% resulting in an ending balance of \$204.5 million. As a result of our deposit growth and the redemption of a \$20 million investment during the year, we were able to reduce our borrowings by \$38.5 million or 57%, from \$67.4 million at March 31, 2001, to \$28.9 million at March 31, 2002. Our assets declined during the year from \$270.2 million at March 31, 2001 to \$263.4 million at March 31, 2002, a decrease of 2.5% for the year.

We recently recognized the 5th year anniversary of the formation of the Hampton Roads Region. This Region has become an important addition to our operations and its performance has exceeded even our most optimistic projections. This past year, the Region experienced its strongest growth in loans and deposits in its short history, as loans increased by \$19.5 million or 43.6%, and deposits increased by \$11.7 million or 51%. With a current loan and deposit portfolio in excess of \$64.3 million and \$34.7 million respectively, we are very excited about the Hampton Roads Region's future potential and its continued contribution to our overall profitability.

In addition to delivering record earnings, we have been very busy improving the products and services we offer to our customers. A new check processing and imaging system has been installed which allows us to provide better service to our checking account customers; and our seventh full service office was opened in Raphine, Virginia during December. This office had deposits totaling \$4.5 million at March 31, 2002. We believe our Raphine office to be a logical expansion of our franchise in the Valley and will provide a much-needed banking option for the market between Staunton and Lexington. We have also announced the ground breaking of our new Verona branch, and are looking forward to expanding our service in this market beginning in the third quarter of fiscal year 2003. As always, we will continue to evaluate additional opportunities to improve our products and services and to enhance our branch network; however, we continue to be mindful of protecting our earnings trend when making these decisions. This is in keeping with our commitment to maintain controlled, profitable growth.



James R. Cooke Jr.
Chairman of the Board

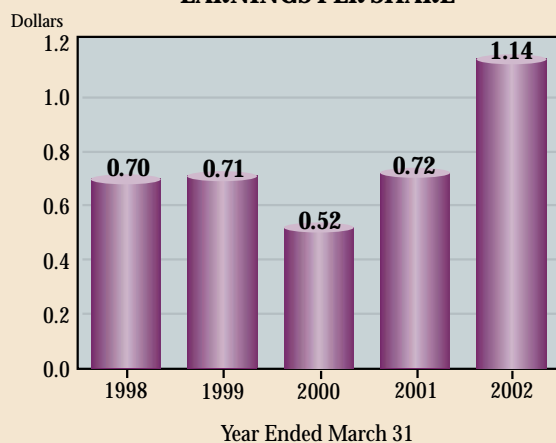


P. Douglas Richard
President & CEO

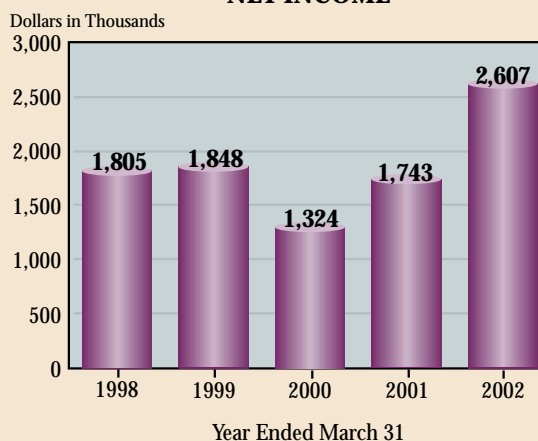


President's Letter

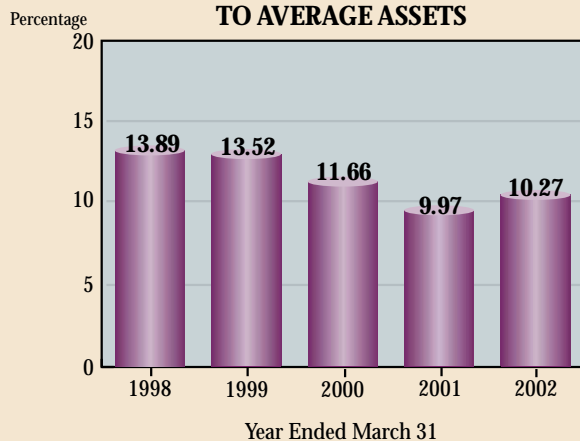
EARNINGS PER SHARE



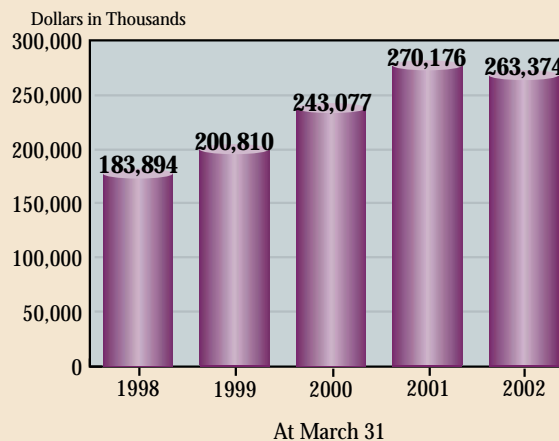
NET INCOME



STOCKHOLDERS' EQUITY TO AVERAGE ASSETS



TOTAL ASSETS



We are confident that our bank and staff will continue to provide the personalized, friendly service and competitive products that our customers have come to expect and enjoy. We believe that the consolidations taking place in the markets we serve, which many times result in larger impersonal institutions, will continue to present opportunities for us to increase market share and enhance stockholder value. Our challenge, as we grow, is not to lose site of the values that have set us apart from the market over the past 74 years.

In this uncertain economic environment, it is important to exercise sound business judgement. We believe we have the right team in place to meet this challenge. We thank our stockholders and customers for their continued support. The success we enjoyed this past year was truly the result of a combined effort among our staff, management, and board of directors. We look forward to that same effort this coming year.

May God bless our nation.

James R. Cooke Jr.
Chairman of the Board

P. Douglas Richard
President & CEO

Board of Directors and Officers



Board of Directors

Charles F. Andersen, M.D. Dr. Andersen is an orthopedic surgeon in private practice in Waynesboro, Virginia.

James R. Cooke, Jr., D.D.S. Dr. Cooke has been, for the past 30 years, a practicing dentist in Staunton, Virginia.

Charles W. Fairchilds Mr. Fairchilds has been the President of Allied Ready Mix in Waynesboro, Virginia since 1987.

Jane C. Hickok Mrs. Hickok was elected Vice Chairman of the Board in October 1994 and Secretary of Community Financial in October 1998. She retired as President and Chief Executive Officer of Community Bank in October 1994 after serving since 1984. Mrs. Hickok also retired as President and Chief Executive Officer of Community Financial Corporation in January 1995, but continues to serve as a director of Community Financial and Community Bank. Mrs. Hickok was elected as a director of Community Bank in 1983 and as a director of Community Financial in 1990 when it became the holding company of Community Bank.



Pictured front row, left to right: P. Douglas Richard, Jane C. Hickok, James R. Cooke, Jr., D.D.S.

Back row, left to right: Charles F. Andersen, M.D., Dale C. Smith, Charles W. Fairchilds, Morgan N. Trimyer, Jr.

P. Douglas Richard Mr. Richard was appointed the Acting President and Chief Executive Officer of Community Financial and Community Bank on January 12, 2000, and became the President and Chief Executive Officer of Community Financial and Community Bank on April 26, 2000. He was appointed to the Board of Directors of Community Financial on April 26, 2000. From January 1, 1997, to January 12, 2000, Mr. Richard was a Senior Vice President of Community Bank. From December 1993 to January 1996 he was President and Chief Executive Officer of Seaboard Bancorp.

Dale C. Smith Mr. Smith is the General Manager and Chief Executive Officer of Augusta Cooperative-Farm Bureau, Inc., a farm supply and retail store.

Morgan N. Trimyer, Jr. Mr. Trimyer served as Vice President and Partner of Welton, Duke & Hawks, Inc., an insurance company headquartered in Portsmouth, Virginia from 1984 to 2001. He was also a Vice President with Valley Insurance Agency, Inc. located in Lexington, Virginia, and has 30 years of experience in the insurance industry in Virginia. He currently serves as Vice President of Bankers Insurance, LLC and is the Director of Marketing.

Hampton Roads Board of Directors



Pictured front row, left to right: Robert M. Thornton, James R. Cooke, Jr., P. Douglas Richard.

Back row, left to right: Chris P. Kyriakides, William R. Waddell, Berard Harrison, Leslie Watson.

Not pictured: Morgan N. Trimyer, Jr.

Officers

P. Douglas Richard
R. Jerry Giles
Benny N. Werner
Norman C. (Butch) Smiley, III

Chris P. Kyriakides
Robert M. (Bobby) Hoffman
Jane P. Orem
Kathy H. Willis
Robert W. Pennington
Dianne F. Campbell
Gary L. Davenport
Kay T. Dean
Danny R. Fields
Darlene A. Hall
Richard J. Mayer
Virginia McCormack
Lyle A. Moffett
Ramona W. Savidge
Thomas R. Wagner
Linda B. Wood
Joe P. Zakaib
Teresa M. Layne
Martha B. Chandler
Lovetta L. Moore
Connie R. Savage
Barbara M. Wood

President & CEO
Senior Vice President/Chief Financial Officer
Senior Vice President
Senior Vice President/
Chief Lending Officer
Senior Vice President/Regional President
Regional Vice President
Regional Vice President
Regional Vice President
Regional Vice President
Assistant Vice President
Assistant Vice President
Assistant Vice President
Assistant Vice President
Assistant Vice President
Assistant Vice President
Assistant Vice President
Assistant Vice President
Assistant Vice President
Assistant Vice President
Assistant Vice President
Branch Officer
Assistant Secretary
Assistant Secretary
Assistant Secretary
Assistant Secretary

INTRODUCTION

Community Financial Corporation ("Community Financial") is a Virginia corporation. Certain of the information presented herein relates to Community Bank, a wholly owned subsidiary of Community Financial and Community First Mortgage Corporation, a wholly owned subsidiary of Community Bank. References in this Annual Report to "we", "us" and "our" refer to Community Financial and/or Community Bank as the context requires.

Community Financial and Community Bank, like all thrift institutions and their holding companies, are subject to comprehensive regulation, examination and supervision by the Office of Thrift Supervision, Department of the Treasury and the Federal Deposit Insurance Corporation.

Our net income is primarily dependent on the difference or spread between the average yield earned on loans and investments and the average rate paid on deposits and borrowings, as well as the relative amounts of such assets and liabilities. The interest rate spread is affected by regulatory, economic, and competitive factors that influence interest rates, loan demand and deposit flows. Like other financial institutions, we are subject to interest rate risk to the degree that our

interest-bearing liabilities, primarily deposits and borrowings with short- and medium-term maturities, mature or reprice more rapidly, or on a different basis, than our interest-earning assets, primarily loans with longer term maturities than deposits and borrowings. While having liabilities that mature or reprice more frequently on average than assets may be beneficial in times of declining interest rates, such an asset/liability structure may result in lower net income or net losses during periods of rising interest rates, unless offset by other non-interest income. Our net income is also affected by, among other things, gains on sale of loans, mortgage-backed securities and investment securities, fee income, provision for loan and real estate losses, operating expenses and income taxes.

ASSET/LIABILITY MANAGEMENT

Management believes it is important to manage the relationship between interest rates and their effect on our net portfolio value. This approach calculates the difference between the present value of expected cash flows from assets and the present value of expected cash flows from liabilities, as well as cash flows from off-balance sheet contracts. Management of our assets and liabilities is done within the context of the marketplace, but also within limits established by the

board of directors on the amount of change in net portfolio value which is acceptable given certain interest rate changes.

Presented in the following table, as of March 31, 2002 and 2001, is an analysis of the our interest rate risk as measured by changes in net portfolio value for instantaneous and sustained parallel shifts in the yield curve, in 100 basis point increments, up and down 300 basis points and compared to board global policy limits and in accordance with Office of Thrift Supervision regulations, based on the assumptions described below. The Board limits have been established with consideration of the dollar impact of various rate changes and our strong capital position. As illustrated in the table, net portfolio value is more sensitive to rising rates than declining rates. This occurs principally because, as rates rise, the market value of fixed-rate loans decline, due to both the rate increase and slowing prepayments. When interest rates decline, we do not experience a significant rise in market value for these loans because borrowers prepay at relatively high rates. The value of our deposits and borrowings change in approximately the same proportion in rising or falling rate scenarios.

Community Financial Corporation



Change in Interest Rate (Basis Points)	Board Limit % Change	<u>March 31, 2002</u>		<u>March 31, 2001</u>	
		\$ Change in NPV	% Change in NPV	\$ Change in NPV	% Change in NPV
(Dollars in Thousands)					
+300	-40%	\$-3,798	-11%	\$-5,800	-18%
+200	-30	-2,175	-6	-3,874	-12
+100	-20	- 943	-3	-2,744	-9
-0-	---	---	---	---	---
-100	-20	351	1	1,499	5
-200	-30	---	---	2,930	9
-300	-40	---	---	4,638	15

Management generally works to maintain a neutral position regarding interest rate risk. In the current interest rate environment, our customers are interested in obtaining long-term credit products and short-term savings products. Management has taken action to counter this trend. A significant effort has been made to reduce the duration and average life of our interest earning assets. As of March 31, 2002, approximately 49% of our gross loan portfolio consisted of loans which reprice during the life of the loan. We emphasize adjustable rate mortgage loans and have increased our portfolio of short-term consumer loans. Longer term fixed-rate mortgage loans, 20 to 30 years, are generally sold in the secondary market. We are currently originating fixed-rate loans for through our subsidiary, Community First Mortgage immediate sale only.

On the deposit side, management has worked to reduce the impact of interest rate changes by emphasizing non-interest bearing or low interest deposit

products and maintaining competitive pricing on longer term certificates of deposit. We have also used Federal Home Loan Bank advances to provide funding for loan originations and to provide liquidity as needed.

In managing our asset/liability mix, we, at times, depending on the relationship between long- and short-term interest rates, market conditions, and consumer preference, may place somewhat greater emphasis on maximizing our net interest income than on strictly matching the interest rate sensitivity of our assets and liabilities. We believe the increased net income that may result from an acceptable mismatch in the actual maturity or repricing of our asset and liability portfolio can provide sufficient returns to justify the increased exposure to sudden and unexpected increases in interest rates which may result from such a mismatch. We have established limits, which may change from time to time, on the level of acceptable interest rate risk. There can be no assurance, however, that in the event

of an adverse change in interest rates, our efforts to limit interest rate risk will be successful.

As with any method of measuring interest rate risk, certain shortcomings are inherent in the method of analysis presented in the foregoing table. For example, although certain assets and liabilities may have similar maturities or periods to repricing, they may react in different degrees to changes in market interest rates. Also, the interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates. Additionally, certain assets, such as adjustable rate mortgage loans, have features which restrict changes in interest rates on a short-term basis and over the life of the asset. Further, in the event of a change in interest rates, expected rates of prepayments on loans and early withdrawals from certificates could likely deviate significantly from those assumed in calculating the table.

Management's Discussion & Analysis of Operations

Average Balances, Interest Rates and Yields

The following table sets forth certain information relating to categories of our interest-earning assets and interest-bearing liabilities for the periods indicated. All average balances are computed on monthly basis. Non-accruing loans have been included in the table as loans carrying a zero yield.

	Year Ended March 31,								
	2002			2001			2000		
	Average Balance	Yield/ Interest Cost		Average Balance	Yield/ Interest Cost		Average Balance	Yield/ Interest Cost	
(Dollars in Thousands)									
<u>Interest-Earning Assets</u>									
Loans	\$215,598	\$16,870	7.82%	\$204,475	\$17,347	8.48%	\$178,801	\$14,566	8.15%
Investment securities and other investments	<u>34,270</u>	<u>2,071</u>	<u>6.04</u>	<u>41,737</u>	<u>2,700</u>	6.48	<u>27,254</u>	<u>1,588</u>	5.83
Total interest-earning assets	<u>249,868</u>	<u>18,941</u>	7.58	<u>246,212</u>	<u>20,047</u>	8.14	<u>206,055</u>	<u>16,154</u>	7.84
<u>Interest-Bearing Liabilities</u>									
Deposits.....	185,039	7,450	4.03	164,959	7,710	4.67	151,057	6,380	4.22
FHLB advances and other borrowings	<u>45,929</u>	<u>1,607</u>	<u>3.50</u>	<u>65,055</u>	<u>4,204</u>	6.46	<u>40,985</u>	<u>2,336</u>	5.70
Total interest-bearing liabilities	<u>230,968</u>	<u>9,057</u>	3.92	<u>230,014</u>	<u>11,914</u>	5.18	<u>192,042</u>	<u>8,716</u>	4.54
Net interest income/interest rate spread.....		<u>\$9,884</u>	3.66		<u>\$8,133</u>	2.96		<u>\$7,438</u>	3.30
Net interest-earning assets/net yield on interest-earning assets	<u>\$18,900</u>		3.96	<u>\$16,198</u>		3.30	<u>\$14,013</u>		3.61
Percentage of interest- earning assets to interest- bearing liabilities.....	108.18%			107.04%			107.30%		

Community Financial Corporation



The following table sets forth our interest rate spread at the dates indicated.

	March 31,		
	2002	2001	2000
Yield On			
Loans	7.18%	8.43%	8.36%
Investment securities and other investments	4.87%	6.17%	6.36%
Total interest-earning assets	6.82%	8.05%	8.03%
Cost Of			
Deposits	3.27%	4.83%	4.27%
FHLB advances and other borrowings	1.95%	5.19%	6.49%
Total interest-bearing liabilities	3.11%	4.93%	4.86%
Interest rate spread	3.71%	3.12%	3.17%

Rate/Volume Analysis

The following table describes the extent to which changes in interest rates and changes in volume of interest-related assets and liabilities have affected our interest income and expense during the periods indicated. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (i) changes in volume (change in volume multiplied by prior year rate), (ii) changes in rate (change in rate multiplied by prior year volume), and (iii) total changes in rate and volume. The combined effect of changes in both volume and rate, which cannot be separately identified, has been allocated proportionately to the change due to volume and the change due to rate.

	Year Ended March 31,					
	2002 v. 2001			2001 v. 2000		
	Increase (Decrease) Due to		Total Increase (Decrease)	Increase (Decrease) Due to		Total Increase (Decrease)
	Volume	Rate	(Decrease)	Volume	Rate	(Decrease)
(Dollars in Thousands)						
Interest-Earning Assets						
Loans	\$ 1,107	\$(1,584)	\$ (477)	\$ 2,131	646	\$ 2,777
Investments securities and other investments	<u>(456)</u>	<u>(173)</u>	<u>(629)</u>	<u>844</u>	<u>272</u>	<u>1,116</u>
Total interest-earnings assets	<u>\$ 651</u>	<u>\$(1,757)</u>	<u>\$(1,106)</u>	<u>\$ 2,975</u>	<u>\$ 918</u>	<u>\$ 3,893</u>
Interest-Bearing Liabilities						
Deposits	\$2,066	\$(2,326)	\$ (260)	\$ 649	\$ 681	\$ 1,330
FHLB advances and other borrowings	<u>(1,015)</u>	<u>(1,582)</u>	<u>(2,597)</u>	<u>1,374</u>	<u>494</u>	<u>1,868</u>
Total interest-bearing liabilities	<u>\$1,051</u>	<u>\$(3,908)</u>	<u>\$(2,857)</u>	<u>\$ 2,023</u>	<u>\$1,175</u>	<u>\$ 3,198</u>
Net interest income			<u>\$ 1,751</u>			<u>\$ 695</u>

ASSET QUALITY

Asset quality is an important factor in the successful operation of a financial institution. The loss of interest income and principal that may result from non-performing assets has an adverse effect on earnings, while the resolution of those assets requires the use of capital and managerial resources.

At March 31, 2002, total non-performing assets, consisting of non-performing loans and real estate owned, were \$941,000 or .36% of total assets compared to \$1,156,000 or .43% at March 31, 2001. Non-performing assets at March 31, 2002 were comprised primarily of single family residential properties acquired through foreclosure. At March 31, 2002, the largest property in non-performing assets was a single family residential loan with an approximate value of \$81,000. Based on current market values of the collateral securing these loans, management anticipates no significant losses in excess of the reserves for losses previously recorded. Due to an uncertain real estate market and the economy in general, no assurances can be given that our level of non-performing assets may not increase in the future.

We maintain an allowance for loan losses to provide for estimated potential losses in our loan portfolio. We determine the level of reserves based on loan performance, the value of the collateral, economic and market conditions, and previous experience. We review the adequacy of the

allowance at least quarterly, utilizing our internal loan classifications system. During fiscal 2002, we increased our allowance for loan losses \$198,000 to \$1,676,000 due primarily to the growth in loans. Management believes that the loan loss reserve is adequate. We have had net charge-offs to our allowance for loan losses of \$175,000, \$61,000, and \$381,000 for the years ended March 31, 2002, 2001 and 2000, respectively. The increase in net charge-offs from 2001 to 2002 is related primarily to increased foreclosures in fiscal 2002. While consumer loans provide a greater yield they generally have a higher rate of charge-offs than mortgage loans. Although management believes it uses the best information available, future adjustments to reserves may be necessary.

FINANCIAL CONDITION

Total assets decreased \$6.8 million to \$263.4 million at March 31, 2002 as a result of a decrease in investment securities of \$13.2 million, partially offset by an increase in loans of \$9.3 million. A decrease in borrowings of \$38.5 million was funded by the decrease in investment securities and an increase in deposits of \$30.2 million. The increase in deposits can be attributed primarily to an increase in demand deposits of \$30.8 million. Management believes the increase in demand deposits is primarily attributable to maintaining competitive rates. The increase in loans receivable was due primarily to competitive pricing on both

mortgage and consumer loans. Stockholders' equity increased \$890,000 to \$26.7 million at March 31, 2002 compared to March 31, 2001. The increase was the result of \$2.6 million of net income offset by dividends paid to stockholders of \$732,000 and common stock repurchased of \$981,000 in fiscal 2002.

RESULTS OF OPERATIONS

Our results of operations depend primarily on the level of our net interest income and noninterest income and the level of our operating expenses. Net interest income depends upon the value of interest-earning assets and interest-bearing liabilities and the interest rate earned or paid on them.

Comparison of Years ended March 31, 2002 and 2001

General. Net income for the year ended March 31, 2002 was \$2,607,000 or \$1.14 diluted earnings per share compared to \$1,743,000 or \$.72 diluted earnings per share for the year ended March 31, 2001. Net income increased due primarily to an increase in net interest income of \$1.8 million.

Our return on average assets was 1.03% for the fiscal year ended 2002 compared to .68% for the fiscal year ended 2001. Return on average equity was 10.01% for fiscal year ended 2002 compared to 6.81% for fiscal year 2001.



Average equity to average assets was 10.27% for the fiscal year ended 2002 compared to 9.97% for the fiscal year ended 2001. We paid dividends to stockholders of \$732,000 during 2002 and \$780,000 during fiscal 2001 representing a dividend payout ratio of 28.08% and 44.75% respectively.

Interest Income.

Total interest income decreased to \$18,941,000 for the fiscal year ended March 31, 2002 as compared to \$20,047,000 for the year ended March 31, 2001. The decrease in total interest income can be attributed to a decrease in the yield on interest-earning assets offset by an increase in the average dollar volume of interest-earning assets, primarily \$11.1 million in loans receivable. Average yields on total interest-earning assets decreased from 8.14% in fiscal 2001 to 7.58% for the current fiscal year due primarily to a lower rate environment.

Interest Expense.

Total interest expense decreased to \$9,057,000 for the fiscal year ended March 31, 2002 from \$11,914,000 for the fiscal year ended March 31, 2001. The decrease in total interest expense is attributable to a decrease in both the average dollar volume of borrowings and the cost of interest bearing liabilities. The cost of funds decreased from 5.18% for the year ended March 31, 2001 to 3.92% for the current year. The increase in deposit balances was due primarily to increases in demand deposits for the current fiscal year.

Provision for Loan Losses.

The provision increased to \$373,000 for the fiscal ended March 31, 2002 from \$321,000 for the fiscal year ended March 31, 2001 due primarily to an increase in loan growth for fiscal 2002. We monitor our loan loss reserve on a quarterly basis and make allocations as necessary. Management believes that the level of our loan loss reserve is adequate. As of March 31, 2002, the total allowance for loan losses amounted to \$1,676,000. At March 31, 2002, our total allowance as a percentage of total loans receivable was .75% and as a percentage of total non-performing loans was 178%.

Noninterest Income.

Noninterest income increased to \$3,382,000 in fiscal 2002 as compared to \$2,899,000 for the fiscal year ended March 31, 2001, primarily due to increased fees on sale of secondary mortgage loans in the Bank's mortgage subsidiary.

Noninterest Expense.

Total noninterest expense increased to \$9,164,000 for the fiscal year ended March 31, 2002 from \$8,241,000 for the fiscal year ended March 31, 2001 due primarily to an increase in compensation expense and data processing expense, primarily related to the opening of a new branch in Raphine during fiscal 2002.

Taxes.

Total taxes increased to \$1,123,000 during the fiscal year ended March 31, 2002 from \$728,000 during fiscal 2001. The effective tax rate for the fiscal year ended March 31, 2002 was 30.1% as compared to 29.4% for the fiscal year ended March 31, 2001.

Comparison of Years ended March 31, 2001 and 2000 General.

Net income for the fiscal year ended March 31, 2001 was \$1,743,000 or \$.72 diluted earnings per share compared to \$1,324,000 or \$.52 diluted earnings per share for the fiscal year ended March 31, 2000. Net income increased due primarily to an increase in net interest income of \$695,000.

Our return on average assets was .68% for the fiscal year ended 2001 compared to .60% for the fiscal year ended 2000. Return on average equity was 6.81% for the fiscal year ended 2001 compared to 5.11% for fiscal year 2000. Average equity to average assets was 9.97% for the fiscal year ended 2001 compared to 11.66% for the fiscal year ended 2000. We paid dividends to stockholders of \$780,000 during 2001 and \$819,000 during fiscal 2000 representing a dividend payout ratio of 44.75% and 61.90% respectively.

Interest Income.

Total interest income increased to \$20,047,000 for the fiscal year ended March 31, 2001 as compared to \$16,154,000 for the fiscal year ended March 31, 2000. The increase in total interest income can be attributed to both increases in the average dollar volume of interest-earning assets, primarily \$14.5 million in investment securities and \$25.7 million in loans receivable and an increase in the yield on interest earning assets. Average yields on total interest-earning assets increased from 7.84% in fiscal 2000 to 8.14% for the fiscal year ended March 31, 2001 due primarily to a higher rate environment.

Interest Expense.

Total interest expense increased to \$11,914,000 for the fiscal year ended March 31, 2001 from \$8,716,000 for the fiscal year ended March 31, 2000. The increase in total interest expense is attributable to increases in both the average dollar volume of interest-bearing liabilities of \$38.0 million and the cost of interest bearing liabilities. The cost of funds increased from 4.54% for the fiscal year ended March 31, 2000 to 5.18% for the current year. The increase in deposit balances was due primarily to increases in certificates of deposit for the fiscal year ended March 31, 2001.

Provision for Loan Losses.

The provision increased to \$321,000 for the fiscal ended March 31, 2001 from \$283,000 for the fiscal year ended March 31, 2000 due primarily to an increase in loan growth for fiscal 2001. We monitor our loan loss reserve on a quarterly basis and make allocations as necessary. Management believes that the level of our loan loss reserve is adequate. As of March 31, 2001, the total allowance for loan losses amounted to \$1,478,000. At March 31, 2001, our total allowance as a percentage of total loans receivable was .68% and as a percentage of total non-performing loans was 128%.

Noninterest Income.

Noninterest income decreased to \$2,899,000 in fiscal 2001 as compared to \$3,196,000 for the fiscal year ended March 31, 2000, pri-

marily due to a decrease in gain on sale of securities, offset by increased fees and gains on sale of secondary mortgage loans in the Bank's mortgage subsidiary.

Noninterest Expense.

Total noninterest expense decreased to \$8,241,000 for the fiscal year ended March 31, 2001 from \$8,258,000 for the fiscal year ended March 31, 2000 due primarily to a decrease in compensation expense offset by an increase in data processing expense.

Taxes.

Total taxes decreased to \$728,000 during the year ended March 31, 2001 from \$770,000 during fiscal 2000. The effective tax rate for the year ended March 31, 2001 was 29.4% as compared to 36.8% for the year ended March 31, 2000. The decrease in taxes is attributable primarily to both an increase in tax preferenced income and a change in the treatment of bad debt losses.

Liquidity and Capital Resources

Our principal sources of funds are customer deposits, advances from the Federal Home Loan Bank of Atlanta, amortization and prepayment of loans, proceeds from the sale of loans and funds provided from operations. Management maintains investments in liquid assets based upon its assessment of (i) our need for funds, (ii) expected deposit flows, (iii) the yields available on short-term liquid assets, (iv) the liquidi-

ty of our loan portfolio and (v) the objectives of our asset/liability management program.

Liquidity represents our ability to meet our on-going funding requirements for contractual obligations, the credit needs of customers, withdrawal of customers' deposits and operating expenses.

Our dominant source of funds during the fiscal year ended March 31, 2002 was from deposits which increased by \$30.2 million.

Our cash decreased \$2.0 million from \$5.2 million at March 31, 2001 to \$3.2 million at March 31, 2002. The decrease in cash was related to the increase in loans receivable.

At March 31, 2002, we had commitments to purchase or originate \$9.5 million of loans.

Certificates of deposit scheduled to mature in one year or less at March 31, 2002 totaled \$52.8 million. Based on our historical experience,



management believes that a significant portion of such deposits will remain with us.

Management further believes that loan repayments and other sources of funds will be adequate to meet our foreseeable short- and long-term liquidity needs.

At March 31, 2002, we had tangible and core capital of 9.07% of adjusted total assets, which was in excess of their respective requirements of 1.5% and 4.0%. We also had risk-based capital of 14.04% of risk weighted assets, which also exceeded its requirement of 8.0%.

IMPACT OF INFLATION AND CHANGING PRICES

The consolidated financial statements and related data presented herein have been prepared in accordance with accounting principles generally accepted in the United States of America which require the measurement of financial position and results of operations in terms of historical dollars without considering changes in the relative purchasing power of money over time because of inflation. Unlike most industrial companies, virtually all of the assets and liabilities of a financial institution are monetary in nature. As a result,

interest rates have a more significant impact on a financial institution's performance than the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or the same magnitude as the price of goods and services. In the current interest-rate environment, equity, maturity structure and quality of our assets and liabilities are critical to the maintenance of acceptable performance levels.

ACCOUNTING PRONOUNCEMENTS

For a discussion of certain accounting pronouncements implemented by us during fiscal 2002 and new pronouncements which will be implemented in the future, see Summary of Accounting Policies to Consolidated Financial Statements.

FORWARD-LOOKING STATEMENTS

This annual report contains forward-looking statements about the Company and its subsidiary which we believe are within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, without limitation, statements with respect

to anticipated future operating and financial performance, growth opportunities, interest rates, cost savings and funding advantages expected or anticipated to be realized by management. Words such as "may," "could," "should," "would," "believe," "anticipate," "estimate," "expect," "intend," "plan" and similar expressions are intended to identify these forward-looking statements.

Forward-looking statements by the Company and its management are based on beliefs, plans, objectives, goals, expectations, anticipations, estimates and intentions of management and are not guarantees of future performance. Factors discussed under the caption

"Management's Discussion and Analysis of Operations" and identified in our filings with the SEC and those presented elsewhere by our management from time to time, could cause actual results to differ materially from those indicated by the forward-looking statements made in this document. The Company disclaims any obligation to update or revise any forward-looking statements based on the occurrence of future events, the receipt of new information, or otherwise.



Yount, Hyde & Barbour, P.C.
Certified Public Accountants
and Consultants

Report of Independent Certified Public Accountants

To the Board of Directors
Community Financial Corporation
Staunton, Virginia

We have audited the accompanying balance sheet of Community Financial Corporation and subsidiary as of March 31, 2002, and the related statements of income, stockholders' equity and cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of Community Financial Corporation and subsidiary for the years ended March 31, 2001 and 2000 were audited by other auditors whose report, dated April 22, 2001, expressed an unqualified opinion on those statements.

We conducted our audit 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 audit provides a reasonable basis for our opinion.

In our opinion, the 2002 financial statements referred to above present fairly, in all material respects, the financial position of Community Financial Corporation and subsidiary as of March 31, 2002, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Yount, Hyde & Barbour, P.C.

Winchester, Virginia
April 12, 2002

50 S. Cameron St.
P.O. Box 2560
Winchester, VA 22604
(540) 662-3417

Offices located in: Winchester, Middleburg, Leesburg, and Culpeper, Virginia
Member: American Institute of Certified Public Accountants / Virginia Society of Certified Public Accountants

Community Financial Corporation & Subsidiary



Consolidated Balance Sheets

<i>March 31,</i>	2002	2001
Assets		
Cash (including interest bearing deposits of approximately \$1,931,000 and \$2,697,000)	\$ 3,206,926	\$ 5,168,499
Securities		
Held to maturity (fair value approximates \$16,781,000 and \$30,170,000 at March 31, 2002 and 2001)	16,773,803	29,905,180
Available for sale, at fair value	8,399,486	8,421,433
Investment in Federal Home Loan Bank stock, at cost	2,600,000	3,150,000
Loans receivable, net	219,433,684	210,549,785
Loans held for sale	4,409,122	4,008,013
Real estate owned, net	793,603	451,310
Property and equipment, net	5,421,183	5,827,020
Accrued interest receivable	1,580,884	1,661,422
Prepaid expenses and other assets	755,280	1,032,871
	\$263,373,971	\$270,175,533
Liabilities and Stockholders' Equity		
Liabilities		
Deposits	\$204,535,456	\$174,307,472
Advances from Federal Home Loan Bank	28,000,000	63,000,000
Securities sold under agreement to repurchase	950,805	4,422,389
Advance payments by borrowers for taxes and insurance	254,846	293,168
Other liabilities	2,937,754	2,347,815
Total liabilities	236,678,861	244,370,844
Commitments and Contingencies		
Stockholders' Equity		
Preferred stock, \$.01 par value, authorized 3,000,000 shares, none outstanding	—	—
Common stock, \$.01 par value, 10,000,000 authorized shares, 2,253,147 and 2,348,832 shares outstanding	22,531	23,488
Additional paid-in capital	4,326,489	4,500,450
Retained earnings	20,223,498	19,144,552
Accumulated other comprehensive income	2,122,592	2,136,199
Total stockholders' equity	26,695,110	25,804,689
	\$263,373,971	\$270,175,533

See accompanying summary of accounting policies and notes to consolidated financial statements.

Community Financial Corporation & Subsidiary

Consolidated Statements of Income

<i>Year Ended March 31,</i>	2002	2001	2000
Interest income			
Loans	\$16,869,736	\$17,347,457	\$14,565,894
Investment securities	1,453,478	2,522,462	1,448,006
Other investments	618,098	177,337	140,048
Total interest income	18,941,312	20,047,256	16,153,948
Interest expense			
Deposits	7,449,753	7,709,614	6,380,089
Borrowed money	1,607,377	4,204,419	2,335,487
Total interest expense	9,057,130	11,914,033	8,715,576
Net interest income	9,884,182	8,133,223	7,438,372
Provision for loan losses	372,708	320,635	282,854
Net interest income after provision for loan losses	9,511,474	7,812,588	7,155,518
Noninterest income			
Service charges, fees and commissions	3,006,799	2,408,678	1,366,212
Gain on sale of securities	—	—	601,412
Gain on sale of loans	279,843	412,650	1,015,447
Other	95,321	77,907	213,400
Total noninterest income	3,381,963	2,899,235	3,196,471
Noninterest expense			
Compensation and employee benefits	4,913,086	4,329,702	4,712,025
Occupancy	1,323,565	1,037,806	942,354
Data processing	828,848	803,180	563,732
Insurance	32,752	32,295	72,530
Other	2,065,342	2,037,783	1,967,601
Total noninterest expense	9,163,593	8,240,766	8,258,242
Income before income taxes	\$3,729,844	\$2,471,057	\$2,093,747
Income taxes			
Current	1,341,215	875,002	920,799
Deferred	(218,567)	(147,336)	(150,932)
Total income taxes	1,122,648	727,666	769,867
Net income	\$2,607,196	\$1,743,391	\$1,323,880
Earnings per share			
Basic	\$ 1.14	\$.72	\$.52
Diluted	\$ 1.14	\$.72	\$.52

See accompanying summary of accounting policies and notes to consolidated financial statements.

Community Financial Corporation & Subsidiary



Consolidated Statements of Stockholders' Equity

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders' Equity
Balance, March 31, 1999	\$ 25,721	\$ 4,897,207	\$ 19,395,509	\$ 2,065,291	\$ 26,383,728
Comprehensive income					
Net income	—	—	1,323,880	—	1,323,880
Change in unrealized gain on available for sale securities	—	—	—	(879,379)	(879,379)
Total comprehensive income	—	—	—	—	444,501
Cash dividends, \$.32 per share	—	—	(819,493)	—	(819,493)
Repurchase of stock (60,620 shares)	(606)	(115,178)	(498,877)	—	(614,661)
Balance, March 31, 2000	25,115	4,782,029	19,401,019	1,185,912	25,394,075
Comprehensive income					
Net income	—	—	1,743,391	—	1,743,391
Change in unrealized gain on available for sale securities	—	—	—	950,287	950,287
Total comprehensive income	—	—	—	—	2,693,678
Cash dividends, \$.32 per share	—	—	(780,102)	—	(780,102)
Exercise of stock options	60	38,940	—	—	39,000
Repurchase of stock (168,774 shares)	(1,687)	(320,519)	(1,219,756)	—	(1,541,962)
Balance, March 31, 2001	23,488	4,500,450	19,144,552	2,136,199	25,804,689
Comprehensive income					
Net income	—	—	2,607,196	—	2,607,196
Change in unrealized gain on available for sale securities	—	—	—	(13,607)	(13,607)
Total comprehensive income	—	—	—	—	2,593,589
Cash dividends, \$.32 per share	—	—	(732,079)	—	(732,079)
Exercise of stock options	10	9,740	—	—	9,750
Repurchase of stock (96,685 shares)	(967)	(183,701)	(796,171)	—	(980,839)
Balance, March 31, 2002	\$ 22,531	\$ 4,326,489	\$ 20,223,498	\$ 2,122,592	\$ 26,695,110

See accompanying summary of accounting policies and notes to consolidated financial statements.

Consolidated Statements of Cash Flow

Year Ended March 31,	2002	2001	2000
Operating activities			
Net income	\$ 2,607,196	\$ 1,743,391	\$ 1,323,880
Adjustments to reconcile net income to net cash provided by operating activities			
Provision for loan losses	372,708	320,635	282,854
Depreciation	683,259	742,575	715,219
Amortization of premium and accretion of discount on securities, net	(111,759)	(65,031)	3,662
(Decrease) in net deferred loan origination fees	(56,390)	(69)	(81,228)
Loans originated for sale	(77,568,899)	(59,763,000)	(59,081,330)
Proceeds from loan sales	77,167,790	58,675,000	59,083,634
Deferred income taxes	(218,567)	347,349	(401,119)
Gain on sale of securities	—	—	(601,412)
(Increase) decrease in other assets	376,696	(319,851)	(124,425)
Increase in other liabilities	778,524	178,618	104,920
Net cash provided by operating activities	\$ 4,030,558	\$ 1,859,617	\$ 1,224,655

Community Financial Corporation & Subsidiary

Consolidated Statements of Cash Flow (Continued)

<i>Year Ended March 31,</i>	2002	2001	2000
Investing activities			
Proceeds from maturities of held to maturity securities	\$ 25,240,000	\$ 2,162,552	\$ 6,237,420
Purchase of held to maturity securities	(11,996,864)	(5,297,230)	(27,260,915)
Proceeds from sale of securities	—	—	612,189
Purchase of available for sale securities	—	—	(4,942,534)
Net increase in loans	(10,587,213)	(24,840,781)	(19,522,241)
Purchase of property and equipment	(277,422)	(99,971)	(1,292,303)
Improvements to other real estate owned	(49,096)	—	—
Proceeds from sale of real estate owned	1,075,232	1,281,213	559,904
Redemption of FHLB stock	650,000	—	1,350,000
Purchase of FHLB stock	(100,000)	(1,200,000)	(1,791,800)
Net cash provided (absorbed) by investing activities	3,954,637	(27,994,217)	(46,050,280)
Financing activities			
Net increase (decrease) in certificates of deposit	(534,215)	18,568,848	4,793,639
Net increase (decrease) in savings and checking deposits	30,762,199	(2,829,651)	759,560
Proceeds from issuance of common stock	9,750	39,000	—
Repurchase of stock	(980,839)	(1,541,962)	(614,661)
Increase (decrease) in securities sold under agreements to repurchase	(3,471,584)	(15,577,611)	20,000,000
Dividends paid	(732,079)	(780,102)	(819,493)
Proceeds (repayments) from advances	(35,000,000)	26,000,000	18,000,000
Net cash provided (absorbed) by financing activities	(9,946,768)	23,878,522	42,119,045
(Decrease) in cash and cash equivalents	(1,961,573)	(2,256,078)	(2,706,580)
Cash and cash equivalents – beginning of year	5,168,499	7,424,577	10,131,157
Cash and cash equivalents – end of year	\$ 3,206,926	\$ 5,168,499	\$ 7,424,577

Supplemental Disclosure of Cash Flow Information

Cash payments of interest expense	\$ 7,846,883	\$ 12,127,146	\$ 8,722,056
Cash payments of income taxes	\$ 1,442,418	\$ 456,114	\$ 967,226

Supplemental Schedule of Non-Cash Investing and Financing Activities

Transfers from loans to real estate acquired through foreclosure	\$ 1,386,996	\$ 909,521	\$ 1,031,173
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See accompanying summary of accounting policies and notes to consolidated financial statements.

Summary of Accounting Policies



PRINCIPLES OF CONSOLIDATION

The accompanying consolidated financial statements include the accounts of Community Financial Corporation (the "Corporation") and its wholly-owned subsidiary, Community Bank (the "Bank") and Community First Mortgage Corporation ("Community First Mortgage"), a wholly-owned subsidiary of the Bank. All material inter-company accounts and transactions have been eliminated in consolidation.

NATURE OF BUSINESS AND REGULATORY ENVIRONMENT

The Bank is a federally chartered thrift and the primary asset of the Corporation. The Corporation provides a full range of banking services to individual and corporate customers through its wholly-owned subsidiary. Community First Mortgage originates mortgage loans to sell to third party investors.

The Office of Thrift Supervision ("OTS") is the primary regulator for federally chartered savings associations, as well as savings and loan holding companies.

The Bank's deposits are insured up to applicable limits by the Savings Association Insurance Fund ("SAIF"), which is administered by the Federal Deposit Insurance Corporation ("FDIC"). The FDIC has specific authority to prescribe and enforce such regulations and issue such orders as it deems necessary to prevent actions or practices by savings associations that pose a serious threat to the SAIF.

The Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") was effective January 1, 1993. FDICIA contained provisions

which allow regulators to impose prompt corrective action on undercapitalized institutions in accordance with a categorized capital-based system.

ESTIMATES

In preparing consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of foreclosed real estate and deferred tax assets.

SECURITIES

Investments in debt securities classified as held-to-maturity are stated at cost, adjusted for amortization of premiums and accretion of discounts using the level yield method. Management has a positive intent and ability to hold these securities to maturity and, accordingly, adjustments are not made for temporary declines in their market value below amortized cost. Investment in Federal Home Loan Bank stock is stated at cost.

Investments in debt and equity securities classified as available-for-sale are stated at market value with unrealized holding gains and losses excluded from earnings and reported as a separate component of stockholders' equity, net of tax effect, until realized. Declines in the fair value of held to maturity and available for sale securities below their costs that are deemed to be other

than temporary are reflected in earnings as realized losses. Gains and losses on the sale of securities are determined using the specific identification method.

LOANS RECEIVABLE

Loans receivable consists primarily of long-term real estate loans secured by first deeds of trust on single family residences, other residential property, commercial property and land located primarily in the state of Virginia. Interest income on mortgage loans is recorded when earned and is recognized based on the level yield method. The Corporation provides an allowance for accrued interest deemed to be uncollectible, which is netted against accrued interest receivable in the consolidated balance sheets.

The Corporation defers loan origination and commitment fees, net of certain direct loan origination costs, and the net deferred fees are amortized into interest income over the lives of the related loans as yield adjustments. Any unamortized net fees on loans fully repaid or sold are recognized as income in the year of repayment or sale.

The Corporation places loans on nonaccrual status after being delinquent greater than 90 days or earlier if the Corporation becomes aware that the borrower has entered bankruptcy proceedings, or in situations in which the loans have developed inherent problems prior to being 90 days delinquent that indicate payments of principal or interest will not be made in full. Whenever the accrual of interest is stopped, previously accrued but uncollected interest income is reversed. Thereafter, interest is recognized only as cash is received until the loan is reinstated to accrual status.

ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses is maintained at a level considered by management to be adequate to absorb future loan losses currently inherent in the loan portfolio. Management's assessment of the adequacy of the allowance is based upon type and volume of the loan portfolio, past loan loss experience, existing and anticipated economic conditions, and other factors which deserve current recognition in estimating future loan losses. Additions to the allowance are charged to operations. Loans are charged-off partially or wholly at the time management determines collectibility is not probable. Management's assessment of the adequacy of the allowance is subject to evaluation and adjustment by the Corporation's regulators.

The allowance for loan losses related to loans identified as impaired is primarily based on the excess of the loan's current outstanding principal balance over the estimated fair market value of the related collateral. A loan is considered to be impaired when it is probable that the Corporation will be unable to collect all principal and interest amounts according to the contractual terms of the loan agreement. A performing loan may be considered impaired. For a loan that is not collateral-dependent, the allowance is recorded at the amount by which the outstanding principal balance exceeds the current best estimate of the future cash flows on the loan discounted at the loan's original effective interest rate.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Corporation does not separately identify individual consumer and residential loans for impairment disclosures.

For impaired loans that are on nonaccrual status, cash payments received are generally applied to reduce the out-

standing principal balance. However, all or a portion of a cash payment received on a nonaccrual loan may be recognized as interest income to the extent allowed by the loan contract, assuming management expects to fully collect the remaining principal balance on the loan.

REAL ESTATE OWNED

Real estate acquired through foreclosure is initially recorded at the lower of fair value, less selling costs, or the balance of the loan on the property at date of foreclosure. Costs relating to the development and improvement of property are capitalized, whereas those relating to holding the property are charged to expense.

Valuations are periodically performed by management, and an allowance for losses is established by a charge to operations if the carrying value of a property exceeds its estimated fair value.

SALE OF LOANS AND PARTICIPATION IN LOANS

The Corporation is able to generate funds by selling loans and participations in loans to the Federal Home Loan Mortgage Corporation and other investors. Under participation service agreements, the Corporation continues to service the loans and the participant is paid its share of principal and interest collections.

The Corporation allocates the cost of acquiring or originating mortgage loans between the mortgage servicing rights and the loans, based on their relative fair values, if the bank sells or securitizes the loans and retains the mortgage servicing rights.

The cost of mortgage servicing rights is amortized in proportion to, and over the period of, estimated net servicing revenues. Impairment of mortgage servicing rights is assessed based on the

fair value of those servicing rights. Fair values are estimated using discounted cash flows based on a current market interest rate. For purposes of measuring impairment, the rights are stratified based on the predominant risk characteristics of the underlying loans. The amount of impairment recognized is the amount by which the capitalized mortgage servicing rights for a stratum exceed their fair value.

PROPERTY AND EQUIPMENT

Property and equipment is stated at cost less accumulated depreciation. Provisions for depreciation are computed using the straight-line method over the estimated useful lives of the individual assets. Expenditures for betterments and major renewals are capitalized and ordinary maintenance and repairs are charged to operations as incurred. Estimated useful lives are three to ten years for furniture and equipment and five to fifty years for buildings and improvements.

INCOME TAXES

Deferred income tax assets and liabilities are determined using the balance sheet method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary difference between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws.

EARNINGS PER SHARE

Basic earnings per share includes no dilution and is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution of stock options that could share in the earnings of the Corporation. The computation of basic and diluted earnings per share is presented in Note 11.



COMPREHENSIVE INCOME

Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income" established rules for the reporting of comprehensive income and its components. Comprehensive income is defined to include all changes in equity except those resulting from investments by and distribution to shareholders. Comprehensive income consists of net income and unrealized gains on available for sale securities and is presented in the Consolidated Statements of Stockholders' Equity.

CASH AND CASH EQUIVALENTS

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, interest-bearing deposits and federal funds sold.

OTHER

Certain reclassifications have been made in the prior years' consolidated financial statements to conform to the March 31, 2002 presentation.

RECENT ACCOUNTING

PRONOUNCEMENTS

In July 2001, the Financial Accounting Standards Board issued two statements – Statement of Financial Accounting Standards ("SFAS") No. 141, Business Combinations, and SFAS No. 142, Goodwill and Other Intangible Assets, which will potentially impact the accounting for goodwill and

other intangible assets. SFAS No. 141 eliminates the pooling method of accounting for business combinations and requires that intangible assets that meet certain criteria be reported separately from goodwill. The Statement also requires negative goodwill arising from a business combination to be recorded as an extraordinary gain. SFAS No. 142 eliminates the amortization of goodwill and other intangibles that are determined to have an indefinite life. The Statement requires, at a minimum, annual impairment tests for goodwill and other intangible assets that are determined to have an indefinite life.

The Corporation does not have any goodwill and other intangible assets.

In June 2001, the Financial Accounting Standards Board issued SFAS No. 143, Accounting for Asset Retirement Obligations. This Statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and associated retirement costs. This Statement is effective for financial statements issued for fiscal years beginning after June 15, 2002. The Statement is not expected to have a material effect on the Corporation's financial statements.

In August 2001, the Financial Accounting Standards Board issued SFAS No. 144, Accounting for the

Impairment or Disposal of Long-Lived Assets. The Statement addresses financial accounting and reporting for the impairment or disposal of long-lived assets. This Statement is effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2001. The Statement is not expected to have a material effect on the Corporation's financial statements.

In April 2002, the Financial Accounting Standards Board issued SFAS 145, Rescission of SFAS Statements No. 4, 44 and 64, Amendment of SFAS Statement No. 13, and Technical Corrections. The Statement removes criteria for reporting gains and losses from debt extinguishment as extraordinary items on the income statement, citing that debt extinguishment has become part of the risk management strategy of many companies. The Statement also modifies accounting treatment for leases in cases where capital leases are modified into operating leases. The treatment requires that a capital lease modified in this manner be accounted for under the sale-lease-back provisions under either SFAS 98 or SFAS 28 as applicable. This Statement shall be applied in fiscal years beginning after May 15, 2002. The Statement is not expected to have a material effect on the Corporation's financial statements.

Notes to Consolidated Financial Statements

1. Securities

A summary of the amortized cost and estimated market values of securities is as follows:

March 31, 2002

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
Held to Maturity				
United States government and agency obligations	\$11,249,759	\$ 41,802	\$ 109,833	\$11,181,728
Other	5,524,044	109,290	34,385	5,598,949
	16,773,803	151,092	144,218	16,780,677
Available for Sale				
Federal Home Loan Mortgage Corporation securities	4,975,952	3,423,534	-	8,399,486
	\$21,749,755	\$3,574,626	\$ 144,218	\$25,180,163

March 31, 2001

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
Held to Maturity				
United States government and agency obligations	\$24,936,982	\$163,324	\$ -	\$25,100,306
Corporate obligations	274,837	-	1,087	273,750
Other	4,693,361	102,163	-	4,795,524
	29,905,180	265,487	1,087	30,169,580
Available for Sale				
Federal Home Loan Mortgage Corporation securities	4,975,952	3,445,481	-	8,421,433
	\$34,881,132	\$3,710,968	\$1,087	\$38,591,013

The amortized cost and estimated market value of securities at March 31, 2002, by contractual maturity, are as follows:

	Amortized Cost	Estimated Market Value
Held to Maturity		
Due in one year or less	\$ 1,021,617	\$ 1,039,191
Due in one through five years	14,502,186	14,533,064
Due in five through ten years	1,250,000	1,208,422
	16,773,803	16,780,677
Available for Sale		
Federal Home Loan Mortgage Corporation Securities	4,975,952	8,399,486
	\$21,749,755	\$25,180,163

Securities having a market value of \$1,517,417 at March 31, 2002 were pledged by the Corporation for purposes required by law.



2. Loans Receivable, Net

Loans receivable are summarized as follows

March 31, 2001	2002	2001
Residential real estate	\$118,730,888	\$136,635,978
Commercial real estate	45,154,022	37,640,675
Construction and land	26,878,167	13,886,116
Commercial business	14,737,436	14,167,204
Consumer	23,881,655	16,704,561
	229,382,168	219,034,534
Less		
Loans in process	8,141,658	6,819,563
Deferred loan fees, net	131,147	187,537
Allowance for loan losses	1,675,679	1,477,649
	9,948,484	8,484,749
	\$219,433,684	\$210,549,785

Loans serviced for others amounted to approximately \$3,377,689 and \$4,662,000 at March 31, 2002 and 2001, respectively. The loans are not included in the accompanying consolidated balance sheets.

The weighted average interest rate on loans receivable was approximately 7.18% and 8.43% at March 31, 2002 and 2001, respectively.

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

Year Ended March 31,	2002	2001	2000
Balance at beginning of year	\$1,477,649	\$1,218,168	\$1,315,888
Provision charged to expense	372,708	320,635	282,854
Losses charged to the allowance, net of recoveries	(174,678)	(61,154)	(380,574)
Balance at end of year	\$1,675,679	\$1,477,649	\$1,218,168

There were no loans considered impaired as of March 31, 2002. Nonaccrual loans excluded from impaired loan disclosure amounted to \$142,234 at March 31, 2002. If interest on these loans had been accrued, such income would have approximated \$5,098 for the year ended March 31, 2002.

3. Property and Equipment

Property and equipment are summarized as follows:

Year Ended March 31,	2002	2001
Buildings	\$4,248,900	\$4,190,880
Land and improvements	2,020,133	1,985,733
Furniture and equipment	2,867,938	2,749,740
Construction in progress	8,546	-
	9,145,517	8,926,353
Less accumulated depreciation and amortization	3,724,334	3,099,333
Net properties and equipment	\$5,421,183	\$5,827,020

Notes to Consolidated Financial Statements

4. Deposits

Year Ended March 31,

2002

2001

Demand deposits

Savings accounts	\$ 36,142,520	\$ 14,413,730
NOW accounts	30,968,115	26,341,852
Money market deposit accounts	13,416,092	9,008,946

Total demand deposits **80,526,727** 49,764,528

Time deposits **124,008,729** 124,542,944

\$204,535,456 \$174,307,472

The aggregate amount of time deposit accounts with a minimum denomination of \$100,000 was approximately \$22,616,987 and \$23,463,000 at March 31, 2002 and 2001, respectively.

Time deposits mature as follows:

Year Ended March 31,

2002

2001

Within one year	\$ 52,837,823	\$106,730,989
One to two years	19,169,440	15,585,843
More than two years	52,001,466	2,226,112

\$124,008,729 \$124,542,944

Interest expense on deposits is summarized as follows:

Year Ended March 31,

2002

2001

2000

Time deposits	\$6,265,873	\$6,594,537	\$5,143,629
Money market deposit and NOW accounts	623,481	685,805	795,965
Savings	560,399	429,272	440,495

\$7,449,753 \$7,709,614 \$6,380,089

5. Fair Value of Financial Instruments

The estimated fair values of the Corporation's financial instruments are as follows:

March 31,

2002

2001

	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets				
Cash and short-term investments	\$ 3,206,926	\$ 3,206,926	\$ 5,168,499	\$ 5,168,000
Securities	25,173,289	25,180,163	38,326,613	38,591,000
Loans, net of allowance for loan losses	223,842,806	225,465,000	214,557,798	213,760,000
Financial liabilities				
Deposits	204,535,456	204,159,000	174,307,472	174,441,000
Advances from Federal Home Loan Bank	28,000,000	28,000,000	63,000,000	63,000,000
Securities sold under agreements to repurchase	950,805	950,805	4,422,389	4,422,000

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value.

Cash and short-term investments

For those short-term investments, the carrying amount is a reasonable estimate of fair value.

Securities

Fair values are based on quoted market prices or dealer quotes. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

Loan receivables

The fair value of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar remaining maturities. This calculation ignores loan fees and certain factors affecting the interest rates charged on various loans such as the borrower's creditworthiness and compensating balances and dissimilar types of real estate held as collateral.



5. Fair Value of Financial Instruments (continued)

Deposit liabilities

The fair value of demand deposits, savings accounts, and certain money market deposits is the amount payable on demand at the balance sheet date. The fair value of fixed-maturity certificates of deposit is estimated using the rates currently offered for deposits of similar remaining maturities.

Advances from Federal Home Loan Bank

For advances that mature within one year of the balance sheet date, carrying value is considered a reasonable estimate of fair value. The fair values of all other advances are estimated using discounted cash flow analysis based on the Corporation's current incremental borrowing rate for similar types of advances.

Securities sold under agreements to repurchase

Securities sold under agreements to repurchase are treated as short-term borrowings and the carrying value approximates fair value.

Commitments to extend credit

The fair value of commitments is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the borrowers. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. Because of the competitive nature of the marketplace, loan fees vary greatly with no fees charged in many cases.

6. Advances From Federal Home Loan Bank

Advances from the Federal Home Loan Bank are summarized as follows:

Due in year ending March 31,	
2003	\$28,000,000

The weighted average interest rate on advances was 1.94% and 5.19% at March 31, 2002 and 2001, respectively. These advances are collateralized by the investment in FHLB stock and the Corporation's portfolio of first mortgage loans under a Blanket Floating Lien Agreement. Value of this collateral as of March 31, 2002 was \$95,100,000.

Notes to Consolidated Financial Statements

6. Advances From Federal Home Loan Bank (continued)

Information related to borrowing activity from the Federal Home Loan Bank is as follows:

<i>Year Ended March 31,</i>	2002	2001	2000
Maximum amount outstanding during the year	\$65,000,000	\$63,000,000	\$42,000,000
Average amount outstanding during the year	\$44,122,346	\$48,339,373	\$32,583,333
Average interest rate during the year	3.48%	6.37%	5.68%

7. Securities Sold Under Agreements to Repurchase

The following is a summary of certain information regarding the Bank's repurchase agreements:

<i>Year Ended March 31,</i>	2002	2001	2000
Balance at end of year	\$ 950,805	\$ 4,422,389	\$20,000,000
Weighted average interest rate during the year	2.97%	6.58%	5.74%
Average amount outstanding during the year	\$ 979,905	\$16,695,213	\$10,000,000
Maximum amount outstanding at any month end during the year	\$2,091,152	\$20,000,000	\$20,000,000

8. Income Taxes

Deferred tax assets (liabilities), included in "Other liabilities" in the consolidated balance sheets are as follows:

<i>Year Ended March 31,</i>	2002	2001
Deferred tax assets		
Allowance for losses	\$ 476,262	\$ 320,782
Other	1,937	884
	478,199	321,666
Deferred tax liabilities		
Depreciable assets	(24,279)	(78,818)
FHLMC stock	(1,300,943)	(1,309,283)
FHLB stock	(28,825)	(36,320)
	(1,354,047)	(1,424,421)
Net deferred tax liability	\$ (875,848)	\$ (1,102,755)

Differences between the statutory and effective tax rates are summarized as follows:

<i>Year Ended March 31,</i>	2002	2001	2000
Tax at statutory rate	34.0%	34.0%	34.0%
Increases (decreases) in taxes resulting from			
State income taxes, net of federal benefit	2.2	1.3	2.1
Non-taxable interest and dividend received deduction	(8.0)	(6.1)	(3.3)
Other	1.9	0.2	4.0
	30.1%	29.4%	36.8%



9. Comprehensive Income

The components of other comprehensive income (loss) are summarized as follows:

<i>Year Ended March 31,</i>	2002	2001	2000
Unrealized gains (losses) on securities:			
Unrealized holding gain (losses) arising during the period	\$ (21,947)	\$1,532,721	\$ (889,052)
Less reclassification adjustment for gains (losses) included in net income	-	-	601,421
Other comprehensive income (loss), before tax	(21,947)	1,532,721	(1,490,473)
Income tax (expense) benefit related to items of other comprehensive income	8,340	(582,434)	611,094
Other comprehensive income (loss), net of tax	\$ (13,607)	\$ 950,287	\$ (879,379)

10. Stockholders' Equity and Regulatory Capital Requirements

Savings institutions must maintain specific capital standards that are no less stringent than the capital standards applicable to national banks. The OTS regulations currently have three capital standards including (i) a tangible capital requirement, (ii) a core capital requirement, and (iii) a risk-based capital requirement. The tangible capital standard requires savings institutions to maintain tangible capital of not less than 1.5% of adjusted total assets. The core capital standard requires a savings institution to maintain core capital of not less than 4.0% of adjusted total assets. The risk-based capital standard requires risk-based capital of not less than 8.0% of risk-weighted assets.

The following table represents the Bank's regulatory capital levels, relative to the OTS requirements applicable at that date:

<i>March 31, 2002</i>	<i>Amount Required</i>	<i>Percent Required</i>	<i>Actual Amount</i>	<i>Actual Percent</i>	<i>Excess Amount</i>
Tangible Capital	\$3,947,000	1.50%	\$23,870,000	9.07%	\$19,923,000
Core Capital	10,525,000	4.00	23,870,000	9.07	13,345,000
Risk-based Capital	15,422,000	8.00	27,045,000	14.04	11,623,000
<i>March 31, 2001</i>	<i>Amount Required</i>	<i>Percent Required</i>	<i>Actual Amount</i>	<i>Actual Percent</i>	<i>Excess Amount</i>
Tangible Capital	\$ 4,048,000	1.50%	\$22,168,000	8.21%	\$18,120,000
Core Capital	10,795,000	4.00	22,168,000	8.21	11,373,000
Risk-based Capital	16,033,000	8.00	25,179,000	12.56	9,146,000

The Bank may not declare or pay a cash dividend, or repurchase any of its capital stock if the effect thereof would cause the net worth of the Bank to be reduced below certain requirements imposed by federal regulations.

Notes to Consolidated Financial Statements

10. Stockholders' Equity and Regulatory Capital Requirements (continued)

Capital distributions by OTS-regulated savings banks are limited by regulation ("Capital Distribution Regulation"). Capital distributions are defined to include, in part, dividends, stock repurchases and cash-out mergers. The Capital Distribution Regulation permits a "Tier 1" savings bank to make capital distributions during a calendar year equal to net income for the current year plus the previous two years net income, less capital distributions paid over that same time period. Any distributions in excess of that amount require prior OTS notice, with the opportunity for OTS to object to the distribution. A Tier 1 savings bank is defined as a savings bank that has, on a pro forma basis after the proposed distribution, capital equal to or greater than the OTS fully phased-in capital requirement and has not been deemed by the OTS to be "in need of more than normal supervision". The Bank is currently classified as a Tier 1 institution for these purposes. The Capital Distribution Regulation requires that savings banks provide the applicable OTS District Director with a 30-day advance written notice of all proposed capital distributions whether or not advance approval is required by the regulation.

11. Earnings Per Share

During the year ended March 31, 2000, the Board of Directors authorized a stock repurchase program under which up to 5%, or 128,607 shares, of the then outstanding shares of the Corporation's stock may be repurchased. During the year ended March 31, 2001, the Board of Directors increased the number of shares of the Corporation's stock which may be repurchased to 372,961. During the years ended March 31, 2002 and 2001, 96,685 and 168,774 shares, respectively, were repurchased for an aggregate amount of approximately \$981,000 and \$1,542,000, respectively.

Earnings per share is calculated as follows:

<i>Year Ended March 31,</i>	2002	2001	2000
Basic earnings			
Income available to common shareholders	\$2,607,196	\$1,743,391	\$1,323,880
Weighted average shares outstanding	2,285,975	2,435,180	2,561,343
Basic earnings per share	\$ 1.14	\$.72	\$.52



11. Earnings Per Share (continued)

<i>Year Ended March 31,</i>	2002	2001	2000
Diluted earnings per share			
Income available to common shareholders	\$2,607,196	\$1,743,391	\$1,323,880
Weighted average shares outstanding	2,285,975	2,435,180	2,561,343
Dilutive effect of stock options	6,212	-	-
Total weighted average shares outstanding	2,292,187	2,435,180	2,561,343
Diluted earnings per share	\$ 1.14	\$.72	\$.52

During the year ended March 31, 2002, stock options representing 112,700 shares were not included in the calculation of earnings per share because they would have been antidilutive.

12. Employee Benefit Plans

Pension Plan

The Corporation has a noncontributory defined benefit pension plan covering substantially all of its employees. The benefits are based on years of service and final average compensation. The Corporation's funding policy is to contribute amounts to the pension trust at least equal to the minimum funding requirements of the Employee Retirement Income Security Act of 1974 (ERISA), but not in excess of the maximum tax deductible amount. Contributions are intended to provide not only for benefits attributed to service to date but also for those expected to be earned in the future. The following is a summary of information with respect to the plan:

<i>Year Ended March 31,</i>	2002	2001	2000
Net periodic pension cost			
Service cost – benefits earned during the period	\$ 90,161	\$ 87,355	\$ 74,653
Interest cost on projected benefit obligations	64,504	58,100	48,874
Actual return on plan assets	(52,247)	(45,515)	(39,563)
Net amortization and deferral	(13,391)	(11,942)	(10,954)
	\$ 89,027	\$ 87,998	\$ 73,010
Accumulated benefit obligation			
Vested benefits	\$741,857	\$608,830	\$511,450
Non-vested benefits	11,833	14,370	23,503
	\$753,690	\$623,200	\$534,953

Notes to Consolidated Financial Statements

12. Employee Benefit Plans (continued)

<i>Year Ended March 31,</i>	2002	2001
Accrued pension cost		
Projected benefit obligation	\$1,078,895	\$885,325
Fair value of plan assets, primarily IPG insurance contracts	956,857	836,978
Projected benefit obligation in excess of assets	(122,038)	(48,347)
Unrecognized prior service cost	3,104	6,204
Unrecognized net (gain) loss	162,565	58,756
Unrecognized net asset	(16,529)	(24,796)
	\$ 27,102	\$ (8,183)

The following assumed rates were used in determining the projected benefit obligations:

<i>Year Ended March 31,</i>	2002	2001
Weighted average discount rate	7.00%	7.75%
Expected long-term rate of return on plan assets	7.50%	7.50%
Increase in future compensation levels	5.00%	5.00%

The measurement dates used to value the plan assets were December 31, 2002 and 2001.

Employee Stock Ownership Plan

The Employee Stock Ownership and 401(k) Profit Sharing Plan (the "Plan") is a combination of a profit sharing plan with 401(k) and a stock bonus plan. The Plan provides for retirement, death, and disability benefits for all eligible employees.

An employee becomes eligible for participation after completion of one year of service. After meeting the eligibility requirements, an employee becomes a member of the Plan on the earliest January 1, April 1, July 1, or October 1 occurring on or after his qualification.

The contributions to the Plan are discretionary and are determined by the Board of Directors. The contributions are limited annually to the maximum amount permitted as a tax deduction under the applicable Internal Revenue Code provisions.

Profit-sharing, pension plan, and retirement expenses were approximately \$223,200, \$156,200 and \$154,400 for the years ended March 31, 2002, 2001 and 2000, respectively.



13. Stock Option Plan

The Corporation has a noncompensatory stock option plan (the "Plan") designed to provide long-term incentives to employees. All options are exercisable upon grant date.

The following table summarizes options outstanding:

<i>Year Ended March 31,</i>	2002		2001		2000	
	Shares	Weighted - Average Exercise Price	Shares	Weighted - Average Exercise Price	Shares	Weighted - Average Exercise Price
Options outstanding at beginning of year	190,950	\$11.60	242,950	\$11.65	228,300	\$11.87
Granted	15,000	10.88	30,000	9.63	27,500	9.90
Forfeited	(200)	12.00	(76,000)	10.86	(12,850)	11.88
Exercised	(1,000)	9.75	(6,000)	6.50	-	-
Options outstanding at end of year	204,750	\$11.56	190,950	\$11.60	242,950	\$11.65

The weighted average fair value of options granted during the years ended March 31, 2002, 2001 and 2000 were \$2.84, \$2.84 and \$2.38, respectively.

The Corporation applies Accounting Principals Board Opinion 25 in accounting for stock options granted to employees. Had compensation expense been determined based upon the fair value of the awards at the grant date and consistent with the method under Statement of Financial Accounting Standards 123, the Corporation's net earnings and net earnings per share would have been decreased to the pro forma amounts as indicated in the following table:

<i>Year Ended March 31,</i>	2002		2001		2000	
As reported	\$2,607,196		\$1,743,391		\$1,323,880	
Pro forma	2,580,866		1,692,271		1,283,921	
Net income per share	Basic	Diluted	Basic	Diluted	Basic	Diluted
As reported	\$1.14	\$1.14	\$0.72	\$0.72	\$0.52	\$0.52
Pro forma	1.13	1.13	0.69	0.69	0.50	0.50

Notes to Consolidated Financial Statements

13. Stock Option Plan (continued)

The fair value of each options granted is estimated on the date of grant using the Black-Sholes option pricing model with the following assumptions used for grants for the year ended March 31, 2002: a risk free interest rate of 5.51%, dividend yield of 2.79%, expected weighted average term of 10 years, and a volatility of 18.88%.

The following table summarizes information about stock options outstanding and exercisable at March 31, 2002:

Options Outstanding/Exercisable			
	Number of Shares	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price Per Share
\$ 8.25 - \$ 9.90	58,000	8.20	\$ 9.59
\$10.00 - \$15.00	146,750	5.90	12.34
	204,750	6.55	\$ 11.56

14. Commitments and Contingencies

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The Corporation evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Corporation upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies but may include single family residences, other residential property, commercial property and land. At March 31, 2002, the Corporation had outstanding commitments to originate loans of approximately \$9,495,000, unused lines of credit amounted to approximately \$13,364,000 and standby letters of credit totaled approximately \$381,000 at March 31, 2002.

Leases

The Corporation is obligated under several noncancellable operating leases. Future minimum annual rental commitments under the leases are as follows:

<i>Year Ending March 31,</i>	<i>Amount</i>
2003	\$253,808
2004	262,867
2005	270,852
2006	279,132
2007	287,718
Thereafter	1,114,253
	\$2,468,630

Total lease expense was approximately \$215,000, \$215,000 and \$219,000 for the years ended March 31, 2002, 2001 and 2000, respectively.

In the normal course of business, the Corporation has entered into employment agreements with certain officers of the Bank.

The Corporation maintains its cash accounts in several correspondent banks. As of March 31, 2002, deposits in excess of amounts insured by the Federal Deposit Insurance Corporation (FDIC) were \$1,960,159.



15. Related Party Transactions

The Corporation has had, and may be expected to have in the future, banking transactions in the ordinary course of business with directors, principal stockholders, executive officers, their immediate families and affiliated companies in which they are principal stockholders (commonly referred to as related parties), on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with others. At March 31, 2002 and 2001, these loans totaled \$996,397 and \$1,250,446, respectively. During the year ended March 31, 2002, total principal payments were \$254,047. There were no principal additions during the year.

16. Selected Quarterly Financial Data (Unaudited)

Condensed quarterly consolidated financial data is shown as follows: (Dollars in thousands except per share data)

<i>Year ended March 31, 2002</i>	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Total interest income	\$5,204	\$4,939	\$4,448	\$4,350
Total interest expense	2,767	2,504	1,992	1,794
Net interest income	2,437	2,435	2,456	2,556
Provision for loan losses	58	116	75	124
Net interest income after provision for loan losses	2,379	2,319	2,381	2,432
Other income	809	834	861	878
Other expenses	2,129	2,222	2,223	2,590
Income before income taxes	1,059	931	1,019	720
Income tax expense	336	289	340	157
Net income	\$ 723	\$ 642	\$ 679	\$ 563
Earnings per share				
Basic	\$0.31	\$0.28	\$0.30	\$0.25
Diluted	0.31	0.28	0.30	0.25

Notes to Consolidated Financial Statements

16. Selected Quarterly Financial Data (Unaudited) (continued)

Condensed quarterly consolidated financial data is shown as follows: (Dollars in thousands except per share data)

<i>Year ended March 31, 2002</i>	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Total interest income	\$4,660	\$5,038	\$5,150	\$5,199
Total interest expense	2,742	3,062	3,116	2,994
Net interest income	1,918	1,976	2,034	2,205
Provision for loan losses	66	101	41	113
Net interest income after provision for loan losses	1,852	1,875	1,993	2,092
Other income	748	761	706	685
Other expenses	1,915	2,033	2,187	2,106
Income before income taxes	685	603	512	671
Income tax expense	248	202	181	97
Net income	\$ 437	\$ 401	\$ 331	\$ 574
Earnings per share				
Basic	\$ 0.18	\$ 0.16	\$ 0.14	\$ 0.24
Diluted	0.18	0.16	0.14	0.24

Community Financial Corporation & Subsidiary



17. Condensed Financial Information of the Corporation (Parent Company Only)

Condensed Balance Sheets			
March 31,	2002	2001	
Assets			
Investment in the Bank, at equity	\$25,992,433	\$24,384,416	
Cash	334,828	1,088,027	
Prepaid expenses and other assets	367,849	332,246	
	\$26,695,110	\$25,804,689	
Liabilities and Stockholders' Equity			
Liabilities	\$ -	\$ -	
Stockholders' Equity			
Common stock	22,531	23,488	
Additional paid-in capital	4,326,489	4,500,450	
Retained earnings	20,223,498	19,144,552	
Accumulated other comprehensive income	2,122,592	2,136,199	
Total stockholders' equity	26,695,110	25,804,689	
	\$26,695,110	\$25,804,689	
Condensed Statements of Income			
Year Ended March 31,	2002	2001	2000
Income			
Dividend from Bank	\$1,000,000	\$3,500,000	\$1,000,000
Interest income	45,459	12,596	14,089
Total income	1,045,459	3,512,596	1,014,089
Noninterest expenses	(68,714)	(88,715)	(46,399)
Income before equity in undistributed net income of the Bank			
Equity in earnings of Bank, net of distributions	1,621,624	(1,709,385)	343,924
Income before income taxes	2,598,369	1,714,496	1,311,614
Income tax (benefit)	(8,827)	(28,895)	(12,266)
Net income	\$2,607,196	\$1,743,391	\$1,323,880

Notes to Consolidated Financial Statements

17. Condensed Financial Information of the Corporation (Parent Company Only) (continued)

Condensed Statements of Cash Flows

<i>Year Ended March 31,</i>	2002	2001	2000
Operating activities			
Net income	\$2,607,196	\$1,743,391	\$1,323,880
Adjustments			
Equity in earnings of Bank, net of distributions	(1,621,624)	1,709,385	(343,924)
(Increase) decrease in prepaid and other assets	(35,603)	(243,396)	(35,600)
Net cash provided by operating activities	949,969	3,209,380	944,356
Investing activities			
Net cash provided by investing activities	-	-	-
Financing activities			
Cash dividends paid on common stock	(732,079)	(780,102)	(819,493)
Repurchase of common stock	(980,839)	(1,541,963)	(614,661)
Stock options exercised	9,750	39,000	-
Net cash absorbed by financing activities	(1,703,168)	(2,283,065)	(1,434,154)
Increase (decrease) in cash	(753,199)	926,315	(489,798)
Cash, beginning of year	1,088,027	161,712	651,510
Cash, end of year	\$ 334,828	\$1,088,027	\$ 161,712

Stockholder Information



Form 10-KSB Report

A copy of the our Annual Report on Form 10-KSB for the fiscal year ended March 31, 2002 including financial statements, as filed with the SEC, will be furnished without charge to our stockholders upon written request to the Secretary, Community Financial Corporation, 38 North Central Avenue, Staunton, Virginia 24401.

Independent Auditors

Yount, Hyde & Barbour, P.C.
50 South Cameron Street
Winchester, Virginia 22601

Market Makers

Scott & Stringfellow, Inc
Knight Securities L.P.
Anderson & Strudwick, Inc.
Sandler O'Neill & Partners

Transfer Agent

Community Bank
acts as Transfer Agent for
Community Financial Corporation

Legal Counsel

*Nelson, McPherson, Summers
& Santos*
12 North New Street
Staunton, Virginia 24401

Silver, Freedman & Taff, L.L.P.
1700 Wisconsin Avenue, N.W.
Washington, D.C. 20007

Williams, Mullen, Christian & Dobbins
Two James Center
1021 East Cary Street
Richmond, Virginia 23210

Common Stock

As of May 31, 2002, there were approximately 510 holders of record of Community Financial common stock. Community Financial common stock is traded on The Nasdaq Small Cap Market under the symbol "CFFC." The shareholders of record number does not reflect persons or entities who hold their stock in nominee or "street" name.

The following tables present the Corporation's high, low and closing sales prices as reported by the Nasdaq Stock Market during the last two fiscal years and the dividends declared by us for the stated periods.

<u>Fiscal 2002</u>	<u>High</u>	<u>Low</u>	<u>Close</u>	<u>Dividend Declared</u>
June 2001	\$10.25	\$9.63	\$9.90	\$.08
September 2001	10.90	9.90	10.60	.08
December 2001	11.05	10.05	10.60	.08
March 2002	11.50	10.88	11.13	.08

<u>Fiscal 2001</u>	<u>High</u>	<u>Low</u>	<u>Close</u>	<u>Dividend Declared</u>
June 2000	\$10.25	\$8.75	\$8.75	\$.08
September 2000	9.13	8.13	8.44	.08
December 2000	9.50	8.00	9.50	.08
March 2001	10.00	9.50	9.63	.08

The Board of Directors of Community Financial makes dividend payment decisions with consideration of a variety of factors, including earnings, financial condition, market considerations and regulatory restrictions. Our ability to pay dividends is limited by restrictions imposed by the Virginia Stock Corporation Act, and indirectly, by the Office of Thrift Supervision. Restrictions on dividend payments from Community Bank to Community Financial (Community Financial's primary source of funds for the payment of dividends to its stockholders) are described in Note 10 of the Notes to Consolidated Financial Statements contained in this Annual Report.



During the fiscal year ending March 31, 2002, Community First Mortgage Corporation enjoyed its second consecutive year of profitability. The retail division of the Company closed \$77.5 million in permanent residential mortgage loans, representing an increase of \$18.2 million over the previous fiscal year. The Company's well earned reputation for providing quality service to its customers was a major factor in the recruitment of several new loan officers both the Richmond and Staunton markets. These new loan officers, as well as a lower interest rate environment relative to Fiscal

2001, were the primary ingredients of the Company's increase in retail production.

The construction lending division, which was established in Fiscal 2000, once again experienced solid growth in Fiscal 2002. The division's builder loan and construction permanent loan programs attracted more new customers, thereby expanding the Company's market share in these portfolios. At fiscal year end, the construction lending division had originated \$13.1 million in new loans, with \$10.67 million in outstanding commitments and \$7.55 million disbursed.

Community First Mortgage Corporation Employees

Tony Bottoms
President

Staff

Kerri Bliss
Lorey Bowles
Lisa Collins
Mary Jean Davis
Steve Davis
Diane Fox
Lisa Kurtz

Debbie Giambanco
Tom Gill
Becky Heldreth
Barbara Henderson
Debra Lynch
David Jones
Bob Michaux
Susan Miller

Rick Perkins
Karen Poe
Brenda Smith
Molly Stout
Kimberly Stump
Becky Tinsley
Dawn Warren

Community First Mortgage Corporation:

Main Office
9201 Arboretum Parkway, Suite 210
Richmond, Virginia 23236
(804) 330-9800

Staunton Office
101 Community Way
Staunton, Virginia 24401
(540) 213-3770

Community Bank Offices

Valley Region



Richmond Road Branch

101 Community Way • Staunton, Virginia 24401
(540) 213-3888



Waynesboro Branch

2934 West Main Street • Waynesboro, Virginia 22980
(540) 943-5000

**Executive and
Administrative Office
Retail Banking**

**Corporate
Headquarters,
Staunton**



38 North Central Avenue
Staunton, Virginia 24401
(540) 886-0796
Fax: (540) 885-0643
E-Mail:
cbnk@cbnk.com
Web Address:
www.cbnk.com



Raphine Branch

2134 Raphine Road • Raphine, Virginia 24472
(540) 377-5300



Stuarts Draft Branch

2658 Stuarts Draft Highway • Stuarts Draft, Virginia 24477
(540) 337-1514

Community Bank Offices



Artist Rendering for new Retail Branch Office on Route 11 in Verona
21 Dick Huff Lane, Verona, Virginia
(projected opening date December 2002)



Hampton Roads Region



Regional Headquarters, Hilltop, Virginia Beach
621 Nevan Road • Virginia Beach, Virginia 23451
(757) 491-8810



Kemps River, Virginia Beach
5300 Kemps River Drive, Suite 100 • Virginia Beach, Virginia 23464
(757) 424-5600

Community Bank was organized in 1928 as a Virginia-chartered building and loan association, converted to a federally-chartered savings and loan association in 1955 and to a federally-chartered savings bank in 1983. In 1988, Community Bank converted to the stock form of organization through the sale and issuance of 656,134 shares of its common stock. Community Financial was organized in 1989 for the purpose of becoming a thrift institution holding company. Effective January 31, 1990, Community Bank completed the holding company reorganization of the bank and Community Financial acquired all of the issued and outstanding shares of common stock of Community Bank. In 1996, Community Financial changed its place of incorporation to the Commonwealth of Virginia from the State of Delaware.

The principal asset of Community Financial is the outstanding stock of Community Bank, its wholly owned subsidiary. Community Financial presently has no separate operations and its business consists only of the business of Community Bank.

Community Bank's primary business is to meet the financial needs of individuals, businesses and community organi-

zations. Community Bank offers real estate, business and personal loans with complementary deposit services such as checking, savings, certificates of deposits, money market and retirement accounts. Flexible, local and prompt decisions on loan and other financial service needs are a primary advantage of banking with Community Bank. "Our Name Really Does Say It All."

Both Community Financial and Community Bank conduct business through a main office located at 38 North Central Avenue, Staunton, Virginia 24401, a second Staunton office at 101 Community Way, Staunton, Virginia 24401, a Waynesboro office at 2934 West Main Street, Waynesboro, Virginia 22980, a Stuarts Draft office at Routes 340 and 608, Stuarts Draft, Virginia 24477, a Raphine office at 2134 Raphine Road, Raphine, Virginia 24472, a Verona office at 21 Dick Huff Lane, Verona, Virginia (projected opening date December, 2002) and two Virginia Beach office at 5300 Kemps River Drive, Suite 100, Virginia Beach, Virginia 23467 and 621 Nevan Road, Virginia Beach, Virginia. The Bank's subsidiary, Community First Mortgage Corporation, conducts business at 9201 Arboretum Parkway, Suite 210, Richmond, Virginia 23236.

Community Bank Employees

Cassie Beaty	Julie Krumpter	Ann Wescott	Robert Pennington	Heather West
Michelle Coffey	Teresa Layne	Jennifer Boxler	Connie Savage	Stephanie Wimer
Danny Fields	Stephanie Leach	Janet Braithwaite	Connie West-Williams	Kim Aldhizer
Wanda Garrison	Virginia McCormack	Lona Cannon	Stacy Whaley	Deborah Burnett
Peggy Miller	Beth Miller	Jessica Green	Kathy Willis	Martha Chandler
Janice Pappas	Wendi Pell	Dana Rogers	Jim Fordham	Ariel Fix
Fran Stauffer	Sally Pritchett	Teresa Tolley	Hugh McMenamin	Emilie McKenzie
Susan Swisher	Kendell Rexrode	Joe Zakaib	Jeff Wagner	Lyle Moffett
Courtney Williams	Rachel Sellers	Pam Addington	Doug Richard	Karen Sheehan
Gretchen Abshire	Marie Schmitt	Maria Dimapelis	Brenda Haley	Sean Smoker
Becky Ballew	Sara Tyree	Denia Jove	Jerry Giles	Linda Turner
Tysha Blackburn	Kelly Vandevander	Lovetta Moore	Renee Fangman	Barbara Wood
Darlene Hall	Dee Wimer	Teresa Ridgeway	Rich Mayer	Butch Smiley
Alisha Hammer	Dianne Campbell	Dianne Booth	Janet Redifer	Thomas Wagner
Heather Miller	David Cropp	Diane Decker	Pamela Ritchie	Gary Davenport
Jessie Palmieri	Thomas Fleisher	Robert Hoffman	Romona Savidge	Stacy Clemmer
Jennifer Raybin	Rose Lilly	Teresa Knapton	Amanda Campbell	Tonna Lotts
Lee Ralston Shaner	Edgar Kurtz	Ellen Kutchak	Jennifer Campbell	Debra Poole
Grace Dick	John Seidler	Chris Kyriakides	Charlott Dean	Linda Wood
Kathleen Fornadel	Edgar Smith	Rosalie Moster	Kay Dean	
Ann Hottel	Glenn VanLear	Jane Orem	Melissa Galvin	
Carolyn Howell	Benny Werner	Catherine Pauly	Janice Seagraves	



Executive & Administrative Offices
38 North Central Avenue
Staunton, Virginia 24401
540-886-0796
www.cbnk.com

