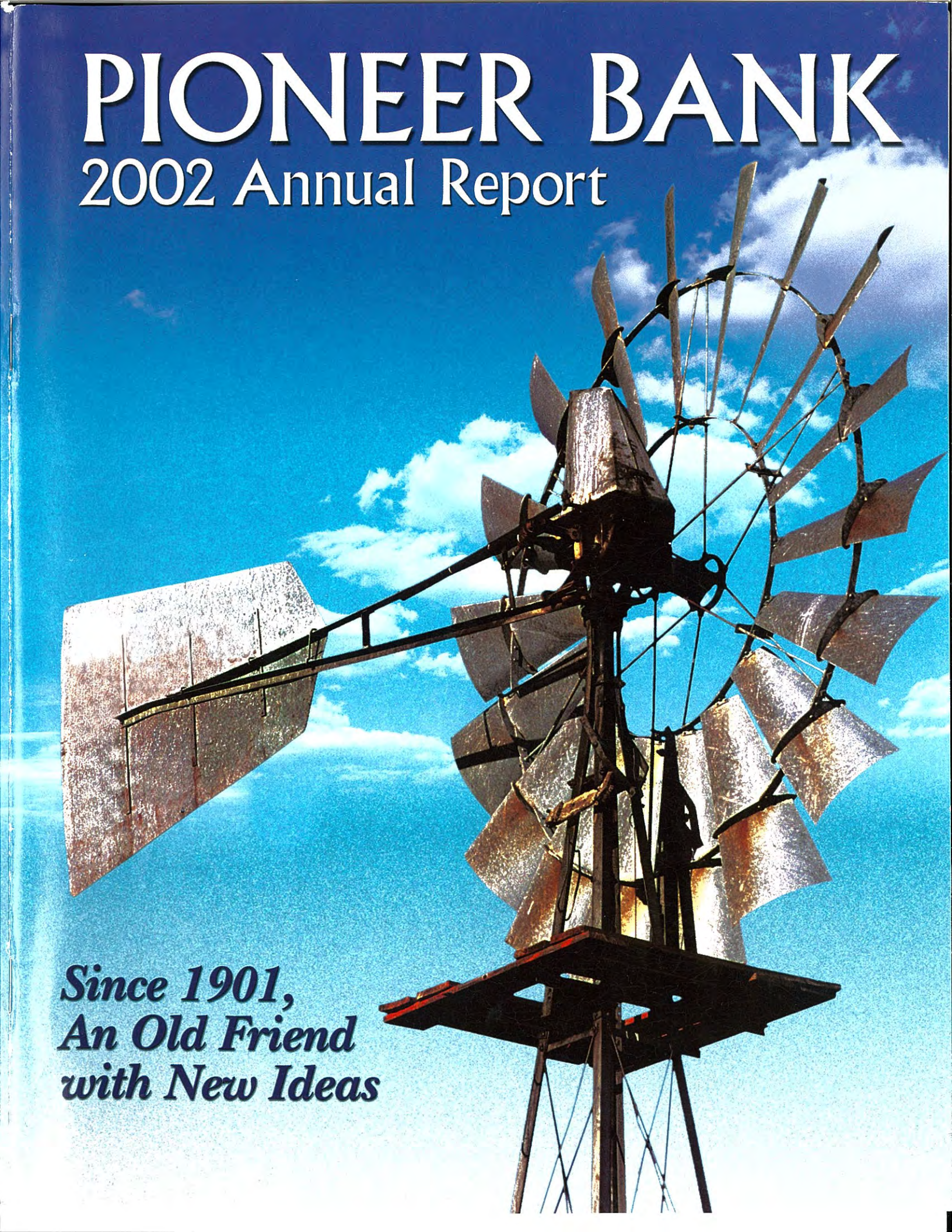


PIONEER BANK

2002 Annual Report



*Since 1901,
An Old Friend
with New Ideas*

MISSION STATEMENT

Pioneer Bank's mission is to provide superior banking products and services to our customers.

We will continue to maintain goals that will enable Pioneer to be a leader in the communities we serve, increase profitability, strive for growth and improvement, provide the highest quality of service to our customers, and sustain integrity, confidence, and success for our stockholders, customers, and employees.



PIONEER BANK

Dear Pioneer Bank Stockholder:

Pioneer Bank experienced excellent operating results in 2002, with record earnings, higher loan production, and deposit growth. We are pleased to report audited earnings of \$4.9 million, due largely to the low interest rate environment, which contributed to increases in the gain on sale of securities, net interest margin, and loan production. These results allowed Pioneer to raise dividends by 14% from \$1.05 in 2001 to \$1.20 in 2002.

Total loan production reached \$215.2 million, an increase of 24% over 2001. Assets rose 10% to \$412.5 million, and Pioneer experienced 10% growth in deposits, due to growth in certificates of deposit and transaction accounts. Our earnings contributed to a 17% increase in stockholder equity, which rose from \$25.3 million to \$29.6 million.

We expect 2003 to be another outstanding year for Pioneer; however, we face an uncertain interest rate environment which will likely reduce earnings from the record levels of 2002. Major goals for 2003 include the formation of a holding company, which will be voted upon by stockholders at our upcoming meeting on April 15, and the construction of a new full service office in South Roswell. The formation of the holding company is designed to improve the liquidity of Pioneer Bank stock; this is explained in detail in the proxy statement. The addition of the South Main office should allow us to expand our already strong presence in the Roswell community. We also are exploring opportunities for expansion in several of our other communities, most notably Las Cruces and Carlsbad.

Our long-term goal is to continue to build shareholder value through expansion of mortgage banking, commercial real estate and business loan activities, as well as growth of core deposits. We will continue to focus on providing Southern New Mexico with superior service.

The Board of Directors and officers would like to express their appreciation to all of our employees, customers, and stockholders for their invaluable contributions to the success of our company. We would also like to thank the retired employees who helped lay the foundation for our current success. I would specifically like to recognize George W. Mitchell who served 22 years as President of Pioneer.

Thank you for your continued support. Please feel free to contact me if you have any comments, questions, or suggestions.

Sincerely,



Jon E. Hitchcock
President

Roswell, New Mexico
March 20, 2003

PIONEER BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
December 31, 2002 and 2001

	<u>2002</u>	<u>2001</u>
ASSETS		
Cash and cash equivalents (Note B)	\$ 15,597,847	\$ 11,168,783
Securities (Note C)		
Available-for-sale	136,488,908	129,681,151
Held-to-maturity fair value: 2002 - \$853,441; 2001 - \$1,233,660	819,404	1,207,185
Loans held for sale, net (Note D)	21,612,875	27,327,703
Loans, net (Note D)	216,205,002	179,669,316
Federal Home Loan Bank, Federal National Mortgage Association and other stock	8,648,617	8,483,700
Office properties and equipment, net (Note E)	6,251,625	6,333,981
Mortgage servicing rights, net (Note F)	2,092,435	3,210,502
Accrued interest receivable	1,674,641	1,557,152
Interest rate cap agreements	-	271,547
Other assets	<u>3,124,528</u>	<u>3,990,628</u>
 Total assets	 <u>\$ 412,515,882</u>	 <u>\$ 372,901,648</u>
 LIABILITIES		
Deposits (Note G)	\$ 261,841,066	\$ 237,759,862
FHLB advances and other borrowings (Note H)	110,357,066	99,796,743
Official checks	4,761,983	4,038,684
Deferred tax liabilities, net (Note I)	1,032,562	1,665,411
Advance payments for taxes and insurance	1,689,854	1,563,368
Accrued interest payable	516,985	545,481
Accounts payable and other liabilities	<u>2,721,441</u>	<u>2,208,295</u>
Total liabilities	382,920,957	347,577,844
 Commitments and contingencies (Note K)		
 Stockholders' equity (Note J)		
Capital stock, \$1 par value, shares authorized: 2,000,000; shares issued and outstanding:		
2002 - 1,008,922; 2001 - 1,008,920	1,008,922	1,008,920
Additional paid-in capital	56,952	56,918
Retained earnings	27,901,284	24,153,338
Accumulated other comprehensive income (Note C)	<u>627,767</u>	<u>104,628</u>
Total stockholders' equity	<u>29,594,925</u>	<u>25,323,804</u>
 Total liabilities and stockholders' equity	 <u>\$ 412,515,882</u>	 <u>\$ 372,901,648</u>

See accompanying notes to consolidated financial statements.

PIONEER BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
Years ended December 31, 2002 and 2001

	<u>2002</u>	<u>2001</u>
Interest and dividend income		
Loans (Note D)	\$ 14,886,915	\$ 14,518,276
Mortgage securities	6,577,113	7,879,761
Investment securities and other	<u>641,677</u>	<u>623,482</u>
	22,105,705	23,021,519
Interest expense		
Deposits (Note G)	5,439,716	8,572,184
FHLB advances and other borrowings	<u>4,863,608</u>	<u>5,321,345</u>
	10,303,324	13,893,529
Net interest income	11,802,381	9,127,990
Loan loss provision (Note D)	<u>72,046</u>	<u>(19,315)</u>
Net interest income after loan loss provision	11,730,335	9,147,305
Other income		
Gain on sale of loans, net (Note D)	2,046,521	2,153,093
Loan administration and service fees	797,452	1,283,425
Impairment recognized on mortgage servicing rights	(1,152,247)	(448,715)
Deposit account fees	837,403	748,487
Gain on sale of securities, net (Note C)	3,053,148	657,140
Gain on sale of investment in real estate	5,644	10,803
Other	<u>322,772</u>	<u>284,187</u>
	5,910,693	4,688,420
Other expenses		
Compensation and employee benefits (Note M)	5,637,880	4,884,362
Equipment	757,570	669,401
Data processing	717,912	664,646
Occupancy	642,503	597,139
Stationery, printing, and office supplies	302,242	299,866
Professional and supervisory	364,940	263,114
Postage and transportation	266,562	246,282
Advertising and public relations	324,095	242,781
Telephone	179,939	171,759
Deposit insurance premiums	42,548	45,990
Other	<u>362,422</u>	<u>340,438</u>
	9,598,613	8,425,778
Income before income tax expense and cumulative effect of change in accounting principle	8,042,415	5,409,947

(Continued)

PIONEER BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
Years ended December 31, 2002 and 2001

	<u>2002</u>	<u>2001</u>
Income before income tax expense and cumulative effect of change in accounting principle	\$ 8,042,415	\$ 5,409,947
Income tax expense (Note I)	<u>3,083,764</u>	<u>2,047,975</u>
Income before cumulative effect of accounting change	4,958,651	3,361,972
Cumulative effect on prior years of adopting SFAS 133 (net of tax benefit of \$332,947)	<u>-</u>	<u>(508,000)</u>
Net income	<u>\$ 4,958,651</u>	<u>\$ 2,853,972</u>
Weighted average number of capital stock shares outstanding	<u>1,008,921</u>	<u>1,008,756</u>
Income per share before cumulative effect of accounting change	\$ 4.91	\$ 3.33
Cumulative effect of accounting change	<u>-</u>	<u>(0.50)</u>
Net income per share	<u>\$ 4.91</u>	<u>\$ 2.83</u>
Dividends per share	<u>\$ 1.20</u>	<u>\$ 1.05</u>

See accompanying notes to consolidated financial statements.

PIONEER BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31, 2002 and 2001

	<u>2002</u>	<u>2001</u>
Cash flows from operating activities		
Net income	\$ 4,958,651	\$ 2,853,972
Cumulative effect of change in accounting principle	-	508,000
Adjustments to reconcile net income to net cash provided by operating activities		
Amortization (accretion) of		
Mortgage servicing rights	1,165,049	757,044
Premiums and discounts on investment and mortgage securities, net	160,424	(24,823)
Interest rate cap agreements	271,547	554,440
Loan loss provision	72,046	(19,315)
Change in mortgage servicing rights impairment allowance	1,152,247	448,715
Net (gain) loss on sales and disposals of		
Loans	(2,046,521)	(2,153,093)
Office properties and equipment	16,152	-
Investments in real estate owned	(5,644)	(10,803)
Securities available-for-sale	(3,053,148)	(657,140)
Federal Home Loan Bank stock dividends	(192,200)	(243,900)
Depreciation of office properties and equipment	524,104	464,948
Origination of mortgage loans held for sale	(66,333,930)	(81,215,596)
Changes in operating assets and liabilities		
Accrued interest receivable	(117,489)	173,421
Other assets	866,083	(874,492)
Official checks	723,299	585,112
Deferred tax liabilities, net of tax effect of unrealized losses	(974,976)	(595,178)
Accrued interest payable	(28,496)	(208,369)
Accounts payable and other liabilities, net of dividends declared, not paid	412,253	255,026
Net cash used in operating activities	(62,430,549)	(79,402,031)
Cash flows from investing activities		
Loan originations and principal payments on loans, net	(36,695,132)	13,366,961
Securities held-to-maturity:		
Maturities and principal reductions	386,058	188,018
Securities available-for-sale:		
Purchases	(106,195,985)	(84,452,777)
Sales	122,454,792	100,235,386
Maturities and principal reductions	53,616,498	45,258,164
Purchase of office properties and equipment	(457,899)	(1,492,450)
Net purchases of FHLB, FNMA, and other stock	-	(1,172,016)
Proceeds from sales of investments in real estate owned	93,044	60,496
Net cash provided by investing activities	33,201,376	71,991,782

(Continued)

PIONEER BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31, 2002 and 2001

	<u>2002</u>	<u>2001</u>
Cash flows from financing activities		
Net increase (decrease) in deposits	\$ 24,081,204	\$ (6,265,006)
Additions to FHLB advances and other borrowings	31,760,323	70,168,051
Payments on FHLB advances and other borrowings	(21,200,000)	(57,267,000)
Net decrease in advance payments for taxes and insurance	126,486	110,470
Sales of capital stock	36	10,268
Payments of cash dividends	(1,109,812)	(1,059,070)
Net cash provided by financing activities	<u>33,658,237</u>	<u>5,697,713</u>
Increase (decrease) in cash and cash equivalents	4,429,064	(1,712,536)
Cash and cash equivalents at beginning of year	<u>11,168,783</u>	<u>12,881,319</u>
Cash and cash equivalents at end of year	<u><u>\$ 15,597,847</u></u>	<u><u>\$ 11,168,783</u></u>
Supplemental disclosures of cash flow information		
Cash paid during the year for		
Interest	\$ 10,331,820	\$ 13,547,458
Income taxes	-	2,820,000
Supplemental schedule of noncash investing and financing activities		
Dividends declared, not paid	\$ 655,799	\$ 554,906
Loan securitizations transferred to AFS securities	72,896,050	60,565,379
Transfer of securities to available-for-sale from held-to-maturity	-	5,623,051
Transfer from loans to other real estate owned	87,400	49,693

See accompanying notes to consolidated financial statements.

PIONEER BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
Years ended December 31, 2002 and 2001

	Capital Stock <u>\$1 Par</u>	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 2000	\$ 1,008,485	\$ 47,085	\$ 22,358,675	\$ (949,265)	\$ 22,464,980
Capital stock issued	435	9,833	-	-	10,268
Comprehensive income					
Net income	-	-	2,853,972	-	2,853,972
Net change in unrealized losses on securities, net of tax	-	-	-	1,053,893	<u>1,053,893</u>
Total comprehensive income					3,907,865
Dividends - \$1.05 per share	<u>-</u>	<u>-</u>	<u>(1,059,309)</u>	<u>-</u>	<u>(1,059,309)</u>
Balance, December 31, 2001	1,008,920	56,918	24,153,338	104,628	25,323,804
Capital stock issued	2	34	-	-	36
Comprehensive income					
Net income	-	-	4,958,651	-	4,958,651
Net change in unrealized losses on securities, net of tax	-	-	-	523,139	<u>523,139</u>
Total comprehensive income					5,481,790
Dividends - \$1.20 per share	<u>-</u>	<u>-</u>	<u>(1,210,705)</u>	<u>-</u>	<u>(1,210,705)</u>
Balance, December 31, 2002	<u>\$ 1,008,922</u>	<u>\$ 56,952</u>	<u>\$ 27,901,284</u>	<u>\$ 627,767</u>	<u>\$ 29,594,925</u>

See accompanying notes to consolidated financial statements.

PIONEER BANK AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2002 and 2001

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

NATURE OF OPERATIONS: Pioneer Bank (the Bank) operates six full customer service facilities, two savings branches, and two loan production offices in the geographic area of the Southwest region of the United States, primarily New Mexico and West Texas. There are no concentrations of credit risk to any one industry. The Bank's primary sources of revenue are from providing loans to customers and servicing mortgage loans for others.

PRINCIPLES OF CONSOLIDATION: The consolidated financial statements include the accounts of the Bank and its wholly owned subsidiary, Pioneer Mortgage Company, and its wholly owned subsidiary, Pioneer Property Management. Significant intercompany transactions and balances are eliminated in consolidation.

USE OF ESTIMATES: The preparation of financial statements, in conformity with accounting principles generally accepted in the United States of America, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The principal areas involving use of estimates and assumptions are the allowance for loan losses, allowance for losses on investments in real estate, the valuation allowance for impairment of mortgage servicing rights, and estimates of fair value of financial instruments. Actual results could differ from those estimates.

CASH AND CASH EQUIVALENTS: The Bank considers all cash on hand, due from banks, and federal funds sold as cash and cash equivalents for purpose of the financial statement presentation.

SECURITIES AND FEDERAL HOME LOAN BANK STOCK: The Bank's securities are classified in two categories and accounted for as follows: "held-to-maturity," reported at amortized cost, adjusted for premiums and discounts that are recognized in income using the interest method over the period to maturity; and "available-for-sale," reported at fair value, with unrealized gains and losses, net of taxes, reported as a net amount in accumulated other comprehensive income. Realized gains and losses on securities available-for-sale are recognized as determined by the specific identification basis upon disposition. Management has the ability and positive intent to hold securities categorized as held-to-maturity until maturity.

Mortgage securities consist of Government National Mortgage Association (GNMA) mortgage-backed securities, Federal National Mortgage Association (FNMA) pass-through certificates, and Federal Home Loan Mortgage Corporation (FHLMC) participation certificates. Also included are collateralized mortgage obligations consisting of FNMA and FHLMC real estate mortgage investment conduits. Adjustments made to mortgage securities amortization and accretion related to changes in prepayments are recorded on a current basis. Federal Home Loan Bank (FHLB) stock is carried at cost.

(Continued)

PIONEER BANK AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2002 and 2001

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

LOANS HELD FOR SALE: Mortgage loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value in the aggregate. Net unrealized losses are recognized in a valuation allowance by charges to income.

LOANS: Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at their unpaid principal balances, less the allowances for loan losses, net deferred loan fees, and unearned discounts.

ALLOWANCE FOR LOAN LOSSES: Each period, the loan loss provision in the consolidated statements of income results from the combination of an estimate by management of probable loan losses that occurred during the current period and the ongoing adjustment of prior estimates of losses occurring in prior periods. In addition, certain regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan losses for adequacy. Such agencies may require the Bank to change the allowance based on their judgment about information available to them at the time of their examination.

To serve as a basis for making this provision each quarter, the Bank maintains a risk monitoring process that considers several factors including: current economic conditions affecting the Bank's customers, the payment performance of individual large loans and pools of homogeneous small loans, portfolio seasoning, changes in collateral values, and detailed reviews of specific large loan relationships. For large loans deemed to be impaired due to an expectation that all contractual payments will probably not be received, impairment is measured by comparing the Bank's recorded investment in the loan to the present value of expected cash flows discounted at the loan's effective interest rate, the fair value of the collateral, or the loan's observable market price.

The loan loss provision increases the allowance for loan losses, a valuation account that is netted against loans on the balance sheet. As the specific customer and amount of a loan loss is confirmed by gathering additional information, taking collateral in full or partial settlement of the loan, bankruptcy of the borrower, and other factors, the loan is written down, thereby reducing the allowance for loan losses. If, subsequent to a writedown, the Bank is able to collect additional amounts from the customer or obtain control of collateral worth more than earlier estimated, a recovery is recorded, thereby increasing the allowance for loan losses.

OFFICE PROPERTIES AND EQUIPMENT: Office properties and equipment are stated at historical cost. Depreciation is computed by the straight-line method over the estimated useful lives of the assets, which range from 3 to 50 years. Leasehold improvements are amortized over the life of the asset or the term of the lease, whichever is shorter. Repairs and maintenance not extending the useful life of the asset are expensed.

(Continued)

PIONEER BANK AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2002 and 2001

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

MORTGAGE SERVICING RIGHTS: The Bank recognizes, as separate assets, rights to service mortgage loans for others, whether the rights are acquired through purchase or result from the sale or securitization of loans with servicing rights retained. In the case where the mortgage loan is originated and sold, the total costs of the mortgage loan are allocated to the mortgage servicing right and the loan based on their relative fair values.

The carrying amount of mortgage servicing rights, and the amortization thereon, is periodically evaluated in relation to estimated fair value. The Bank stratifies the underlying mortgage portfolio by certain risk characteristics, including loan type, interest rate and maturity, for purposes of measuring impairment. The Bank estimates the fair value of each stratum by calculating the discounted present value of future net servicing income based on management's best estimate of remaining loan lives. The Bank has determined that the primary risk characteristic of the mortgage servicing rights is the contractual interest rate of the underlying mortgage loans.

The carrying value of mortgage servicing rights is amortized in proportion to, and over the period of, estimated net servicing revenues.

INVESTMENTS IN REAL ESTATE: Foreclosed real estate is initially recorded at fair value upon acquisition, establishing a new cost basis. After foreclosure, real estate is carried at the lower of carrying amount or estimated fair value, less estimated selling costs, which is generally determined by an independent appraisal. Subsequent to acquisition, management periodically re-evaluates the properties and provides allowances for any differences.

DERIVATIVES: All derivative instruments are recorded at their fair values. If derivative instruments are designated as hedges of fair values, both the change in the fair value of the hedge and the hedged item are included in current earnings. Fair value adjustments related to cash flow hedges are recorded in other comprehensive income and reclassified to earnings when the hedged transaction is reflected in earnings. Ineffective portions of hedges are reflected in earnings as they occur.

The operations of the Bank are subject to risk of interest rate fluctuations to the extent there are differences between the amount of the Bank's interest-earning assets and interest-bearing liabilities that mature or reprice in specified periods. To the extent that the Bank is unable to naturally hedge its interest-earning assets and interest-earning liabilities, the Bank uses, among other strategies, interest rate cap agreements. The Bank has entered into interest rate cap agreements to reduce the impact of increases in short-term interest rates affecting deposits and short-term borrowings. The interest rate cap agreements are not for speculation purposes.

(Continued)

PIONEER BANK AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2002 and 2001

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

INTEREST AND FEES ON LOANS: Interest on loans is accrued and credited to income on a level yield basis. The accrual of interest on impaired loans is discontinued after the loan is 90 days past due or when, in management's opinion, the borrower may be unable to meet payments as they become due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received. Loan origination fees, net of direct origination costs, are deferred and amortized and recognized as an adjustment to the yield of the related loan. If the loan is held for sale, the loan origination fees are deferred until the loan is sold.

GAIN OR LOSS ON SALE OF LOANS AND LOAN PARTICIPATIONS: Gains and losses on sales of mortgage loans and mortgage loan participations are based on the difference between allocated amortized book value of the loans sold and sales proceeds.

INCOME TAXES: The Bank files a consolidated income tax return with its subsidiary, Pioneer Mortgage Company, and as agreed, the income taxes of Pioneer Mortgage Company determined to be currently payable are remitted to the Bank. The calculation of taxes payable is based on Pioneer Mortgage Company's respective contribution to consolidated taxable income.

Deferred tax expenses or benefits result from changes in deferred tax liabilities and assets. Deferred tax liabilities and assets are recognized for the estimated future tax effects attributable to temporary differences between the basis of assets and liabilities for tax and financial statement purposes. As explained in Note I, it is not necessary to provide deferred taxes on the portion of the allowance for loan losses for tax purposes that arose in years prior to 1988. Deferred tax liabilities or assets are determined using the current marginal rate in effect at the end of each period.

NET INCOME AND DIVIDENDS PER SHARE: Net income per share of capital stock has been computed on the basis of the weighted-average number of shares of capital stock outstanding. There were no other classes of stock or common stock equivalents at December 31, 2002 or 2001. Dividends are paid based on the actual number of shares outstanding on the day of record.

COMPREHENSIVE INCOME: Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses on securities available-for-sale and unrealized gains and losses on cash flow hedges and changes in minimum pension liability, which are also recognized as separate components of equity.

(Continued)

PIONEER BANK AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2002 and 2001

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

ACCOUNTING STANDARD ADOPTED: On January 1, 2001, the Bank adopted new accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the consolidated statements of financial position and measure those instruments at fair value, and only if certain conditions are met, they may be recognized as one of three hedging designations. The accounting for changes in the fair value of a derivative depends on the intended use of the derivative and the resulting designation.

Special accounting for qualifying hedges allows derivative gains and losses to offset related results on the hedged item in the income statement and requires that a company must formally document, designate, and assess the effectiveness of transactions that receive hedge accounting. The Bank has only limited involvement with derivative financial instruments and does not use them for trading purposes. They are used to manage well-defined interest rate and price risks. Management has adopted procedures for identifying derivative instruments and hedging activities as defined and is able to report these activities appropriately. Items identified as derivatives are the interest rate cap agreements that are used to manage interest rate risk and commitments to originate loans and sell mortgages and mortgage-backed securities. These commitments are subject to valuation changes between the commitment date and the delivery date.

As a result of adopting the new standards, the Bank reduced the carrying value of its interest rate caps to fair value on January 1, 2001. The impact of this change totaled \$508,000 after taxes and is reflected as the cumulative effect on prior years of adopting Statement of Financial Accounting Standards (SFAS) No. 133 in the 2001 consolidated statement of income.

NEWLY ISSUED BUT NOT YET EFFECTIVE ACCOUNTING STANDARDS: New accounting standards on asset retirement obligations, restructuring activities and exit costs, operating leases, and early extinguishment of debt were issued in 2002. Management determined that when the new accounting standards are adopted in 2003, they will not have a material impact on the Bank's financial condition or results of operations.

RECLASSIFICATIONS: Some items in the prior year financial statements were reclassified to conform to the current presentation.

(Continued)

PIONEER BANK AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2002 and 2001

NOTE B - CASH AND CASH EQUIVALENTS

Cash and cash equivalents, subject to regulatory reserve requirements, totaled approximately \$3,721,000 and \$3,142,000 at December 31, 2002 and 2001, respectively. Cash and cash equivalents consisted of the following:

	<u>2002</u>	<u>2001</u>
Cash and due from banks	\$ 14,124,725	\$ 10,959,866
Interest-bearing deposits	<u>1,473,122</u>	<u>208,917</u>
	<u>\$ 15,597,847</u>	<u>\$ 11,168,783</u>

NOTE C - SECURITIES

The amortized cost and estimated market values of debt securities are as follows. Actual maturities may differ from contractual maturities because borrowers have the right to prepay obligations without prepayment penalties.

December 31, 2002					
	Contractual Maturity in Years	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<u>Securities Available-for-Sale</u>					
U.S. Treasury securities	< 1	\$ 1,001,771	\$ 8,229	\$ -	\$ 1,010,000
Other equity investments		2,000,000	9,225	-	2,009,225
Mortgage-backed securities and collateralized mortgage obligations		<u>132,421,520</u>	<u>1,087,998</u>	<u>(39,835)</u>	<u>133,469,683</u>
Total securities available-for-sale		<u>\$ 135,423,291</u>	<u>\$ 1,105,452</u>	<u>\$ (39,835)</u>	<u>\$ 136,488,908</u>
<u>Securities Held-to-Maturity</u>					
Mortgage-backed securities and collateralized mortgage obligations		<u>\$ 819,404</u>	<u>\$ 34,037</u>	<u>\$ -</u>	<u>\$ 853,441</u>
December 31, 2001					
	Contractual Maturity in Years	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<u>Securities Available-for-Sale</u>					
U.S. Treasury securities	< 1	\$ 500,103	\$ -	\$ (103)	\$ 500,000
	1 - 5	1,009,128	28,997	-	1,038,125
Mortgage-backed securities and collateralized mortgage obligations		<u>127,998,868</u>	<u>574,151</u>	<u>(429,993)</u>	<u>128,143,026</u>
Total securities available-for-sale		<u>\$ 129,508,099</u>	<u>\$ 603,148</u>	<u>\$ (430,096)</u>	<u>\$ 129,681,151</u>
<u>Securities Held-to-Maturity</u>					
Mortgage-backed securities and collateralized mortgage obligations		<u>\$ 1,207,185</u>	<u>\$ 26,475</u>	<u>\$ -</u>	<u>\$ 1,233,660</u>

(Continued)

PIONEER BANK AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2002 and 2001

NOTE C - SECURITIES (Continued)

Effective January 1, 2001, the Bank adopted the provisions of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. As permitted by SFAS No. 133, the Bank reclassified certain securities held-to-maturity to securities available-for-sale. The securities that were reclassified had a book value of \$5,623,051 and a fair value of \$5,564,241 at January 1, 2001.

All components of accumulated other comprehensive income for the Bank are directly related to securities activity. An analysis of changes in accumulated other comprehensive income follows:

	<u>2002</u>	<u>2001</u>
Net unrealized holding gains on securities arising during the period	\$ 3,918,414	\$ 2,341,298
Reclassification adjustment for realized gains included in net income	(3,053,148)	(657,140)
Income tax	<u>(342,127)</u>	<u>(630,265)</u>
	<u>\$ 523,139</u>	<u>\$ 1,053,893</u>

At December 31, 2002 and 2001, the Bank had pledged securities of approximately \$28,403,000 and \$22,081,000, respectively, to secure deposits. At December 31, 2002 and 2001, securities having a market value of approximately \$1,010,000 and \$500,000, respectively, were pledged to secure the treasury tax and loan account.

The following table presents components of gains and losses on sales of available-for-sale securities:

	<u>2002</u>	<u>2001</u>
Gains	\$ 3,324,976	\$ 938,412
Losses	<u>(271,828)</u>	<u>(281,272)</u>
	<u>\$ 3,053,148</u>	<u>\$ 657,140</u>

(Continued)

PIONEER BANK AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2002 and 2001

NOTE D - LOANS

Loans consisted of the following:

	<u>2002</u>	<u>2001</u>
Loans held for sale		
Mortgage loans held for sale		
Conventional	\$ 12,667,323	\$ 14,184,583
FHA insured and VA insured	9,022,573	13,207,234
Deferred loan fees, net	<u>(77,021)</u>	<u>(64,114)</u>
Loans held for sale, net	<u>\$ 21,612,875</u>	<u>\$ 27,327,703</u>
Loans		
Mortgage loans held for investment		
Conventional	\$ 134,724,936	\$ 101,466,488
FHA insured and VA guaranteed	49,917,440	50,678,066
Commercial	8,552,751	5,323,040
Construction and land	7,502,337	10,248,768
Deferred loan costs, net	<u>29,322</u>	<u>58,312</u>
Mortgage loans held for investment, net	200,726,786	167,774,674
Consumer loans		
Installment and other loans	7,974,263	7,172,295
Second mortgages	844,249	867,868
Business	6,881,231	3,683,977
Savings account loans	234,977	555,945
Unearned discounts	<u>(20,950)</u>	<u>(22,967)</u>
Consumer loans, net	15,913,770	12,257,118
Allowance for loan losses	<u>(435,554)</u>	<u>(362,476)</u>
Loans, net	<u>\$ 216,205,002</u>	<u>\$ 179,669,316</u>

Net gains from sales of loans were \$2,046,521 and \$2,153,093 in 2002 and 2001, respectively.

At December 31, 2002 and 2001, approximately \$202,881,000 and \$178,067,000, respectively, of mortgage loans (including those held for sale) were pledged to secure Federal Home Loan Bank advances and other borrowings.

(Continued)

PIONEER BANK AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2002 and 2001

NOTE D - LOANS (Continued)

An analysis of the activity in the allowance for loan losses is as follows:

	<u>2002</u>	<u>2001</u>
Balance at beginning of year	\$ 362,476	\$ 397,646
Recoveries	3,079	50,112
Loan loss provision	72,046	(19,315)
Charge-offs	<u>(2,047)</u>	<u>(65,967)</u>
Balance at end of year	<u>\$ 435,554</u>	<u>\$ 362,476</u>

At December 31, 2002 and 2001, there were no loans for which a portion of the allowance was specifically allocated. Impaired loans were as follows:

	<u>2002</u>	<u>2001</u>
Impaired loans outstanding at year end	\$ 3,090,000	\$ 1,187,000
Average of impaired loans during the year	1,827,000	1,213,000
Interest income forgone during impairment	91,000	22,000
Cash-basis interest income recognized	52,600	-

Nonperforming loans were as follows:

	<u>2002</u>	<u>2001</u>
Loans past due over 90 days still on accrual	\$ -	\$ -
Nonaccrual loans	3,090,000	1,187,000

NOTE E - OFFICE PROPERTIES AND EQUIPMENT

Office properties and equipment consisted of:

	<u>2002</u>	<u>2001</u>
Land	\$ 2,011,829	\$ 2,011,830
Buildings and leasehold improvements	4,462,703	4,416,924
Furniture, equipment, and autos	3,951,807	3,796,092
Construction in progress	<u>78,628</u>	<u>1,892</u>
	10,504,967	10,226,738
Less accumulated depreciation	<u>(4,253,342)</u>	<u>(3,892,757)</u>
Office properties and equipment, net	<u>\$ 6,251,625</u>	<u>\$ 6,333,981</u>

(Continued)

PIONEER BANK AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2002 and 2001

NOTE E - OFFICE PROPERTIES AND EQUIPMENT (Continued)

The Bank leases office space for administrative offices and certain branch offices under various operating leases with terms ranging through 2004. Lease payments included in occupancy expense totaled \$225,262 and \$219,148 for the years ended December 31, 2002 and 2001, respectively. Future minimum lease payments under the non-cancelable operating leases are:

2003	\$ 230,068
2004	<u>53,998</u>
	<u>\$ 284,066</u>

NOTE F - MORTGAGE SERVICING RIGHTS AND LOAN SERVICING

Mortgage loans serviced for others are not included in the accompanying consolidated statements of financial condition. The unpaid principal balances of these loans are:

	<u>2002</u>	<u>2001</u>
Mortgage loans underlying pass-through securities		
GNMA	\$ 142,241,045	\$ 140,811,497
FNMA	84,127,976	70,894,290
FHLMC	<u>724,401</u>	<u>1,012,142</u>
	227,093,422	212,717,929
Mortgage loan portfolios serviced for		
FNMA	54,782,123	77,704,280
FHLMC	32,380,186	44,629,217
Other investors	<u>38,179,464</u>	<u>26,169,327</u>
	125,341,773	148,502,824
	<u>\$ 352,435,195</u>	<u>\$ 361,220,753</u>

Custodial balances on deposit at the Bank, in connection with the foregoing loan servicing, amounted to \$14,878,106 and \$10,149,482 at December 31, 2002 and 2001, respectively.

(Continued)

PIONEER BANK AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2002 and 2001

NOTE F - MORTGAGE SERVICING RIGHTS AND LOAN SERVICING (Continued)

An analysis of changes in mortgage servicing rights follows:

	<u>2002</u>	<u>2001</u>
Balance, beginning of year	\$ 3,210,502	\$ 3,154,595
Capitalized	1,199,229	1,261,666
Amortization	(1,165,049)	(757,044)
Change in impairment allowance	<u>(1,152,247)</u>	<u>(448,715)</u>
Balance, end of year	<u>\$ 2,092,435</u>	<u>\$ 3,210,502</u>

NOTE G - DEPOSITS

A comparative summary of deposits by remaining term to maturity follows:

	<u>2002</u>	<u>2001</u>
No contractual maturities	\$ 134,271,864	\$ 120,738,462
2003	86,582,276	95,750,117
2004	11,725,016	11,704,144
2005	20,435,741	2,516,742
2006	2,300,015	4,575,432
2007	<u>6,526,154</u>	<u>2,474,965</u>
	<u>\$ 261,841,066</u>	<u>\$ 237,759,862</u>

At December 31, 2002 and 2001, approximately \$28,403,000 and \$22,081,000, respectively, of mortgage securities were pledged to secure public unit deposits.

Time deposits of \$100,000 or more were \$36,230,000 and \$36,281,000 at year-end 2002, and 2001, respectively.

(Continued)

PIONEER BANK AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2002 and 2001

NOTE H - FEDERAL HOME LOAN BANK ADVANCES AND OTHER BORROWINGS

FHLB advances and other borrowings consist of fixed rate, fixed term advances that must be secured by mortgage loans or other assets acceptable to the FHLB. At December 31, 2002 and 2001, the Bank's advances were secured by a blanket assignment of mortgage loans with a market value greater than the amount of outstanding advances. At December 31, 2002 and 2001, securities with fair values of approximately \$1,010,000 and \$500,000, respectively, and mortgage loans of approximately \$208,881,000 and \$178,067,000, respectively, were pledged to secure FHLB advances and other borrowings. A summary of FHLB advances and other borrowings follows:

	Maturity Date	Rate	December 31,	
			2002	2001
FHLB advances and borrowings	1-02-02	2.030%	\$ -	\$ 10,600,000
	1-07-02	1.950	-	10,600,000
	1-02-03	1.350	8,000,000	-
	9-01-03	5.440	22,000,000	22,000,000
	4-19-04	5.100	10,000,000	10,000,000
	4-20-04	5.185	5,000,000	5,000,000
	5-20-04	3.566	10,000,000	10,000,000
	1-18-05	5.710	5,000,000	5,000,000
	1-26-05	5.510	2,481,900	2,481,900
	4-19-05	5.272	10,000,000	10,000,000
	5-16-05	4.052	8,500,000	-
	4-10-06	5.249	14,000,000	14,000,000
	10-10-06	3.092	10,000,000	-
	10-30-06	3.220	5,000,000	-
Treasury, tax and loan			375,166	114,843
			<u>\$ 110,357,066</u>	<u>\$ 99,796,743</u>

NOTE I - INCOME TAXES

The Bank records tax expense equal to the sum of deferred tax expense and income taxes currently payable or refundable. Total income tax expense in the accompanying consolidated statements of income are:

	2002	2001
Current		
Federal	\$ 3,255,115	\$ 2,184,034
State	803,625	459,119
Deferred		
Federal	(761,939)	(479,178)
State	(213,037)	(116,000)
	<u>\$ 3,083,764</u>	<u>\$ 2,047,975</u>

(Continued)

PIONEER BANK AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2002 and 2001

NOTE I - INCOME TAXES (Continued)

The differences between total tax expense and the amount computed by applying the applicable statutory federal income tax rate of 34% to income before income taxes were:

	<u>2002</u>	<u>2001</u>
Computed "expected" tax expense	\$ 2,734,421	\$ 1,839,382
State income taxes	388,518	225,515
Other	<u>(39,175)</u>	<u>(16,922)</u>
	<u>\$ 3,083,764</u>	<u>\$ 2,047,975</u>

Deferred taxes are attributable to temporary differences, such as the use of accelerated depreciation methods for tax purposes, the excess of the allowance for loan losses for financial reporting purposes over the amount for tax purposes that arose after 1987, the exclusion from taxable income for certain stock dividends, the recognition of unrealized gains and losses on securities for tax purposes, the deduction of loan origination costs for tax purposes, and the deferral of deductions for accrued liabilities under the Bank's medical and dental benefit plan. Certain unrealized gains and losses on securities available-for-sale are recognized currently for income tax purposes. Deferred taxes consisted of:

	<u>2002</u>	<u>2001</u>
Deferred tax assets	\$ 1,644,100	\$ 803,087
Deferred tax liabilities	<u>(2,676,662)</u>	<u>(2,468,498)</u>
	<u>\$ (1,032,562)</u>	<u>\$ (1,665,411)</u>

The Bank has not recorded a valuation allowance with respect to the deferred tax assets because it is anticipated that the assets are fully realizable.

As of January 1, 1996, Internal Revenue Code (IRC) Section 593, which allowed thrifts an 8% taxable income deduction for bad debts, was repealed. The Bank is required to recapture, over a six-year period, its bad debt reserve into income to the extent its reserve at December 31, 1995 exceeded its reserve recalculated without regard to IRC Section 593. As of December 31, 1995, the amount to be recaptured totaled \$679,000, for which a deferred tax liability had been recorded. The recapture was deferred for two years based upon the Bank's residential loan portfolio growth. In 1998, the Bank began recapturing approximately \$113,000 of its bad debt reserves per year, and as of December 31, 2002, the total amount recaptured was approximately \$566,000.

(Continued)

PIONEER BANK AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2002 and 2001

NOTE I - INCOME TAXES (Continued)

The permanent deferral of bad debt reserves prior to 1988 was not affected by the repeal of Section 593. The Bank's allowance for loan losses for tax purposes for which no deferred tax liability has been recognized and the corresponding unrecognized deferred tax liability are \$1,597,000 and \$613,000, respectively, as of December 31, 2002. Deferred tax liabilities are recognized for this temporary difference only if it is apparent that it will reverse and become taxable in the foreseeable future. This difference could become taxable in the future if the Bank fails to meet the definition of a qualifying financial institution for tax purposes or if distributions are made to stockholders in excess of accumulated earnings for tax purposes. Management does not anticipate that any event resulting in the reversal of this difference will occur.

NOTE J - REGULATORY MATTERS

The Bank is subject to certain restrictions on the amount of dividends it may declare without prior regulatory approval. The Bank is also subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of its assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk-weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of Total and Tier 1 Capital (as defined by regulation) to Risk-Weighted Assets (as defined) and Core Capital (as defined) to Adjusted Total Assets (as defined). Management believes, as of December 31, 2002 and 2001, that the Bank met all regulatory capital adequacy requirements to which it is subject.

The most recent notifications from the OTS as of December 31, 2002 and 2001 categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum Total risk-based, Tier 1 risk-based, and Core Capital ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the institution's category. The Bank's actual capital amounts and ratios are also presented in the table:

(Continued)

PIONEER BANK AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2002 and 2001

NOTE J - REGULATORY MATTERS (Continued)

	Actual (\$ in thousands)		Amount Needed to be Considered Adequately Capitalized (\$ in thousands)		Amount Needed to be Considered Well Capitalized Under Prompt Corrective Action (\$ in thousands)	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
<u>As of December 31, 2002</u>						
Total Risk-Based Capital (to risk-weighted assets)	\$ 29,392	19.0%	\$ 12,386	8.0%	\$ 15,482	10.0%
Tier 1 Risk-Based Capital (to risk-weighted assets)	28,956	18.7	6,193	4.0	9,289	6.0
Core Capital (to adjusted total assets)	28,956	7.0	16,450	4.0	20,562	5.0
<u>As of December 31, 2001</u>						
Total Risk-Based Capital (to risk-weighted assets)	\$ 25,582	19.3%	\$ 10,591	8.0%	\$ 13,239	10.0%
Tier 1 Risk-Based Capital (to risk-weighted assets)	25,219	19.1	5,296	4.0	7,943	6.0
Core Capital (to adjusted total assets)	25,219	6.8	14,912	4.0	18,640	5.0

NOTE K - COMMITMENTS AND CONTINGENCIES

In the ordinary course of business, the Bank may become a party to certain claims and legal actions. In the opinion of management, after consultation with legal counsel, the ultimate disposition of these matters is not expected to have a material effect on the consolidated financial condition of the Bank.

Also, the Bank has various outstanding commitments and contingent assets and liabilities that are not reflected in the accompanying consolidated financial statements. Those financial instruments with off-balance-sheet risk are used to meet the financial needs of the Bank's customers and include commitments to extend credit and standby letters of credit. They involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated statements of financial condition. The contract or notional amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

(Continued)

PIONEER BANK AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2002 and 2001

NOTE K - COMMITMENTS AND CONTINGENCIES (Continued)

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual notional amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments. The approximate contract or notional amounts of financial instruments whose contract amounts represent credit risk at December 31, 2002 are:

Undisbursed lines of credit and loans in process	\$ 10,097,000
Commitments to originate loans	1,131,000
Loans sold with recourse	96,000
Commitments to sell mortgages and mortgage-backed securities	5,776,000

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. At December 31, 2002, commitments to make loans at fixed rates totaled \$235,000. The fixed rate commitments had interest rates of 4.875%.

NOTE L - FAIR VALUE OF FINANCIAL INSTRUMENTS

Carrying amounts and estimated fair values of financial instruments were as follows at year-end:

	2002		2001	
	Carrying <u>Amount</u>	Fair <u>Value</u>	Carrying <u>Amount</u>	Fair <u>Value</u>
<u>Financial Assets</u>				
Cash and cash equivalents	\$ 15,597,847	\$ 15,597,847	\$ 11,168,783	\$ 11,168,783
Securities available-for-sale	136,488,908	136,488,908	129,681,151	129,681,151
Securities held-to-maturity	819,404	853,441	1,207,185	1,233,660
Loans held for sale	21,612,875	22,583,621	27,327,703	27,763,588
Loans, net	216,205,002	226,143,852	179,669,316	182,427,167
Federal Home Loan Bank and FNMA stock	8,648,617	8,648,617	8,483,700	8,483,700
Mortgage servicing rights	2,092,435	2,398,439	3,210,502	3,962,600
Accrued interest receivable	1,674,641	1,674,641	1,557,152	1,557,152
Interest rate cap agreements	-	-	271,547	271,547

(Continued)

PIONEER BANK AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2002 and 2001

NOTE L - FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

	2002		2001	
	<u>Carrying Amount</u>	<u>Fair Value</u>	<u>Carrying Amount</u>	<u>Fair Value</u>
<u>Financial Liabilities</u>				
Deposits	\$ 261,841,066	\$ 263,428,182	\$ 237,759,862	\$ 238,515,654
Federal Home Loan Bank advances	110,357,066	113,265,076	99,796,743	101,511,425
Advance payments for taxes and insurance	1,689,854	1,689,854	1,563,368	1,563,368
Accrued interest payable	516,985	516,985	545,481	545,481

The methods and assumptions used to estimate fair value are described as follows.

The carrying amount is the estimated fair value for cash and cash equivalents, short-term borrowings, Federal Home Loan Bank stock, accrued interest receivable and payable, demand deposits, short-term debt, and variable rate loans or deposits that reprice frequently and fully. Security fair values are based on market prices or dealer quotes, and if no such information is available, on the rate and term of the security and information about the issuer. For fixed rate loans or deposits and for variable rate loans or deposits with infrequent repricing or repricing limits, fair value is based on discounted cash flows using current market rates applied to the estimated life and credit risk. Fair values for impaired loans are estimated using discounted cash flow analysis or underlying collateral values. The fair value of loans held for sale is based on market quotes. The fair value of debt is based on current rates for similar financing. The fair value of commitments is based on the current fees or cost that would be charged to enter into or terminate such arrangements. The fair value of commitments is not materially different from the nominal value.

NOTE M - RETIREMENT PLANS

The Bank has a qualified 401(k) retirement savings plan for employees. Matching contributions are optional at the discretion of the Board of Directors. The level of matching contributions made by the Bank to eligible employee compensation and plan expenses, included in compensation and employee benefits in the accompanying consolidated statements of income, were as follows for 2002 and 2001:

<u>Year</u>	<u>Match</u>	<u>Compensation</u>	<u>Expense</u>
2002	100%	5.0%	\$ 110,115
2001	100%	5.0%	97,696

(Continued)

PIONEER BANK AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2002 and 2001

NOTE M - RETIREMENT PLANS (Continued)

The Bank maintains a non-qualified retirement plan (hereinafter referred to as "Indexed Retirement Plan" or "IRP") for certain key executive officers. At the time the IRP was established, the Bank purchased single premium life insurance policies having a total face value of \$800,000 on the lives of the participants. A death benefit for each executive has also been provided by endorsement of 80% of the non-at-risk insurance proceeds. Benefits are accrued under this plan to the extent that policy earnings exceed a cost of funds index tied to the Bank's cost of funds. The Bank has accrued benefits of \$274,896 and \$241,060, recorded in other liabilities, as of December 31, 2002 and 2001, respectively, under the IRP. As of December 31, 2002 and 2001, the cash surrender value of the life insurance policies under the IRP were approximately \$1,184,000 and \$1,130,000, respectively, which are recorded in other assets.

NOTE N - RELATED PARTY TRANSACTIONS

It is the policy of the Bank to provide mortgage loans made to its full-time officers and employees for the purpose of financing their personal residences. Any other loans made by the Bank to directors or officers are fully secured.

An analysis of loans over \$60,000 to directors and executive officers is:

	<u>2002</u>	<u>2001</u>
Balance at beginning of year	\$ 63,710	\$ 273,341
Originations	306,306	-
Principal repayments	<u>(8,299)</u>	<u>(209,631)</u>
Balance at end of year	<u>\$ 361,717</u>	<u>\$ 63,710</u>

(Continued)

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS
PIONEER BANK AND SUBSIDIARY



Board of Directors and Stockholders
Pioneer Bank and Subsidiary
Roswell, New Mexico

We have audited the accompanying consolidated statements of financial condition of Pioneer Bank and Subsidiary as of December 31, 2002 and 2001 and the related consolidated statements of income, cash flows, and stockholders' equity for the years then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Pioneer Bank and Subsidiary as of December 31, 2002 and 2001 and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note A, during 2001, the Company adopted new accounting guidance on derivatives.


Crowe, Chizek and Company LLP

Oak Brook, Illinois
February 14, 2003

PIONEER BANK AND SUBSIDIARY
SELECTED FINANCIAL DATA – UNAUDITED
December 31, 2002

The following table sets forth selected financial data for the last five years:

	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>
Interest and					
dividend income	\$ 22,105,705	\$ 23,021,519	\$ 22,765,151	\$ 22,063,276	\$ 18,330,476
Interest expense	10,303,324	13,893,529	15,476,093	13,633,862	11,150,099
Net interest income	11,802,381	9,127,990	7,289,058	8,429,414	7,180,377
Net income	4,958,651	2,853,972	2,531,461	2,808,132	3,601,198
Per share data					
Net income	4.91	2.83	2.51	2.78	3.57
Dividends	1.20	1.05	1.05	1.10	1.15
Securities	137,308,312	130,888,336	129,185,627	103,717,275	97,184,550
Loans	237,817,877	206,997,019	198,852,714	206,262,488	189,797,230
Total assets	412,515,882	372,901,648	362,962,161	341,548,512	312,175,994
Deposits	261,841,066	237,759,862	244,024,868	255,020,073	225,022,207
Borrowings	110,357,066	99,796,743	86,895,692	59,938,707	57,513,179
Stockholders' equity	29,594,925	25,323,804	22,464,980	18,521,823	20,068,720
Loans serviced for others	352,435,195	361,220,753	341,273,727	359,062,606	388,960,563
Customer service facilities					
Full service facilities	6	6	6	6	6
Banking branches	3	3	2	2	2
Loan production offices	2	2	2	2	2

PIONEER BANK AND SUBSIDIARY
SELECTED FINANCIAL DATA – UNAUDITED
December 31, 2002

2002 Compared to 2001

	Average Balance		Average Rate		Interest		Interest Variance	Interest Variance Attributable to:	
	<u>2002</u>	<u>2001</u>	<u>2002</u>	<u>2001</u>	<u>2002</u>	<u>2001</u>		<u>Volume</u>	<u>Rate</u>
Interest and dividend income									
Loans	\$ 215,561	\$ 194,785	6.91%	7.45%	\$14,887	\$ 14,518	\$ 369	\$ 1,435	\$ (1,066)
Mortgage securities	133,568	133,804	4.92	5.89	6,577	7,880	(1,303)	(12)	(1,291)
Securities	<u>15,864</u>	<u>13,100</u>	<u>4.05</u>	<u>4.76</u>	<u>642</u>	<u>623</u>	<u>19</u>	<u>112</u>	<u>(93)</u>
Total interest earning assets	<u>\$ 364,993</u>	<u>\$ 341,689</u>	<u>6.06%</u>	<u>6.74%</u>	<u>\$22,106</u>	<u>\$ 23,021</u>	<u>\$ (915)</u>	<u>\$ 1,535</u>	<u>\$ (2,450)</u>
Interest expenses									
Deposits	\$ 250,479	\$ 236,522	2.17%	3.62%	\$ 5,440	\$ 8,572	\$ (3,132)	\$ 303	\$ (3,435)
Borrowed funds	<u>101,441</u>	<u>95,011</u>	<u>4.79</u>	<u>5.60</u>	<u>4,864</u>	<u>5,321</u>	<u>(457)</u>	<u>308</u>	<u>(765)</u>
Total interest-bearing liabilities	<u>\$ 351,920</u>	<u>\$ 331,533</u>	<u>2.93%</u>	<u>4.19%</u>	<u>\$10,304</u>	<u>\$ 13,893</u>	<u>\$ (3,589)</u>	<u>\$ 611</u>	<u>\$ (4,200)</u>
Net interest spread and income			<u>3.13%</u>	<u>2.55%</u>	<u>\$11,802</u>	<u>\$ 9,128</u>			
Ratio of net interest income to average interest-earning assets					<u>3.23%</u>	<u>2.67%</u>			

2001 Compared to 2000

	Average Balance		Average Rate		Interest		Interest Variance	Interest Variance Attributable to:	
	<u>2002</u>	<u>2001</u>	<u>2002</u>	<u>2001</u>	<u>2002</u>	<u>2001</u>		<u>Volume</u>	<u>Rate</u>
Interest and dividend income									
Loans	\$ 194,785	\$ 205,729	7.45%	7.55%	\$14,518	\$ 15,533	\$ (1,015)	\$ (816)	\$ (199)
Mortgage securities	133,804	97,666	5.89	6.37	7,880	6,226	1,654	2,128	(474)
Securities	<u>13,100</u>	<u>16,436</u>	<u>4.76</u>	<u>6.12</u>	<u>623</u>	<u>1,006</u>	<u>(383)</u>	<u>(159)</u>	<u>(224)</u>
Total interest earning assets	<u>\$ 341,689</u>	<u>\$ 319,831</u>	<u>6.74%</u>	<u>7.12%</u>	<u>\$23,021</u>	<u>\$ 22,765</u>	<u>\$ 256</u>	<u>\$ 1,154</u>	<u>\$ (898)</u>
Interest expenses									
Deposits	\$ 236,522	\$ 245,203	3.62%	4.42%	\$ 8,572	\$ 10,827	\$ (2,255)	\$ (315)	\$ (1,940)
Borrowed funds	<u>95,011</u>	<u>73,908</u>	<u>5.60</u>	<u>6.29</u>	<u>5,321</u>	<u>4,649</u>	<u>672</u>	<u>1,182</u>	<u>(510)</u>
Total interest-bearing liabilities	<u>\$ 331,533</u>	<u>\$ 319,111</u>	<u>4.19%</u>	<u>4.85%</u>	<u>\$13,893</u>	<u>\$ 15,476</u>	<u>\$ (1,583)</u>	<u>\$ 868</u>	<u>\$ (2,451)</u>
Net interest spread and income			<u>2.55%</u>	<u>2.27%</u>	<u>\$ 9,128</u>	<u>\$ 7,289</u>			
Ratio of net interest income to average interest-earning assets					<u>2.67%</u>	<u>2.29%</u>			

PIONEER BANK AND SUBSIDIARY

CORPORATE INFORMATION

General Information

Pioneer Bank is a federally chartered stock savings bank. The Bank's deposits are insured by the Federal Deposit Insurance Corporation through the Savings Association Insurance Fund. The principal business of the Bank is to finance the purchase, construction, or improvement of residential real estate.

The Bank has one subsidiary, Pioneer Mortgage Company, which is involved in residential construction and mortgage lending, primarily in West Texas.

CORPORATE OFFICES

Pioneer Bank
306 North Pennsylvania
P.O. Box 130
Roswell, NM 88202-0130

INDEPENDENT PUBLIC ACCOUNTANTS

Crowe, Chizek and Company LLP
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P.O. Box 3697
Oak Brook, IL 60522-3697

GENERAL COUNSEL

Sanders, Bruin, Coll & Worley, P.A.
701 W. Country Club Rd.
P.O. Box 550
Roswell, NM 88202-0550

REGISTRAR AND TRANSFER AGENT

Pioneer Bank

ANNUAL MEETING

The annual meeting of shareholders of Pioneer Bank will be held at 2:00 p.m. on April 15, 2003 at the Sally Port Inn, 2000 North Main, Roswell, New Mexico.

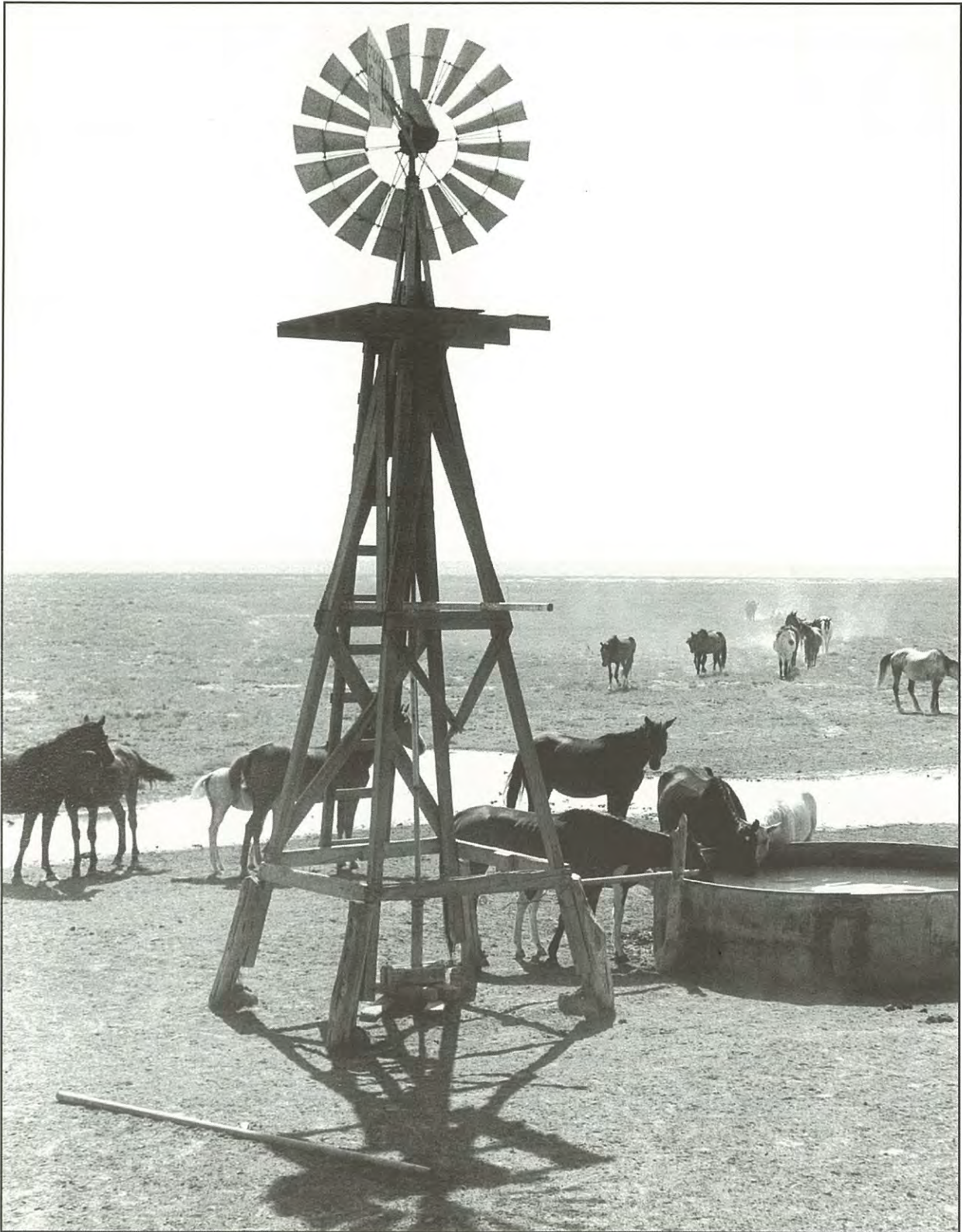
MARKET FOR CAPITAL STOCK

The capital stock of Pioneer Bank is not traded on any exchange nor is there a market maker in the stock. The market for the stock is limited and sporadic. There are no accurate quarterly high bid and low bid quotations available; accordingly, such bid information by quarter is not shown. Recent trades of issued and outstanding stocks have ranged from \$25.25 to \$28.00 per share. As of December 31, 2002, there were approximately 355 holders of record of Pioneer capital stock. Dividends of \$1.20 and \$1.05 per share were declared in 2002 and 2001, respectively.

PIONEER PRESIDENTS

"Leadership is not magnetic personality—that can just as well be a glib tongue. It is not "making friends and influencing people"—that is flattery. Leadership is lifting a person's vision to higher sights, the raising of a person's performance to a higher standard, the building of a personality beyond its normal limitations." In recognition of Pioneer's past and present leadership, we would like to include the following brief history of Pioneer Bank and biographies of the men who have led Pioneer for over 100 years.

- | | |
|--------------|--|
| 1901-1902 | D.S. Rosenwald was unanimously elected as Pioneer's first President. Rosenwald and James Hervey were instrumental in raising the \$200,000 that constituted Pioneer's starting capital. |
| 1902-1903 | Nathan Jaffa, Pioneer's second President, was the chief of the volunteer fire department in 1889 and Mayor of Roswell from April to December of 1903. |
| 1903-1906 | C.C. Tannehill becomes Pioneer's third President. |
| 1906-1907 | Nathan Jaffa serves a second term as President |
| 1907-1935 | E.A. Cahoon serves as President for 28 years. During his term, Pioneer moved three times, from the Garst Building to 303 N. Main and then to 117 W. Third St. |
| 1935-1951 | Following a long history of public service, J.F. Hinkle becomes President. Hinkle was Mayor of Roswell from 1904-1906 and Governor of New Mexico from 1923-1924. He also served as Commissioner of Public Lands for New Mexico. |
| 1951-1952 | R.H. McCune is elected as Pioneer's sixth President. |
| 1952-1966 | H.D.O. Hammond becomes Pioneer's seventh President. |
| 1966-1970 | Clayton Menefee begins to expand the company beyond Roswell's borders. In 1967, "Roswell Building and Loan" became "Roswell Savings and Loan Association," and the first branch office is opened in Ruidoso. |
| 1970-1980 | William A. McAlpine begins a term that includes a host of organizational changes, paving the way for significant expansion. In 1973, a merger with the Equitable Building & Loan created the largest savings and loan in Southern New Mexico, with more than 7,000 members and assets exceeding \$35 million. In 1974, the Alamogordo branch opened. In 1975, the company's name was changed to "Pioneer Savings & Trust Association," and Pioneer Mortgage Company was organized. In July of 1976, Pioneer converted from a mutual association to a stock association with its first issue of common stock. The first Pioneer Mortgage Company branch office opened in 1977 in El Paso, and full-service branch is opened in Carlsbad. In 1978, Pioneer continued its expansion by moving into Hobbs. |
| 1980-2002 | George Mitchell serves 22 years as President, a period exceeded only by E.A. Cahoon's. In 1982, Pioneer restored the historic Nestor Armijo House, the first two-story home in the Mesilla Valley, saving the building from destruction and providing a home for Pioneer in Las Cruces until 1991, when Pioneer moved to its current Telshor location. Three months later, Pioneer Mortgage Company opened a branch in Midland. Pioneer Bank became a federal association in April of 1983, changing its name to "Pioneer Savings & Trust, F.A." Pioneer Mortgage Company opened a branch in Odessa in 1993. In 1994, Pioneer became "Pioneer Savings Bank." In 1998, Pioneer expanded its Roswell operations by opening branches at Sunset and Alameda and North Main and Berrendo. In 2000, "Pioneer Savings Bank" became "Pioneer Bank." In 2001, Pioneer opened the doors of the Las Cruces Roadrunner branch. |
| 2002-Present | Jon Hitchcock becomes President after 22 years of service to Pioneer, much of which was spent as Executive Vice President. In 2002, Pioneer experienced record loan production, deposit levels and earnings. |



South Windmill on Miles Wiggins' Ranch, 1943.

Photo by **Walt Wiggins**

Special thanks to Sharon Jaskiewicz and Roger Burnett at the Historical Society for Southeast New Mexico

PIONEER BANK

Proud of Our Products and Services

- 
- Advantage Account
 - Pioneer Checking
 - 55+ Checking
 - No Frills Checking
 - Free Checking
 - Commercial Checking
 - Savings Accounts
 - Super Savings Accounts
 - Money Market Accounts
 - Certificates of Deposit
 - Easy Access CD
 - IRA Accounts
 - Mortgage Loans
 - Business Loans
 - Consumer Loans
 - 24-Hour Banking Services Line
(800) 375-1088
 - Internet Banking
www.pioneerbnk.com

PIONEER BANK AND SUBSIDIARY

BOARD OF DIRECTORS

G. Eugene Bell

Vice President – Bell Gas

James L. Bruin

Attorney

Patricia J. Cooper

Investments

Stephen P. Puntch

Senior Vice President – Pioneer Bank

James D. Harris

Owner – Charles, Garland and
Harris Agency

Jon E. Hitchcock

President – Pioneer Bank

Timothy Z. Jennings

State Senator and Rancher

Arthur R. McQuiddy

President – McQuiddy
Communications & Energy, Inc.

George W. Mitchell

Investments

C. W. Ritter

President – Ritter Enterprises, Inc.

OFFICERS

PIONEER BANK

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Chairman of the Board

Jon E. Hitchcock

Vice President

John Dick-Peddie
Charlotte Y. Gipson
Suzi K. Glass
Daniel A. Hostetler
Alan W. Johnson
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Dee Ann Nuñez
Rosalyn Robinson
Rebecca E. Underation
Michael R. Vineyard
Debe M. Wagner

Senior Vice President

Britt Donaldson
Stephen P. Puntch

Secretary

Barba N. McCampbell

Vice President & Comptroller

Gayla I. Morris

Assistant Secretary

Anna K. Ritchey
Jessica L. Rodriguez
Dawn L. Selter

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Patricia M. Barresi
Davis E. Bennett
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Sylvia Masi
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Nancy L. Smith
Carolyn S. Spencer
Robert D. Vie
Debra M. Young

Assistant VP & Treasurer

Pamela D. McClain

PIONEER MORTGAGE COMPANY

Vice President

Freida J. Goodrum
Pamela A. Sparks

PIONEER BANK

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1020 Tenth Street, P.O. Box 1707, Alamogordo, New Mexico 88311
(505) 437-9075

111 North Canal Street, P.O. Box S, Carlsbad, New Mexico 88221
(505) 887-6551

1020 North Turner Street, P.O. Box 177, Hobbs, New Mexico 88241
(505) 393-2102

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