SOUTHSIDE BANCSHARES INC
Form 10-K405
March 15, 2001

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

Form 10-K

(MARK ONE)

X ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2000

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM ______ TO _____

COMMISSION FILE NUMBER 0-12247

SOUTHSIDE BANCSHARES, INC.
(Exact name of registrant as specified in its charter)

TEXAS	75-1848732
(State of incorporation)	(I.R.S. Employer Identification No.)
1201 S. BECKHAM AVENUE, TYLER, TEXAS	75701
(Address of Principal Executive Offices)	(Zip Code)

Registrant's telephone number, including area code: (903) 531-7111

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
NONE	NONE

Securities registered pursuant to Section 12(g) of the Act:

COMMON STOCK
(Title of Class)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES X NO

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained,

to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

As of March 2, 2001, 7,499,916 shares of common stock of Southside Bancshares, Inc. were outstanding. The aggregate market value of common stock held by nonaffiliates of the registrant as of March 2, 2001 was $52,226,913.

DOCUMENTS INCORPORATED BY REFERENCE

Registrant's Proxy Statement to be filed for the Annual Meeting of Shareholders to be held April 19, 2001. (Part III)

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PART I

ITEM 1. BUSINESS

GENERAL

Southside Bancshares, Inc. (the "Company"), incorporated in Texas in 1982, is a bank holding company for Southside Bank (the "Bank" or "Southside Bank"), headquartered in Tyler, Texas. Tyler has a metropolitan area population of approximately 171,000 and is located approximately 90 miles east of Dallas, Texas and 90 miles west of Shreveport, Louisiana. The Bank has the largest deposit base in the Tyler metropolitan area and is the largest bank based on asset size headquartered in East Texas.

At December 31, 2000, the Company had total assets of $1.2 billion, total loans of $481.4 million, deposits of $720.6 million, and shareholders' equity of $51.7 million. The Company had net income of $9.8 million and $7.9 million and diluted earnings per share of $1.24 and $1.00 for the years ended December 31, 2000 and 1999, respectively. The Company has paid a cash dividend every year since 1970.

The Bank is a community-focused financial institution that offers a full range of financial services to individuals, businesses and nonprofit organizations in the communities it serves. These services include consumer and commercial loans, deposit accounts, trust services, safe deposit services and brokerage services.

The Bank's consumer loan services include 1-4 family residential mortgage loans, home improvement loans, automobile loans and other installment loans. The Bank began offering home equity loans in January 1998 when a new Texas law first permitting such loans took effect. Commercial loan services include short-term working capital loans for inventory and accounts receivable, short and medium-term loans for equipment or other business capital expansion and commercial real estate loans. The Bank also offers construction loans primarily for owner-occupied 1-4 family residential and commercial real estate.

The Bank offers a variety of deposit accounts having a wide range of interest rates and terms, including savings, money market, interest and noninterest bearing checking accounts and certificate accounts. The Bank's trust services include investment, management, administration and advisory services, primarily for individuals and, to a lesser extent, partnerships and corporations. At December 31, 2000, the Bank's trust department managed approximately $207 million of trust assets. Through its 25% owned securities brokerage affiliate, BSC Securities, L.C., the Bank offers full retail

investment services to its customers. In early 1997, the Company formed a consumer finance subsidiary, Countywide Loans, Inc. ("Countywide"), to provide basic financial services such as small loans, check cashing and money orders to individuals, which at December 31, 2000, had $.9 million in loans outstanding.

The Company and the Bank are subject to comprehensive regulation, examination and supervision by the Board of Governors of the Federal Reserve System (the "FRB"), the Texas Department of Banking (the "TDB") and the Federal Depository Insurance Corporation (the "FDIC"), and are subject to numerous laws and regulations relating to the extension of credit and making of loans to individuals.

The administrative offices of the Company are located at 1201 S. Beckham Avenue, Tyler, Texas 75701, and the telephone number is 903-531-7111. The Company's website can be found at www.southside.com.

MARKET AREA

The Company considers its primary market area to be all of Smith and Gregg Counties in East Texas, and to a lesser extent, portions of adjoining counties. During 1998 and 1999, the Bank opened three branches in Gregg County and one branch in Smith County. The Bank plans to open two additional branches in Lindale and Whitehouse, both in Smith County, which should open during 2001. The Company expects its presence in the Gregg County market area to increase in the future, however, the city of Tyler in Smith County presently represents the Company's primary market area.

The principal economic activities in the Company's market area include retail, distribution, manufacturing, medical services, education and oil and gas industries. Additionally, Tyler's industry base includes conventions and tourism, as well as retirement relocation. All of these support a growing regional system of medical service, retail and education centers. Tyler is home to several nationally recognized health care systems. Tyler hospitals represent all major specialties and employ over 6,500 individuals. In 1998, Target Stores opened a multi-state distribution center in the greater Tyler area along Interstate 20 that employs over 1,000 workers.

The Bank serves its markets through twelve full service branch locations, including seven branches located in grocery stores. The branches are located in and around Tyler and Longview. Several longtime Longview banking veterans joined the Bank to lead the Company in its expansion into the Longview market. The Company's television and radio advertising has extended into this market area for several years, providing the Bank name recognition in the greater Longview area.

The Bank also maintains four motor bank facilities and Countywide maintains one location. The Bank's customers may also access various banking services through 21 ATMs owned by the Bank and ATMs owned by others, through debit cards, and through the Bank's automated telephone, internet and electronic banking products. These products allow the Bank's customers to apply for loans, access account information and conduct various transactions from their telephones and computers.

LENDING ACTIVITIES

The Company's main objective is to seek attractive lending opportunities in East Texas, primarily in Smith and Gregg Counties. Substantially all of the

Bank's loans are made to borrowers who live in and conduct business in East Texas, with the exception of selected municipal loans. Total loans as of December 31, 2000 increased $94.0 million or 24.3% while the average balance was up $93.1 million or 27.3% when compared to 1999.

Real estate loans as of December 31, 2000 increased $53.7 million or 23.5% from December 31, 1999. Loans to individuals increased $12.3 million or 15.6% from December 31, 1999 and commercial loans increased $28.0 million or 35.1%.

The increase in real estate loans is due to a stronger real estate market and a strong commitment by the Company to residential mortgage lending. Commercial loans increased as a result of commercial growth in the Company's market area. Commercial loans also increased due to the growth of loans made to municipalities in Texas. Loans to individuals increased due to greater penetration in the Company's market area. In the portfolio, loans dependent upon private household income represent a significant concentration. Due to the number of customers involved who work in all sectors of the local economy, the Company believes the risk in this portion of the portfolio is adequately spread throughout the economic community.

The aggregate amount of loans that the Bank is permitted to make under applicable bank regulations to any one borrower, including related entities, is 25% of unimpaired certified capital and surplus. The Bank's legal lending limit at December 31, 2000 was $10 million. The Bank's largest loan relationship at December 31, 2000 was approximately $7.5 million.

The average yield on loans for the year ended December 31, 2000 increased to 8.45% from 8.28% for the year ended December 31, 1999. This increase was reflective of the repricing characteristics of the loans and the increase in lending rates during 2000.

LOAN PORTFOLIO COMPOSITION AND ASSOCIATED RISK

The following table sets forth loan totals net of unearned discount by category for the years presented:

	December 31,				
	2000	1999	1998	1997	1996
	(in thousands)				
Real Estate Loans:					
Construction	$ 25,108	$ 18,489	$ 10,509	$ 10,299	$ 7,
1-4 Family Residential	134,672	112,699	93,215	76,243	62,
Other	122,665	97,556	68,140	55,802	57,
Commercial Loans	107,711	79,722	67,977	61,972	51,
Loans to Individuals	91,279	78,980	79,882	91,719	79,
Total Loans	$ 481,435	$ 387,446	$ 319,723	$ 296,035	$ 258,

For purposes of this discussion, the Company's loans are divided into three categories: Real Estate Loans, Commercial Loans, and Loans to Individuals.

REAL ESTATE LOANS

Real estate loans represent the Company's greatest concentration of loans. However, the amount of risk associated with this group of loans is mitigated in part due to the type of loans involved. At December 31, 2000, the majority of the Company's real estate loans were collateralized by properties located in Smith and Gregg Counties. Of the $282.4 million in real estate loans, $134.7 million or 47.7% represent loans collateralized by residential dwellings that are primarily owner occupied. Historically, the amount of losses suffered on this type of loan has been significantly less than those on other properties. The Company's loan policy requires appraisal prior to funding any real estate loans and also outlines the requirements for appraisals on renewals.

Management pursues an aggressive policy of reappraisal on any real estate loan that becomes troubled and potential exposures are recognized and reserved for as soon as they are identified. However, the slow pace of absorption for certain types of properties could adversely affect the volume of nonperforming real estate loans held by the Company.

Real estate loans are divided into three categories: 1-4 Family Residential Mortgage Lending, Construction Loans and Commercial Real Estate Loans.

1-4 Family Residential Mortgage Lending

Residential loan originations are generated by the Company's in-house originations staff, marketing efforts, present customers, walk-in customers and referrals from real estate agents, mortgage brokers and builders. The Company focuses its lending efforts primarily on the origination of loans secured by first mortgages on owner-occupied, 1-4 family residences. Substantially all of the Company's 1-4 family residential mortgage originations are secured by properties located in Smith and Gregg Counties, Texas. Historically, the Company has sold a portion of its loan originations to secondary market investors pursuant to ongoing purchase commitments.

The Company's fixed rate 1-4 family residential mortgage loans generally have maturities ranging from five to 30 years. These loans are typically fully amortizing with monthly payments sufficient to repay the total amount of the loan or amortizing with a balloon feature, typically due in fifteen years or less.

The Company reviews information concerning the income, financial condition, employment and credit history when evaluating the creditworthiness of the applicant.

In November 1997, Texas voters approved a change to the Texas Constitution allowing home equity loans. The Company began offering this form of real estate lending beginning January 1, 1998 when the law became effective. At December 31, 2000, these loans totaled $17.9 million.

Construction Loans

The Company's construction loans are collateralized by property located

primarily in the Company's market area. The Company's emphasis for construction loans is directed toward properties that will be owner occupied. Occasionally, construction loans for projects built on speculation are financed, but these typically have substantial secondary sources of repayment. The Company's construction loans to individuals generally have fixed interest rates during the construction period. Construction loans to individuals are typically made in connection with the granting of the permanent loan on the property.

Commercial Real Estate Loans

In determining whether to originate commercial real estate loans, the Company generally considers such factors as the financial condition of the borrower and the debt service coverage of the property. Commercial real estate loans are made at both fixed and adjustable interest rates for terms generally up to 20 years. Commercial real estate loans primarily include commercial office buildings, retail, medical and warehouse facilities, hotels and churches. The majority of these loans, with the exception of those for hotels and churches, are collateralized by owner occupied properties.

COMMERCIAL LOANS

The Company's commercial loans are diversified to meet most business needs. Loan types include short-term working capital loans for inventory and accounts receivable and short and medium-term loans for equipment or other business capital expansion. Management does not consider there to be any material concentration of risk in any one industry type, other than medical, in this loan category since no industry classification represents over 10% of loans. The medical community represents a concentration of risk in the Company's Commercial loan and Commercial Real Estate loan portfolio (see "Market Area"). Risk in the medical community is mitigated because it is spread among multiple practice types and multiple specialties.

In its commercial business loan underwriting, the Company assesses the creditworthiness, ability to repay, and the value and liquidity of the collateral being offered. Terms are generally granted commensurate with the useful life of the collateral offered.

The Company formed a special lending department during 1998 that makes loans to municipalities and school districts throughout the state of Texas. The majority of the loans to municipalities and school districts have tax pledges which additionally support these loans in addition to collateral. Average loans to municipalities and school districts increased approximately $16.2 million during the year ended December 31, 2000. At December 31, 2000, the Company had Commercial Loans to municipalities and school districts of $31.1 million and Real estate loans to municipalities and school districts of $1.3 million.

LOANS TO INDIVIDUALS

The Bank is a major consumer lender in its trade territory and has been for many years. The majority of consumer loans outstanding are those secured by vehicles, including the "indirect" vehicle loan portfolio, which at December 31, 2000 was approximately $3.9 million. The indirect vehicle loans on the Company's books were originated through automobile dealers but underwritten directly by the Company using the same underwriting guidelines used for its direct vehicle loans. However, due to market forces that were contributing to declining profit margins on indirect vehicle loans, the Company exited the indirect vehicle loan program effective January 2, 1998 to concentrate on direct vehicle loans. Direct vehicle loans accounted for approximately $52.4 million at December 31, 2000. Additionally, the Company makes loans for a full range of other consumer purposes, which may be secured or unsecured depending on the credit quality and purpose of the loan.

At this point, the economy in the Bank's trade territory appears stable. One area of concern is the nationwide personal bankruptcy rate. Management expects this rate to have some adverse effect on the Company's net charge-offs. Most of the Company's loans to individuals are collateralized, which management believes will limit the exposure in this area should current bankruptcy levels continue.

Consumer loan terms vary according to the type and value of collateral, length of contract and creditworthiness of the borrower. The underwriting standards employed by the Company for consumer loans include an application, a determination of the applicant's payment history on other debts, with greatest weight being given to payment history with the Company, and an assessment of the borrower's ability to meet existing obligations and payments on the proposed loan. Although creditworthiness of the applicant is a primary consideration, the underwriting process also includes a comparison of the value of the collateral, if any, in relation to the proposed loan amount.

LOAN MATURITIES AND SENSITIVITY TO CHANGES IN INTEREST RATES

The following table represents loan maturities and sensitivity to changes in interest rates. The amounts of total loans outstanding at December 31, 2000, which, based on remaining scheduled repayments of principal, are due in (1) one year or less*, (2) more than one year but less than five years, and (3) more than five years*, are shown in the following table. The amounts due after one year are classified according to the sensitivity to changes in interest rates.

	Due in One Year or Less	After One but within Five Years	After Five Years
		(in thousands)	
Construction Loans	$ 15,736	$ 7,845	$ 1,527
Real Estate Loans-Other	107,403	126,248	23,686
Commercial Loans	86,117	20,492	1,102
All Other Loans	58,204	29,442	3,633
Total Loans	$ 267,460	$ 184,027	$ 29,948

Loans with Maturities After One Year for Which:		
	Interest Rates are Fixed or Predetermined	$ 213,346
	Interest Rates are Floating or Adjustable	$ 24,604

* The volume of commercial loans due within one year reflects the Company's general policy of limiting such loans to a short-term maturity. Loans are shown net of unearned discount. Nonaccrual loans are reflected in the due after five years column.

LOANS TO AFFILIATED PARTIES

In the normal course of business, the Company's subsidiary, Southside Bank, makes loans to certain of the Company's, as well as its own, officers, directors, employees and their related interests. As of December 31, 2000 and

1999, these loans totaled $8.9 million and $8.8 million or 17.2% and 23.3% of Shareholders' Equity, respectively. Such loans are made in the normal course of business at normal credit terms, including interest rate and collateral requirements and do not represent more than normal credit risks contained in the rest of the loan portfolio for loans of similar types.

LOAN LOSS EXPERIENCE AND RESERVE FOR LOAN LOSSES

The loan loss reserve is based on the most current review of the loan portfolio at that time. Several methods are used to maintain the review in the most current manner. First, the servicing officer has the primary responsibility for updating significant changes in a customer's financial position. Accordingly, each officer prepares status updates on any credit deemed to be experiencing repayment difficulties which, in the officer's opinion, would place the collection of principal or interest in doubt. Second, an internal review officer from the Company is responsible for an ongoing review of the Company's entire loan portfolio with specific goals set for the volume of loans to be reviewed on an annual basis. Independent Bank Services, L.C., a partially owned subsidiary of the Bank, supplements the internal review officer's process by performing additional loans reviews designed to achieve overall goals of penetration. Third, Southside Bank is regulated and examined by the FDIC and/or the Texas Department of Banking on an annual basis.

At each review of a credit, a subjective analysis methodology is used to grade the respective loan. Categories of grading vary in severity to include loans which do not appear to have a significant probability of loss at the time of review to grades which indicate a probability that the entire balance of the loan will be uncollectible. If full collection of the loan balance appears unlikely at the time of review, estimates or appraisals of the collateral securing the debt are used to allocate the necessary reserves. A list of loans, which are graded as having more than the normal degree of risk associated with them, is maintained by the internal review officer. This list is updated on a periodic basis, but no less than quarterly by the servicing officer in order to properly allocate necessary reserves and keep management informed on the status of attempts to correct the deficiencies noted in the credit.

Industry experience shows that a portion of the Company's loans will become delinquent and a portion of the loans will require partial or entire charge-off. Regardless of the underwriting criteria utilized, losses may be experienced as a result of various factors beyond the Company's control, including, among other things, changes in market conditions affecting the value of properties and problems affecting the credit of the borrower. Management's determination of the adequacy of allowance for loan losses is based on various considerations, including an analysis of the risk characteristics of various classifications of loans, previous loan loss experience, specific loans which would have loan loss potential, delinquency trends, estimated fair value of the underlying collateral, current economic conditions, the views of the regulators (who have the authority to require additional reserves), and geographic and industry loan concentration.

In addition to maintaining an ongoing review of the loan portfolio, the internal review officer maintains a history of the loans that have been charged-off without first being identified as problems. This history is used to assist in gauging the amount of nonspecifically allocated reserve necessary, in addition to the portion which is specifically allocated by loan. The internal review officer also uses the loan portfolio data collected to determine the allocation of reserve for loan loss appropriate for the risk in each of the

Company's major loan categories.

As of December 31, 2000, the Company's review of the loan portfolio indicates that a loan loss reserve of $5.0 million is adequate.

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The following table presents information regarding the average amount of net loans outstanding, changes in the reserve for loan losses, the ratio of net loans charged-off to average loans outstanding, and an allocation of the reserve for loan loss.

LOAN LOSS EXPERIENCE AND RESERVE FOR LOAN LOSSES

	Years Ended		
	2000	1999	19
		(dollars in	
Average Net Loans Outstanding	$ 434,559	$ 341,466	$ 30
Balance of Reserve for Loan Loss at Beginning of Period	$ 4,575	$ 3,564	$
Loan Charge-Offs:			
Real Estate-Construction	(15)	--	
Real Estate-Other	(14)	--	
Commercial Loans	(522)	(114)	
Loans to Individuals	(891)	(651)	
Total Loan Charge-Offs	(1,442)	(765)	(
Recovery of Loans Previously Charged off:			
Real Estate-Construction	--	--	
Real Estate-Other	34	5	
Commercial Loans	57	106	
Loans to Individuals	240	209	
Total Recovery of Loans Previously Charged-Off	331	320	
Net Loan Charge-Offs	(1,111)	(445)	(
Provision for Loan Loss	1,569	1,456	
Balance at End of Period	$ 5,033	$ 4,575	$
Ratio of Net Charge-Offs to Average Loans Outstanding	.26%	.13%	

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Allocation of Reserve for Loan Loss (dollars in thousands):

	December 31,						
	2000		1999		1998		
	Amount	% of Total	Amount	% of Total	Amount	% of Total	Amoun
Real Estate-Construction	$ 230	4.6%	$ 91	2.0%	$ 52	1.5%	$ 5
Real Estate-Other	2,124	42.2%	1,804	39.4%	1,291	36.2%	1,08
Commercial Loans	1,561	31.0%	1,558	34.1%	1,182	33.2%	1,18
Loans to Individuals	1,097	21.8%	1,077	23.5%	1,017	28.5%	1,04
Unallocated	21	.4%	45	1.0%	22	.6%	1
Balance at End of Period	$5,033	100%	$4,575	100%	$3,564	100%	$3,37

See "Consolidated Financial Statements - Note 6. Loans and Reserve for Possible Loan Losses."

NONPERFORMING ASSETS

Nonperforming assets consist of delinquent loans over 90 days past due, nonaccrual loans, other real estate owned and restructured loans. Nonaccrual loans are those loans which are more than 90 days delinquent and collection in full of both the principal and interest is in doubt. Additionally, some loans that are not delinquent may be placed on nonaccrual status due to doubts about full collection of principal or interest. When a loan is categorized as nonaccrual, the accrual of interest is discontinued and the accrued balance is reversed for financial statement purposes. Other Real Estate Owned (OREO) represents real estate taken in full or partial satisfaction of debts previously contracted. The OREO consists of two real estate properties. The Company is actively marketing the properties and they are not held for investment purposes. Restructured loans represent loans which have been renegotiated to provide a reduction or deferral of interest or principal because of deterioration in the financial position of the borrowers. Categorization of a loan as nonperforming is not in itself a reliable indicator of potential loan loss. Other factors, such as the value of collateral securing the loan and the financial condition of the borrower must be considered in judgments as to potential loan loss.

The following table of nonperforming assets is classified according to

bank regulatory call report guidelines:

NONPERFORMING ASSETS

	Years Ended December 31,				
	2000	1999	1998	1997	1996
	(dollars in thousands)				
Loans 90 Days Past Due:					
Real Estate	$ 577	$ 233	$ 412	$ 454	$ 21
Loans to Individuals	43	58	44	232	17
Commercial	599	48	120	56	8
	1,219	339	576	742	47
Loans on Nonaccrual:					
Real Estate	336		2	108	64
Loans to Individuals	216	281	263	177	11
Commercial	78	422	167	1,059	77
	630	703	432	1,344	1,53
Restructured Loans:					
Real Estate	160	178	197	214	23
Loans to Individuals	151	214	222	189	10
Commercial	78	56	54	32	6
	389	448	473	435	40
Total Nonperforming Loans	2,238	1,490	1,481	2,521	2,40
Other Real Estate Owned	43	140	195	364	27
Repossessed Assets	196	209	326	206	26
Total Nonperforming Assets	$ 2,477	$ 1,839	$ 2,002	$ 3,091	$ 2,94
Percentage of Total Assets	.22%	.18%	.23%	.54%	.6
Percentage of Loans and Leases, Net of Unearned Income	.51%	.47%	.63%	1.04%	1.1

Total nonperforming assets increased $638,000 or 34.7% between December 31, 1999 and December 31, 2000. On January 3, 2001, one loan of $268,000 in the nonperforming asset category, loans 90 days past due, was paid in full. Nonperforming assets as a percentage of assets increased .04% from the previous year and as a percentage of loans increased .04%. Nonperforming assets represent a drain on the earning ability of the Company. Earnings losses are due both to the loss of interest income and the costs associated with maintaining the OREO, for taxes, insurance and other operating expenses. In addition to the nonperforming assets, at December 31, 2000 in the opinion of management, the Company had $431,000 of loans identified as potential problem loans. A potential problem loan is a loan where information about possible credit problems of the

borrower is known, causing management to have serious doubts about the ability of the borrower to comply with the present loan repayment terms and may result in a future classification of the loan in one of the nonperforming asset categories.

The following is a summary of the Company's recorded investment in loans (primarily nonaccrual loans) for which impairment has been recognized in accordance with FAS114:

	Total	Valuation Allowance	Carrying Value
		(in thousands)	
Real Estate Loans......................	$ 336	$ 32	$ 304
Commercial Loans.......................	78	20	58
Loans to Individuals...................	216	29	187
Balance at December 31, 2000...........	$ 630	$ 81	$ 549

	Total	Valuation Allowance	Carrying Value
		(in thousands)	
Commercial Loans.......................	$ 422	$ 225	$ 197
Loans to Individuals...................	281	44	237
Balance at December 31, 1999...........	$ 703	$ 269	$ 434

For the years ended December 31, 2000 and 1999, the average recorded investment in impaired loans was approximately $567,000 and $565,000, respectively. During the years ended December 31, 2000 and 1999, the amount of interest income reversed on impaired loans placed on nonaccrual and the amount of interest income subsequently recognized on the cash basis was not material.

The net amount of interest recognized on loans that were nonaccruing or restructured during the year was $122,000, $125,000 and $94,000 for the years ended December 31, 2000, 1999 and 1998, respectively. If these loans had been accruing interest at their original contracted rates, related income would have been $138,000, $137,000 and $113,000 for the years ended December 31, 2000, 1999 and 1998, respectively.

The following is a summary of the Allowance for Losses on Other Real Estate Owned for the years presented:

	Years Ended December 31,		
	2000	1999	1998
	(in thousands)		
Balance at beginning of year	$ 61	$ 658	$ 672
Acquisition of OREO	--	61	--
Disposition of OREO	(61)	(658)	(14)
Balance at end of year	$ --	$ 61	$ 658

SECURITIES ACTIVITY

The securities portfolio of the Company plays a primary role in management of the interest rate sensitivity of the Company and, therefore, is managed in the context of the overall balance sheet. The securities portfolio generates a substantial percentage of the Company's interest income and serves as a necessary source of liquidity.

The Company accounts for debt and equity securities as follows:

Held to Maturity (HTM). Debt securities that management has the positive intent and ability to hold until maturity are classified as HTM and are carried at their remaining unpaid principal balance, net of unamortized premiums or unaccreted discounts. Premiums are amortized and discounts are accreted using the level interest yield method over the estimated remaining term of the underlying security.

Available for Sale (AFS). Debt and equity securities that will be held for indefinite periods of time, including securities that may be sold in response to changes in market interest or prepayment rates, needs for liquidity and changes in the availability of and the yield of alternative investments are classified as AFS. These assets are carried at market value. Market value is determined using published quotes as of the close of business. Unrealized gains and losses are excluded from earnings and reported net of tax as a separate component of shareholders' equity until realized.

Management attempts to deploy investable funds into instruments which are expected to increase the overall return of the portfolio given the current assessment of economic and financial conditions, while maintaining acceptable levels of capital, interest rate and liquidity risk.

The following table sets forth the carrying amount of Investment Securities, Mortgage-backed Securities and Marketable Equity Securities at December 31, 2000 and 1999:

December 31,

Available for Sale:	2000	1999
	(in thousands)	
U.S. Treasury	$ 6,015	$ 9,467
U.S. Government Agencies..................	3,502	21,168
Mortgage-backed Securities:		
Direct Govt. Agency Issues.............	254,667	232,855
Other Private Issues...................	14,619	40,821
State and Political Subdivisions...........	45,150	55,543
Other Stocks and Bonds.....................	22,336	28,609
Total..............................	$ 346,289	$ 388,463

	December 31,	
Held to Maturity:	2000	1999
	(in thousands)	
U.S. Government Agencies.................	$ 39,888	$ 42,871
Mortgage-backed Securities:		
Direct Govt. Agency Issues............	67,498	14,967
Other Private Issues..................	75,463	58,931
State and Political Subdivisions..........	54,994	43,048
Other Stocks and Bonds....................	9,626	289
Total.............................	$ 247,469	$ 160,106

The Company invests in mortgage-backed and related securities, including mortgage participation certificates, which are insured or guaranteed by U.S. Government agencies and government sponsored enterprises, and collateralized mortgage obligations and real estate mortgage investment conduits. Mortgage-backed securities (which also are known as mortgage participation certificates or pass-through certificates) represent a participation interest in a pool of single-family or multi-family mortgages, the principal and interest payments on which are passed from the mortgage originators, through intermediaries (generally U.S.

Government agencies, government sponsored enterprises, and direct whole loans) that pool and repackage the participation interests in the form of securities, to investors such as the Company. U.S. Government agencies and government sponsored enterprises, which guarantee the payment of principal and interest to investors, primarily include the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association and the Government National Mortgage Association. The whole loans the Company purchases are all AAA rated collateralized mortgage obligations and real estate mortgage investment conduit tranches rated AAA due to credit support and/or insurance coverage.

Mortgaged-backed securities typically are issued with stated principal amounts, and the securities are backed by pools of mortgages that have loans with interest rates that are within a range and have varying maturities. The characteristics of the underlying pool of mortgages, i.e., fixed-rate or adjustable-rate, as well as prepayment risk, are passed on to the certificate holder. The term of a mortgaged-backed pass-through security thus approximates the term of the underlying mortgages.

The Company's mortgaged-backed derivative securities include collateralized mortgage obligations, which include securities issued by entities which have qualified under the Internal Revenue Code as real estate mortgage investment conduits. Collateralized mortgage obligations and real estate mortgage investment conduits (collectively collateralized mortgage obligations) have been developed in response to investor concerns regarding the uncertainty of cash flows associated with the prepayment option of the underlying mortgagor and are typically issued by governmental agencies, government sponsored enterprises and special purpose entities, such as trusts, corporations or partnerships, established by financial institutions or other similar institutions. A collateralized mortgage obligation can be collateralized by loans or securities which are insured or guaranteed by Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, the Government National Mortgage Association, or whole loans which, in the Company's case, are all rated AAA. In contrast to pass-through mortgage-backed securities, in which cash flow is received pro rata by all security holders, the cash flow from the mortgages underlying a collateralized mortgage obligation is segmented and paid in accordance with a predetermined priority to investors holding various collateralized mortgage obligation classes. By allocating the principal and interest cash flows from the underlying collateral among the separate collateralized mortgage obligation classes, different classes of bonds are created, each with its own stated maturity, estimated average life, coupon rate and prepayment characteristics.

Like most fixed-income securities, mortgage-backed and related securities are subject to interest rate risk. However, unlike most fixed-income securities, the mortgage loans underlying a mortgage-backed or related security generally may be prepaid at any time without penalty. The ability to prepay a mortgage loan generally results in significantly increased price and yield volatility (with respect to mortgage-backed and related securities) than is the case with non-callable fixed income securities. Furthermore, mortgage-backed derivative securities often are more sensitive to changes in interest rates and prepayments than traditional mortgage-backed securities and are, therefore, even more volatile.

The combined Investment Securities, Mortgage-backed Securities, and Marketable Equity Securities portfolio increased to $593.8 million on December 31, 2000, compared to $548.6 million on December 31, 1999, an increase of $45.2 million or 8.2%. Mortgage-backed Securities increased $64.7 million or 18.6% during 2000 when compared to 1999. State and Political Subdivisions increased $1.6 million or 1.6% during 2000. U.S. Treasury securities decreased during 2000 compared to 1999 by $3.5 million or 36.5%, U.S. Government Agency securities decreased $20.6 million or 32.2% and Other Stocks and Bonds increased $3.1 million or 10.6% in 2000 compared to 1999 due to increased purchases of corporate bonds and increases in FHLB Dallas equity securities. During the first half of 2000, as rates continued to increase, the Company sold securities with an overall lower yield and, in some cases a longer average life and replaced them with securities with higher yields reflective of the interest rate environment at that time.

During the second quarter ended June 30, 2000, the Company issued $54.4 million of long-term brokered CD's with one-year call options and additional call options every six months thereafter, until the CD matures. The average

yield on these CD's was 8.19% with an average life of 10.8 years. Obtaining this long-term funding enabled the Bank to take advantage of the higher interest rate environment, primarily through the purchase of securities without incurring significant additional interest rate risk. The options associated with these CD's may provide the Bank with valuable balance sheet opportunities in the future. The higher cost associated with these callable CD's will have a negative impact on net interest spread during the next several quarters. In conjunction with the issuance of these long-term brokered CD's, securities were purchased with an overall duration and yield approximately that of the brokered CD's.

The market value of the Securities portfolio at December 31, 2000 was $599.8 million, which represented a net unrealized gain on that date of $1.0 million. The net unrealized gain was comprised of $13.5 million in unrealized gains and $12.5 million of unrealized losses. Net unrealized gains and losses on AFS securities, which is a component of Shareholders' Equity on the consolidated balance sheet, can fluctuate significantly as a result of changes in interest rates. Because management cannot predict the future direction of interest rates, the effect on Shareholders' Equity in the future cannot be determined; however, this risk is monitored closely through the use of shock tests on the AFS securities portfolio using an array of interest rate assumptions.

During the month ended January 31, 2000 and the year ended December 31, 1999, the Company transferred securities totaling $91.7 million and $132.4 million, respectively, from AFS to HTM due to changes in market conditions. Of the total transferred, $21.2 million and $66.3 million were investment securities and $70.5 million and $66.1 million were mortgage-backed securities. The unrealized loss on the securities transferred from AFS to HTM was $2.6 million and $5.6 million, net of tax, at the date of transfer. There were no securities transferred from AFS to HTM during the year ended December 31, 1998. There were no sales from the HTM portfolio during the years ended December 31, 2000 or 1999.

On January 1, 2001, the Company adopted Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" (FAS133) and Financial Accounting Standards No. 137, "Accounting for Derivative Instruments and Hedging Activities (FAS137). The transition provisions contained in FAS133 provide that at the date of initial application, an entity may transfer any debt security classified as HTM to AFS or trading. Effective January 1, 2001, as part of implementing FAS133 and FAS137, the Company elected to transfer all of its securities out of the HTM category in accordance with FAS133 guidance. Securities transferred on January 1, 2001 and sold during the first quarter ended March 31, 2001, will be accounted for as trading securities. All other securities transferred will be accounted for as AFS securities.

The maturities classified according to the sensitivity to changes in interest rates of the December 31, 2000 securities portfolio and the weighted yields are presented below. Tax-exempt obligations are shown on a taxable equivalent basis. Mortgage-backed securities are classified according to repricing frequency and cash flows from street estimates of principal prepayments.

MATURING OR REPRICING		
	After 1 But	After 5 But

Available For Sale:	Within 1 Yr. Amount	Within 1 Yr. Yield	Within 5 Yrs. Amount	Within 5 Yrs. Yield	Within 10 Yrs. Amount	Within 10 Yrs. Yield
	(dollars in thousands)					
U.S. Treasury	$ 6,015	6.08%	$ --		$ --	
U.S. Government Agencies	3,502	6.09%	--		--	
Mortgage-backed Securities	73,413	7.73%	141,503	7.72%	45,820	7.67%
State and Political Subdivisions	630	7.77%	1,308	8.86%	1,640	7.88%
Other Stocks and Bonds	19,974	8.10%	1,139	6.98%	971	7.00%
Total	$103,534	7.65%	$143,950	7.72%	$ 48,431	7.66%

Held to Maturity:	MATURING OR REPRICING Within 1 Yr. Amount	Within 1 Yr. Yield	After 1 But Within 5 Yrs. Amount	After 1 But Within 5 Yrs. Yield	After 5 But Within 10 Yrs. Amount	After 5 But Within 10 Yrs. Yield
	(dollars in thousands)					
U.S. Government Agencies.............	$ 12,534	7.28%	$ 3,874	6.88%	$ 10,023	7.19%
Mortgage-backed Securities...........	20,619	7.20%	46,044	7.37%	25,464	7.32%
State and Political Subdivisions	495	7.15%	1,880	7.27%	2,920	7.73%
Other Stocks and Bonds..............	1,991	6.88%	1,479	7.18%	--	
Total...............................	$ 35,639	7.21%	$ 53,277	7.33%	$ 38,407	7.32%

DEPOSITS AND BORROWED FUNDS

Deposits provide the Company with its primary source of funds. The increase of $133.1 million or 22.6% in Total Deposits during 2000 provided the Company with funds for the growth in loans and a portion of the growth in securities. Time Deposits increased $89.2 million or 34.7% during 2000 compared to 1999. This increase was due in part to $54.4 million of brokered CD's issued during the second quarter ended June 30, 2000. Noninterest Bearing Demand Deposits increased $16.3 million or 10.8% during 2000. Interest Bearing Demand Deposits increased $23.9 million or 15.0% and Saving Deposits increased $3.7 million or 18.4% during 2000. The latter three categories, which are considered the lowest cost deposits, comprised 51.9% of total deposits at December 31, 2000 compared to 56.2% at December 31, 1999. The increase in Total Deposits, not including the brokered CD's issued, was reflective of overall bank growth and branch expansion and was the primary source of funding the increase in Loans.

The following table sets forth the Company's deposits by category at

December 31, 2000 and 1999:

	December 31, 2000	December 31, 1999
	(in thousands)	
Noninterest Bearing Demand Deposits	$ 166,899	$ 150,629
Interest Bearing Demand Deposits	183,383	159,505
Savings Deposits	24,007	20,282
Time Deposits	346,316	257,128
Total Deposits	$ 720,605	$ 587,544

During the year ended December 31, 2000, total time deposits of $100,000 or more increased $63.7 million or 72.8% from December 31, 1999. This increase was due to $54.4 million of brokered CD's issued during the second quarter ended June 30, 2000 and overall bank growth which accounted for an increase of $9.3 million in time certificates of deposit at year ended December 31, 2000, and more than offset the decrease in Public Funds of $1.2 million at December 31, 2000.

The table below sets forth the maturity distribution of time deposits of $100,000 or more issued by the Company at December 31, 2000 and 1999:

	December 31, 2000			December 31, 1999		
	Time Certificates of Deposit	Other Time Deposits	Total	Time Certificates of Deposit	Other Time Deposits	
	(in thousands)					
Three months or less................	$ 22,671	$ 377	$ 23,048	$ 29,146	$ 377	$
Over three to six months............	16,603	12,000	28,603	14,345	13,228	
Over six to twelve months...........	27,076	459	27,535	11,377	459	
Over twelve months..................	71,956	--	71,956	18,536	--	
Total......................	$ 138,306	$ 12,836	$ 151,142	$ 73,404	$ 14,064	$

Short-term Obligations, consisting primarily of FHLB Dallas advances and Federal Funds Purchased, decreased $29.8 million or 16.0% during 2000 when compared to 1999. FHLB Dallas advances are collateralized by FHLB Dallas stock, nonspecified real estate loans and securities.

	Years Ended	
	2000	1999
	(dollars in tho	
Federal Home Loan Bank ("FHLB") Dallas Advances		
Balance at end of period	$ 148,940	$ 181
Average amount outstanding during the period(1)	156,265	155
Maximum amount outstanding during the period	188,899	186
Weighted average interest rate during the period(2)	6.3%	
Interest rate at end of period	6.1%	

(1) The average amount outstanding during the period was computed by dividing the total month-end outstanding principal balances by the number of months in the period.

(2) The weighted average interest rate during the period was computed by dividing the actual interest expense (annualized) by average balance outstanding during the period.

Long-term Obligations primarily consisting of FHLB Dallas advances and Junior Subordinated Debentures increased $21.9 million during 2000 to $216.6 million or an 11.2% increase when compared to $194.7 million in 1999. The increase is primarily a result of the Company issuing $17.0 million of convertible preferred securities.

On November 2, 2000, the Company through its wholly-owned subsidiary, Southside Capital Trust II (the "Trust II Issuer"), sold 1,695,000 cumulative convertible preferred securities at a liquidation amount of $10 per convertible preferred security for an aggregate amount of $16,950,000. These securities have a convertible feature that allows the owner to convert each security to a share of the Company's common stock at a conversion price of $10 per common share.

On May 18, 1998, the Company through its wholly-owned subsidiary, Southside Capital Trust (the "Trust Issuer"), sold 2,000,000 Preferred Securities (the "Junior Subordinated Debentures") at a liquidation amount of $10 per Preferred Security for an aggregate amount of $20,000,000. These securities have a distribution rate of 8.50% per annum payable at the end of each calendar quarter.

THE BANKING INDUSTRY IN TEXAS

The banking industry is affected by general economic conditions such as interest rates, inflation, recession, unemployment and other factors beyond the Company's control. During the mid to late 1980's, declining oil prices had an indirect effect on the Company's business, and the deteriorating real estate market caused a significant portion of the increase in the Company's nonperforming assets during that period. During the early 1990's the East Texas economy entered into a recovery and growth period that continued throughout the year 2000. During the last ten years the East Texas economy has diversified, decreasing the overall impact of declining oil prices, however, the East Texas economy is still affected by the oil industry. One area of concern continues to

be the personal bankruptcy rate occurring nationwide. Management expects this trend to have some effect on the Company's net charge-offs. Management of the Company, however, cannot predict whether current economic conditions will improve, remain the same or decline.

COMPETITION

The activities engaged in by the Company and its subsidiary, Southside Bank, are highly competitive. Financial institutions such as savings and loan associations, credit unions, consumer finance companies, insurance companies, brokerage companies and other financial institutions with varying degrees of regulatory restrictions compete more vigorously for a share of the financial services market. Brokerage companies continue to become more competitive in the financial services arena and pose an ever increasing challenge to banks. Legislative changes also greatly affect the level of competition the Company faces. During 1998 federal legislation allowed credit unions to expand their membership criteria. This allows credit unions to use their expanded membership capabilities combined with tax-free status to compete more fiercely for traditional bank business. Because banks do not enjoy a tax-free status, credit unions will have a competitive advantage. Currently, the Company must compete against some institutions located in East Texas and elsewhere in the Company's service area which have capital resources and legal loan limits substantially in excess of those available to the Company and Southside Bank. The Company expects the competition to increase.

EMPLOYEES

At December 31, 2000, the Company employed approximately 365 full time equivalent persons. None of the employees are represented by any unions or similar groups, and the Company has not experienced any type of strike or labor dispute. The Company considers the relationship with its employees to be good.

EXECUTIVE OFFICERS OF THE REGISTRANT

The executive officers of the Company and Southside Bank as of December 31, 2000, were as follows:

B. G. Hartley (Age 71), Chairman of the Board and Chief Executive Officer of the Company since 1983. He also serves as Chairman of the Board and Chief Executive Officer of the Company's subsidiary, Southside Bank, having served in these capacities since the Bank's inception in 1960.

Sam Dawson (Age 53), President, Secretary and Director of the Company. President, Chief Operations Officer and Director of the Company's subsidiary, Southside Bank since 1996. He became an officer of the Company in 1982 and of Southside Bank during 1975.

Robbie N. Edmonson (Age 68), Vice Chairman of the Board of the Company and the Company's subsidiary, Southside Bank. He joined Southside Bank as a vice president in 1968.

Jeryl Story (Age 49), Executive Vice President of the Company. Senior Executive Vice President - Loan Administration, Senior Lending Officer and Director of the Company's subsidiary, Southside Bank, since 1996. He joined Southside Bank in 1979 as an officer in Loan Documentation.

Lee R. Gibson (Age 44), Executive Vice President and Chief Financial Officer of the Company and of the Company's subsidiary, Southside Bank. He is also a Director of Southside Bank. He became an officer of the Company in 1985 and of Southside Bank during 1984.

All the individuals named above serve in their capacity as officers of

the Company and/or Southside Bank at the pleasure of each entities' Board of Directors.

SUPERVISION AND REGULATION

Banking is a complex, highly regulated industry. The primary goals of the bank regulatory scheme are to maintain a safe and sound banking system and to facilitate the conduct of sound monetary policy. In furtherance of these goals, Congress has created several largely autonomous regulatory agencies and enacted numerous laws that govern banks, bank holding companies and the banking industry. The descriptions of and references to the statutes and regulations below are brief summaries and do not purport to be complete. The descriptions are qualified in their entirety by reference to the specific statutes and regulations discussed.

THE COMPANY

As bank holding companies under the Bank Holding Company Act of 1956, as amended (the "BHC Act"), the Company and Southside Delaware are registered with and subject to regulation by the Federal Reserve. The Company and Southside Delaware are required to file annual and other reports with, and furnish information to, the Federal Reserve, which makes periodic inspections of the Company and Southside Delaware.

The Bank Holding Company Act provides that a bank holding company must obtain the prior approval of the Federal Reserve for the acquisition of more than five percent of the voting stock or substantially all the assets of any bank or bank holding company. In addition, the Bank Holding Company Act restricts the extension of credit to any bank holding company by its subsidiary bank. The Bank Holding Company Act also provides that, with certain exceptions, a bank holding company may not engage in any activities other than those of banking or managing or controlling banks and other authorized subsidiaries or own or control more than five percent of the voting shares of any company that is not a bank. The Federal Reserve has deemed limited activities to be closely related to banking and therefore permissible for a bank holding company.

Traditionally, the activities of bank holding companies have been limited to the business of banking and activities closely related or incidental to banking. The Gramm-Leach-Bliley Financial Services Modernization Act of 1999, which became effective on March 11, 2000, expands the types of activities in which a bank holding company may engage. Subject to various limitations, the Modernization Act generally permits a bank holding company to elect to become a "financial holding company." A financial holding company may affiliate with securities firms and insurance companies and engage in other activities that are "financial in nature." Among the activities that are deemed "financial in nature" are, in addition to traditional lending activities, securities underwriting, dealing in or making a market in securities, sponsoring mutual funds and investment companies, insurance underwriting and agency activities, certain merchant banking activities and activities that the Federal Reserve considers to be closely related to banking.

A bank holding company may become a financial holding company under the Modernization Act if each of its subsidiary banks is "well capitalized" under the Federal Deposit Insurance Corporation Improvement Act prompt corrective action provisions, is well managed and has at least a satisfactory rating under the Community Reinvestment Act. In addition, the bank holding company must file a declaration with the Federal Reserve that the bank holding company wishes to

become a financial holding company. A bank holding company that falls out of compliance with these requirements may be required to cease engaging in some of its activities.

Any bank holding company that does not elect to become a financial holding company remains subject to the current restrictions of the Bank Holding Company Act. In a similar manner, a bank may establish one or more subsidiaries, which subsidiaries may then engage in activities that are financial in nature. However, applicable law and regulation provide that the amount of investment in these activities generally are limited to 45% of the total assets of the bank, and these investments are not aggregated with the bank for determining compliance with capital adequacy guidelines. Further, the transactions between the bank and this type of subsidiary are subject to a number of limitations.

Under the Modernization Act, the Federal Reserve serves as the primary "umbrella" regulator of financial holding companies, with supervisory authority over each parent company and limited authority over its subsidiaries. Expanded financial activities of financial holding companies generally will be regulated according to the type of such financial activity: banking activities by banking regulators, securities activities by securities regulators and insurance activities by insurance regulators. The Modernization Act also imposes additional restrictions and heightened disclosure requirements regarding private information collected by financial

institutions. All implementing regulations under the Modernization Act have not yet become effective in final form, and the Company cannot predict the full sweep of the new legislation and have not yet determined whether it will elect to become a financial holding company.

The Federal Reserve has cease-and-desist powers over bank holding companies and their nonbanking subsidiaries where their actions would constitute a serious threat to the safety, soundness or stability of a subsidiary bank. Federal regulatory agencies also have authority to regulate debt obligations (other than commercial paper) issued by bank holding companies. This authority includes the power to impose interest ceilings and reserve requirements on such debt obligations. A bank holding company and its subsidiaries are also prohibited from engaging in certain tie-in arrangements in connection with any extension of credit, lease or sale of property or furnishing of services.

Federal banking law generally provides that a bank holding company may acquire or establish banks in any state of the United States, subject to certain aging and deposit concentration limits. In addition, Texas banking laws permit a bank holding company which owns stock of a bank located outside the State of Texas to acquire a bank or bank holding company located in Texas. This type of acquisition may occur only if the Texas bank to be directly or indirectly controlled by the out-of-state bank holding company has existed and continuously operated as a bank for a period of at least five years. In any event, a bank holding company may not own or control banks in Texas the deposits of which would exceed 20% of the total deposits of all federally-insured deposits in Texas. The Company has no present plans to acquire or establish banks outside the State of Texas but have not eliminated the possibility of doing so.

The Federal Reserve has promulgated capital adequacy regulations for all bank holding companies with assets in excess of $150 million. The Federal Reserve's capital adequacy regulations are based upon a risk based capital determination, whereby a bank holding company's capital adequacy is determined in light of the risk, both on- and off-balance sheet, contained in the company's

assets. Different categories of assets are assigned risk weightings and are counted at a percentage of their book value.

The regulations divide capital between Tier 1 capital (core capital) and Tier 2 capital. For a bank holding company, Tier 1 capital consists primarily of common stock, related surplus, noncumulative perpetual preferred stock, minority interests in consolidated subsidiaries and a limited amount of qualifying cumulative preferred securities. Goodwill and certain other intangibles are excluded from Tier 1 capital. Tier 2 capital consists of an amount equal to the allowance for loan and lease losses up to a maximum of 1.25% of risk weighted assets, limited other types of preferred stock not included in Tier 1 capital, hybrid capital instruments and term subordinated debt. Investments in and loans to unconsolidated banking and finance subsidiaries that constitute capital of those subsidiaries are excluded from capital. The sum of Tier 1 and Tier 2 capital constitutes qualifying total capital. The Tier 1 component must comprise at least 50% of qualifying total capital.

Every bank holding company has to achieve and maintain a minimum Tier 1 capital ratio of at least 4.0% and a minimum total capital ratio of at least 8.0%. In addition, banks and bank holding companies are required to maintain a minimum leverage ratio of Tier 1 capital to average total consolidated assets (leverage capital ratio) of at least 3.0% for the most highly-rated, financially sound banks and bank holding companies and a minimum leverage ratio of at least 4.0% for all other banks. The Federal Deposit Insurance Corporation and the Federal Reserve define Tier 1 capital for banks in the same manner for both the leverage ratio and the risk-based capital ratio. However, the Federal Reserve defines Tier 1 capital for bank holding companies in a slightly different manner. As of December 31, 2000, the Company's Tier 1 leverage capital ratio was 6.31%.

The guidelines also provide that banking organizations experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory level, without significant reliance on intangible assets. The guidelines also indicate that the Federal Reserve will continue to consider a "Tangible Tier 1 Leverage Ratio" in evaluating proposals for expansion or new activities. The Tangible Tier 1 Leverage Ratio is the ratio of Tier 1 capital, less intangibles not deducted from Tier 1 capital, to quarterly average total assets. As of December 31, 2000, the Federal Reserve had not advised the Company of any specific minimum Tangible Tier 1 Leverage Ratio applicable to the Company.

As a bank holding company that does not, as an entity, currently engage in separate business activities of a material nature, the Company's ability to pay cash dividends depends upon the cash dividends it receives from the bank through Southside Delaware. The Company's only sources of income are dividends paid by the bank. The Company must pay all of its operating expenses from funds received by it from the bank. Therefore,

shareholders may receive dividends from the Company only to the extent that funds are available after payment of the Company's operating expenses. In addition, in November 1985 the Federal Reserve adopted a policy statement concerning payment of cash dividends, which generally prohibits bank holding companies from paying dividends except out of operating earnings, and the prospective rate of earnings retention appears consistent with the bank holding company's capital needs, asset quality and overall financial condition.

THE BANK

The bank is subject to various requirements and restrictions under the laws of the United States and the State of Texas, and to regulation, supervision and regular examination by the Texas Department of Banking and the Federal Deposit Insurance Corporation. The Texas Department of Banking and the Federal Deposit Insurance Corporation have the power to enforce compliance with applicable banking statutes and regulations. These requirements and restrictions include requirements to maintain reserves against deposits, restrictions on the nature and amount of loans that may be made and the interest that may be charged thereon and restrictions relating to investments and other activities of the bank.

Transactions with Affiliates. The bank may not engage in specified transactions (including, for example, loans) with its affiliates unless the terms and conditions of those transactions are substantially the same or at least as favorable to the bank as those prevailing at the time for comparable transactions with or involving other nonaffiliated entities. In the absence of comparable transactions, any transaction between the bank and its affiliates must be on terms and under circumstances, including credit standards, that in good faith would be offered or would apply to nonaffiliated companies. In addition, transactions referred to as "covered transactions" between the bank and its affiliates may not exceed 10% of the bank's capital and surplus per affiliate and an aggregate of 20% of its capital and surplus for covered transactions with all affiliates. Certain transactions with affiliates, such as loans, also must be secured by collateral of specific types and amounts. The bank also is prohibited from purchasing low quality assets from an affiliate. Every company under common control with the bank, including the Company and Southside Delaware, are deemed to be affiliates of the bank.

Loans to Insiders. Federal law also constrains the types and amounts of loans that the bank may make to its executive officers, directors and principal shareholders. Among other things, these loans must be approved by the bank's board of directors in advance, must be on terms and conditions as favorable to the bank as those available to an unrelated person and are limited in amount.

Regulation of Lending Activities. Loans made by the bank are also subject to numerous federal and state laws and regulations, including the Truth-In-Lending Act, Federal Consumer Credit Protection Act, the Texas Consumer Credit Code, the Texas Consumer Protection Code, the Equal Credit Opportunity Act, the Real Estate Settlement Procedures Act and adjustable rate mortgage disclosure requirements. Remedies to the borrower or consumer and penalties to the bank are provided if the bank fails to comply with these laws and regulations. The scope and requirements of these laws and regulations have expanded significantly in recent years.

Branch Banking. Pursuant to the Texas Finance Code, all banks located in Texas are authorized to branch statewide. Accordingly, a bank located anywhere in Texas has the ability, subject to regulatory approval, to establish branch facilities near any of the Bank's facilities and within its market area. If other banks were to establish branch facilities near the Bank or any of its facilities, it is uncertain whether these branch facilities would have a material adverse effect on the business of the Bank.

In 1994 Congress adopted the Reigle-Neal Interstate Banking and Branching Efficiency Act of 1994. That statute provides for nationwide interstate banking and branching, subject to certain aging and deposit concentration limits that may be imposed under applicable state laws. Current Texas law permits interstate branching only through acquisition of a financial institution that is at least five years old, and after the acquisition, the resulting institution and its affiliates cannot hold more than 20% of the total deposits in the state. Accordingly, a bank with its main office outside of Texas generally cannot branch on a de novo basis into Texas. The new law permits applicable regulatory

authorities to approve de novo branching in Texas by institutions located in states that would permit Texas institutions to branch on a de novo basis into those states.

The Federal Deposit Insurance Corporation has adopted regulations under the Riegle-Neal Act to prohibit an out-of-state bank from using the new interstate branching authority primarily for the purpose of deposit production. These regulations include guidelines to insure that interstate branches operated by an out-of-state

bank in a host state are reasonably helping to meet the credit needs of the communities served by the out-of-state bank.

Governmental Monetary Policies. The commercial banking business is affected not only by general economic conditions but also by the monetary policies of the Federal Reserve. Changes in the discount rate on member bank borrowings, control of borrowings, open market operations, the imposition of and changes in reserve requirements against member banks, deposits and assets of foreign branches, the imposition of and changes in reserve requirements against certain borrowings by banks and their affiliates and the placing of limits on interest rates which member banks may pay on time and savings deposits are some of the instruments of monetary policy available to the Federal Reserve. Those monetary policies influence to a significant extent the overall growth of all bank loans, investments and deposits and the interest rates charged on loans or paid on time and savings deposits. The nature of future monetary policies and the effect of such policies on the future business and earnings of the bank, therefore, cannot be predicted accurately.

Dividends. All dividends paid by the Bank are paid to the Company, the sole indirect shareholder of the Bank, through Southside Delaware. The general dividend policy of the Bank is to pay dividends at levels consistent with maintaining liquidity and preserving applicable capital ratios and servicing obligations of the Company. The dividend policy of the Bank is subject to the discretion of the board of directors of the Bank and will depend upon such factors as future earnings, financial conditions, cash needs, capital adequacy, compliance with applicable statutory and regulatory requirements and general business conditions.

The ability of the Bank, as a Texas banking association, to pay dividends is restricted under applicable law and regulations. The Bank generally may not pay a dividend reducing its capital and surplus without the prior approval of the Texas Banking Commissioner. All dividends must be paid out of net profits then on hand, after deducting expenses, including losses and provisions for loan losses. The Federal Deposit Insurance Corporation has the right to prohibit the payment of dividends by the Bank where the payment is deemed to be an unsafe and unsound banking practice. The Bank is also subject to certain restrictions on the payment of dividends as a result of the requirements that it maintain an adequate level of capital in accordance with guidelines promulgated from time to time by the Federal Deposit Insurance Corporation.

The exact amount of future dividends on the stock of the Bank will be a function of the profitability of the Bank in general and applicable tax rates in effect from year to year. The Bank's ability to pay dividends in the future will directly depend on its future profitability, which cannot be accurately estimated or assured.

Capital Adequacy. In 1990, the federal banking regulators promulgated

capital adequacy regulations to which all national and state banks, such as the Bank, are subject. These requirements are similar to the Federal Reserve requirements promulgated with respect to bank holding companies discussed previously.

Changes in Management. Any depository institution that has been chartered less than two years, is not in compliance with the minimum capital requirements of its primary federal banking regulator or is otherwise in a troubled condition must notify its primary federal banking regulator of the proposed addition of any person to the board of directors or the employment of any person as a senior executive officer of the institution at least 30 days before such addition or employment becomes effective. During this 30-day period, the applicable federal banking regulatory agency may disapprove of the addition of employment of such director or officer. The Bank is not subject to any such requirements.

Enforcement Authority. The federal banking laws also contain civil and criminal penalties available for use by the appropriate regulatory agency against certain "institution-affiliated parties" primarily including management, employees and agents of a financial institution, as well as independent contractors such as attorneys and accountants and others who participate in the conduct of the financial institution's affairs and who caused or are likely to cause more than minimum financial loss to or a significant adverse affect on the institution, who knowingly or recklessly violate a law or regulation, breach a fiduciary duty or engage in unsafe or unsound practices. These practices can include the failure of an institution to timely file required reports or the submission of inaccurate reports. These laws authorize the appropriate banking agency to issue cease and desist orders that may, among other things, require affirmative action to correct any harm resulting from a violation or practice, including restitution, reimbursement, indemnification or guarantees against loss. A financial institution may also be ordered to restrict its growth, dispose of certain assets or take other action as determined by the ordering agency to be appropriate.

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Annual Audits. Every bank with total assets in excess of $500 million, such as the Bank, must have an annual independent audit made of the bank's financial statements by a certified public accountant to verify that the financial statements of the bank are presented in accordance with generally accepted accounting principles and comply with such other disclosure requirements as prescribed by the Federal Deposit Insurance Corporation.

Prompt Corrective Action. Banks are subject to restrictions on their activities depending on their level of capital. The Federal Deposit Insurance Corporation's "prompt corrective action" regulations divides banks into five different categories, depending on their level of capital. Under these regulations, a bank is deemed to be "well capitalized" if it has a total risk-based capital ratio of 10% or more, a core capital ratio of six percent or more and a leverage ratio of five percent or more, and if the bank is not subject to an order or capital directive to meet and maintain a certain capital level. Under these regulations, a bank is deemed to be "adequately capitalized" if it has a total risk-based capital ratio of eight percent or more, a core capital ratio of four percent or more and a leverage ratio of four percent or more (unless it receives the highest composite rating at its most recent examination and is not experiencing or anticipating significant growth, in which instance it must maintain a leverage ratio of three percent or more). Under these regulations, a bank is deemed to be "undercapitalized" if it has a total risk-based capital ratio of less than eight percent, a core capital ratio of less than four percent or a leverage ratio of less than four percent. Under

these regulations, a bank is deemed to be "significantly undercapitalized" if it has a risk-based capital ratio of less than six percent, a core capital ratio of less than three percent and a leverage ratio of less than three percent. Under such regulations, a bank is deemed to be "critically undercapitalized" if it has a leverage ratio of less than or equal to two percent. In addition, the Federal Deposit Insurance Corporation has the ability to downgrade a bank's classification (but not to "critically undercapitalized") based on other considerations even if the bank meets the capital guidelines.

If a state nonmember bank, such as the Bank, is classified as undercapitalized, the bank is required to submit a capital restoration plan to the Federal Deposit Insurance Corporation. An undercapitalized bank is prohibited from increasing its assets, engaging in a new line of business, acquiring any interest in any company or insured depository institution, or opening or acquiring a new branch office, except under certain circumstances, including the acceptance by the Federal Deposit Insurance Corporation of a capital restoration plan for the bank.

If a state nonmember bank is classified as undercapitalized, the Federal Deposit Insurance Corporation may take certain actions to correct the capital position of the bank. If a bank is classified as significantly undercapitalized, the Federal Deposit Insurance Corporation would be required to take one or more prompt corrective actions. These actions would include, among other things, requiring sales of new securities to bolster capital, improvements in management, limits on interest rates paid, prohibitions on transactions with affiliates, termination of certain risky activities and restrictions on compensation paid to executive officers. If a bank is classified as critically undercapitalized, the bank must be placed into conservatorship or receivership within 90 days, unless the Federal Deposit Insurance Corporation determines otherwise.

The capital classification of a bank affects the frequency of examinations of the bank and impacts the ability of the bank to engage in certain activities and affects the deposit insurance premiums paid by the bank. The Federal Deposit Insurance Corporation is required to conduct a full-scope, on-site examination of every bank at least once every twelve months. An exception to this rule provides that banks that have assets of less than $100 million, are categorized as "well capitalized," were found to be well managed with a composite rating of "outstanding" and have not been subject to a change in control during the last 12 months, need only be examined by the Federal Deposit Insurance Corporation once every 18 months.

Banks also may be restricted in their ability to accept brokered deposits, depending on their capital classification. "Well capitalized" banks are permitted to accept brokered deposits, but all banks that are not well capitalized are not permitted to accept such deposits. The Federal Deposit Insurance Corporation may, on a case-by-case basis, permit banks that are adequately capitalized to accept brokered deposits if the Federal Deposit Insurance Corporation determines that acceptance of such deposits would not constitute an unsafe or unsound banking practice with respect to the bank.

Risk Based Deposit Insurance Premiums. The Federal Deposit Insurance Corporation assesses insurance premiums on a bank's deposits at a variable rate depending on the probability that the deposit insurance fund will incur a loss with respect to the bank. The Federal Deposit Insurance Corporation determines the deposit insurance assessment rates on the basis of the bank's capital classification and

supervisory evaluations. Each of these categories has three subcategories, resulting in nine assessment risk classifications. The three subcategories with respect to capital are "well capitalized," "adequately capitalized" and "less than adequately capitalized" (that would include "undercapitalized," "significantly undercapitalized" and "critically undercapitalized" banks). The three subcategories with respect to supervisory concerns are "healthy," "supervisory concern" and "substantial supervisory concern." A bank is deemed "healthy" if it is financially sound with only a few minor weaknesses. A bank is deemed subject to "supervisory concern" if it has weaknesses that, if not corrected, could result in significant deterioration of the bank and increased risk to the Bank Insurance Fund of the Federal Deposit Insurance Corporation. A bank is deemed subject to "substantial supervisory concern" if it poses a substantial probability of loss to the Bank Insurance Fund.

Deposit Insurance. The bank's deposits are insured up to $100,000 per insured account by the Bank Insurance Fund. The bank's deposit insurance assessments may increase depending upon the risk category and subcategory, if any, to which the bank is assigned by the Federal Deposit Insurance Corporation. Any increase in insurance assessments could have an adverse effect on the bank's earnings.

Management of the Company and the Bank cannot predict what other legislation might be enacted or what other regulations might be adopted or the effects thereof.

CAPITAL GUIDELINES

Southside Bank is regulated by the TDB and the FDIC. The FDIC requires minimum levels of Tier 1 capital and risk-based capital for FDIC-insured institutions. The FDIC requires a minimum leverage ratio of 3% of adjusted total assets for the highest rated banks. Other banks are required to meet a leverage standard of 4% or more, determined on a case-by-case basis.

On December 31, 2000, the minimum ratio for qualifying total risk-based capital was 8% of which 4% must be Tier 1 capital. Southside Bank's actual capital to total assets and risk-based capital ratios at December 31, 2000 were in excess of the minimum requirements.

Also see discussion of "Capital Resources" under Item 7.

USURY LAWS

Texas usury laws limit the rate of interest that may be charged by state banks. Certain Federal laws provide a limited preemption of Texas usury laws. The maximum rate of interest that Southside Bank may charge on direct business loans under Texas law varies between 18% per annum and (i) 28% per annum for business and agricultural loans above $250,000 or (ii) 24% per annum for other direct loans. Texas floating usury ceilings are tied to the 26-week United States Treasury Bill Auction rate. Other ceilings apply to open-end credit card loans and dealer paper purchased by Southside Bank. A Federal statute removes interest ceilings under usury laws for loans by Southside Bank which are secured by first liens on residential real property.

ECONOMIC ENVIRONMENT

The monetary policies of regulatory authorities, including the FRB, have a significant effect on the operating results of bank holding companies and their subsidiaries. The FRB regulates the national supply of bank credit. Among the means available to the FRB are open market operations in United States Government Securities, changes in the discount rate on member bank borrowings, changes in reserve requirements against member and nonmember bank deposits, and

loans and limitations on interest rates which member banks may pay on time or demand deposits. These methods are used in varying combinations to influence overall growth and distribution of bank loans, investments and deposits. Their use may affect interest rates charged on loans or paid for deposits.

Also see discussion of "Banking Industry in Texas" above.

ITEM 2. PROPERTIES

Southside Bank owns the following properties:

- A two story building in Tyler, Texas, at 1201 South Beckham Avenue and the property adjacent to the main bank building, known as the Southside Bank Annex. These properties house the executive offices of Southside Bancshares, Inc.

- Property and a building directly adjacent to the building housing the Southside Bank Annex. The building is referred to as the Operations Annex, where various back office lending, accounts payable operations, other support areas and training facilities are located.

- Land and building located at 1010 East First Street in Tyler where motor bank facilities are located.

- Property and a building located at the intersection of South Broadway Avenue and Grande Boulevard in Tyler. The tract is occupied by Southside Bank's South Broadway branch, which currently provides a full line of banking services.

- Property and a building on South Broadway Avenue near the South Broadway branch where motor bank facilities are located.

- Twenty-one Automatic Teller Machines (ATM) facilities located throughout Smith and Gregg Counties.

- Building located in the downtown square of Tyler which houses Southside Bank's Downtown branch, providing a full line of banking services.

- Gentry Parkway branch and motor bank facility at 2121 West Gentry Parkway in Tyler.

- Property at 2001 Judson Road in Longview, Texas, where the Company constructed a permanent branch facility complete with motor bank facilities.

- Property on U.S. Highway 69 in Lindale, Texas, where the Company will construct a permanent branch facility complete with motor bank facilities.

- Property in Whitehouse, Texas, where the Company will construct a permanent branch facility complete with motor bank facilities.

The Company completed expansion and remodeling of the operations annex building, located on the property of the bank's headquarters during 2000. The Company purchased property in Longview, Texas at 2001 Judson Road during 1998.

Construction of a permanent branch facility at this location began during 1999 and was completed during 2000. The Company purchased property in Lindale on Highway 69, north of Interstate 20 on which it plans to build a branch facility with motor bank facilities during 2001. During the second quarter of 2000, the Company received approval from the Federal Deposit Insurance Corporation to open a second full service branch in Lindale. The Company plans to open the Lindale branch in temporary facilities during the first half of 2001. The Company also acquired property in Whitehouse, Texas in southern Smith County on which it plans to begin construction of a full service branch during 2001.

ITEM 3. LEGAL PROCEEDINGS

Southside Bank is party to legal proceedings arising in the normal conduct of business. Management of the Company believes that such litigation is not material to the financial position or results of the operations of the Company or Southside Bank.

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ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

During the three months ended December 31, 2000, there were no meetings, annual or special, of the shareholders of the Company. No matters were submitted to a vote of the shareholders, nor were proxies solicited by management or any other person.

PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

MARKET INFORMATION

The Company's common stock began trading on the Nasdaq National Market on May 14, 1998 under the symbol "SBSI." Prior to that the Company's common stock was not actively traded on any established public trading market. The high/low prices shown below represent the closing prices on the Nasdaq National Market for the period from January 1, 1999 to December 31, 2000. During the second quarter of 2000, the Company declared and paid a two for one stock split. During the fourth quarter of 2000, the Company declared and paid a 5% stock dividend. During the third quarter of 1999 and 1998, the Company declared and paid a 5% stock dividend. Stock prices listed below have been adjusted to give retroactive recognition to stock splits and stock dividends.

Year Ended	1st qtr.	2nd qtr.	3rd qtr.	
December 31, 2000	$ 8.99 - 7.97	$ 9.45 - 7.93	$ 8.36 - 7.33	$
December 31, 1999	$ 9.10 - 7.79	$ 8.28 - 7.71	$ 11.21 - 8.00	$

See "Item 7. Capital Resources" for a discussion of the Company's common stock repurchase program.

STOCKHOLDERS

There were approximately 1,111 holders of record of the Company's common

stock, the only class of equity securities currently issued and outstanding, as of February 28, 2001.

DIVIDENDS

Cash dividends declared and paid were $0.225 per share for the year ended December 31, 2000. Cash dividends declared and paid were $.20 per share for the years ended December 31, 1999 and 1998. Stock dividends of 5% were also declared and paid during each of the years ended December 31, 2000, 1999 and 1998. The Company has paid a cash dividend at least once every year since 1970. Future dividends will depend on the Company's earnings, financial condition and other factors which the Board of Directors of the Company considers to be relevant.

ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth selected financial data regarding the Company's results of operations and financial position for, and as of the end of, each of the fiscal years in the five-year period ended December 31, 2000. This information should be read in conjunction with "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations," as set forth in this report.

	As of and For the Years Ended Decemb			
	2000	1999	1998	1997
	(in thousands, except per share da			
Investment Securities	$ 161,285	$ 182,452	$ 132,794	$ 71
Mortgage-backed and Related Securities	$ 412,247	$ 347,574	$ 341,004	$ 141
Loans, Net of Reserve for Loan Loss	$ 476,402	$ 382,871	$ 316,159	$ 292
Total Assets	$ 1,151,881	$ 1,012,565	$ 876,329	$ 571
Deposits	$ 720,605	$ 587,544	$ 515,034	$ 462
Long-term Obligations	$ 216,595	$ 194,704	$ 176,027	$ 28
Interest & Deposit Service Income	$ 83,463	$ 67,468	$ 49,030	$ 39
Net Income	$ 9,825	$ 7,924	$ 5,351	$ 5
Net Income Per Common Share-Basic	$ 1.29	$ 1.03	$ .69	$

Net Income Per Common Share-Diluted.............	$ 1.24	$ 1.00	$ .66	$
Cash Dividends Declared Per Common Share.........	$ .225	$ .20	$ .20	$

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

The following discussion and analysis provides a comparison of the Company's results of operations for the years ended December 31, 2000, 1999 and 1998 and financial condition as of December 31, 2000 and 1999. This discussion should be read in conjunction with the financial statements and related notes. All share data has been adjusted to give retroactive recognition to stock splits and stock dividends.

FORWARD-LOOKING INFORMATION

Certain statements of other than historical fact that are contained in this document and in written material, press releases and oral statements issued by or on behalf of the Company may be considered to be "forward-looking statements" as that term is defined in the Private Securities Litigation Reform Act of 1995. These statements may include words such as "expect," "estimate," "project," "anticipate," "should," "intend," "probability," "risk," "target," "objective" and similar expressions. Forward-looking statements are subject to significant risks and uncertainties and the Company's actual results may differ materially from the results discussed in the forward-looking statements. For example, certain market risk disclosures are dependent on choices about key model characteristics and assumptions and are subject to various limitations. See "Item 1 - Business" and "Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations." By their nature, certain of the market risk disclosures are only estimates and could be materially different from what actually occurs in the future. As a result, actual income gains and losses could materially differ from those that have been estimated. Other factors that could cause actual results to differ materially from forward-looking statements include, but are not limited to general economic conditions, either nationally or in the State of Texas, legislation or regulatory changes which adversely affect the businesses in which the Company is engaged, changes in the interest rate environment which reduce interest margins, significant increases in competition in the banking and financial services industry, changes in consumer spending, borrowing and saving habits, technological changes, the Company's ability to increase market share and control expenses, the effect of compliance with legislation or regulatory changes, the effect of changes in accounting policies and practices and the costs and effects of unanticipated litigation.

FINANCIAL CONDITION

Total assets increased $139.3 million or 13.8% to $1.2 billion at December 31, 2000 from $1.0 billion at December 31, 1999. The increase was primarily attributable to a $93.5 million increase in net loans and a $45.2 million increase in the securities portfolio. The securities portfolio totaled $593.8 million at December 31, 2000 compared to $548.6 million at December 31, 1999. At December 31, 2000, net loans were $476.4 million compared to $382.9 million at December 31, 1999. The increase in loans and securities was funded

primarily by retail deposit growth.

Nonperforming assets at December 31, 2000 totaled $2.5 million, representing 0.22% of total assets, compared to $1.8 million or 0.18% of total assets at December 31, 1999. Nonaccruing loans decreased to $630,000 and the ratio of nonaccruing loans to total loans decreased to 0.13% at December 31, 2000 as compared to $703,000 or 0.18% at December 31, 1999. Real estate owned decreased to $43,000 at December 31, 2000 from $140,000 at December 31, 1999. Loans 90 days past due at December 31, 2000 totaled $1.2 million compared to $.3 million at December 31, 1999, an increase of $.9 million.

Deposits increased $133.1 million to $720.6 million at December 31, 2000 from $587.5 million at December 31, 1999. FHLB Dallas advances were $328.6 million at December 31, 2000, a $27.3 million decrease from $355.9 million at December 31, 1999. Short-term FHLB Dallas advances decreased $32.3 million to $148.9 million at December 31, 2000 from $181.2 million at December 31, 1999. Long-term FHLB Dallas advances increased $4.9 million to $179.6 million at December 31, 2000 from $174.7 million at December 31, 1999. Other borrowings at December 31, 2000 and 1999 totaled $44.3 million and $24.8 million, respectively, and at December 31, 2000 consisted of $7.3 million short-term borrowings, $17.0 million of Long-term Junior Subordinated Convertible Debentures and $20.0 million of Long-term Junior Subordinated Debentures.

On November 2, 2000, the Company through its wholly-owned subsidiary, Southside Capital Trust II (the "Trust II Issuer"), sold 1,695,000 cumulative convertible preferred securities at a liquidation amount of $10 per convertible preferred security for an aggregate amount of $16,950,000. These securities have a convertible feature that allows the owner to convert each security to a share of the Company's common stock at a conversion price of $10 per common share.

On May 18, 1998, the Company through its wholly-owned subsidiary, Southside Capital Trust (the "Trust Issuer"), sold 2,000,000 Preferred Securities at a liquidation amount of $10 per Preferred Security for an aggregate amount of $20,000,000. It has a distribution rate of 8.50% per annum payable at the end of each calendar quarter.

Shareholders' equity at December 31, 2000 totaled $51.7 million compared to $37.7 million at December 31, 1999. The increase primarily reflects the net income recorded for the year ended December 31, 2000 and a decrease in the accumulated other comprehensive loss of $6.3 million, partially offset by the repurchase of 94,050 shares of the outstanding stock at an average price of $8.65 per share and the declaration of cash dividends.

LEVERAGE STRATEGY

In May 1998 the Company implemented a leverage strategy designed to enhance its profitability with acceptable levels of credit, interest rate and liquidity risk. The leverage strategy consists of borrowing long and short-term funds from the Federal Home Loan Bank and investing the funds primarily in mortgage-backed securities, and to a lesser extent, long-term municipal securities. Although mortgage-backed securities often carry lower yields than traditional mortgage loans and other types of loans the Company makes, these securities generally increase the overall quality of the Company's assets by virtue of the securities' underlying insurance or guarantees, are more liquid than individual loans and may be used to collateralize the Company's borrowings or other obligations. While the strategy of investing a substantial portion of the Company's assets in mortgage-backed and municipal securities has resulted in

lower interest rate spreads and margins, the Company believes that the lower operating expenses and reduced credit and interest rate risk of this strategy have enhanced its overall profitability.

While the Company may increase its leverage to offset interest expense associated with this convertible preferred securities offering, the balance sheet strategy going forward will be to gradually replace a portion of the Company's securities portfolio with higher yielding loans. On the liability side, the Company intends to gradually replace a portion of the short-term Federal Home Loan Bank borrowings with deposits. The intended net result is to increase the Company's net interest spread. Since completing the initial phase of the Company's leverage strategy during the second quarter of 1999, its net interest spread has begun to increase. The leverage strategy is dynamic and requires ongoing management. As interest rates, funding costs and security spreads change, the Company's determination of the proper securities to purchase and funding to obtain must be re-evaluated.

RESULTS OF OPERATIONS

The Company's results of operations are dependent primarily on net interest income, which is the difference between the income earned on its loan, securities and investment portfolios and its cost of funds, consisting of the interest paid on deposits and borrowings. Results of operations are also affected by the Company's noninterest income, provision for loan losses and noninterest expenses. General economic and competitive conditions, particularly changes in interest rates, government policies and actions of regulatory authorities, also significantly affect the Company's results of operations. Future changes in applicable law, regulations or government policies may also have a material impact on the Company.

COMPARISON OF OPERATING RESULTS FOR THE YEARS ENDING DECEMBER 31, 2000 COMPARED TO DECEMBER 31, 1999

OVERVIEW

During the year ended December 31, 2000, the Company's net income increased $1.9 million or 24.0% to $9.8 million, from $7.9 million for the same period in 1999. The increase in net income was primarily attributable to an increase in interest income due to a more favorable net interest spread and the growth in earning assets. Noninterest income, not including gains or losses on sales of securities, also grew due to deposit services income. These increases were partially offset by an increase in noninterest expense and losses on sales of securities. Earnings per share of $1.24 represented an increase of $0.24 or 24.0% over the year ended December 31, 1999.

NET INTEREST INCOME

Net interest income is the principal source of a financial institution's earnings stream and represents the difference or spread between interest and fee income generated from interest earning assets and the interest expense paid on deposits and borrowed funds. Fluctuations in interest rates as well as volume and mix changes in interest earning assets and interest bearing liabilities materially impact net interest income.

Net interest income for the year ended December 31, 2000 was $29.3 million, an increase of $4.6 million or 18.7% compared to the same period in 1999. Average interest earning assets increased $109.0 million or 12.3%, while

the net yield on average earning assets increased from 3.02% at December 31, 1999 to 3.22% at December 31, 2000. As interest rates increased during 1999 and the first half of 2000, the Company's premium mortgage-backed securities increased in yield as prepayment speeds decreased. This increase in yield, along with the increase in average loans, combined to increase the net interest spread. Future increases in the net interest spread will become more difficult due to competition and long-term liabilities purchased at higher rates.

During the year ended December 31, 2000, average loans, funded primarily by the growth in average deposits and average Federal Home Loan Bank advances, increased $93.1 million or 27.3%, compared to the same period in 1999. The average yield on loans increased from 8.28% at December 31, 1999 to 8.45% at December 31, 2000, reflective of an overall increase in interest rates. The increase in interest income on Loans of $8.0 million or 28.5% was the result of the increase in Average Loans and average yield on loans during 2000.

Average investment and mortgage-backed securities increased $17.8 million or 3.4% for the year ended December 31, 2000 when compared to the same period in 1999. This increase was a direct result of the leverage strategy implemented in 1998. The overall yield on Average Securities increased to 7.35% during the year ended December 31, 2000 from 6.35% during the same period in 1999, due in part to decreased prepayment speeds on mortgage-backed securities which led to decreased amortization expense, combined with a restructuring of a portion of the securities portfolio into higher yielding securities due to higher overall interest rates. Interest income on investment and mortgage-backed securities increased $6.2 million in 2000 or 20.0% compared to 1999 due to the increase in the Average Securities and the increase in the average yield of securities during 2000.

Interest income from marketable equity securities, federal funds and other interest earning assets increased $461,000 or 34.6% for the year ended December 31, 2000 when compared to 1999 as a result of higher rates and a special dividend of $304,000 on the Company's FHLB Dallas stock which more than offset the average balance decrease of 7.5%.

During the year ended December 31, 2000, the mix of the Company's Interest Earning Assets reflected an increase in Loans compared to the prior year end as Loans averaged 43.5% of Total Average Interest Earning Assets compared to 38.4% during 1999, a direct result of significant loan growth. Securities averaged 56.1% of the total and Other Interest Earning Asset categories averaged 0.4% for December 31, 2000. During 1999 the comparable mix was 60.7% in Securities and 0.9% in the Other Interest Earning Asset categories.

Total interest expense increased $10.1 million or 28.1% to $46.1 million during the year ended December 31, 2000 as compared to $36.0 million during the same period in 1999. The increase was attributable to an increase in average interest bearing liabilities of $108.5 million or 14.3% and an increase in the average yield on interest bearing liabilities from 4.75% at December 31, 1999 to 5.33% at December 31, 2000. Average interest bearing deposits increased $95.2 million or 23.8% while the average rate paid increased from 4.13% at December 31, 1999 to 4.81% at December 31, 2000. Average Time Deposits increased $74.3 million or 31.8% while the average rate paid increased 87 basis points. Average Interest Bearing Demand Deposits increased $17.9 million or 12.1% and Average Savings Deposits increased $2.9 million or 15.2%. Average Noninterest Bearing Demand Deposits increased during 2000 $8.4 million or 6.1%. The latter three categories, which are considered the lowest cost deposits, comprised 52.0% of total average deposits during the year ended December 31, 2000 compared to 56.6% during 1999 and 54.2% during 1998. The increase in Average Total Deposits is reflective of overall bank growth, brokered CD issuance, branch expansion and, except for the brokered CD's issued, was the primary source of funding the increase in Average Loans.

During the second quarter ended June 30, 2000, the Company issued $54.4 million of long-term brokered CD's with one-year call options and additional call options every six months thereafter, until the CD matures. The average yield on these CD's was 8.19% with an average life of 10.8 years. Obtaining this long-term funding should enable the Bank to take advantage of the higher interest rate environment, primarily through the purchase of securities without incurring significant additional interest rate risk. The higher cost associated with these callable CD's will have a negative impact on net interest spread during the next several quarters. The options associated with these CD's may provide the bank with valuable balance sheet opportunities in the future.

During the second quarter, the bank introduced a new Platinum Money Market Deposit Account. This account pays a higher rate on larger deposit balances than the bank's other money market account. As deposits shift to the new money market account, the higher interest cost associated with this change will have a negative impact on net interest margin. The bank hopes to attract new deposits due to the competitive rate of this account. While the interest rate on this account is higher than the Company's previous money market account, the interest rate is comparable to and in some cases is lower than the rate for short-term borrowings from the FHLB. As new deposits are obtained, short-term FHLB Dallas funds may be replaced which may offset some of the negative impact on the Bank's net interest margin.

The following table sets forth the Company's deposit averages by category for the years ended December 31, 2000, 1999 and 1998:

COMPOSITION OF DEPOSITS

	Years Ended December 31,				
	2000		1999		
	(dollars in thousands)				
	AVG. BALANCE	AVG. YIELD	AVG. BALANCE	AVG. YIELD	B