

*The Abigail Adams National Bancorp . . . committed to achieving excellence as a community financial institution focused on meeting the needs of women, minorities, not-for-profit organizations and the business and professional community. . .*

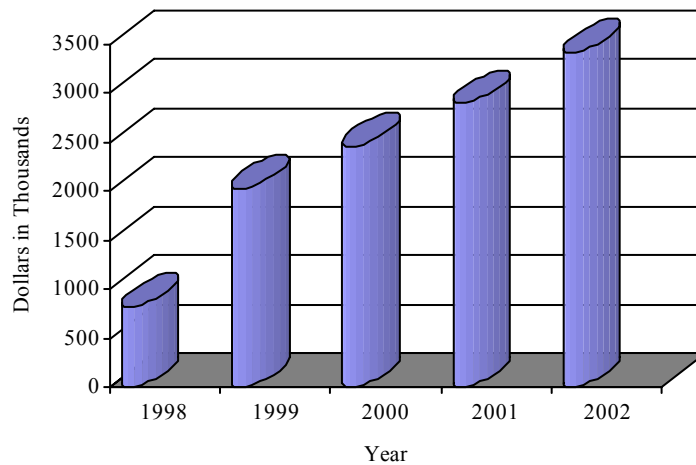
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**FINANCIAL HIGHLIGHTS**  
(Dollars in thousands, except per share data)

	2003	2002
<b>Averages</b>		
Assets		\$190,131
Loans		143,454
Allowance for loan losses		(2,071)
Deposits		162,422
Stockholders' equity		20,097
<b>At Year-End</b>		
Assets		\$204,950
Loans		156,536
Allowance for loan losses		(2,297)
Deposits		174,768
Stockholders' equity		21,192
Book value per share		\$7.05
<b>For the Year</b>		
Net income		\$3,415
Cash dividends		1,297
<b>Per Common Share</b>		
Basic earnings		\$1.14
Diluted earnings		\$1.13
Cash dividends		\$0.44

**Net Income**



Dear Shareholders, Customers and Friends,

Abigail Adams National Bancorp, Inc. and its subsidiary, the Adams National Bank, will celebrate their 25<sup>th</sup> anniversary in 2003. We have been a community bank in the heart of Washington, D.C. for a quarter of a century and look forward to many more years.

Abigail Adams National Bancorp, Inc. and its subsidiary, The Adams National Bank, achieved another milestone in 2002. We increased deposits and, most importantly, increased returns to our shareholders for the fourth consecutive year. Sixteen quarters of record-breaking performance is a remarkable achievement for our bank, and we are proud of it.

How did we do this? The answer is really very simple: we continued doing business as usual.

We maintained our focus of providing the best banking services possible to our market base of small to mid-size businesses and not-for-profit organizations in Washington, D.C. and the surrounding counties of Maryland and Virginia.

We maintained our high quality of customer service providing community banking in a metropolitan environment.

We continued to develop products and services that our customer base - current and potential - needed or wanted.

We continued to participate in the lives of our communities, both individually and corporately.

The numbers and charts on the following pages speak for themselves. We have remained true to our mission for the 25 years we have been in operation and the rewards of doing so were passed on to you in cash and stock dividends.

Our pledge to you is also simple: we will continue to do business as usual!

Jeanne Delaney Hubbard  
Chairwoman, President & CEO  
Abigail Adams National Bancorp, Inc.

Kathleen Walsh Carr  
President & CEO  
The Adams National Bank

**ABIGAIL ADAMS NATIONAL BANCORP, INC. AND SUBSIDIARY**  
**SELECTED FINANCIAL DATA**

(Dollars in thousands, except per share data)

	December 31,				
	2002	2001	2000	1999	1998
<b>Income Statement Data:</b>					
Total interest income	\$12,831	\$12,734	\$12,809	\$10,645	\$10,753
Total interest expense	2,580	3,734	4,067	3,338	3,930
Net interest income	10,251	9,000	8,742	7,307	6,823
Provision for (recovery of) loan losses	443	260	536	90	(15)
Total noninterest income	1,954	1,980	1,545	1,542	1,335
Total noninterest expense	6,064	6,025	5,665	5,407	6,838
Provision for income taxes	2,282	1,802	1,626	1,323	519
Net income	3,415	2,893	2,460	2,029	816
<b>Per Common Share Data:</b>					
Basic net income per share	\$1.14	\$0.96	\$0.84	\$0.71	\$0.29
Diluted net income per share	\$1.13	\$0.96	\$0.84	\$0.70	\$0.28
Cash dividends	\$0.44	\$0.36	\$0.31	\$0.29	\$0.17
<b>Selected Balance Sheet Data:</b>					
Total assets	\$204,950	\$178,170	\$160,651	\$141,770	\$128,881
Investment securities	26,545	24,413	25,151	16,761	21,789
Loans	156,536	138,061	118,440	108,823	94,220
Allowance for loan losses	2,297	1,911	1,654	1,137	1,134
Total deposits	174,768	153,091	137,657	122,570	108,665
Stockholders' equity	21,192	18,888	16,973	14,459	13,599
<b>Selected Ratios:</b>					
Return on average assets	1.80%	1.78%	1.63%	1.57%	0.63%
Return on average stockholders' equity	16.99%	16.02%	15.69%	14.46%	6.19%
Average equity to average assets	10.57%	11.08%	10.39%	10.86%	10.38%
Dividend payout ratio	38.94%	37.74%	36.96%	41.56%	61.29%
Net charge-offs (recoveries) to average loans	0.04%	0.003%	0.02%	0.09%	(0.01)%
Nonperforming loans to total loans	0.29%	0.28%	0.26%	0.07%	0.46%
Allowance for loan losses to loans	1.47%	1.38%	1.40%	1.04%	1.20%

On December 31, 2002, a 10% stock dividend was issued. All per common share data used in this report has been restated to reflect the stock dividend.

## **Management's Discussion and Analysis of Financial Condition and Results of Operations**

Abigail Adams National Bancorp, Inc. (the "Company") is the parent of The Adams National Bank (the "Bank"), a national bank with five full-service branches located in Washington, D.C. The Company reports its financial results on a consolidated basis with the Bank.

When used in this Annual Report the words or phrases "will likely result," "are expected to," "will continue," "is anticipated," "estimate," "project" or similar expressions are intended to identify "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements are subject to certain risks and uncertainties, including among other things, changes in economic conditions in the Company's market area, changes in policies by regulatory agencies, fluctuations in interest rates, demand for loans in the Company's market area and competition that could cause actual results to differ materially from historical earnings and those presently anticipated or projected. The Company wishes to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made. The Company wishes to advise readers that the factors listed above could affect the Company's financial performance and could cause the Company's actual results for future periods to differ materially from any opinions or statements expressed with respect to future periods in any current statements.

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

The following analysis of financial condition and results of operations should be read in conjunction with the Company's Consolidated Financial Statements and Notes thereto.

### **Results of Operations**

#### ***Overview***

The Company reported an 18.0% increase in net income in 2002, as compared to 2001. Net income was \$3,415,000 or \$1.13 per share (diluted) for 2002, an increase of \$522,000 from the \$2,893,000 or \$.96 per share (diluted) reported for the year ended December 31, 2001. The increase in net income was attributable to efforts to closely monitor the cost of funds and cost control measures over noninterest expense. Book value per share was \$7.05 at December 31, 2002, an increase of \$0.75 from the book value per share of \$6.30 at December 31, 2001. Dividends per common share increased 22.2% to \$0.44 for 2002, as compared to \$0.36 paid in 2001.

#### ***Analysis of Net Interest Income***

Net interest income, which is the sum of interest and certain fees generated by earning assets minus interest paid on deposits and other funding sources, is the principal source of the Company's earnings. Net interest income increased by \$1,251,000 or 13.9%, to \$10,251,000 for the year ended December 31, 2002, as compared to \$9,000,000 in 2001. The improvement in net interest income resulted from growth in earning assets, combined with the management of interest rates paid on deposits. Average earning assets totaling \$181,470,000 increased by \$26,012,000 or 16.7%, as compared to the average of \$155,458,000 in 2001. The yield on the interest-earning assets was 7.07% in 2002 and 8.19% in 2001, a decrease of 112 basis points. The decrease in yields was due to the significant decrease in market interest rates during 2001 and 2002. Loans, the highest yielding component of earning assets, represented 79.1% of total average earning assets for 2002, as compared to 79.0% for 2001. Average loans increased to \$143,454,000 for 2002 from \$122,802,000 for 2001, an increase of \$20,652,000 or 16.8%. The average yield on loans was 7.84% in 2002, compared to 8.96% in 2001, a decrease of 112 basis points, due in part to adjustable and variable rate loans that use the Prime Rate as an index.

Funding for earning assets comes from interest-bearing liabilities, non-interest-bearing liabilities and stockholders' equity. The percentage of average earning assets funded by average interest-bearing liabilities was 67.8% in 2002 and 66.5% in 2001. Average interest bearing liabilities were \$122,990,000, an increase of \$19,686,000 or 19.1%, compared to \$103,304,000 reported last year. The cost of interest-bearing funds was 2.10% in 2002, a decrease of 151 basis points from a yield of 3.61% in 2001.

The net interest margin, which is net interest income as a percentage of average interest-earning assets, was 5.65% for 2002, a decrease of 14 basis points from the 5.79% net interest margin for 2001, due to the previously mentioned changes in earning assets and interest-bearing liabilities. The net interest spread, which is the difference between the average interest rate earned on interest-earning assets and interest paid on interest-bearing liabilities, was 4.97% for 2002, reflecting an increase of 39 basis points from the 4.58% reported in 2001.

The following tables present the average balances, net interest income and interest yields/rates for 2002 and 2001 and an analysis of the dollar changes in interest income and interest expense.

**Distribution of Assets, Liabilities and Stockholders' Equity Yields and Rates**  
**For the Years Ended December 31, 2002, and 2001**  
(Dollars in thousands)

	2002			2001		
	Average Balances	Interest Income/ Expense	Average Rates	Average Balances	Interest Income Expense	Average Rates
<b>Assets</b>						
Loans (a)	\$143,454	\$11,243	7.84%	\$122,802	\$11,009	8.96%
Investment securities	25,663	1,393	5.43%	21,222	1,268	5.98%
Federal funds sold	7,633	115	1.51%	6,672	270	4.06%
Interest-bearing bank balances	4,720	80	1.69%	4,762	187	3.93%
Total earnings assets	181,470	12,831	7.07%	155,458	12,734	8.19%
Allowance for loan losses	(2,071)			(1,768)		
Cash and due from banks	7,144			6,441		
Other assets	3,588			2,757		
Total assets	190,131			162,888		
<b>Liabilities and Stockholders' Equity</b>						
Savings, NOW and Money market accounts	\$63,126	890	1.41%	\$48,098	1,119	2.33%
Certificates of deposit	53,237	1,544	2.90%	49,652	2,416	4.87%
Customer repurchase agreements	5,856	92	1.57%	4,703	140	2.97%
Long-term debt	771	54	7.00%	851	59	6.96%
Total interest-bearing liabilities	122,990	2,580	2.10%	103,304	3,734	3.61%
Noninterest bearing deposits	46,059			40,615		
Other liabilities	985			915		
Stockholders' equity	20,097			18,054		
Total liabilities and stockholders' equity	\$190,131			\$162,888		
FTE net interest income		\$10,251			\$9,000	
Net interest spread			4.97%			4.58%
Net interest margin			5.65%			5.79%

a) The loan averages are stated net of unearned income, and the averages include loans on which the accrual of interest has been discontinued. Net loan fees included in interest income were \$552,000 and \$377,000 for 2002 and 2001, respectively.

**Interest Rates and Interest Differential**  
**Analysis of Changes in Fully Taxable Equivalent Net Interest Income**  
(Dollars in thousands)

	For the years ended December 31, 2002 versus 2001			For the years ended December 31, 2001 versus 2000		
	Net Increase (Decrease)	Change per:		Net Increase (Decrease)	Change per:	
		Rate	Volume		Rate	Volume
Interest income from:						
Loans	\$234	(\$1,570)	\$1,804	\$367	(\$782)	\$1,149
Investment securities	125	(140)	265	(136)	(117)	(19)
Federal funds sold	(155)	(194)	39	(119)	(145)	26
Interest-bearing bank balances	(107)	(105)	(2)	(187)	(112)	(75)
Total interest income	<u>97</u>	<u>(2,009)</u>	<u>2,106</u>	<u>(75)</u>	<u>(1,156)</u>	<u>1,081</u>
Interest expense on:						
Savings, NOW and money market	(229)	(596)	367	(235)	(380)	145
Certificates of deposit	(872)	(1,046)	174	(66)	(229)	163
Short-term borrowings	(48)	(82)	34	(27)	(49)	22
Long-term debt	(5)	--	(5)	(5)	--	(5)
Total interest expense	<u>(1,154)</u>	<u>(1,724)</u>	<u>570</u>	<u>(333)</u>	<u>(658)</u>	<u>325</u>
Net interest income	<u>\$1,251</u>	<u>(\$285)</u>	<u>\$1,536</u>	<u>\$258</u>	<u>(\$498)</u>	<u>\$756</u>

Note: The change in interest due to both rate and volume has been allocated to change due to rate.

***Noninterest Income***

Total noninterest income for 2002, which consists primarily of service charges on deposits and other fee income, decreased \$27,000 or 1.4% from the prior year to \$1,954,000 in 2002, as compared to \$1,981,000 in 2001. Service charges on deposit accounts totaled \$1,636,000, an increase of \$99,000 or 6.4% from the prior year. The increase was due to higher levels of transaction activity and the increase in service charge fees. The gain on sale of loans was \$127,000 in 2002, as compared to \$94,000 for the prior year. During 2001, income realized from the unamortized discounts on investment securities that were called totaled \$183,000.

***Noninterest Expense***

Total noninterest expense for the year ended December 31, 2002, increased by \$39,000 or .65% to \$6,064,000 from \$6,025,000 for 2001. The efficiency ratio for 2002 was 49.7%, which was an improvement from the ratio of 54.9% for 2001. Occupancy expense increased 2.3% or \$27,000 to \$1,180,000 from \$1,153,000 in 2001, primarily due to the relocation of the Main office location. Data processing expense increased 4.1% or \$17,000 to \$428,000, as a result of the upgrade of equipment. Other operating expense increased 3.4% or \$42,000 to \$1,273,000 from the \$1,231,000 reported last year, primarily due to increases in office supplies, courier expense, directors' fees, and loan expenses. Salaries and benefits expense decreased \$25,000 or .8% from the prior year to \$2,982,000. Professional fees decreased \$22,000 or 9.8% from the prior year to \$202,000, as a result of the lower level of legal fees.

### ***Income Tax Expense***

Income tax expense of \$2,282,000 for 2002 increased \$480,000 or 26.6% from the income-tax expense of \$1,802,000 recorded one year earlier. The increase in income tax was a result of the 21.4% increase the Company's pretax income, as compared to the prior year. The effective tax rate for 2002 was 40.1%, compared to 38.4% for 2001.

### **Financial Condition**

#### ***Overview***

Total assets increased to \$204,950,000 at December 31, 2002 from \$178,170,000 at December 31, 2001, an increase of \$26,780,000 or 15.0%. The net increase in total assets was primarily attributable to an increase of \$18,476,000 in the loan portfolio. Total liabilities increased 15.4% or \$24,476,000 to \$183,758,000. The return on average assets for 2002 was 1.80%, as compared to 1.78% for 2001.

#### ***Analysis of Loans***

Total loans outstanding at December 31, 2002 increased 13.4% over previous year-end levels to a total of \$156,536,000. Commercial loans increased 11.0%, real estate commercial mortgages increased 4.4%, residential mortgages increased 46.2% and construction loans increased 31.0%. Installment loans decreased 29.8%, due to the discontinuation of the Visa loan portfolio during 2002. The following table summarizes the loan concentrations at December 31, 2002 and 2001.

	2002	2001
Service Industry	23%	26%
Real estate development/finance	51	50
Wholesale/retail	16	14
Other	10	10
Total	<u>100%</u>	<u>100%</u>

The table entitled "Analysis of Loan Maturity and Interest Sensitivity" summarizes the maturity distribution and interest sensitivity of the Company's loan portfolio at December 31, 2002. The balances exclude any adjustment for net deferred fees and unearned income. Loans having no stated maturity, no stated schedule of repayment, overdrafts, and demand loans are included in the "Within 1 Year" category.

#### **Analysis of Loan Maturity and Interest Sensitivity At December 31, 2002 (In thousands)**

	Within 1 Year	1 to 5 Years	After 5 Years	Total
<b>Maturity of Loan</b>				
Commercial	\$30,282	\$4,690	\$1,328	\$36,300
Real estate - commercial	15,830	54,212	10,632	80,674
Real estate - residential	13,306	19,652	1,778	34,736
Real estate - construction	3,184	1,001	--	4,185
Installment	613	352	14	979
Total loans	<u>\$63,215</u>	<u>\$79,907</u>	<u>\$13,752</u>	<u>\$156,874</u>
<b>Interest-Rate Sensitivity of Loans</b>				
Predetermined rates	\$11,078	\$65,297	\$13,752	\$90,127
Variable rates	52,137	14,610	--	66,747
Total loans	<u>\$63,215</u>	<u>\$79,907</u>	<u>\$13,752</u>	<u>\$156,874</u>

For additional information about loans, see Note 4 of the Notes to Consolidated Financial Statements.

### ***Analysis of Investments***

The investment securities classified as available for sale are used to maintain adequate liquidity and to provide a base for executing management's asset/liability strategy. Investment securities classified as available for sale may be sold in response to changes in interest rates, restructuring of maturity distributions, the need for additional funds for loans, tax planning and regulatory needs, as well as, other purposes. Investment securities classified as available for sale were \$16,315,000 at December 31, 2002, a decrease of \$3,585,000 or 18.0% from \$19,900,000 at December 31, 2001. The investment securities available for sale portfolio consists of U.S. government agencies, mortgage-back securities and equity securities. The weighted average life of the portfolio at December 31, 2002 was 1.6 years, using call dates as expected maturities.

Investment securities classified as held to maturity were \$10,230,000 at December 31, 2002, an increase of \$5,717,000 or 126.7% from \$4,513,000 at December 31, 2001. Investment securities classified as held to maturity consist of U.S. government agencies and mortgage-back securities. The weighted average maturity of the portfolio at December 31, 2002 is 2.7 years, using call dates expected maturities.

The table entitled "Analysis of Investment Securities Portfolio," sets forth by major categories, the amortized cost basis, approximate market values and the weighted-average yields of investment securities held to maturity and available for sale at December 31, 2002.

#### **Analysis of Investment Securities Portfolio At December 31, 2002 (Dollars in thousands)**

	Held to Maturity			Available for Sale		
	Amortized Cost Basis	Market Value	Average Yield	Amortized Cost Basis	Market Value	Average Yield
U.S. government agencies:						
One year or less	--	--	--	\$1,001	\$1,023	5.78%
After one, but within five years	1,000	1,005	4.00%	3,500	3,540	5.31%
After five, but within ten years	5,000	5,020	4.17%	5,000	5,042	4.76%
Total federal agency securities	6,000	6,025	4.14%	9,501	9,605	5.07%
Mortgage-backed securities:						
After one, but within five years	1,033	1,041	4.17%	--	--	--
After five, but within ten	3,197	3,206	4.14%	2,727	2,761	3.68%
Total mortgage-backed	4,230	4,247	4.15%	2,727	2,761	3.68%
Marketable equity securities	--	--	--	3,770	3,949	7.93%
Total investment securities	<u>\$10,230</u>	<u>\$10,272</u>	4.14%	<u>\$15,998</u>	<u>\$16,315</u>	5.53%

For additional information about investment securities, see Note 1 (c) and Note 3 of the Notes to Consolidated Financial Statements.

### ***Deposits***

Deposits are the Company's primary source of funds, providing funding for 89.5% of average earning assets in 2002 and 89.0% in 2001. Average interest-bearing deposits were \$116,362,000 in 2002, which was a 19.0% increase over prior year levels. Total deposits grew 14.2% to \$174,768,000 at December 31, 2002, an increase of \$21,677,000 from the balance of \$153,091,000 at December 31, 2001. Overall, higher-yielding certificates of deposit were replaced by lower cost deposits, as compared to the prior year. The following table sets forth the dollar amounts in the various types of deposit programs.

December 31,	
2002	2001

	Amount	Percent	Amount	Percent
	(Dollars in thousands)			
Demand deposits	\$46,890	26.8%	\$40,407	26.4%
Savings accounts	5,064	2.9%	4,411	2.9%
NOW accounts	23,190	13.3%	17,333	11.3%
Money market accounts	46,976	26.9%	31,891	20.8%
Total non-certificates	122,120	69.9%	94,042	61.4%
Total certificates	52,648	30.1%	59,049	38.6%
Total deposits	\$174,768	100.0%	\$153,091	100.0%

The following table indicates the certificates of deposit by time remaining until maturity as of December 31, 2002.

	Maturity				Total
	3 Months or Less	Over 3 to 6 Months	Over 6 to 12 Months	Over 12 Months	
	(Dollars in thousands)				
Certificates of deposit less than \$100,000	\$6,324	\$5,644	\$6,486	\$2,194	\$20,648
Certificates of deposit of \$100,000 or more	5,985	11,535	8,111	6,369	32,000
Total certificates of deposit	\$12,309	\$17,179	\$14,597	\$8,563	\$52,648

#### ***Borrowed Funds***

Short-term borrowings increased 64.8%, as compared to the prior year and consisted of repurchase agreements totaling \$7,313,000 at December 31, 2002. Average repurchase agreements for 2002 were \$5,856,000, which was an increase of \$1,153,000 or 24.5%, as compared to the 2001 averages. For additional information on short-term borrowings, see Note 10 of the Notes to Consolidated Financial Statements.

Long-term debt consisted of a term loan from the Federal Home Loan Bank, with a principal balance of \$724,000 at December 31, 2002, as compared to \$810,000 at December 31, 2001, a decrease of 10.6%. The decrease was due to scheduled repayments. The average long-term debt for 2002 was \$771,000, a decrease of \$80,000 or 9.4% from the average for 2001. For additional information on long-term debt, see Note 9 of the Notes to Consolidated Financial Statements.

	Years ended December 31,			
	Maximum Outstanding at Any Month End	Average Balance	Average Interest Rate	Average Interest Rate at Year End
	(Dollars in thousands)			
<b>2002:</b>				

Long term debt	\$803	\$771	7.00%	\$724	6.95%
Short term borrowings	8,327	5,856	1.57%	7,313	0.92%
<b>2001:</b>					
Long term debt	888	851	6.96%	810	6.95%
Short term borrowings	5,630	4,703	2.97%	4,437	1.62%

### ***Stockholders' Equity***

Stockholders' equity at December 31, 2002 was \$21,192,000, an increase of \$2,304,000 or 12.2% from \$18,888,000 at December 31, 2001. Dividends of \$1,297,000 were declared on the common stock in 2002, representing an 18.9% increase over 2001. The annual dividend payout rate in 2002 was \$.44 per Common share, a 22.2% increase over 2001. The dividend payout ratio was 38.9% and 37.7% for 2002 and 2001, respectively. The ratio of average stockholders' equity to average assets for 2002 was 10.6%, as compared to 11.1% for 2001. The return on average equity was 17.0% for 2002 and 16.0% for 2001.

### **Asset Quality**

#### ***Loan Portfolio and Adequacy of the Allowance for Loan Losses***

Management believes the allowance for loan losses accounting policy is critical to the portrayal and understanding of our financial condition and results of operations. As such, selection and application of this "critical accounting policy" involves judgments, estimates, and uncertainties that are susceptible to change. In the event that different assumptions or conditions were to prevail, and depending upon the severity of such changes, the possibility of materially different financial condition or results of operations is a reasonable likelihood.

The Company manages the risk characteristics of its entire loan portfolio in an effort to maintain an adequate allowance for loans losses and identify problem loans so that the risks in the portfolio can be identified on a timely basis. Management performs a periodic analysis of risk factors that includes the primary sources of repayment on individual loans, liquidity and financial condition of borrowers and guarantors, and the adequacy of collateral. Loans subject to individual reviews are analyzed and segregated by risk according to the Company's internal risk rating scale. Management also considers changes in the size and character of the loan portfolio, changes in nonperforming and past-due loans, historical loss experience, concentrations of loans to specific borrowers and industries, and general and regional economic conditions, as well as other factors existing at the determination date. This review takes into account the judgment of the individual loan officers, the credit risk manager, senior management and the Board of Directors. The Company also has an independent loan review performed by an outside consultant periodically throughout the year. Although credit policies are designed to minimize risk, management recognizes that loan losses will occur and that the amount of these losses will fluctuate depending on the risk characteristics of the loan portfolio.

The allowance for loan losses is established through provisions for loan losses as a charge to earnings based upon management's ongoing evaluation. The balance of the allowance for loan losses was \$2,297,000 or 1.47% of loans at December 31, 2002 and \$1,911,000 or 1.38% of loans at December 31, 2001. The provision for loan losses was \$443,000 for 2002 and \$260,000 for 2001. Net loan losses were \$57,000 or .04% of average loans in 2002 and \$3,000 or .003% of average loans in 2001. The increase in the allowance reflects the Bank's loan growth in 2002, the composition of the loan portfolio and current economic conditions.

While historical losses have been modest, the current economic conditions of the market area and the concentration of loans in the higher risk classifications (e.g. commercial and industrial, and commercial real estate mortgages) warrant maintenance of the allowance for loan losses at its current level. The Bank's loan portfolio has grown 13.4%, and most of the change in the allowance was attributable to higher reserves for commercial loans and commercial real estate loans. Repayment of loans can be significantly impacted by the economic weaknesses that persisted in 2002. Retail sales and service industries reported slow growth and decline in tourism, due to the continuing impact of the events of September 11<sup>th</sup> and the sniper attacks in the metropolitan area in the fourth

quarter of 2002. All of these factors raise concerns about the impact on the Bank's customer base. Management believes that the allowance for loan losses at December 31, 2002 is adequate given past experience and the underlying concerns surrounding the Company's loan portfolio. For additional information on the analysis of loan losses, see Note 4 of the Notes to Consolidated Financial Statements.

The following table presents the allocation of the allowance for loan losses by categories.

	December 31,			
	2002		2001	
	Reserve Amount	% of Loans to Total Loans	Reserve Amount	% of Loans to Total Loans
	(Dollars in thousands)			
Commercial	\$817	23.1%	\$673	23.7%
Real estate - mortgages	1,361	76.2%	1,155	75.3%
Installment	13	0.7%	34	1.0%
Unallocated	106	--	49	--
Total loans	<u>\$2,297</u>	<u>100.0%</u>	<u>\$1,911</u>	<u>100.0%</u>

### ***Nonperforming Assets***

Nonperforming assets include nonaccrual loans, restructured loans, past-due loans and other real estate owned. Nonperforming assets at December 31, 2002 and 2001 represented 0.22% of total assets in both years and totaled \$460,000 and \$386,000, respectively. Of the nonaccrual loans at December 31, 2002 and 2001, the balances guaranteed by the SBA totaled \$294,000 and \$229,000, respectively. There were no past-due loans, defined as loans that are 90 days or more delinquent and still accruing interest, at December 31, 2002 or 2001. See Note 4 of the Notes to Consolidated Financial Statements.

The following table presents nonperforming assets by category at December 31, 2002 and 2001.

	2002	2001
	(Dollars in thousands)	
Nonaccrual loans:		
Commercial	\$460	\$385
Installment - individuals	--	1
Total nonaccrual loans	<u>460</u>	<u>386</u>
Past due loans:	<u>--</u>	<u>--</u>
Total nonperforming assets	<u>\$460</u>	<u>\$386</u>
Nonperforming assets exclusive of SBA guarantee	\$165	\$157
Ratio of nonperforming assets to gross loans	0.29%	0.28%
Ratio of nonperforming assets to total assets	0.22%	0.22%
Allowance for loan losses to nonperforming assets	500%	495%
Ratio of net charge-offs to average loans	0.040%	0.003%

Loans totaling \$3,468,000 and \$1,343,000 at December 31, 2002 and 2001 respectively, were classified as monitored credits subject to management's attention and are not reported in the preceding table. Their classification is reviewed on a quarterly basis. The balances of the monitored credits guaranteed by the SBA totaled \$1,989,000 and \$215,000 as of December 31, 2002 and 2001, respectively.

### **Liquidity and Capital Resources**

#### ***Liquidity***

Liquidity is a product of the Company's operating, investing, and financing activities and is represented by cash and cash equivalents. Principal sources of funds are from deposits, short and long term debt, principal and interest payments on outstanding loans, maturity of investment securities, and funds provided from operations. As shown in

the consolidated Statement of Cash Flows, operating activities provided significant levels of funds in 2002 and 2001, primarily from net income. Investing activities were a net user of funds in both 2002 and 2001 to fund loan and investment security growth. Financing activities provided funds primarily from deposit growth in 2002 and 2001. Cash dividends required \$206,000 more in funds in 2002 than 2001. Overall, net cash and cash equivalents increased in 2002 by \$6,204,000, as compared to a decrease of \$152,000 in 2001. Liquid assets improved to 9.5% of total assets at December 31, 2002, as compared to 7.9% of total assets at the end of the previous year.

The Company uses projections and ratios to monitor liquidity. A commonly-used measure of liquidity is the loan-to-deposit ratio. The 2002 average loan-to-deposit ratio was 88.3%, which was slightly below the 2001 level of 88.8%. The Company has additional sources of liquidity, consisting of unsecured and secured lines of credit and unpledged securities available for sale. See Note 9 and Note 10 of the Notes to Consolidated Financial Statements.

### ***Capital Resources***

Capital levels are monitored by management on a quarterly basis in relation to financial forecasts for the year and regulatory requirements. The Corporation and the Bank continue to maintain a strong capital position. The following table presents the Company's and the Bank's capital position relative to their various minimum statutory and regulatory capital requirements at December 31, 2002. The Company and the Bank are considered "well-capitalized" under regulatory guidelines. For additional information, see Note 14 of the Notes to the Consolidated Financial Statements.

	Company		Bank		Minimum Capital Requirements
	Amount	Ratio	Amount	Ratio	
	(Dollars in thousands)				
Leverage ratio	\$21,003	10.42%	\$20,592	10.22%	4.00%
Tier 1 risk-based ratio	21,003	12.12%	20,592	11.87%	4.00%
Total risk-based ratio	23,171	13.37%	23,009	13.26%	8.00%

## Market Risk

The Company is exposed to various market risks in the normal course of conducting business. Market risk is the potential loss arising from adverse changes in interest rates, prices, and liquidity. The Company has established the Asset/Liability Committee (ALCO) to monitor and manage those risks. ALCO meets periodically and is responsible for approving asset/liability policies, formulating and implementing strategies to improve balance sheet and income statement positioning, and monitoring the interest rate sensitivity. The company manages its interest-rate risk sensitivity through the use of a simulation model that projects the impact of rate shocks, rate cycles, and rate forecast estimates on the net interest income and economic value of equity (the net present value of expected cash flows from assets and liabilities). These simulations provide a test for embedded interest-rate risk and takes into consideration factors such as maturities, reinvestment rates, prepayment speeds, repricing limits, decay rates and other factors. The results are compared to risk tolerance limits set by ALCO policy. The rate-shock risk simulation projects the impact of instantaneous parallel shifts in the yield curve. At December 31, 2002, an instantaneous rate increase of 100 basis points indicates a positive change of \$263,000 or a 2.7% increase in net interest income and indicates a negative change of \$634,000 or 2.1% decrease in the economic value of equity from the base case. Likewise, an instantaneous decrease in rates of 100 basis points indicates a negative change of \$33,000 or a .34% decrease in the net interest income and indicates a positive change of \$859,000 or 2.9% increase in the economic value of equity.

The table below sets forth, as of December 31, 2002, the estimated changes in the Company's net interest income and economic value of equity, which would result from the designated instantaneous changes in the yield curve.

Changes in Interest Rates (basis points)	Net Interest Income			Economic Value of Equity		
	Estimated Value	Amount of Change	Percent Change	Estimated Value	Amount of Change	Percent Change
	(Dollars in thousands)					
+200	\$9,948	\$212	2.18%	\$27,543	(\$2,049)	(6.92)%
+100	9,999	263	2.71%	28,958	(634)	(2.14)%
base	9,735	--	--	29,592	--	--
-100	9,702	(33)	(.34)%	30,451	859	2.90%
-200	9,011	(724)	(7.44)%	30,160	568	1.92%

**Summary of Operations by Quarter and Summary of Market Data**  
(Unaudited)

(Dollars in thousands, except per share data)

	Three Months Ended			
	12/31	9/30	6/30	3/31
<b>Summary of Operations by Quarter:</b>				
<b>2002:</b>				
Interest income	\$3,311	\$3,251	\$3,195	\$3,074
Net interest income	2,717	2,608	2,548	2,378
Provision for loan losses	150	105	88	100
Net income	900	874	848	793
Per common share: (a)				
Basic earning	\$0.31	\$0.29	\$0.28	\$0.26
Diluted earnings	\$0.30	\$0.29	\$0.28	\$0.26
Dividends declared	\$0.11	\$0.11	\$0.11	\$0.11
Average shares outstanding for: (a)				
Basic earnings per share	3,002,971	3,001,957	3,001,957	3,000,924
Diluted Earnings per share	3,019,786	3,017,984	3,018,124	3,016,893
<b>2001:</b>				
Interest income	\$3,183	\$3,173	\$3,137	\$3,241
Net interest income	2,355	2,253	2,181	2,211
Provision for loan losses	70	70	60	60
Net income	756	724	708	705
Per common share: (a)				
Basic earnings	\$0.24	\$0.24	\$0.24	\$0.24
Diluted earnings	\$0.24	\$0.24	\$0.24	\$0.24
Dividends declared	\$0.11	\$0.09	\$0.08	\$0.08
Average shares outstanding for: (a)				
Basic earnings per share	2,994,063	2,983,398	2,983,398	2,983,398
Diluted Earnings per share	3,005,120	2,994,573	2,990,494	2,987,620
<b>Summary of Market Data:</b>				
Common stock price: (a)(b)				
2002	\$15.80-11.54	\$13.27-11.38	\$15.91-12.51	\$16.37-11.86
2001	\$12.33-12.00	\$10.18-9.89	\$9.93-9.85	\$7.59-7.27

(a) On December 31, 2002, a 10% stock dividend was paid. All common share data used in this report has been restated to reflect the stock dividend.

(b) The above market data presents the range of high and low bid quotations for the shares as reported by the Nasdaq Stock Market.

At December 31, 2002, the Company had 552 shareholders of record.

**ABIGAIL ADAMS NATIONAL BANCORP, INC. AND SUBSIDIARY**  
**Consolidated Balance Sheets**  
**December 31, 2002 and 2001**

	2002	2001
<b>Assets</b>		
Cash and due from banks	\$7,507,145	\$5,607,875
Federal funds sold	8,469,016	4,163,836
Interest-bearing deposits in other banks	3,486,332	4,328,091
Investment securities available for sale at fair value	16,314,939	19,899,546
Investment securities held to maturity (market value of \$10,272,046 and \$4,425,356 for 2002 and 2001, respectively)	10,229,905	4,512,960
Loans	156,536,280	138,060,683
Less: allowance for loan losses	(2,296,608)	(1,910,963)
Loans, net	154,239,672	136,149,720
Bank premises and equipment, net	1,211,943	670,200
Other assets	3,490,692	2,837,887
Total assets	\$204,949,644	\$178,170,115
<b>Liabilities and Stockholders= equity</b>		
Liabilities:		
Deposits		
Noninterest-bearing deposits	\$46,890,447	\$40,407,437
Interest-bearing deposits	127,877,743	112,683,200
Total deposits	174,768,190	153,090,637
Short-term borrowings	7,312,776	4,436,618
Long-term debt	724,151	809,695
Other liabilities	952,686	944,903
Total liabilities	183,757,803	159,281,853
Commitments and contingencies (Note 7 and 11)		
Stockholders= equity (Note 1):		
Common stock, \$0.01 par value, authorized 5,000,000 shares; issued 3,021,119 in 2002 and 2,742,582 shares in 2001; outstanding 3,004,679 shares in 2002 and 2,727,636 in 2001	30,211	27,426
Additional paid-in capital	17,185,310	13,047,784
Retained earnings	3,886,313	5,884,201
Less: Treasury stock, 16,440 shares in 2002 and 14,946 in 2001, at cost	(98,349)	(98,349)
Accumulated other comprehensive income	188,356	27,200
Total stockholders= equity	21,191,841	18,888,262
Total liabilities and stockholders= equity	\$204,949,644	\$178,170,115

See notes to consolidated financial statements.

**ABIGAIL ADAMS NATIONAL BANCORP, INC. AND SUBSIDIARY**  
**Consolidated Statements of Income**  
**Years ended December 31, 2002 and 2001**

	2002	2001
<b>Interest income</b>		
Interest and fees on loans	\$11,243,243	\$11,008,526
Interest and dividends on investment securities:		
Taxable	1,392,919	1,268,092
Other interest income	194,631	457,487
Total interest income	12,830,793	12,734,105
<b>Interest expense</b>		
Interest on deposits	2,434,000	3,535,398
Interest on short-term borrowings	92,586	139,664
Interest on long-term debt	53,600	59,238
Total interest expense	2,580,186	3,734,300
Net interest income	10,250,607	8,999,805
Provision for loan losses	442,500	260,000
Net interest income after provision for loan losses	9,808,107	8,739,805
<b>Noninterest income</b>		
Service charges on deposit accounts	1,635,861	1,537,046
Other income	317,797	443,653
Total noninterest income	1,953,658	1,980,699
<b>Noninterest expense</b>		
Salaries and employee benefits	2,981,605	3,006,789
Occupancy and equipment expense	1,179,968	1,152,507
Professional fees	201,635	223,606
Data processing fees	427,993	411,025
Other operating expense	1,273,001	1,231,450
Total noninterest expense	6,064,202	6,025,377
Income before provision for income taxes	5,697,563	4,695,127
Provision for income taxes	2,282,216	1,802,440
<b>Net income</b>	\$3,415,347	\$2,892,687
<b>Earnings per share:</b>		
Basic	\$1.14	\$0.96
Diluted	\$1.13	\$0.96
<b>Average common shares outstanding:</b>		
Basic	3,002,058	2,990,373
Diluted	3,025,194	2,998,761

See notes to consolidated financial statements.

**ABIGAIL ADAMS NATIONAL BANCORP, INC. AND SUBSIDIARY**  
**Consolidated Statements of Changes in Stockholders= Equity**  
**Years Ended December 31, 2002 and 2001**

	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Employee Stock Ownership Plan (ESOP)	Accumulated Other Comprehensive Income	Total
<b>Balance at December 31, 2000</b>	\$27,354	\$12,992,334	\$4,082,112	(\$87,144)	(\$55,122)	\$13,876	\$16,973,410
Comprehensive income:							
Net income	--	--	2,892,687	--	--	--	2,892,687
Change in net unrealized gain on investment securities	--	--	--	--	--	13,324	13,324
Total comprehensive income	--	--	--	--	--	--	2,906,011
Dividends declared (\$0.36 per share)	--	--	(1,090,588)	--	--	--	(1,090,588)
Issuance of shares under Stock Option Programs	7	5,246	--	--	--	--	5,253
Release of shares under ESOP	--	50,259	--	--	55,122	--	105,381
Redemption of shares under ESOP	--	--	--	(11,205)	--	--	(11,205)
Other stock adjustments	65	(55)	(10)	--	--	--	--
<b>Balance at December 31, 2001</b>	27,426	13,047,784	5,884,201	(98,349)	--	27,200	18,888,262
Comprehensive income:							
Net income	--	--	3,415,347	--	--	--	3,415,347
Change in net unrealized gain on investment securities available for sale, net of taxes of \$110,075	--	--	--	--	--	161,156	161,156
Total comprehensive income	--	--	--	--	--	--	3,576,503
Dividends declared (\$0.44 per share)	--	--	(1,296,935)	--	--	--	(1,296,935)
Issuance of shares under Stock Option Programs	41	23,970	--	--	--	--	24,011
10% Stock dividend	2,744	4,113,556	(4,116,300)	--	--	--	--
<b>Balance at December 31, 2002</b>	\$30,211	\$17,185,310	\$3,886,313	(\$98,349)	--	\$188,356	\$21,191,841

See notes to consolidated financial statements

**ABIGAIL ADAMS NATIONAL BANCORP, INC. AND SUBSIDIARY**  
**Consolidated Statements of Cash Flows**  
**Years ended December 31, 2002 and 2001**

	2002	2001
<b>Cash flows from Operating Activities:</b>		
Net Income	\$3,415,347	\$2,892,687
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	442,500	260,000
Depreciation and amortization	271,409	284,608
Profit sharing contribution of ESOP shares	--	105,381
Accretion of loan discounts and fees	(253,255)	(151,546)
Net discount (accretion)/premium amortization on investment securities	21,200	(205,046)
Deferred income taxes (benefits)	(28,873)	(79,709)
(Increase) decrease in other assets	(734,006)	719,135
Increase (decrease) in other liabilities	7,781	(571,267)
<b>Net cash provided by operating activities</b>	<b>3,142,103</b>	<b>3,254,243</b>
<b>Cash flows from Investing Activities:</b>		
Proceeds from maturities of investment securities held to maturity	7,500,000	2,500,000
Proceeds from maturities of investment securities available for sale	14,500,000	29,975,000
Proceeds from repayment of mortgage-backed securities	1,353,086	121,680
Purchase of investment securities held to maturity	(12,746,779)	(4,015,000)
Purchase of investment securities available for sale	(12,488,612)	(28,259,460)
Net decrease in interest-bearing deposits in other banks	841,759	824,226
Net increase in loans	(18,279,197)	(19,472,246)
Purchase of bank premises and equipment	(813,153)	(159,885)
<b>Net cash used in investing activities</b>	<b>(20,132,896)</b>	<b>(18,485,685)</b>
<b>Cash flows from Financing Activities:</b>		
Net increase in transaction and savings deposits	28,078,945	5,388,003
Net (decrease) increase in time deposits	(6,401,392)	10,045,461
Net increase in short-term borrowings	2,876,158	819,900
Payments on long-term debt	(85,544)	(77,820)
Proceeds from issuance of common stock, net of expenses	24,011	5,253
Payment of distributions from ESOP	--	(11,205)
Cash dividends paid to common stockholders	(1,296,935)	(1,090,588)
<b>Net cash provided by financing activities</b>	<b>23,195,243</b>	<b>15,079,004</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>6,204,450</b>	<b>(152,438)</b>
<b>Cash and cash equivalents at beginning of year</b>	<b>9,771,711</b>	<b>9,924,149</b>
<b>Cash and cash equivalents at end of year</b>	<b>\$15,976,161</b>	<b>\$9,771,711</b>
Supplementary disclosures:		
Interest paid on deposits and borrowings	\$2,582,360	\$3,724,640
Income taxes paid	\$2,410,000	\$2,061,602

See notes to consolidated financial statements.

**ABIGAIL ADAMS NATIONAL BANCORP, INC. AND SUBSIDIARY**  
**Notes to Consolidated Financial Statements**

**1. Summary of Significant Accounting Policies**

Abigail Adams National Bancorp, Inc. (the ACompany@) is a one-bank holding company that provides its customers with banking and non-banking financial services through its principal wholly-owned subsidiary, The Adams National Bank (the ABank@). The Bank offers various loan, deposit, and other financial service products to its customers. The Bank=s customers include individuals, not-for-profit, and commercial enterprises. Its principal market areas encompass Washington, D.C. and the surrounding metropolitan area.

The Company and the Bank prepare their financial statements on the accrual basis and in conformity with accounting principles generally accepted in the United States of America. The more significant accounting policies are explained below. As used herein, the term the Company includes the Bank, unless the context otherwise requires.

**(a) Principles of Consolidation**

The consolidated financial statements include the accounts of the Company and the Bank. All significant intercompany accounts and transactions have been eliminated in consolidation.

**(b) Cash and Cash Equivalents**

The Company has defined cash and cash equivalents as those amounts included in ACash and due from banks@ and AFederal funds sold.@

**(c) Securities**

Management determines the appropriate classification of securities at the time of purchase. Securities which the Company has the ability and the intent to hold until maturity are classified as investment securities to be held to maturity and are reported at amortized cost. Investment securities which are not classified as held to maturity or trading account assets are classified as available for sale and are reported at fair value with unrealized gains and losses reported as a separate component of stockholders= equity. Unrealized gains and losses reflect the difference between fair market value and amortized cost of the individual securities as of the reporting date. The market value of securities is generally based on quoted market prices or dealer quotes. The Company does not maintain a trading account. Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method. Premiums and discounts are amortized using a method which approximates the effective interest method over the term of the security.

**(d) Loans**

The Company originates commercial, commercial real estate and consumer loans in the Washington D.C. metropolitan area. Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are stated at the amount of unpaid principal, adjusted for deferred loan fees and origination costs, and reduced by an allowance for loan losses. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method.

The accrual of interest is discontinued at the time a loan becomes 90 days delinquent, unless the credit is well-secured and in the process of collection. In all cases, loans are placed on nonaccrual or charged-off at an earlier date, if collection of principal or interest is considered doubtful. All interest accrued but not collected for loans placed on nonaccrual or charged-off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for the return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

(e) **Allowance for Loan Losses**

The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses, when management believes that collectibility of the principal is unlikely. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan losses and may require the Bank to make additions to the allowance based on their judgments about information available to them at the time of their examinations.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as either doubtful, substandard or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimates of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

A loan is impaired when it is probable, based upon current information and events, the Company will be unable to collect all contractual principal and interest payments due in accordance with the terms of the loan agreement. Impaired loans are valued based on the fair value of the related collateral, if the loans are collateral dependent. For all other impaired loans, the specific reserves approximate the present values of expected future cash flows discounted at the loan's effective interest rate. The amount of the impairment, if any, and any subsequent changes are included in the allowance for loan losses.

(f) **Loan Origination Fees and Costs**

Loan origination fees net of costs directly attributable to loan originations are deferred using the interest method and recognized over the estimated lives of the loans, as an adjustment to the related loan's yield. Deferred fees and costs are not amortized during periods in which interest income is not being recognized because of concerns about the realization of loan principal or interest.

(g) **Depreciation**

Depreciation of Bank equipment is computed using the estimated useful lives of the respective assets, ranging from three to five years, on the straight-line basis. Depreciation of Bank premises, consisting of leasehold improvements, are amortized on a straight-line basis over the estimated useful lives of the respective assets or the terms of the respective leases, whichever is shorter. Expenditures for major renewals and betterments of Bank premises and equipment are capitalized at cost.

(h) **Federal Home Loan Bank Stock**

The Bank, as a member of the Federal Home Loan Bank (FHLB) system, is required to maintain an investment in capital stock of the FHLB in an amount equal to the greater of 1% of its outstanding home loans or 5% of advances from the FHLB. No ready market exists for the FHLB stock, and it has no quoted market value.

(i) **Stockholders' Equity**

All per share data presented has been retroactively adjusted for the 10% stock dividend declared on December 17, 2002 and issued on December 31, 2002.

(j) **Earnings Per Share**

Basic earnings per share computations are based upon the weighted average number of shares outstanding during the periods. Diluted earnings per share computations are based upon the weighted average number of shares outstanding during the period plus the dilutive effect of outstanding stock options and stock performance awards. Per share amounts are based on the weighted average number of shares outstanding during each period, as adjusted for the 10% stock dividend in 2002, as follows:

	2002	2001
Weighted average shares	3,002,058	\$2,990,373
Effect of dilutive stock options	23,136	8,388
Dilutive potential average common shares	<u>3,025,194</u>	<u>2,998,761</u>

(k) **Stock-Based Compensation Plans**

During 2002, the Company adopted FASB Statement No. 148 "Accounting for Stock-Based Compensation – Transition and Disclosure, Amendment of FASB Statement No. 123." At December 31, 2002, the Company has five stock-based compensation plans, which are described more fully in Note 15. The Company accounts for those plans under the recognition and measurement principals of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. Accordingly, compensation expense was recorded equal to the difference between the quoted market price of the underlying common stock on the date of grant and the exercise price. The following table illustrates the effect on net income and earnings per share had compensation cost for all of the stock-based compensation plans been determined based on the grant date fair values of awards. (The method described in FASB Statement No. 123, Accounting for Stock-Based Compensation.)

	Years Ended December 31,	
	2002	2001
	(Dollars in thousands, except per share data)	
Net income as reported	\$3,415	\$2,893
Deduct total stock based compensation expense determined under fair value based method, net of related tax effects	(9)	(9)
Pro forma net income	<u>3,404</u>	<u>2,884</u>
Basic earnings per share, as reported	\$1.14	\$0.96
Basic earnings per share, pro forma	\$1.14	\$0.96
Diluted earnings per share, as reported	\$1.13	\$0.96
Diluted earnings per share, pro forma	\$1.13	\$0.96

(l) **Comprehensive Income**

Comprehensive Income is the change in equity of a business enterprise during a reporting period from transactions and other events and circumstances from non-owner sources. In addition to the Company's net income, change in equity components under comprehensive income reporting include net changes in unrealized gains and losses on investment securities available for sale.

(m) **Risks and Uncertainties**

The Company is subject to competition from other financial institutions, and is also subject to the regulations of certain federal agencies and undergoes periodic examination by those regulatory authorities.

In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of

the date of the balance sheet and revenues and expenses for the period. Actual results could differ significantly from these estimates.

Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the allowance for loan losses and the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans. In connection with the determination of the allowances for loan losses and other real estate, management periodically obtains independent appraisals for significant properties owned or serving as collateral for loans.

(n) **Income Taxes**

The Company records a provision for income taxes based upon the amounts of current taxes payable (or refundable) and the change in net deferred tax assets or liabilities during the year. Deferred tax assets and liabilities are recognized for the tax effects of differing carrying values of assets and liabilities for tax and financial statement reporting purposes that will reverse in future periods. Deferred tax assets and liabilities are included in the financial statements at currently enacted income tax rates applicable to the period in which the deferred tax assets and liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

(o) **Reclassifications**

Certain reclassifications have been made to amounts previously reported in 2001 to conform with the 2002 presentation.

2. **Restrictions on Cash Balances**

Included in cash and due from banks are balances maintained within the Company to satisfy legally required reserves and to compensate for services provided from correspondent banks. Restricted balances maintained totaled \$4,206,000 and \$2,985,000 at December 31, 2002 and 2001, respectively. There were no other withdrawal, usage restrictions or legally required compensating balances at December 31, 2002 or 2001.

3. **Securities**

The amortized cost and estimated fair value of investment securities to be held to maturity and investment securities available for sale at December 31, 2002, and 2001 are as follows:

	Amortized Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
December 31, 2002:				
<b>Investment Securities - available for sale:</b>				
U.S. government agencies and corporations	\$9,500,563	\$104,749	\$--	\$9,605,312
Mortgage-backed securities	2,727,511	33,016	--	2,760,527
Marketable equity securities	3,769,855	179,245	--	3,949,100
Total	<u>\$15,997,929</u>	<u>\$317,010</u>	<u>\$--</u>	<u>\$16,314,939</u>
<b>Investment Securities - held to maturity:</b>				
U.S. government agencies and corporations	\$6,000,000	\$24,616	\$--	\$6,024,616
Mortgage-backed securities	\$4,229,905	\$17,525	--	4,247,430
Total	<u>\$10,229,905</u>	<u>\$42,141</u>	<u>\$--</u>	<u>\$10,272,046</u>
December 31, 2001:				
<b>Investment Securities - available for sale:</b>				
U.S. government agencies and corporations	\$14,501,300	\$138,314	\$165,145	\$14,474,469
Mortgage-backed securities	2,072,251	8,765	--	2,081,016
Marketable equity securities	3,280,216	86,811	22,966	3,344,061
Total	<u>\$19,853,767</u>	<u>\$233,890</u>	<u>\$188,111</u>	<u>\$19,899,546</u>
<b>Investment Securities - held to maturity:</b>				
U.S. government agencies and corporations	<u>\$4,512,960</u>	<u>\$5,315</u>	<u>\$92,919</u>	<u>\$4,425,356</u>

Total	<u>\$4,512,960</u>	<u>\$5,315</u>	<u>\$92,919</u>	<u>\$4,425,356</u>
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Securities with carrying values of \$20,691,000 and \$19,923,000 at December 31, 2002 and 2001, respectively, were pledged to collateralize public deposits and repurchase agreements.

The cost and estimated fair value of investment securities to be held to maturity and investment securities available for sale at December 31, 2002, by contractual maturity are shown on the following table. Expected maturities may differ from contractual maturities in mortgage-backed securities, because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties; therefore, these securities are not included in maturity categories in the following table.

	December 31, 2002	
	Cost	Estimated Fair Value
<b>Investment Securities - available for sale:</b>		
Due in one year or less	\$1,000,563	\$1,023,440
Due after one year through five years	3,500,000	3,539,700
Due after five years through ten years	5,000,000	5,042,172
Mortgage-backed securities	2,727,511	2,760,527
Equity securities and other	3,769,855	3,949,100
Total	<u>\$15,997,929</u>	<u>\$16,314,939</u>
<b>Investment Securities - held to maturity:</b>		
Due in one year or less	\$--	\$--
Due after one year through five years	6,000,000	6,024,616
Mortgage-backed securities	4,229,905	4,247,430
Total	<u>\$10,229,905</u>	<u>\$10,272,046</u>

#### 4. Loans

The loan portfolio at December 31, 2002 and 2001, consisted of the following:

	2002	2001
Commercial and industrial	<u>\$36,299,774</u>	<u>\$32,707,108</u>
Real estate:		
Commercial mortgage	80,673,789	77,278,918
Residential mortgage	34,736,414	23,764,561
Construction and development	4,184,658	3,193,939
Installment to individuals	979,170	1,394,221
	<u>156,873,805</u>	<u>138,338,747</u>
Less: net deferred loan fees	(337,525)	(278,064)
Total	<u>\$156,536,280</u>	<u>\$138,060,683</u>

A substantial portion of the Company's loans are secured by real estate in the Washington, D.C. metropolitan area. Accordingly, the Company's loan portfolio is susceptible to changes in market conditions in the Washington metropolitan area.

Included in the accompanying consolidated balance sheets are certain loans that are accounted for on a non-accrual basis. At December 31, 2002 and 2001, non-accrual loans totaled approximately \$460,000 and \$386,000, respectively. Had the loans been current in accordance with their original terms, gross interest income for these loans would have been \$24,000 and \$52,000 in 2002 and 2001, respectively. At December 31, 2002 and 2001, the Company had no loans greater than 90 days delinquent, which were still accruing interest.

A loan is considered impaired, when based upon current information and events, the Company deems it probable that it will be unable to collect all amounts due under the loan agreement based on contractual repayment terms. Impaired loans, which include non-accrual loans, amounted to \$460,000 and \$386,000, at December 31, 2002 and 2001, respectively. The average recorded investment in impaired loans was \$528,000 and \$301,000, during 2002 and 2001, respectively. There were no impaired loans that were not in non-accrual status at December 31, 2002 and at December 31, 2001. There were no commitments to extend additional funds to borrowers whose loans are classified as impaired. Interest income recognized on impaired loans during the year ended December 31, 2002 and 2001, which has not been disclosed above in the discussion of non-accrual and restructured loans was \$19,000 and \$47,000, respectively. The allowance for loan losses did not contain a specific reserve for impaired loans at December 31, 2002 but did contain a specific reserve of \$125,000 at December 31, 2001. Management deemed the level of the loan loss allowance to be adequate at December 31, 2002.

An analysis of the allowance for loan losses for the years ended December 31, 2002 and 2001, follows:

	2002	2001
Balance at January 1	\$1,910,963	\$1,654,033
Provision for loan losses	442,500	260,000
Recoveries:		
Commercial	8,523	6,593
Installment to individuals	5,353	14,435
Total recoveries	13,876	21,028
Charge-offs:		
Commercial	(55,112)	(8,746)
Installment to individuals	(15,619)	(15,352)
Total charge-offs	(70,731)	(24,098)
Net charge-offs	(56,855)	(3,070)
Balance at December 31	\$2,296,608	\$1,910,963
Ratio of net charge-offs to average total loans	(0.040)%	(0.003)%
Average total loans outstanding during the year	\$143,453,829	\$122,802,000

The Company has engaged in banking transactions in the ordinary course of business with some of its directors, officers, principal shareholders and their associates. All loans or commitments to extend loans and the payment of overdrafts included in such transactions are made on the same terms, including interest rates and collateral, as those prevailing at the time for comparable loans with unrelated persons and do not involve more than the normal risk of collectibility. At December 31, 2002 and 2001, none of these loans are reported as non-accrual, restructured or classified. The aggregate amount of loans to related parties for the years ended December 31, 2002 and 2001 was \$105,000.

#### 5. Bank Premises and Equipment

Bank premises and equipment at December 31, 2002 and 2001 is summarized as follows:

	2002	2001
Furniture and equipment	\$2,501,638	\$2,408,496
Leasehold improvements	1,178,459	1,352,386
Subtotal, at cost	3,230,097	3,760,882
Accumulated depreciation and amortization	(2,018,154)	(3,090,682)
Total, net	\$1,211,943	\$670,200

Amounts charged to operating expenses for depreciation and amortization expense aggregated \$271,409 and \$284,608 in 2002 and 2001, respectively.

## 6. Deposits

At December 31, 2002, the scheduled maturities on all time deposits are as follows:

Year	< \$100,000	> \$100,000	Total
2003	\$18,454,398	\$25,630,835	\$44,085,233
2004	1,665,811	5,967,453	7,633,264
2005	330,964	--	330,964
2006	100,520	--	100,520
2007	96,468	401,639	498,107
	<u>\$20,648,161</u>	<u>\$31,999,927</u>	<u>\$52,648,088</u>

Related party deposits totaled approximately \$236,000 and \$279,000 at December 31, 2002 and 2001, respectively. In management's opinion, interest rates paid on these deposits, where applicable, are available to others at the same terms.

## 7. Leasing Arrangements

The Company and banking subsidiary have entered into various noncancelable operating leases. These noncancelable operating leases are subject to renewal options under various terms. Some leases provide for periodic rate adjustments based on cost-of-living index changes. Rental expense in 2002 and 2001 was approximately \$668,000 and \$677,000, respectively. The following is a schedule of future minimum payments under noncancelable operating leases that have initial or remaining lease terms in excess of one year as of December 31, 2002:

2003	\$656,837
2004	643,305
2005	660,684
2006	669,809
2007	683,010
2008 and thereafter	<u>3,835,628</u>
Total	<u>\$7,149,273</u>

## 8. Income Taxes

Income tax expense for 2002 and 2001 consists of:

	2002	2001
Current:		
Federal	\$1,825,760	\$1,486,898
District of Columbia	<u>485,329</u>	<u>395,251</u>
	<u>2,311,089</u>	<u>1,882,149</u>
Deferred tax expense (benefit):		
Federal	(22,810)	(62,970)
District of Columbia	<u>(6,063)</u>	<u>(16,739)</u>
	<u>(28,873)</u>	<u>(79,709)</u>
Total:		
Federal	1,802,950	1,423,928
District of Columbia	<u>479,266</u>	<u>378,512</u>
	<u>\$2,282,216</u>	<u>\$1,802,440</u>

Income tax expense differed from the amounts computed by applying the statutory federal income tax rate of 34 % to pretax income, as a result of the following:

	2002		2001	
	Amount	%	Amount	%
Tax expense at statutory rate	\$1,937,171	34.0%	\$1,596,343	34.0%
Increase in taxes resulting from District of Columbia franchise tax, net of Federal tax effect	316,316	5.6%	249,818	5.3%
Other	28,729	0.5%	(43,721)	-0.9%
Total	<u>\$2,282,216</u>	<u>40.1%</u>	<u>\$1,802,440</u>	<u>39.4%</u>

The following is a summary of the tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2002 and 2001:

	2002	2001
Deferred tax assets:		
Allowance for loan losses	\$689,353	\$508,523
Deferred loan fees	28,486	42,728
Furniture and equipment	117,884	258,184
Compensated absences	12,351	10,327
Other	2,139	1,782
Total gross deferred tax assets	<u>850,213</u>	<u>821,544</u>
Deferred tax liabilities:		
Unrealized gain on investment securities	(128,655)	(18,579)
Other	(654)	(858)
Total gross deferred tax liabilities	<u>(129,309)</u>	<u>(19,437)</u>
Net deferred tax assets	<u>\$720,904</u>	<u>\$802,107</u>

#### 9. Long-term Debt

In November 2002, the Bank entered into an agreement with the Federal Home Loan Bank (FHLB) for advances collateralized with a blanket floating lien of first mortgages and commercial real estate. The maximum amount that could be borrowed under this agreement is approximately \$11,600,000. No funds were borrowed in 2002 under this agreement. In 1996, the Bank borrowed funds from the FHLB that mature on December 1, 2008, at a fixed rate of 6.95%. The outstanding balance of loans pledged at December 31, 2002 and 2001, to collateralize this debt is \$825,000 and \$1,139,000, respectively, and consists of loans secured by first liens on one- to four-family, multifamily and commercial mortgages. Annual principal maturities as of December 31, 2002 are as follows:

2003	\$94,034
2004	103,366
2005	113,625
2006	124,902
2007	137,299
2008	150,925
Total	<u>\$724,151</u>

#### 10. Short-term Borrowings

Short-term borrowings consist primarily of Federal funds purchased, short-term borrowings from the FHLB, and securities sold under repurchase agreements. Federal funds purchased represent funds borrowed overnight. The Bank has unsecured Federal fund lines of credit from correspondent banking relationships, which can provide up to \$7,000,000 in liquidity. Short-term borrowing from the FHLB are collateralized by investment securities. No short-term FHLB borrowings or Federal fund lines of credit borrowings were outstanding at December 31, 2002 and 2001.

Securities sold under repurchase agreements generally involve the receipt of immediately available funds which mature in one business day or roll over under a continuing contract. In accordance with these contracts, the underlying securities sold are U.S. government agencies, which are segregated from the Company's other investment securities in the Bank's Federal Reserve Bank account. The book value of the underlying securities sold under these repurchase agreements at December 31, 2002 and 2001 was approximately \$9,896,000 and \$6,057,000, respectively.

Short-term borrowings for 2002 and 2001 are summarized below:

	2002	2001
Balance at end of year	\$7,312,776	\$4,436,618
Daily average balance outstanding during year	5,856,182	4,702,954
Maximum balance outstanding as of any month-end during year	8,327,851	5,629,749
Daily average interest rate during year	1.58%	2.97%
Average interest rate on balance at the end of year	0.92%	1.62%

#### 11. Commitments and Contingent Liabilities

In the normal course of business, there are various outstanding commitments and contingent liabilities, such as commitments to extend credit, that are not reflected in the accompanying consolidated financial statements. These commitments include revolving credit agreements, term loan commitments, and short-term borrowing agreements. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being funded, the total commitment amounts do not necessarily represent future liquidity requirements. Both loan commitments and standby letters of credit have credit risk essentially the same as that involved in extending loans to customers and are subject to the normal credit approval procedures and policies. Collateral is obtained based on management's assessment of the customer's credit. At December 31, 2002 and 2001, the following financial instruments were outstanding whose contracts represent credit risk:

	2002	2001
Commitment to originate loans	\$2,628,000	\$4,049,000
Unfunded commitments under lines of credit	\$31,439,000	\$24,492,000
Commercial and standby letters of credit	\$1,968,000	\$937,000
Portion of letters collateralized	82%	72%

Under the terms of an employment agreement with the current President and CEO of the Bank, the Bank is obligated to make payments totaling approximately \$185,000, in the event she chooses to exercise her rights under the agreement. These funds are held in the grantor trust established on February 25, 1998.

The Company and the Bank are defendants in litigation and claims arising from the normal course of business. Based upon consultation with legal counsel, management is of the opinion that the outcome of any claims and pending or threatened litigation will not have a material adverse impact on the Company's financial position, results of operations or liquidity.

## 12. Restrictions on Dividend Payments and Loans by Affiliated Bank

The primary source of dividends paid by the Company to its shareholders is dividends received from the Bank. Federal regulations restrict the total dividend payments that a national banking association may make during any calendar year to the total net income of the bank for the current year plus retained net income for the preceding two years, without prior regulatory approval. At December 31, 2002, approximately \$6,745,000 of retained earnings of the Bank was available for dividend declarations. Restrictions are also imposed upon the ability of the Bank to make loans to the Company, purchase stock in the Company or use the Company's securities as collateral for indebtedness of the Bank. At December 31, 2002, the Company and the Bank were in compliance with regulatory requirements.

## 13. Parent Company Only Financial Statements

Presented below are the condensed financial statements of Abigail Adams National Bancorp:

### Condensed Balance Sheets

	December 31	
	2002	2001
<b>Assets:</b>		
Interest-bearing balances with bank subsidiary	\$124,645	\$211,789
Investment in subsidiary bank	20,780,460	18,400,232
Loans	--	85,000
Other assets	306,955	212,221
Total assets	<u>\$21,212,060</u>	<u>\$18,909,242</u>
<b>Liabilities and Stockholders= Equity:</b>		
Other liabilities	\$20,219	\$20,980
Stockholders= equity	21,191,841	18,888,262
Total liabilities and stockholders= equity	<u>\$21,212,060</u>	<u>\$18,909,242</u>

### Condensed Statements of Income

	Years Ended December 31	
	2002	2001
<b>Income</b>		
Interest earned on balances with subsidiary bank	578	\$571
Interest on loans	1,578	759
Dividends from subsidiary bank	1,400,000	1,100,000
Total income	<u>1,402,156</u>	<u>1,101,330</u>
<b>Expenses</b>		
Salaries and benefits	--	3,758
Professional fees	42,560	62,953
Other	302,472	326,860
Total expenses	<u>345,032</u>	<u>393,571</u>
Income before taxes and equity in undistributed net income of subsidiary	1,057,124	707,759
Income tax expense (benefit)	(139,151)	(150,580)
Income before equity in undistributed earnings of subsidiary	1,196,275	858,339
Equity in undistributed net income of subsidiary	2,219,072	2,034,348
<b>Net Income</b>	<u>\$3,415,347</u>	<u>\$2,892,687</u>

**Condensed Statement of Cash Flows**

	Years Ended December 31	
	2002	2001
<b>Operating Activities:</b>		
Net Income	\$3,415,347	\$2,892,687
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Equity in undistributed net income of subsidiary	(2,219,072)	(2,034,348)
ESOP compensation	--	105,381
Other, net	(95,495)	(121,811)
Net cash provided by operating activities	<u>1,100,780</u>	<u>841,909</u>
<b>Investing Activities:</b>		
Net decrease (increase) in lines of credit	85,000	(85,000)
Net cash provided by (used in) investing activities	<u>85,000</u>	<u>(85,000)</u>
<b>Financing Activities:</b>		
Proceeds from issuance of common stock, net	24,011	5,253
Redemptions of shares from ESOP	--	(11,205)
Cash dividends paid to stockholders	(1,296,935)	(1,090,588)
Net cash used in financing activities	<u>(1,272,924)</u>	<u>(1,096,540)</u>
Net decrease in cash and cash equivalents	(87,144)	(339,631)
Cash and cash equivalents at beginning of year	<u>211,789</u>	<u>551,420</u>
Cash and cash equivalents at end of year	<u>\$124,645</u>	<u>\$211,789</u>

**14. Regulatory Capital Requirements**

The Company and the Bank are subject to various regulatory capital requirements administered by federal banking agencies. These regulatory capital requirements involve quantitative measures of the Company=s assets, liabilities and certain off-balance sheet items, and also qualitative judgments by the regulators. Failure to meet minimum capital requirements can subject the Company to a series of increasingly restrictive actions. To be considered "well-capitalized," an institution must generally have a leverage ratio of at least 5%, a Tier 1 risk-based capital ratio of at least 6% and a total risk-based capital ratio of at least 10%. At December 31, 2002 and 2001, the Company and the Bank exceed all capital adequacy requirements to which they are subject, and the Bank qualifies as "well-capitalized."

The following table presents the capital position of the Company and the Bank relative to their various minimum statutory and regulatory capital requirements at December 31, 2002 and 2001.

	Actual		Minimum Capital Requirements		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
(Dollars in Thousands)						
<b>December 31, 2002:</b>						
Total Capital to Risk Weighted Assets:						
Consolidated	\$23,171	13.37%	\$13,882	8.00%	N/A	N/A
Bank	23,009	13.26%	13,961	8.00%	17,326	10.00%
Tier 1 Capital to Risk Weighted Assets:						
Consolidated	21,003	12.12%	6,941	4.00%	N/A	N/A
Bank	20,592	11.87%	6,930	4.00%	10,396	6.00%
Leverage Ratio:						
Consolidated	21,003	10.42%	8,063	4.00%	N/A	N/A
Bank	20,592	10.22%	8,061	4.00%	10,076	5.00%
<b>December 31, 2001:</b>						
Total Capital to Risk Weighted Assets:						
Consolidated	\$20,746	13.74%	\$12,082	8.00%	N/A	N/A
Bank	20,508	13.60%	12,061	8.00%	15,077	10.00%
Tier 1 Capital to Risk Weighted Assets:						
Consolidated	18,861	12.49%	6,041	4.00%	N/A	N/A
Bank	18,373	12.19%	6,031	4.00%	9,046	6.00%
Leverage Ratio:						
Consolidated	18,861	10.86%	6,944	4.00%	N/A	N/A
Bank	18,373	10.55%	6,965	4.00%	8,706	5.00%

N/A = not applicable

## 15. Benefit Plans

The Company has various stock option plans for directors and certain key employees. At December 31, 2002, there were 181,924 shares of common stock reserved for future issuance under the stock option plans of which there were 27,236 shares under option outstanding. The terms of the options are determined by the Board of Directors. Options generally vest over three years, and no options may be exercised beyond ten years from the grant date. The option price per share of the qualified employees= incentive stock option plans equals the fair market value at the date of the grant. The option price for the non-qualified options range from 85% to 90% of the fair market value at the date of the grant.

The Company accounts for its stock option plans under APB Opinion No. 25. The amount equal to the difference between the quoted market price of the stock on the date of grant and the amount the grantee is required to pay is recorded as compensation expense. In 2002 and 2001, compensation expense of approximately \$6,000, has been recorded for each year for the non-qualified stock option plans.

At December 31, 2002, the options outstanding have a weighted average contractual life of 6.5 years. The fair value of each option grant is estimated on the date of the grant using a Black-Scholes based option pricing model. The last option plan was granted in 2000, and the assumptions used were a 5.27% risk-free interest rate, an expected dividend yield of 1.5%, an expected life of 10 years, and an expected volatility of 27%. There were no grants in 2002 or 2001.

The following is a summary of activity of the Company's stock option plans for 2002 and 2001:

	2002		2001	
	Shares Under Option	Weighted Average Exercise Price	Shares Under Option	Weighted Average Exercise Price
Outstanding at beginning of year	31,611	\$5.67	34,361	\$5.67
Granted	--	--	--	--
Exercised	(4,375)	\$5.49	(917)	\$5.73
Forfeited/Expired	--	--	(1,833)	\$5.73
Outstanding at end of year	27,236	\$5.70	31,611	\$5.67
Exercisable at end of year	27,236	\$5.70	23,360	\$5.65
Weighted avg. FV of options granted	--	--	--	--

The Company offers an employee stock ownership plan ("ESOP") with 401(k) provisions. Participants may elect to contribute to the 401(k) up to the lesser of \$40,000 or 100% of their eligible annual earnings. The Bank may make a discretionary matching contribution of 50% of a participant's deferral contribution on the first 6% of the deferral amount subject to the maximum allowable under federal regulations. The Board of Directors may elect to pay an additional discretionary contribution on an annual basis. The employer's discretionary contributions vest over three years. The Company's 401(k) expense was \$54,000 and \$58,000 in 2002 and 2001, respectively, which is included in salaries and benefits in the accompanying consolidated statements of income.

The Employee Stock Ownership Plan (@ESOP@) was established in 1996 and acquired 42,969 Common shares of the Company purchased at \$5.09 per share. All the shares were allocated to participants' accounts as of December 31, 2001. In 2002, the Bank accrued a contribution of \$75,000 toward the purchase of Common shares of the Company for the ESOP. The ESOP expense was approximately \$75,000 and \$91,000 for the years ended December 31, 2002 and 2001, respectively.

#### 16. Other Noninterest Expense

The following is a summary of the significant components of other operating expense for the years ended December 31, 2002 and 2001:

	2002	2001
Courier service and bank security	\$144,716	\$137,887
Stationery and office supplies	110,929	105,032
Directors' and committee fees	147,700	134,400
Insurance	89,265	104,472
Taxes, other	98,086	94,079
Telephone	89,194	89,829
Other	593,111	565,751
Total other operating expense	<u>\$1,273,001</u>	<u>\$1,231,450</u>

#### 17. Shareholder Rights Plan

In accordance with a Rights Agreement (@Rights Agreement@), dated April 20, 1995, as amended, the Company declared a dividend of one share purchase right for each share of the Company's common stock outstanding on April 25, 1994 (@Right@). Each Right entitles the holder to purchase one share of the Company's common stock at an exercise price of \$11.70. Subject to certain exceptions, the Rights will be exercisable if a person or group of persons acquires 25% or more of the Company's common stock (@Acquiring Person@), or announces a tender offer resulting in the ownership of 25% or more of the common stock, or if the Board determines that a person or group of persons holding 15% or more of the Company's common stock is an Adverse Person, as defined in the Rights Agreement. Upon the occurrence of one of the

triggering events, all holders of Rights, except the Acquiring Person or Adverse Person, would be entitled to purchase the Company's common stock at 50% of the market price. The Board of Directors may redeem the Rights for \$0.01 per share or amend the Plan at any time before a person becomes an Acquiring Person. The Rights expire on December 31, 2003.

#### 18. Fair Value of Financial Instruments

The following table presents the estimated fair values of the Company's financial instruments at December 31, 2002 and 2001 and is followed by a general description of the methods and assumptions used to estimate such fair values.

	December 31, 2002		December 31, 2001	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
<b>Financial Assets:</b>				
Cash and due from banks	\$7,507,145	\$7,507,145	\$5,607,875	\$5,607,875
Federal funds sold and interest-bearing deposits in other banks	11,955,348	11,955,348	8,491,927	8,491,927
Investment securities available for sale	16,314,939	16,314,939	19,899,546	19,899,546
Investment securities held to maturity	10,229,905	10,272,046	4,512,960	4,425,356
Loans, net	154,239,672	155,090,000	136,149,720	137,145,037
<b>Financial Liabilities:</b>				
Deposits	174,768,190	175,099,000	153,090,637	153,270,157
Short-term borrowings	7,312,776	7,312,776	4,436,618	4,436,618
Long-term debt	724,151	804,000	809,695	856,000

The following methods and assumptions were used by the Company in estimating the fair value of its financial instruments.

**Cash and due from banks.** The carrying amounts reported in the balance sheet approximate fair value due to the short-term nature of these assets.

**Federal funds sold and interest-bearing deposits in other banks.** The carrying amounts of short-term investments on the balance sheet approximate fair value.

**Investments securities available for sale and investment securities to be held to maturity.** The estimated fair values of securities by type are based on quoted market prices, when available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

**Loans.** Estimated fair values for variable rate loans, which reprice frequently and have no significant credit risk, are based on carrying value. Estimated fair value for all other loans are estimated using discounted cash flow analyses, based on interest rates currently offered on loans with similar terms to borrowers of similar credit quality.

**Deposits.** The fair value of deposits with no stated maturity, such as noninterest-bearing deposits, NOW accounts, savings and money market deposit accounts, is the amount payable on demand as of year-end. Fair values for time deposits are estimated using discounted cash flow analyses, based on the current interest rates offered for deposits of similar maturities.

**Short-term borrowings.** The carrying values of federal funds purchased, securities sold under agreements to repurchase and other short-term borrowings approximate fair values.

**Long-term debt.** The fair value of the long-term debt is estimated by using discounted cash flow analyses, based on the current rates offered for similar borrowing arrangements.

***Loan commitments, standby and commercial letters of credit.*** The estimated fair value of these off-balance-sheet instruments are based on cost. Carrying amounts which are comprised of the unamortized fee income and where necessary, reserves for any expected credit losses from these financial instruments, are immaterial.

## **INDEPENDENT AUDITOR'S REPORT**

The Board of Directors and Stockholders  
Abigail Adams National Bancorp, Inc.  
Washington, D.C.

We have audited the accompanying consolidated balance sheets of Abigail Adams National Bancorp, Inc. and subsidiary (the "Company") as of December 31, 2002 and 2001, and the related consolidated statements of income, changes in stockholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

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

McGladrey & Pullen, LLP  
Alexandria, Virginia  
January 28, 2003



## STOCKHOLDER INFORMATION

### **CORPORATE HEADQUARTERS:**

Abigail Adams National Bancorp, Inc.  
1130 Connecticut Avenue, NW  
Suite 200  
Washington, D.C. 20036  
(202) 772-3600

### **FINANCIAL INFORMATION:**

Copies of printed financial information including the Annual Report as filed with the Securities and Exchange Commission on Form 10-KSB are available without charge, upon written request to Karen E. Troutman, Senior Vice President and Chief Financial Officer, at the address listed above.

### **ANNUAL MEETING:**

The annual meeting of shareholders of Abigail Adams National Bancorp will be held at 3:00 p.m. on Tuesday, May 20, 2003 at the Corporate Headquarters at the address listed above.

### **SHAREHOLDER ASSISTANCE:**

Questions concerning your shareholder account, including change of address forms, records or information about lost certificates or dividend checks, should be directed to our transfer agent at the address listed below or access your shareholder information online at [www.amstock.com](http://www.amstock.com).

American Stock Transfer & Trust Company  
59 Maiden Lane  
New York, N.Y. 10038  
(800-937-5449)

### **INTERNET:**

Information on bank products and services is available on our Web site at [www.adamsbank.com](http://www.adamsbank.com).

### **STOCK LISTING:**

Abigail Adams National Bancorp, Inc. Common Stock is listed on the NASDAQ National Market under the symbol AANB.

### **INDEPENDENT AUDITORS:**

McGladrey & Pullen, LLP  
201 Thomas Johnson Drive  
Frederick, Maryland 21702

### **SPECIAL COUNSEL:**

Luse Gorman Pomerenk & Schick, P.C.  
5335 Wisconsin Avenue, NW, Suite 400  
Washington, D.C. 20015

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**DIRECTORS OF THE ABIGAIL ADAMS NATIONAL BANCORP  
and THE ADAMS NATIONAL BANK**

**Jeanne D. Hubbard**  
Chairwoman, President and  
CEO  
Abigail Adams National Bancorp

**Kathleen Walsh Carr**  
President & CEO  
The Adams National Bank

**Michelle D. Bernard**  
President  
Odyssey International

**David A. Bradley**  
Moss, McGee, Bradley, Kelly &  
Foley

**A. George Cook, III**  
Principal  
George Cook & Company

**Carl E. Hecht**  
Chairman  
US Tag

**Lynne M. Miller**  
CEO  
Environmental Strategies  
Corporation

**Douglas Reynolds**  
Attorney  
Cabell County Public Defenders  
Office

**Marshall T. Reynolds**  
Chairman & CEO  
Champion Industries, Inc.

**Patricia G. Shannon**  
President & CEO  
Boys & Girls Clubs of Greater  
Washington

**Robert L. Shell, Jr.**  
CEO  
Guyan International

**Marianne Steiner**  
Principal  
Larkspur Marketing

**Joseph L. Williams**  
Chairman & CEO  
Basic Supply Company, Inc.

**Bonita A. Wilson**  
Principal  
Bonnie Wilson & Company

**EXECUTIVE OFFICERS**

**Jeanne D. Hubbard**  
Chairwoman, President and  
Chief Executive Officer of  
Abigail Adams National  
Bancorp, Inc.

**Kathleen Walsh Carr**  
President & Chief Executive  
Officer of The Adams National  
Bank

**Karen E. Troutman**  
Chief Financial Officer and  
Senior Vice President of  
Abigail Adams National  
Bancorp and The Adams  
National Bank

**OFFICE LOCATIONS**

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**Deposit Operations**  
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