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BLACKHAWK BANCORP INC
 Form 10QSB
 November 15, 2002

FORM 10-QSB
 SECURITIES AND EXCHANGE COMMISSION
 WASHINGTON, D.C. 20549

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (D)
 OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2002

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 0-18599

BLACKHAWK BANCORP, INC.
 (EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

WISCONSIN
 (STATE OR OTHER JURISDICTION OF
 INCORPORATION OR ORGANIZATION)

39-1659424
 (I. R. S. EMPLOYER
 IDENTIFICATION NO.)

400 BROAD STREET
 БЕЛОIT, WISCONSIN 53511
 (ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

(608) 364-8911
 (REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE)
 NOT APPLICABLE

(FORMER NAME, FORMER ADDRESS AND FORMER FISCAL YEAR, IF CHANGED SINCE LAST
 REPORT)

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, and (2) has been subject to such filing requirements
 for the past 90 days.

YES X NO
 ----- -----

Indicate the number of shares outstanding of each of the issuer's classes of
 common stock, as of the latest practicable date.

CLASS OF COMMON STOCK -----	OUTSTANDING AT NOVEMBER 12, 2002 -----
\$.01 PAR VALUE	2,507,065 SHARES

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PART I - FINANCIAL INFORMATION

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BLACKHAWK BANCORP, INC. AND SUBSIDIARY UNAUDITED CONSOLIDATED BALANCE SHEETS

	SEPTEMBER 30, 2002 ----	DECEMBER 2001 ----
ASSETS		

	(Dollars in thousands)	
Cash and cash equivalents	\$ 11,475	\$ 11,
Interest-bearing deposit accounts	336	7,
Federal funds sold and other short-term investments	4,009	16,
Securities available for sale	74,001	42,
Securities held to maturity, fair value of \$25,406 and \$24,172	24,287	23,
Federal Home Loan Bank of Chicago stock, at cost	2,480	2,
Loans held for sale	2,599	2,
Loans, net of allowance for loan losses of \$2,706 and \$2,404	188,818	206,
Bank premises and equipment, net	6,674	6,
Accrued interest receivable	2,085	2,
Cash value of bank owned life insurance	5,677	
Intangible assets	4,736	5,
Other assets	1,178	1,
	-----	-----
Total Assets	\$328,355	\$330,

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LIABILITIES AND SHAREHOLDERS' EQUITY

LIABILITIES:

Deposits:

Non-interest bearing	\$ 30,841	\$ 36,
Interest bearing	209,109	212,
Total deposits	239,950	249,

Borrowed Funds:

Short-term borrowings	24,368	6,
Other borrowings	35,900	48,
Total borrowed funds	60,268	54,

Accrued interest payable

Accrued interest payable	862	1,
--------------------------	-----	----

Other liabilities	1,431	1,
-------------------	-------	----

Total Liabilities	302,511	306,
-------------------	---------	------

SHAREHOLDERS' EQUITY:

Preferred stock

1,000,000 shares, \$.01 par value per share authorized, none issued or outstanding	--	
--	----	--

Common stock

10,000,000 shares, \$.01 par value per share authorized, shares issued: 2,507,065 at September 30, 2002, 2,371,398 at December 31, 2001; shares outstanding: 2,506,188 at September 30, 2002, 2,366,418 at December 31, 2001	25	
--	----	--

Additional paid-in capital	8,700	7,
----------------------------	-------	----

Retained earnings	15,827	15,
-------------------	--------	-----

Treasury stock, 877 at September 30, 2002 and 4,980 at

December 31, 2001 shares, at cost	(10)	
-----------------------------------	------	--

Accumulated other comprehensive income	1,302	
--	-------	--

Total Shareholders' Equity	25,844	23,
----------------------------	--------	-----

Total Liabilities and Shareholders' Equity	\$328,355	\$330,
--	-----------	--------

See Notes to Unaudited Consolidated Financial Statements

BLACKHAWK BANCORP, INC. AND SUBSIDIARY
UNAUDITED CONSOLIDATED STATEMENTS OF INCOME

THREE MONTHS ENDED SEPTEMBER 30

2002 2001

INTEREST INCOME:

(Dollars in thousands)

Interest and fees on loans	\$3,608	\$4,661
----------------------------	---------	---------

Interest on securities:

Taxable	946	731
---------	-----	-----

Exempt from federal income taxes	210	198
----------------------------------	-----	-----

Interest on fed funds sold and other short-term investments	62	12
---	----	----

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Interest on interest-bearing deposits	3	5
	-----	-----
Total Interest Income	4,829	5,607
	-----	-----
INTEREST EXPENSE:		
Interest on deposits	1,459	2,101
Interest on short-term borrowings	89	82
Interest on other borrowings	533	711
	-----	-----
Total Interest Expense	2,081	2,894
	-----	-----
Net Interest Income	2,748	2,713
Provision for loan losses (Note 2)	422	400
	-----	-----
Net Interest Income After Provision For Loan Losses	2,326	2,313
	-----	-----
OTHER OPERATING INCOME:		
Service charges on deposit accounts	396	396
Gain on sale of mortgage loans	95	151
Gain on sale of securities	--	38
Brokerage and annuity commissions	48	13
Net loss on sale of other assets	(17)	(22)
Other income	179	162
	-----	-----
Total Other Operating Income	701	738
	-----	-----
OTHER OPERATING EXPENSES:		
Salaries and employee benefits	1,233	1,300
Occupancy expense, net	193	184
Furniture and equipment	225	189
Data processing	184	176
Amortization of intangible assets	78	124
Legal and professional fees	116	158
Office supplies	63	65
Telephone and telecommunications	77	69
Other operating expenses	471	430
	-----	-----
Total Other Operating Expenses	2,640	2,695
	-----	-----
Income Before Income Taxes	387	356
Provision for Income Taxes	85	98
	-----	-----
Net Income	\$302	\$258
	-----	-----
Basic Earnings Per Share	\$ 0.12	\$ 0.11
	-----	-----
Diluted Earnings Per Share	\$ 0.12	\$ 0.11
	-----	-----
Dividends Per Share	\$ 0.09	\$ 0.09
	-----	-----

See Notes to Unaudited Consolidated Financial Statements

BLACKHAWK BANCORP, INC. AND SUBSIDIARY
UNAUDITED CONSOLIDATED STATEMENTS OF INCOME

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	NINE MONTHS ENDED SEPTEMBER 30,	
	2002	2001
	----	----
	(Dollars in thousands)	
INTEREST INCOME:		
Interest and fees on loans	\$11,188	\$14,195
Interest on securities:		
Taxable	2,560	2,360
Exempt from federal income taxes	627	561
Interest on fed funds sold and other short-term investments	116	50
Interest on interest-bearing deposits	32	31
	-----	-----
Total Interest Income	14,523	17,197
	-----	-----
INTEREST EXPENSE:		
Interest on deposits	4,567	6,987
Interest on short-term borrowings	184	417
Interest on other borrowings	1,652	2,081
	-----	-----
Total Interest Expense	6,403	9,485
	-----	-----
Net Interest Income	8,120	7,712
Provision for loan losses (Note 2)	683	675
	-----	-----
Net Interest Income After Provision For Loan Losses	7,437	7,037
	-----	-----
OTHER OPERATING INCOME:		
Service charges on deposit accounts	1,142	1,113
Gain on sale of mortgage loans	221	381
Gain on sale of securities	229	132
Brokerage and annuity commissions	130	96
Net loss on sale of other assets	(19)	(17)
Other income	510	460
	-----	-----
Total Other Operating Income	2,213	2,165
	-----	-----
OTHER OPERATING EXPENSES:		
Salaries and employee benefits	3,964	3,897
Occupancy expense, net	641	571
Furniture and equipment	654	588
Data processing	570	498
Amortization of intangible assets	232	372
Legal and professional fees	412	369
Office supplies	188	214
Telephone and telecommunications	227	216
Other operating expenses	1,372	1,225
	-----	-----
Total Other Operating Expenses	8,260	7,950
	-----	-----
Income Before Income Taxes	1,390	1,252
Provision for Income Taxes	341	376
	-----	-----
Net Income	\$1,049	\$876
	-----	-----
Basic Earnings Per Share	\$ 0.43	\$ 0.37
	-----	-----
Diluted Earnings Per Share	\$ 0.43	\$ 0.37
	-----	-----
Dividends Per Share	\$ 0.27	\$ 0.33

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See Notes to Unaudited Consolidated Financial Statements

BLACKHAWK BANCORP, INC. AND SUBSIDIARY
UNAUDITED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

	NINE MONTHS ENDED SEPTEMBER 30,	
	2002	2001
	----	----
	(Dollars in thousands)	
Common Stock:		
Balance at beginning of period	\$ 24	\$ 23
Stock options exercised	1	1
	-----	-----
Balance at end of period	25	24
	-----	-----
Additional Paid-in Capital:		
Balance at beginning of period	7,555	7,417
Stock options exercised	1,152	150
Sale of treasury stock	(7)	(3)
	-----	-----
Balance at end of period	8,700	7,564
	-----	-----
Retained Earnings:		
Balance at beginning of period	15,447	15,573
Net income	1,049	876
Dividends declared on common stock	(669)	(777)
	-----	-----
Balance at end of period	15,827	15,672
	-----	-----
Treasury Stock, at cost:		
Balance at beginning of period	(58)	(120)
Sale of treasury stock	48	39
	-----	-----
Balance at end of period	(10)	(81)
	-----	-----
Accumulated other comprehensive income:		
Balance at beginning of period	773	102
Other comprehensive income, net of taxes	529	937
	-----	-----
Balance at end of period	1,302	1,039
	-----	-----
Total Shareholders' Equity	\$25,844	\$24,218
	-----	-----

See Notes to Unaudited Consolidated Financial Statements

BLACKHAWK BANCORP, INC. AND SUBSIDIARY
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

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NINE MONTHS EN
SEPTEMBER 3

2002

(Dollars in thou

CASH FLOWS FROM OPERATING ACTIVITIES:

Net Income	\$ 1,049
Adjustments to reconcile net income to net cash provided by (used in) operating activities:	
Provision for loan losses	683
Provision for depreciation and amortization	939
Amortization of premiums and (accretion of discounts) on Investment securities, net	105
Gain on sale of loans held for sale	(221)
FHLB stock dividends	(92)
(Gain) loss on sale of property, equipment and OREO	94
Gain on sale of securities	(229)
Tax benefit of non-qualified stock options exercised	(72)
Change in assets and liabilities:	
Decrease in other assets	455
(Increase) decrease in accrued interest receivable	(22)
Decrease in accrued interest payable	(182)
Increase (decrease) in other liabilities	(110)

Net cash provided by operations before loan originations and sales	2,397
Loans originated for sale	(18,094)
Proceeds from sale of loans held for sale	18,468

Net cash provided by operating activities	2,771

CASH FLOWS FROM INVESTING ACTIVITIES:

Decrease in interest-bearing deposit accounts	7,521
Decrease in federal funds sold and other short-term investments	12,409
Proceeds from maturities and calls of securities available-for-sale	7,886
Purchase of securities available-for-sale	(46,757)
Proceeds from maturities and calls of securities held-to-maturity	2,914
Purchase of securities held-to-maturity	(3,522)
Proceeds from sale of securities available-for-sale (Loans originated), net of principal collected	16,547
Purchase of bank owned life insurance	(5,000)
Proceeds from the sale of property, equipment and OREO	430
Purchase of bank premises and equipment	(669)

Net cash provided by investing activities	282

See Notes to Unaudited Consolidated Financial Statements.

BLACKHAWK BANCORP, INC. AND SUBSIDIARY
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
(CONTINUED)

NINE MONTHS EN
SEPTEMBER 3

2002

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(Dollars in thou

CASH FLOWS FROM FINANCING ACTIVITIES:

Stock options exercised	\$ 1,153
Sale of treasury stock	41
Net decrease in deposits	(9,654)
Net increase (decrease) in short-term borrowings	18,281
Proceeds from other borrowings	--
Payments on other borrowings	(12,488)
Dividends paid	(657)

Net cash used in financing activities	(3,324)

Increase in cash and cash equivalents	(271)

CASH AND CASH EQUIVALENTS:

Beginning	11,746

Ending	\$11,475

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

Cash payments for:	
Interest	\$ 6,586
Income taxes	\$ (50)

SUPPLEMENTAL SCHEDULE OF NON-CASH FINANCING

ACTIVITIES:	
Other assets acquired in settlement of loans	\$ 335

See Notes to Unaudited Consolidated Financial Statements.

BLACKHAWK BANCORP, INC. AND SUBSIDIARY
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2002

Note 1. General:

The unaudited consolidated financial statements include the accounts of Blackhawk Bancorp, Inc. and its subsidiaries. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the financial position, results of operation and cash flows for the interim periods have been made. The results of operations for the three and nine months ended September 30, 2002 are not necessarily indicative of the results to be expected for the entire fiscal year.

The unaudited interim financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and industry practice. Certain information in footnote disclosure normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America and industry practice has been condensed or omitted pursuant to rules and regulations of the Securities and Exchange Commission. The more significant policies used by the Company in preparing and presenting its financial statements are stated in the Corporation's Form 10-KSB. These financial statements should be read in conjunction with the consolidated financial statements and notes

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thereto included in the Company's December 31, 2001 audited financial statements.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions which affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements, as well as the reported amounts of income and expenses during the reported periods. Actual results could differ from those estimates.

Certain reclassifications have been made to the 2001 historical financial statements to conform to the 2002 presentation.

Note 2. Allowance For Loan Losses

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

	THREE MONTHS ENDED SEPTEMBER 30,	
(Dollars in thousands)	2002	2001
	----	----
Balance at beginning of period	\$2,519	\$2,057
Provision charged to expense	422	400
Loans charged off	237	394
Recoveries	2	12
	-----	-----
Balance at end of period	\$2,706	\$2,075
	-----	-----

	NINE MONTHS ENDED SEPTEMBER 30,	
(Dollars in thousands)	2002	2001
	----	----
Balance at beginning of period	\$2,404	\$3,894
Provision charged to expense	683	675
Loans charged off	419	2,562
Recoveries	38	68
	-----	-----
Balance at end of period	\$2,706	\$2,075
	-----	-----

Note 3. Earnings Per Share

Presented below are the calculations for basic and diluted earnings per share:

	THREE MONTHS ENDED SEPTEMBER 30,		
	2002	2001	
	----	----	
Basic:			
Net income available to common stockholders	\$ 302,000	\$ 258,000	\$1
	-----	-----	---

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Weighted average shares outstanding	2,503,832	2,363,312	
Basic earnings per share	\$0.12	\$0.11	
Diluted:			
Net income available to common stockholders	\$ 302,000	\$258,000	\$1
Weighted average shares outstanding	2,503,832	2,363,312	2
Effect of dilutive stock options outstanding	6,176	23,053	
Diluted weighted average shares outstanding	2,510,008	2,386,365	2
Diluted earnings per share	\$0.12	\$0.11	

Note 4. Recent Accounting Developments

Business Combinations

In September 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 141, "Business Combinations", and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 supersedes Accounting Principles Board (APB) Opinion No. 16, "Business Combinations", and SFAS No. 38, "Accounting for Preacquisition Contingencies of Purchased Enterprises." SFAS No. 141 requires the use of the purchase method of accounting for business combinations initiated after September 30, 2001. SFAS No. 142 supersedes APB Opinion No. 17, "Intangible Assets." SFAS No. 142 addresses how intangible assets acquired outside of a business combination should be accounted for upon acquisition and how goodwill and other intangible assets should be accounted for after they have been initially recognized. SFAS No. 142 eliminates the amortization for goodwill and other intangible assets with indefinite lives. Other intangible assets with a finite life will be amortized over their useful life. Goodwill and other intangible assets with indefinite useful lives shall be tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset may be impaired. SFAS No. 142 is effective for fiscal years beginning after December 15, 2001.

The Company's strategy over the past several years has included business combinations accounted for under the purchase accounting method which created goodwill upon the transactions' closings. The Company has goodwill of \$3.1 million on its balance sheet as of September 30, 2002. It was previously being amortized over 20 years. The pronouncement eliminates amortization of this asset and subjects it to periodic impairment analysis.

The Company's balance sheet also includes \$1,420,000 and \$1,652,000 of other intangible assets, primarily deposit intangibles, related to business combinations, as of September 30, 2002 and December 31, 2001. Amortization expense related to these other intangible assets totaled \$232,000 for the nine months ended September 30, 2002 and 2001.

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The Company adopted SFAS No. 142 on January 1, 2002. The Company has completed the first step of its impairment testing of goodwill and has concluded that there is no impairment. The impact of this standard on the three and nine month periods ended September 30, 2002 and 2001 is as follows:

	THREE MONTHS ENDED		
	SEPTEMBER 30,		
	2002	2001	
	----	----	
Reported net income	\$ 302,000	\$ 258,000	\$1
Add back: goodwill amortization	--	46,000	--
Adjusted net income	\$ 302,000	\$ 304,000	\$1
	-----	-----	-----
	-----	-----	-----
 BASIC EARNINGS PER SHARE:			
Reported net income	\$0.12	\$0.11	
Add back: goodwill amortization	--	0.02	
Adjusted net income	\$0.12	\$0.13	
	-----	-----	
	-----	-----	
 DILUTED EARNINGS PER SHARE:			
Reported net income	\$0.12	\$0.11	
Add back: goodwill amortization	--	0.02	
Adjusted net income	\$0.12	\$0.13	
	-----	-----	
	-----	-----	

Note 5. Recent Regulatory Developments

On July 30, President Bush signed the Sarbanes-Oxley Act of 2002 (the "Act"). This legislation impacts corporate governance of public companies, affecting their officers and directors, their audit committees, their relationships with their accountants and the audit function itself. Certain provisions of the Act became effective on July 30, 2002. Other provisions will become effective as the SEC adopts appropriate rules.

The Act implements a broad range of corporate governance and accounting measures for public companies designed to promote honesty and transparency in corporate America and better protect investors from corporate wrongdoing. The Act includes the creation of an independent accounting oversight board to oversee the audit of public companies and their auditors, provisions restricting non-audit services performed by independent accountants for public companies and additional corporate governance and responsibility provisions.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

The purpose of Management's discussion and analysis is to provide relevant information regarding the Registrant's financial condition and its results of operations. The information included herein should be read in conjunction with the company's consolidated financial statements and footnotes thereto

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for the year ended December 31, 2001.

This quarterly Report contains certain "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 areas 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.

RESULTS OF OPERATIONS

The company reported net income of \$302,000 for the three months ended September 30, 2002, an increase of \$44,000 or 17.1% from the \$258,000 reported for the same three month period in 2001. Net income for the nine month period ended September 30, 2002 was \$1,049,000, an increase of \$173,000, or 19.7% from the \$876,000 reported for the same period in 2001.

Diluted earnings per share were \$0.12 and \$0.43 for the three and nine months ended September 30, 2002, respectively, compared to \$0.11 and \$0.37 for the same periods in 2001. This represents an increase of 9.1% and 16.2% for the three month and nine month periods, respectively.

Net income for the three and nine months periods ended September 30, 2002 includes the effect of adopting Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets." Accordingly, amortization of intangible assets with indeterminable useful lives resulting from prior acquisitions accounted for under the purchase method of accounting was discontinued. The adoption of SFAS No. 142 had the impact of increasing net income by \$46,000 and \$140,000 for the three and nine months ended September 30, 2002, respectively, compared to the same periods in 2001.

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 primary source of the company's earnings. Net interest income increased by \$35,000, or 1.3%, to \$2,748,000 for the quarter ended September 30, 2002, compared to \$2,713,000 for the comparable period in 2001. On a year to date basis net interest income increased by \$408,000, or 5.3%, to \$8,120,000 compared to \$7,712,000 for the first nine months of 2001. The net interest margin, which is the tax equivalent net interest income divided by average interest earning assets was 3.76% and 3.83% for the three and nine month periods ended September 30, 2002. The third quarter net interest margin represents a 5 basis point decrease compared to the 2001 third quarter net interest margin of 3.81%. The year to date net interest margin of 3.83% represents a 21 basis point increase compared to the 3.62% net interest margin realized for the same period in 2001.

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The following tables set forth the company's consolidated average balances of assets, liabilities and shareholders' equity, interest income and expense on related items, and the company's average rate for the three and nine month periods ended September 30, 2002 and 2001. The tax-equivalent yield calculations assume a Federal Tax Rate of 34%:

AVERAGE BALANCE SHEET WITH RESULTANT INTEREST AND RATES

(yields on a tax-equivalent basis)

	Three Months ended September 30, 2002			Three Months
	Average Balance	Interest	Average Rate	Average Balance
INTEREST EARNING ASSETS:				
Interest-bearing deposit accounts	\$ 477	\$ 3	2.50%	\$ 535
Federal funds sold & short-term investments	10,197	62	2.41%	1,366
Investment securities:				
Taxable investment securities	77,182	946	4.86%	48,697
Tax-exempt investment securities	19,784	210	6.38%	18,623
Total investment securities	96,966	1,156	5.17%	67,320
Loans	193,773	3,608	7.39%	223,776
TOTAL EARNING ASSETS	\$301,413	\$4,829	6.50%	\$292,997
Allowance for loan losses	(2,491)			(2,193)
Cash and cash equivalents	10,569			10,068
Other assets	17,013			17,963
TOTAL ASSETS	\$326,504			\$318,835
INTEREST BEARING LIABILITIES:				
Interest bearing checking accounts	\$ 32,461	\$ 86	1.05%	\$ 29,439
Savings deposits	53,901	153	1.13%	51,861
Time deposits	123,716	1,220	3.91%	125,906
Total interest bearing deposits	210,078	1,459	2.76%	207,206
Short-term borrowings	18,405	89	1.92%	8,984
Other borrowings	39,442	533	5.36%	48,763
TOTAL INTEREST-BEARING				

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LIABILITIES	\$267,925	\$2,081	3.08%	\$264,953
		-----	-----	
NET INTEREST SPREAD			3.42%	

Checking accounts	30,641			27,548
Other liabilities	2,217			2,550
	-----			-----
Total liabilities	300,783			295,051
Shareholders' equity	25,721			23,784
	-----			-----
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$326,504			\$318,835
	-----			-----
NET INTEREST MARGIN		\$2,748	3.76%	
		-----	-----	
		-----	-----	

AVERAGE BALANCE SHEET WITH RESULTANT INTEREST AND RATES

(yields on a tax-equivalent basis)

	Nine Months ended September 30, 2002			Nine Months e
	Average Balance	Interest	Average Rate	Average Balance
	-----	-----	-----	-----
INTEREST EARNING ASSETS:				
Interest-bearing deposit accounts	\$ 2,327	\$ 32	1.84%	\$ 846
Federal funds sold & short-term investments	7,901	116	1.96%	1,504
Investment securities:				
Taxable investment securities	66,732	2,560	5.13%	51,324
Tax-exempt investment securities	19,565	627	6.49%	17,529
	-----	-----	-----	-----
Total investment securities	86,297	3,187	5.44%	68,853
Loans	197,854	11,188	7.56%	224,351
TOTAL EARNING ASSETS	\$294,379	\$14,523	6.74%	\$295,553
		-----	-----	
Allowance for loan losses	(2,509)			(3,307)
Cash and cash equivalents	10,073			10,048
Other assets	17,104			18,007
	-----			-----
TOTAL ASSETS	\$319,047			\$320,302
	-----			-----

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INTEREST BEARING LIABILITIES:				
Interest bearing checking accounts	\$ 32,253	\$ 259	1.07%	\$ 27,659
Savings deposits	53,819	474	1.18%	50,532
Time deposits	122,204	3,834	4.19%	130,825
	-----	-----		-----
Total interest bearing deposits	208,276	4,567	2.93%	209,016
Short-term borrowings	13,058	184	1.88%	11,680
Other borrowings	41,027	1,652	5.38%	47,615
TOTAL INTEREST-BEARING LIABILITIES	\$262,361	\$ 6,403	3.26%	\$268,311
		-----	-----	
NET INTEREST SPREAD			3.48%	

Checking accounts	29,723			25,918
Other liabilities	2,115			2,566
	-----			-----
Total liabilities	294,199			296,795
Shareholders' equity	24,848			23,507
	-----			-----
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$319,047			\$320,302
	-----			-----

NET INTEREST MARGIN		\$8,120	3.83%	
		-----	-----	
		-----	-----	

For the three months ended September 30, 2002, total interest income decreased by \$778,000, or 13.9%, to \$4,829,000 compared to \$5,607,000 for the same period in 2001. The decrease in interest income is due to a 123 basis point decrease in the yield on average earning assets to 6.50% for the third quarter of 2002, compared to 7.73% for the same period in 2001. The decrease in the yield on average earning assets for the third quarter of 2002 compared to the third quarter of 2001 is offset by an \$8.4 million increase in average earning assets. For the nine months ended September 30, 2002, total interest income decreased by \$2,674,000, or 15.5%, to \$14,523,000 compared to \$17,197,000 for the same period in 2001. The decrease in interest income is due to a 117 basis point decrease in the yield on average earning assets to 6.74% compared to 7.91% for the same period in 2001 and a .4% decrease in average earning assets.

The decrease in the yield on average earning assets reflects a shift in the asset mix from loans to investment securities and short-term investments for the three and nine month periods ended September 30, 2002 compared to the same periods in 2001. The decrease in the yield on average earning assets also reflects the lower interest rate environment during the third quarter and first nine months of 2002 compared to the same periods in 2001, which resulted from the Federal Reserve Bank's lowering of managed rates by 375 basis points during 2001. If managed rates continue to decrease or even remain at current levels, interest income and the average rate on earning assets are expected to continue to decline as more assets reprice.

Interest and fees on loans decreased 22.6% to \$3,608,000 for the three months ended September 30, 2002 compared to \$4,661,000 for the same period of 2001. This decrease was the result of a \$30.0 million or 13.4% decrease in average

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loans outstanding and an 87 basis point decrease in yield on the portfolio. Interest and fees on loans decreased 21.2% to \$11,188,000 for the nine months ended September 30, 2002 compared to \$14,195,000 in same period of 2001. This decrease was the result of a \$26.5 million or 11.8% decrease in average loans outstanding and a 90 basis point decrease in yield on the portfolio. The decrease in average loans outstanding for the three and nine month periods ended September 30, 2002 compared to the same periods in 2001 is largely attributable to the refinancing activity in the residential real estate market. The decrease in the bank's residential real estate portfolio accounted for \$18.6 million of the overall year to date decrease. The remaining decrease is the result of economic conditions and lower loan demand in the company's primary markets. The lower yield on average loans reflects the overall lower interest rate environment and competitive pricing pressure for quality credit customers.

Interest income on taxable securities increased by \$215,000 or 29.4% in the third quarter of 2002 to \$946,000 compared to \$731,000 for the same period in 2001. Average balances of taxable investment securities increased 58.5% to \$77.2 million for the quarter ended September 30, 2002 compared to \$48.7 million for the same period in the prior year. However, the yield on average taxable investment securities decreased 110 basis points to 4.86% for the third quarter of 2002 compared to 5.96% for the third quarter of 2001. Tax exempt investment securities increased \$1.2 million, or 6.2% to an average balance of \$19.8 million for the three months ended September 30, 2002 compared to \$18.6 for the same period in 2001. Interest income on taxable securities increased by \$200,000 or 8.5% in the first nine months of 2002 to \$2,560,000 from \$2,360,000 for the same period in 2001. Average balances of taxable investment securities increased 30.0% to \$66.7 million for the nine months ended September 30, 2002 compared to \$51.3 million for the same period in the prior year. The increase in average balances outstanding was offset by a decrease of 102 basis points in average yield to 5.13% for the first nine months of 2002 compared to 6.15% for the first nine months of 2001. Average tax exempt securities increased to \$19.6 million for the nine months ended September 30, 2002 compared to \$17.5 for the same period in 2001, while their average tax equivalent yield increased from 6.48% for the nine months ended September 30, 2001 to 6.49% for the same period in 2002.

Interest from fed funds sold and short-term investments increased to \$62,000 and \$116,000 for the three and nine month periods ended September 30, 2002, respectively, compared to \$12,000 and \$50,000 during the same periods in 2001. The quarterly and year to date increases in interest on fed funds sold and short-term investments is due to increased average balances. Funds from the reduction in the loan portfolio were held in short-term investments before being used to purchase longer-term investment securities. The Company invested a portion of these funds in a short-term reverse repurchase agreement having an average balance of \$6.9 million for the third quarter of 2002 compared to a \$0 balance for the same period in 2001. Funds were held in this temporary investment in anticipation of the purchase of a bank-owned life insurance asset, \$5 million of which was funded on September 30, 2002.

Total interest expense decreased by \$813,000, or 28.1%, to \$2,081,000 for the three months ended September 30, 2002 compared to \$2,894,000 for the same period in 2001. For the nine months ended September 30, 2002 total interest expense decreased by \$3,082,000, or 32.5%, to \$6,403,000 compared to \$9,485,000 for the same period in 2001. The decrease in total interest expense is the result of the aforementioned lower interest rate environment coupled with favorable shifts in the company's funding mix.

While interest paid on deposits decreased \$642,000, or 30.6% to \$1,459,000 during the three months ended September 30, 2002 compared to \$2,101,000 for the same period in 2001, average total deposits increased \$6.0 million quarter over quarter. Year to date interest paid on deposits decreased \$2,420,000, or 34.6% to \$4,567,000 compared to \$6,987,000 for the same period in 2001 while average

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total deposits decreased by \$740,000. In addition to the impact of the overall lower interest rate environment the company's funding cost was reduced due to favorable shifts in the funding mix. For the nine months ended September 30, 2002 the average balance of time deposits decreased \$8.6 million, or 6.6%, to \$122.2 million compared to \$130.8 million for the same period in 2001. The decrease in the average balance of time deposits was offset with increases in the average balances of checking accounts, interest-bearing checking accounts and savings accounts of \$3.8 million, \$4.6 million and \$3.3 million, respectively.

Interest on short-term borrowings increased \$7,000 to \$89,000 for the three months ended September 30, 2002 compared to \$82,000 for the same period in 2001. This increase is the result of an increase of \$7.2 million in average securities repurchase agreements entered into with the company's commercial customers for the three months ended September 30, 2002 compared to the same period in 2001. The substantial increase in balances is offset by lower rates due to the decrease in managed interest rates mentioned earlier. For the nine months ended September 30, 2002 interest on short-term borrowings decreased \$233,000 to \$184,000 compared to \$417,000 for the same period in 2001. This decrease is the net result of the decrease in managed interest rates as mentioned earlier and a \$1.4 million, or 11.8% increase in average short-term borrowings to \$13.1 million for the nine months ended September 30, 2002 compared to \$11.7 million for the same period in 2001.

Interest expense on other borrowings decreased \$178,000 and \$429,000 to \$533,000 and \$1,652,000 for the three and nine month periods ended September 30, 2002 compared to \$711,000 for the third quarter and \$2,081,000 for the first nine months of 2001. The decrease is primarily the result of the maturity of \$6.8 million of Federal Home Loan Bank term advances in January 2002.

PROVISION FOR LOAN LOSSES

The provision for loan losses (provision) is an amount added to the allowance for loan losses (allowance) to provide for the known and estimated amount of loans that will not be collected. Actual loan losses are charged against (reduce) the allowance when management believes that the collection of principal will not occur. Subsequent recoveries of amounts previously charged to the allowance, if any, are credited to (increase) the allowance. Management determines the appropriate provision based upon a number of criteria, including a detailed evaluation of certain credits, historical performance, economic conditions and overall quality of the loan portfolio.

The provision was \$422,000 in the third quarter of 2002, an increase of \$22,000 or 5.5% from the \$400,000 in the third quarter of 2001. For the first nine months of 2002, the provision was \$683,000 compared to \$675,000 during the same time period a year ago.

Activity in the allowance for loan losses is detailed in footnote 2 to the unaudited consolidated financial statements. Charge-offs, net of recoveries for the third quarter of 2002 decreased by \$147,000 or 38.5% to \$235,000 compared to \$382,000 for the third quarter of 2001. Year to date net charge-offs decreased \$2,113,000 or 84.7% to \$381,000 compared to \$2,494,000 for the first nine months of 2001. The 2001 year to date net charge-offs include \$1.9 million related to one large commercial real estate loan that was provided for in 2000. Although net charge-offs, even after excluding the \$1.9 million related to one loan, have decreased, the provision for loan losses has remained slightly above the prior year levels. The provision level has been maintained due to an increase in non-performing loans to \$3,206,000 at September 30, 2002 compared to \$3,164,000 at December 31, 2001.

The year to date increases in the provision combined with reduced net charge-offs and a decrease in the loan portfolio have resulted in an increase in the

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ratio of the allowance to total loans to 1.39% at September 30, 2002 compared to 1.14% at December 31, 2001.

OTHER OPERATING INCOME

Total other operating income decreased \$37,000, or 5.0%, to \$701,000 for the three months ended September 30, 2002 compared to \$738,000 for the same period in 2001. Year to date total other operating income increased \$48,000, or 2.2%, to \$2,213,000 compared to \$2,165,000 for the same period in 2001.

Service charges on deposit accounts were \$396,000 for the quarters ended September 30, 2002 and 2001. Year to date service charges on deposits increased \$29,000, or 2.6%, to \$1,142,000 compared to \$1,113,000 in the prior year.

Gain on the sale of mortgage loans decreased \$56,000 or 37.1% to \$95,000 for the third quarter of 2002 compared to the \$151,000 of gains recognized during the third quarter of 2001. In the third quarter of 2002, \$6.2 million of loans were sold to the secondary market compared to \$7.8 million for the same period in 2001. Year to date gain on sale of mortgage loans decreased \$160,000 or 42.0% to \$221,000 compared to \$381,000 for the same period in 2001. The decrease is due to lower volume and lower margins on the loans sold. The average gain in 2002 was 1.20% on \$18.5 million in loans sold to the secondary market compared to an average gain of 1.77% on the \$21.5 million of loans sold in the same period in 2001. The lower volume in 2002 is the result of turn-over in the company's mortgage banking management and origination staff. These changes in staff have resulted in better quality control and risk management in the company's mortgage banking activities.

The Company recognized no securities gains in the third quarter of 2002 compared to \$38,000 in the third quarter of 2001. Year to date the company has realized \$229,000 in securities gains, a \$97,000 or 73.4% increase over the \$132,000 realized for the nine months ended September 30, 2001.

Brokerage and annuity commissions increased \$35,000 to \$48,000 for the quarter ended September 30, 2002 compared to \$13,000 for the same period in 2001. Year to date brokerage and annuity commissions increased \$34,000, or 35.4%, to \$130,000 for the first nine months of 2002 compared to \$96,000 for the same period in 2001.

OPERATING EXPENSES

Total operating expenses decreased \$55,000, or 2.0%, to \$2,640,000 for the three months ended September 30, 2002 compared to \$2,695,000 for the same period in 2001. For the first nine months of 2002 total operating expenses increased \$310,000, or 3.9%, to \$8,260,000 compared to \$7,950,000 for the same period in 2001. The decrease in operating expenses for the third quarter compared to last year is attributable to a change in the company's vacation policy that resulted in the reversal of \$157,000 of accrued vacation, and the discontinuance of amortization of goodwill pursuant to SFAS No. 142. Operating expenses for the first nine months of 2002 include increases due to the recruitment of several key management personnel during 2001 and 2002 and severance payments to former executives. These increases are partially off-set by \$145,000 of benefit realized for the nine months ended September 30, 2002 from the change in the company's vacation policy.

Salaries and employee benefits decreased \$67,000 or 5.2% to \$1,233,000 for the quarter ended September 30, 2002 compared to \$1,300,000 for the third quarter of 2001. For the first nine months of 2002 total salaries and employee benefits increased \$67,000 or 1.7% to \$3,964,000 compared to \$3,897,000 for the same period in 2001. Salaries and employee benefits were reduced by \$157,000 and \$145,000 for the three and nine month periods ended September 30, 2002, respectively, as a result of the company's change in its vacation policy. The

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company changed its vacation policy to eliminate the vesting of vacation on December 31 for the following year. Instead, vacation will be earned and used in the same year.

Occupancy expenses increased 12.3%, or \$70,000, to \$641,000 for the nine months ended September 30, 2002 compared to \$571,000 for the nine months ended September 30, 2001. This increase includes a \$75,000 charge related to the Wal-Mart branch consolidation discussed in The Company's second quarter 2002 Form 10-QSB.

Furniture and equipment expenses increased \$36,000 or 19.0% to \$225,000 for the quarter ended September 30, 2002 compared to \$189,000 for the same quarter in 2001. For the first nine months of 2002 furniture and equipment expense increased \$66,000, or 11.2%, to \$654,000 compared to \$588,000 for the same period in 2001, The increase relates primarily to increased depreciation and maintenance on computer equipment.

Data processing costs increased \$72,000, or 14.4%, to \$570,000 for the nine months ended September 30, 2002. This increase reflects the cost of the company's internet banking and platform systems, which were implemented at the end of 2001, and a conversion credit that was received in the first nine months of 2001.

Amortization of intangible assets decreased \$46,000 or 37.1% to \$78,000 for the three months ended September 30, 2002 compared to \$124,000 for the third quarter of 2001. For the first nine months of 2002 amortization of intangible assets decreased \$140,000 or 37.6% to \$232,000 compared to \$372,000 for the same period in 2001, reflecting the discontinuance of amortization of goodwill pursuant to SFAS No. 142, as discussed in Note 4 to the unaudited consolidated financial statements.

Legal and professional fees decreased \$42,000 or 26.6% to \$116,000 for the third quarter of 2002 compared to \$158,000 for the third quarter of 2001. For the first nine months of 2002 legal and professional fees increased \$43,000 or 11.7% to \$412,000 compared to \$369,000 for the same period in 2001. The increase in the year to date legal fees compared to the first nine months of 2001 relate to a legal claim against a former data processing service provider and charges in the first quarter of 2002 for a bank regulatory exam. The suit against the company's former data provider has not yet been settled, but is set to go to trial in February, 2003. Management expects to incur additional legal expenses as the trial date approaches.

Other operating expenses increased \$41,000 or 9.5% to \$471,000 for the three months ended September 30, 2002 compared to \$430,000 for the same period a year ago. For the first nine months of 2002 other operating expenses increased \$147,000 or 12% to \$1,372,000 compared to \$1,225,000 for the same period in 2001. The increase in the third quarter of 2002 compared to the same period in 2001 reflects higher costs for marketing, postage and travel and entertainment. The increase on a year to date basis also includes \$117,000 of charges to accrue severance payments for executive officers that left the company in 2002. These charges were partially offset by an \$87,000 credit against other operating expenses due to an adjustment related to stale reconciling items.

Income taxes decreased \$13,000, or 13.3%, to \$85,000 for the three months ended September 30, 2002 from \$98,000 for the same period in 2001. For the nine months ended September 30, 2002 income taxes decreased \$35,000, or 9.3%, to \$341,000 from \$376,000 for the same period in 2001. The decline in effective tax rate to 24.5% for the nine month period ended September 30, 2002 from 30.0% for the same period of 2001 is reflective of greater tax efficiency brought about by an increase in non-taxable interest from the municipal bond portfolio and a reduction in nondeductible purchase accounting amortization.

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BALANCE SHEET ANALYSIS

OVERVIEW

Total assets decreased to \$328.4 million at September 30, 2002 compared to \$330.3 million at December 31, 2001, a decrease of .6%. The December 31, 2001 balance sheet included short-term year-end deposits of \$14.4 million, which were invested in federal funds sold at December 31, 2001. Excluding these deposits, total assets increased 4.0% from December 31, 2001 to September 30, 2002. While total assets, excluding the short-term year-end deposits, increased by \$12.5 million, there was a considerable shift in balances from loans and short-term investments to investment securities. Securities available for sale increased by \$31.4 million, while loans, net of allowance for loan losses, decreased by \$17.6 million. Short-term investments, excluding the overnight investments related to year-end deposits of \$14.4 million, decreased by \$5.5 million. In addition, on September 30, 2002 Blackhawk State Bank purchased \$5.0 million in Bank Owned Life Insurance (BOLI) assets. The BOLI, which insures the lives of key employees, was purchased to help off-set the cost of increasing employee benefits. The company's subsidiary bank is the owner and sole beneficiary of all BOLI contracts.

LOANS

Net portfolio loans decreased \$17.6 million, or 8.5%, to \$188.8 million on September 30, 2002 compared to \$206.4 million on December 31, 2001. The composition of loans is shown in the following table:

	September 30, 2002	December 31, 2001	Change in Balance	As a % of Total Loans September 30, 2002	December 2001

	(Dollars in millions)				
Residential Real Estate	\$76.0	\$83.3	(\$7.3)	39.1%	39.4%
Commercial Real Estate	\$32.4	\$35.0	(\$2.6)	16.7%	16.5%
Construction and Land					
Development	\$7.6	\$6.2	\$1.3	3.9%	2.9%
Commercial	\$53.0	\$56.5	(\$3.6)	27.3%	26.7%
Consumer	\$24.5	\$29.5	(\$5.0)	12.6%	14.0%
Other	\$0.7	\$1.0	(\$0.3)	0.4%	0.5%

The historically low interest rate environment has led to substantial prepayments on the company's 1-4 family residential real estate portfolio. Also, the economic conditions in the company's primary markets have adversely effected loan demand leading to decreases in all categories of loans outstanding, except for construction and land development. In addition, the company's focus on relationship banking has resulted in the subsidiary bank not pursuing certain "transactions" that may have resulted in increased loan balances, but offered no opportunity to form other relationships with the client.

NON-PERFORMING LOANS

Non-performing loans includes loans which have been categorized by management as non-accruing because collection of interest is not assured, and loans which are past-due ninety days or more as to interest and/or principal payments.

The following summarizes information concerning non-performing loans:

	SEPTEMBER 30, 2002	DECEMBER 31, 2001
(Dollars in thousands)		

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Non-accruing loans	\$3,106	\$2,808
Past due 90 days or more and still accruing	100	356
	-----	-----
Total non-performing loans	\$3,206	\$3,164
	-----	-----
Performing loans classified as impaired	\$ 769	\$1,147

ASSET QUALITY

The allowance for loan losses was \$2.7 million or 1.39% of total loans at September 30, 2002 compared to \$2.4 million or 1.14% of total loans at December 31, 2001. As of September 30, 2002, non-performing loans and performing loans classified as impaired totaled \$3,975,000 compared to \$4,311,000 at December 31, 2001. 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 the collectibility of the principal is unlikely. The allowance for loan losses is adequate to cover probable credit losses relating to specifically identified loans, as well as probable credit losses inherent in the balance of the loan portfolio. In accordance with FASB Statements 5 and 114, the allowance is provided for losses that have been incurred as of the balance sheet date. The allowance is based on past events and current economic conditions, and does not include the effects of expected losses on specific loans or groups of loans that are related to future events or expected changes in economic conditions. Management reviews a calculation of the allowance for loan losses on a quarterly basis. While management uses the best information available to make its evaluation, future adjustments to the allowance may be necessary if there are significant changes in economic conditions.

In addition, various regulatory agencies periodically review the allowance for loan losses. These agencies may require the bank to make additions to the allowance for loan losses based on their judgments of collectibility based on information available to them at the time of their examination. The policy of the Company is to place a loan on non-accrual status if: (a) payment in full of interest and principal is not expected, or (b) principal or interest has been in default for a period of 90 days or more, unless the obligation is both in the process of collection and well secured. Well secured is defined as collateral with sufficient market value to repay principal and all accrued interest. A debt is in the process of collection if collection of the debt is proceeding in due course either through legal action, including judgement enforcement procedures, or in appropriate circumstances, through collection efforts not involving legal action which are reasonably expected to result in repayment of the debt or in its restoration to current status.

At September 30, 2002 the allowance for loan losses to total non-performing and impaired loans equaled 68.1% compared to 55.7% at December 31, 2001. While the total nonperforming and impaired loans decreased by \$336,000 there was a considerable shift in the make-up of non-performing loans. As a result of increased collection efforts total residential real estate loans either on non-accrual or past due 90 days and still accruing was reduced by \$1,132,000 to \$1,412,000 compared to \$2,544,000 at December 31, 2001. The reduction in non-performing residential real estate loans was offset by an increase in nonperforming commercial and industrial loans of \$1,171,000 to \$1,392,000 at September 30, 2002 compared to \$221,000 at December 31, 2001. The majority of this increase relates to one loan that was added to nonperforming during the third quarter of 2002.

SHORT-TERM INVESTMENTS

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Fed funds sold and other short-term investments decreased \$12.4 million to \$4.0 million at September 30, 2002 compared to \$16.4 million at December 31, 2001. The decrease primarily reflects the liquidation of short-term year-end investments on January 2, 2002 associated with the December 31, 2001 year-end deposits of \$14.4 million.

INVESTMENT SECURITIES

Securities available for sale increased \$31.4 million, or 73.6%, to \$74.0 million at September 30, 2002 compared to \$42.6 million at December 31, 2001. The increase in investments in securities available for sale resulted from the redeployment of cash flows from the decrease in loans. Securities held to maturity increased \$.6 million or 2.3% to \$24.3 million at September 30, 2002 from \$23.7 million at December 31, 2001.

DEPOSITS

Total deposits decreased \$9.7 million to \$239.9 million at September 30, 2002 compared to \$249.6 million at December 31, 2001. As noted above, the Company's December 31, 2001 financial statements reflect short-term year-end deposits of \$14.4 million. Excluding the short-term year-end deposits, total deposits increased 2.0% from December 31, 2001. Excluding the short-term year-end deposits of \$5.9 million and \$8.5 million included in non-interest bearing and interest bearing deposits, respectively, non-interest bearing deposits increased by \$0.1 million and interest bearing deposits increased by \$4.6 million at September 30, 2002 compared to December 31, 2001.

BORROWINGS

Short-term borrowings increased \$18.3 million to \$24.4 million at September 30, 2002 from \$6.1 million at year-end. The increase is due to higher outstanding balances of repurchase agreements with commercial customers, \$3.8 million in Fed funds purchased at September 30, 2002 and the refinancing of \$5.2 million of term debt into a one year revolving note during August 2002. Other borrowings, consisting of long-term borrowings incurred in part to complete the First Financial acquisition and term advances from the Federal Home Loan Bank ("FHLB"), were \$35.9 million at September 30, 2002 compared to \$48.4 million at December 31, 2001. The decrease primarily reflects the repayment of \$6.8 million in FHLB advances during January 2002 and the August 2002 refinancing of the term debt into a revolving note.

SHAREHOLDERS' EQUITY

Total shareholders' equity increased \$2.1 million to \$25.8 million at September 30, 2002 compared to \$23.7 million at December 31, 2001. During the first nine months of 2002 additional paid in capital increased by \$1.1 million from stock options exercised. Accumulated other comprehensive income, which is the adjustment of securities available for sale to market value, net of tax, increased \$.5 million to \$1.3 million at September 30, 2002 from \$.8 million at December 31, 2001. In addition the company declared three dividends of \$0.09 per share on common stock, which totaled \$669,000.

The Company is subject to certain regulatory capital requirements and continues to remain in compliance with the requirements. The following table shows the company's capital ratios and regulatory requirements.

SEPTEMBER 30, 2002	DECEMBER 31, 2001	REGULATORY REQUIREMENTS
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Total Capital (To Risk-Weighted Assets)	10.9%	9.6%	8.0%
Tier I Capital (To Risk-Weighted Assets)	9.7%	8.5%	4.0%
Tier I Capital (To Average Assets)	6.2%	5.9%	4.0%

The Company's subsidiary bank meets regulatory capital requirements to be considered well capitalized.

ASSET/LIABILITY MANAGEMENT

Asset/liability management is the process of identifying, measuring and managing the risk to the Company's earnings and capital resulting from the movements in interest rates. It is the Company's objective to protect earnings and capital while achieving liquidity, profitability and strategic goals.

The Company focuses its measure of interest rate risk on the effect a shift in interest rates would have on earnings rather than on the amount of assets and/or liabilities subject to repricing in a given time period. Since not all assets or liabilities move at the same rate and at the same time, a determination must be made as to how each interest earning asset and each interest bearing liability adjusts with each change in the base rate. The Company develops, evaluates and amends its assumptions on an ongoing basis and analyzes its earnings exposure quarterly.

In addition to the effect on earnings, a monthly evaluation is made to determine the change in the economic value of the equity with various changes in interest rates. This determination indicates how much the value of the assets and the value of the liabilities change with a specified change in interest rates. The net difference between the economic values of the assets and liabilities results in an economic value of equity.

LIQUIDITY

Liquidity, as it relates to the subsidiary bank, is a measure of its ability to fund loans and withdrawals of deposits in a cost-effective manner. The Bank's principal sources of funds are deposits, scheduled amortization and prepayment of loan principal, maturities of investment securities, short-term borrowings and income from operations. Additional sources include purchasing fed funds, sale of securities, sale of loans, borrowing from both the Federal Reserve Bank and Federal Home Loan Bank, and dividends paid by Nevahawk, a wholly owned subsidiary of the Bank.

The liquidity needs of the Company generally consist of payment of dividends to its shareholders, payments of principal and interest on borrowed funds, and a limited amount of expenses. The sources of funds to provide this liquidity are issuance of capital stock and dividends from its subsidiary bank. Certain restrictions are imposed upon the Bank, which could limit its ability to pay dividends if it did not have net earnings or adequate capital in the future. The Company maintains adequate liquidity to pay its expenses.

OFF BALANCE SHEET ITEMS AND CONTINGENCIES

Off-balance sheet items consist of commitments to originate mortgage loans, unused lines of credit and standby letters of credit totaling approximately \$32.9 million as of September 30, 2002. This compares to \$25.8 million at December 31, 2001. The Company's commitments to originate mortgage loans are on a best effort basis; therefore there are no contingent liabilities associated with them. The Bank has historically funded off-balance sheet commitments with its primary sources of funds and management anticipates that this will continue.

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At September 30, 2002 the Company continues to carry a \$271,000 receivable related to a \$541,000 claim against a former data processing service provider ("Provider"). The claim relates to an improper charge made by ("Provider") to the Company's check clearing account maintained with the Federal Home Loan Bank of Chicago. Trial in this matter has been rescheduled for February 2003. The receivable will be adjusted based on the results of the upcoming trial or other developments as they occur. Legal fees relating to this matter are being expensed as incurred. Management intends to aggressively pursue recovery of the entire \$541,000, that was improperly charged, and related legal fees.

ITEM 3. CONTROLS AND PROCEDURES

We maintain a set of disclosure controls and procedures that are designed to ensure that information required to be disclosed by us in the reports filed by us under the Securities Exchange Act of 1934, as amended ("Exchange Act") is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Within the 90 days prior to the date of this report, we carried out an evaluation, under the supervision and with the participation of our management, including our President and Chief Executive Officer, and Senior Vice President and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-14 of the Exchange Act. Based on that evaluation, our President and Chief Executive Officer, and Senior Vice President and Chief Financial Officer concluded that our disclosure controls and procedures are effective.

There have been no significant changes in our internal controls or other factors that could significantly affect those controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

PART II

OTHER INFORMATION

ITEM 6. A) EXHIBITS

See Exhibit Index following the signature page in this report, which is incorporated herein by this reference.

B) REPORTS ON FORM 8-K

There were two reports on Form 8-K filed during the third quarter of 2002.

A report dated July 17, 2002 announced the election of Prudence A. Harker as a director of Blackhawk Bancorp, Inc. and its subsidiary, Blackhawk State Bank.

A report dated August 28, 2002 announced a change in the registrant's certifying accountant.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Blackhawk Bancorp, Inc.

(Registrant)

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Date: November 12, 2002

/s/R. Richard Bastian, III

R. Richard Bastian, III
President and Chief Executive Officer

/s/Todd J. James

Todd J. James
Senior Vice President and Chief Financial Officer

/s/Thomas L. Lepinski

Thomas L. Lepinski, CPA
Principal Accounting Officer

CERTIFICATIONS

I, R. Richard Bastian, III, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of Blackhawk Bancorp, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

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- b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 12, 2002

/s/R. Richard Bastian, III

R. Richard Bastian, III
President and CEO

I, Todd J. James, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of Blackhawk Bancorp, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have

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identified for the registrant's auditors any material weaknesses in internal controls; and

- b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 12, 2002

/s/Todd J. James

Todd J. James
Senior Vice President and CFO

BLACKHAWK BANCORP, INC.

INDEX TO EXHIBITS

Exhibit Number	Description	Incorporated Herein By Reference To:	Filed Here- with	Page No.
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4.1	Amended and restated Articles of Incorporation of the Registrant	Exhibit 3.1 to Amendment No. 1 to Registrant's Registration Statement on Form S-1 (Reg. No. 33-32351)		
4.2	By-laws of Registrant as amended	Exhibit 3.2 to Amendment No. 1 to Registrant's Registration Statement on Form S-1 (Reg. No. 33-32351)		
4.3	Plan of Conversion Beloit Savings Bank as amended	Exhibit 1.2 to Amendment No. 1 to Registrant's Registration Statement on Form S-1 (Reg. No. 33-32351)		
4.4	Employment Agreement		X	30-44
99	Certification Pursuant to 18 U. S. C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002		X	44

