GOUVERNEUR BANCORP INC
Form 10QSB
February 11, 2004

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

FORM 10-QSB

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

For the quarterly period ended December 31, 2003

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 001-14910

GOUVERNEUR BANCORP, INC.
(Exact name of small business issuer as specified in its charter)

United States	04-3429966
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

42 Church Street, Gouverneur, New York 13642
(Address of principal executive offices)

Issuer's telephone number (315) 287-2600

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [X] No [ ]

Class	Outstanding at December 31, 2003
Common Stock, par value $ .01	2,279,009

Transitional Small Business Disclosure Format (check one):
Yes [ ] No [X]

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

The financial statements presented in this Form 10-QSB, beginning on the following page, reflect the consolidated financial condition and results of operations of the Company and its subsidiary, Gouverneur Savings and Loan Association (the "Bank"), operating in a mutual holding company structure.

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GOUVERNEUR BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(In thousands, except share data) (Unaudited)

	December 31, 2003	September 3 2003
Assets:		
Cash and due from banks	$ 1,839	$ 1,76
Interest-bearing deposits in bank	1,241	2,52
Total cash and cash equivalents	3,080	4,28

Securities available-for-sale	16,691	17,47
Securities held-to-maturity (fair value of $379 at December 31, 2003 and $459 at September 30, 2003)	379	45
Loans, net of deferred fees	70,466	65,39
Less allowance for loan losses	(663)	(65
Loans, net	69,803	64,73
Federal Home Loan Bank stock, at cost	860	61
Premises and equipment, net	1,460	1,48
Accrued interest receivable and other assets	2,564	90
Total assets	$ 94,837	$ 89,95
Liabilities:		
Deposits: Non interest-bearing demand	$ 733	$ 80
NOW and money market	9,311	9,40
Savings	19,179	19,15
Time	28,487	29,05
Total deposits	57,710	58,42
Securities sold under agreements to repurchase	5,700	5,70
Advances form Federal Home Loan Bank	11,500	6,50
Other liabilities	2,114	1,77
Total liabilities	77,024	72,39
Shareholders' Equity:		
Preferred stock, $.01 par value, 1,000,000 shares authorized; none issued	--	-
Common stock, $.01 par value, 9,000,000 shares authorized; 2,384,040 shares issued	24	2
Additional paid-in capital	4,590	4,57
Retained earnings	13,572	13,36
Treasury Stock, at cost, 105,031 shares at December 31, 2003 and 106,156 at September 30, 2003	(532)	(53
Accumulated other comprehensive income	499	48
Unearned common stock held by MRP	(77)	(8
Unallocated common stock held by ESOP	(263)	(27
Total shareholders' equity	17,813	17,55
Total liabilities and shareholders' equity	$ 94,837	$ 89,95

See accompanying notes to the consolidated financial statements.

GOUVERNEUR BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share data) (Unaudited)

	Three Months December 3	
	2003	
Interest income:		
Loans	$ 1,175	$
Securities	151	
Other short-term investments	3	
Total interest income	1,329	
Interest expense:		
Deposits	256	
Borrowings - short-term	28	
Borrowings - long-term	121	
Total interest expense	405	
Net interest income	924	
Provision for loan losses	25	
Net interest income after provision for loan losses	899	
Non-interest income		
Service charges	45	
Realized gain (loss) on sales of securities	(9)	
Other	32	
Total non-interest income	68	
Non-interest expenses		
Salaries and employee benefits	338	
Directors fees	20	
Occupancy and Equipment	81	
Data processing	33	
Postage and supplies	20	
Professional fees	32	
Foreclosed assets, net	8	
Other	94	
Total non-interest expenses	626	
Income before income tax expense	341	
Income tax expense	134	
Net income	$ 207	$
Earnings per common share - basic	$ 0.09	$
Earnings per common share - diluted	$ 0.09	$

See accompanying notes to the consolidated financial statements.

GOUVERNEUR BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
Three months ended December 31, 2003
(In thousands, except share data) (Unaudited)

	Common Stock	Additional Paid In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensiv Income
Balance at September 30, 2003	$ 24	$ 4,577	$ 13,365	$ (537)	$ 487
Comprehensive Income:					
Net Income			207		
Change in net unrealized gain on securities available for sale, net of taxes					12
Total comprehensive income					
Allocation of ESOP shares (1,984 shares)		13			
Amortization of MRP					
Exercise of stock options (1,125 shares)				5	
Balance at December 31, 2003	$ 24	$ 4,590	$ 13,572	$ (532)	$ 499

GOUVERNEUR BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
Three months ended December 31, 2002
(In thousands, except share data) (Unaudited)

	Common Stock	Additional Paid In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensiv Income
Balance at					

September 30, 2002	$ 24	$ 4,570	$ 13,025	$ (543)	$ 537
Comprehensive Income:					
Net Income			98		
Change in net unrealized gain on securities available for sale, net of taxes					65
Total comprehensive income					
Allocation of ESOP shares (1,841 shares)		8			
Amortization of MRP					
Exercise of stock options (1,125 shares)				6	
Balance at December 31, 2002	$ 24	$ 4,578	$ 13,123	$ (537)	$ 602

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GOUVERNEUR BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands) (Unaudited)

	Three Months Ended December 31,	
	2003	2002
Cash flows from operating activities:		
Net Income	$ 207	$ 98
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	31	37
Provision for loan losses	25	40
Net loss (gain) on sales of securities	9	(6)
Net amortization of securities	21	27
Allocated and earned shares of ESOP and MRP	32	22
Decrease (increase) in other assets	(20)	112
Increase (decrease) in other liabilities	329	(29)
Net cash provided by operating activities	634	301
Cash flows from investing activities:		
Net increase in loans	(4,500)	(1,498)
Purchase of loans	(609)	--
Proceeds from sales of securities AFS	4,300	507
Proceeds from maturities and principal reductions AFS	1,756	962
Purchases of securities AFS	(5,283)	(1,732)

Proceeds from maturities and principal reductions HTM	20	264
Additions to premises and equipment	(7)	(19)
Redemption (purchase) of Federal Home Loan Bank stock	(250)	75
Purchase of bank owned life insurance	(1,561)	--
Net cash used in investing activities	(6,134)	(1,441)
Cash flows from financing activities:		
Net increase (decrease) in deposits	(713)	1,203
Net increase in short-term borrowings	5,000	--
Exercise of stock options	5	6
Net cash provided by financing activities	4,292	1,209
Net increase (decrease) in cash and cash equivalents	(1,208)	69
Cash and cash equivalents at beginning of period	4,288	3,047
Cash and cash equivalents at end of period	$ 3,080	$ 3,116
Non-cash investing activities:		
Additions to foreclosed assets	$ 19	$ 174
Cash paid during the period for:		
Interest	398	525
Income taxes	66	18

See accompanying notes to consolidated financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Business

Gouverneur Bancorp, Inc. (the Company) operates as a savings and loan holding company. Its only subsidiary is the Bank. The consolidated financial statements include the accounts of the Company and the Bank. All material intercompany accounts and transactions have been eliminated in this consolidation.

Cambray Mutual Holding Company ("Cambray MHC"), the Company's parent mutual holding company, held 1,311,222 shares or 57.5% of the Company's issued and outstanding common stock, and shareholders other than Cambray MHC held 967,787 shares or 42.5% of such stock at December 31, 2003.

2. Basis of Presentation

The accompanying unaudited consolidated financial statements were prepared in accordance with instructions for Form 10-QSB and, therefore, do not include information or footnotes necessary for a complete presentation of financial position, results of operations, and cash flows in conformity with generally accepted accounting principles. However, in the opinion of management, all adjustments consisting of only normal recurring adjustments or accruals which are necessary for a fair presentation of the consolidated financial statements have been made at and for the three months ended December 31, 2003 and 2002. The results of operations for the three month period ended December 31, 2003 are not necessarily indicative of the results which may be expected for an entire fiscal year or other interim periods.

3. Earnings Per Common Share

Basic earnings per share is calculated by dividing net income available to common shareholders by the weighted average number of shares outstanding during the period. Unallocated shares held by the Company's Employee Stock Ownership Plan ("ESOP") are not included in the weighted average number of shares outstanding. Unearned shares held by the Company's Management Recognition Plan ("MRP") are not included in the weighted average number of shares outstanding. Diluted earnings per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued (for example, through the exercise of common stock options), as well as any adjustment to income that would result from the assumed issuance.

Basic and diluted earnings per common share were computed as follows:

(In thousands, except per share data)

	Three Months Ended December 31,	
	2003	2002
Basic earnings per common share:		
Net income	$ 207	$ 98
Weighted average common shares outstanding	2,206	2,199
Basic earnings per common share	$ 0.09	$ 0.04
Diluted earnings per common share:		
Net income	$ 207	$ 98
Weighted average common shares outstanding	2,206	2,199
Additional potentially dilutive securities (equivalent in common stock)		
Common Stock options	34	30
Diluted weighted average common shares outstanding	2,240	2,229
Diluted earnings per common share	$ 0.09	$ 0.04

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4. Comprehensive Income

Comprehensive income, presented in the consolidated statements of changes in shareholders' equity, consists of net income and the net change for the period in after-tax unrealized gains or losses on securities available for sale. Accumulated other comprehensive income in the consolidated statements of financial condition represents the net unrealized gains or losses on securities available for sale as of the reporting dates, net of related tax effect.

A summary of the unrealized gains and reclassification adjustments of securities available for sale and the related tax effects for the three-month periods ended December 31, 2003 and 2002 is as follows (in thousands):

	Three Months Ended December 31, 2003	Three Months Ended December 31, 2002
Unrealized holding gains arising during the period	$ 13	$ 114
Reclassification adjustment for (gains) losses realized in net income during period	9	(6)
	22	108
Tax effect	(10)	(43)
Other comprehensive income, net of tax	$ 12	$ 65

5. Stock Option and Management Recognition Plans

The Company has a Stock Option Plan ("SOP") and a MRP for directors, officers and key employees. The Company accounts for stock options granted under the SOP and MRP in accordance with the provisions of Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. The Company provides pro forma net income and pro forma earnings per share disclosures for employee stock options grants as if the fair-value-based method defined in Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation, had been applied. The fair value of the shares awarded, under the MRP, measured as of the grant date, is recognized as unearned compensation (a component of shareholders' equity) and amortized to compensation expense over the vesting period.

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based compensation (in thousands, except per share data):

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	Three Months Ended December 31, 2003	Three Months Ended December 31, 2002
Net income, as reported	$ 207	$ 98

Total stock-based compensation expense determined under fair value method for all awards, net of taxes	(6)	(7)
Amounts included in determination of net income, net of taxes	4	3
Pro forma net income	$ 205	$ 94

6. Recently Issued Accounting Standards

In November 2002, the FASB issued FASB Interpretation No. 45 (FIN 45), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." This Interpretation expands the disclosures to be made by a guarantor in its financial statements about its obligations under certain guarantees and requires the guarantor to recognize a liability for the fair value of an obligation assumed under certain specified guarantees. FIN 45 clarifies the requirements of FASB Statement No. 5, "Accounting for Contingencies." In general, FIN 45 applies to contracts or indemnification agreements that contingently require the guarantor to make payments to the guaranteed party based on changes in an underlying instrument that is related to an asset, liability or equity security of the guaranteed party, which would include financial standby letters of credit. Certain guarantee contracts are excluded from both the disclosure and recognition requirements of this Interpretation, including among others, guarantees related to commercial letters of credit and loan commitments. The disclosure requirements of FIN 45 require disclosure of the nature of the guarantee, the maximum potential amount of future payments that the guarantor could be required to make under the guarantee and the current amount of the liability, if any, for the guarantor's obligations under the guarantee. The accounting recognition requirements of FIN 45 are to be applied prospectively to guarantees issued or modified after December 31, 2002.

In April 2003, the Financial Accounting Standards Board issued FASB Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51." This interpretation provides new guidance for the consolidation of variable interest entities (VIEs) and requires such entities to be consolidated by their primary beneficiaries if the entities do not effectively disperse risk among parties involved. The interpretation also adds disclosure requirements for investors that are involved with unconsolidated VIEs. The disclosure requirements apply to all financial statements issued after January 31, 2003, and are effective for the first fiscal year or interim period ending after December 31, 2003, for VIEs acquired before February 1, 2003.

In May 2003, the Financial Accounting Standards Board issued Statement No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity." This Statement requires that an issuer classify a financial instrument that is within its scope as a liability. Many of these instruments were previously classified as equity. This Statement was effective for financial instruments entered into or modified after May 31, 2003 and otherwise was effective beginning July 1, 2003.

The provisions of the above interpretations and statements did not have or are not expected to have a significant impact on the financial condition or results of operations of the Company.

7. Retained Earnings

Cambray MHC has waived receipt of past dividends of the Company. The dividends are considered as restrictions in the retained earnings of the Company. As of December 31, 2003, the aggregate retained earnings restricted for cash dividends waived was $747,000.

8. Reclassification of prior year income and expense

Certain items in the 2002 financial statements have been reclassified to conform to the 2003 financial statement presentation format. These reclassifications had no effect on net income.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Gouverneur Bancorp, Inc. ("We" or the "Company") is a corporation organized under the laws of the United States, in connection with the reorganization of its wholly owned subsidiary, Gouverneur Savings and Loan Association (the "Bank"), into a mutual holding company structure. The Company's assets consist primarily of all the outstanding capital stock of the Bank and cash of $136,000 at December 31, 2003. The Company's principal business is the ownership of the Bank. The Company is a savings and loan holding company registered with the Office of Thrift Supervision ("OTS") and subject to regulation under federal banking laws and regulations. In this document, references to the Company include the Bank, unless the context denotes otherwise. The terms "Registrant", "we", "our" or similar terms refer to Gouverneur Bancorp, Inc.

The Bank has been and continues to be a community oriented financial institution offering a variety of financial services. The Bank attracts deposits from the general public and uses those deposits together with funds borrowed from the Federal Home Loan Bank ("FHLB"), to make loans and other investments. Most of the loans are one to four family residential mortgages. The Bank's deposit accounts are insured by the Savings Association Insurance Fund ("SAIF") of the Federal Deposit Insurance Corporation ("FDIC"), and the Bank is subject to regulation by the FDIC and the OTS.

Our profitability depends, to a large extent, on our net interest income, which is the difference between the interest we receive on our interest earning assets, such as loans and investments, and the interest we pay on deposits and other interest bearing liabilities. Other categories of expenses generally include the provision for loan losses, salaries and employee benefits costs, net expenses on real estate owned and various categories of operational expenses. External factors, such as general economic and competitive conditions, particularly changes in interest rates, government policies and actions of regulatory authorities, can have a substantial effect on profitability.

Forward-Looking Statements

When we use words or phrases like "will probably result," "we expect," "will continue," "we anticipate," "estimate," "project," "should cause" or similar expressions in this 10-QSB or in any press releases, public announcements, filings with the Securities and Exchange Commission or other disclosures, we are making "forward-looking statements" as described in the Private Securities Litigation Reform Act of 1995. In addition, certain information we will provide in the future on a regular basis, such as analysis of the adequacy of our allowance for loan losses or an analysis of interest rate sensitivity of our assets and liabilities, is always based on predictions of the future. From time to time, we may also publish other forward-looking statements regarding anticipated financial performance, business prospects, and similar matters.

The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. We want you to know that a variety of future events could cause our actual results and experience to differ materially from what was anticipated in our forward-looking statements. Some of the risks and uncertainties that may affect our operations, performance, development and results, the interest rate sensitivity of our assets and liabilities, and the adequacy of our allowance for loan losses, include:

- Local, regional, national or global economic conditions which could cause an increase in loan delinquencies, a decrease in property values, or a change in the housing turnover rate;

- Changes in market interest rates or changes in the speed at which market interest rates change;

- Changes in laws and regulations affecting us, including changes in accounting standards;

- Changes in competition; and

- Changes in consumer preferences.

Please do not rely unduly on any forward-looking statements, which are valid only as of the date made. Many factors, including those described above, could affect our financial performance and could cause our actual results or circumstances for future periods to differ materially from what we anticipate or project. We have no obligation to update any forward-looking statements to reflect future events which occur after the statements are made.

Critical Accounting Policies

Note 2 to the consolidated financial statements of the Company (included in item 7 of the Annual Report on Form 10-KSB of the Company for the year ended September 30, 2003) lists significant accounting policies used in the development and presentation of its financial statements. This discussion and analysis, the significant accounting policies, and other financial statement disclosures identify and address key variables and other qualitative and quantitative factors that are necessary for an understanding and evaluation of the Company's results of operations.

The most significant estimate in the preparation of the Company's financial statements is for the allowance for loan losses and the related provision for loan losses. Please refer to the discussion of this calculation under "Comparison of Financial Condition" below.

Comparison of Financial Condition at December 31, 2003 and September 30, 2003.

During the three months from September 30, 2003 through December 31, 2003, total assets increased $4.8 million, or 5.3% from $90.0 million to $94.8 million. Net loans increased by $5.1 million, or 7.9% from $64.7 million to $69.8 million. This increase resulted from growth of $4.3 million in residential real estate loans, $0.3 million in commercial real estate loans and $0.6 million in other commercial loans combined with a decrease of $0.1 million in other consumer loans. Our growth in real estate loans is the result of growth in each of our offices, $1.7 million in Alexandria Bay, $1.3 million in Clayton and $1.3 million in Gouverneur. Most of these loans, booked during the quarter ended December 31, 2003, originated in the previous quarter when demand for loans is traditionally higher, as compared to the winter season when loan demand is normally weak. The growth in other commercial loans was from the purchase of two USDA guaranteed loans totaling $609,000 in October 2003. That portfolio now totals $3.05 million. The decline in other consumer loans was the result of a decrease in automobile loans by $0.1 million. Special low and no rate financing arrangements offered by automobile manufacturers have also decreased demand for the Bank's automobile loans, although we have seen more activity recently.

Our borrowed funds from FHLB, consisting of advances and securities repurchase obligations, were $17.2 million on December 31, 2003 and $12.2 million on September 30, 2003. The increase in borrowed funds has been used to fund the additional loan growth. We experienced a decrease in deposits of approximately $0.7 million, or 1.2% during the quarter as deposits fell from $58.4 million to $57.7 million. The reduction consisted of decreases of $0.1 million, $0.1 million and $0.5 million in demand deposits, NOW and money market accounts, and in time deposits, respectively.

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Our shareholders' equity rose by $256,000 during the quarter as net income of $207,000, combined with increases of $32,000 in share allocation in the ESOP and amortization in the MRP, $12,000 in the fair value (net of taxes) of our available-for-sale securities portfolio and the issuance of $5,000 in treasury stock. Treasury stock was used to supply the 1,125 shares needed when one director exercised some of his vested stock options.

Non-performing assets increased to $853,000 at December 31, 2003 from $824,000 on September 30, 2003 while the ratio of non-performing assets to total assets decreased from 0.92% to 0.90% over the same period. Non-performing loans decreased from 1.08% of total loans September 30, 2003 to 1.06% at December 31, 2003. A summary of the Company's non-performing assets and related ratios follows:

Non-performing assets	December 31, 2003	September 30, 2003
Non-accrual loans		
Residential mortgages and home equity loans	$ 235	$ 198
Commercial mortgages	83	83
Consumer other	32	85
Commercial other	172	112
Total non-accrual loans	522	478
Restructured commercial mortgage	220	225
Total non-performing loans	742	703
Foreclosed real estate	92	92
Other repossessed assets	19	29
Total non-performing assets	$ 853	$ 824

Non-performing loans to total loans	1.06%	1.08%
Non-performing assets to total assets	0.90%	0.92%

All five non-accrual residential mortgages are currently in foreclosure proceedings.

One borrower, in bankruptcy proceedings, has four loans, all non-accrual, totaling $210,000 at December 31, 2003, comprised of an $83,000 commercial mortgage, $112,000 other commercial loan, $13,000 automobile loan and $2,000 in unsecured credit. The $112,000 loan mentioned above and another non-accrual loan for $60,000 comprise the commercial other loan total of $172,000. We will be auctioning the equipment that is the collateral for the $60,000 loan, which carries an 80% SBA guarantee, in the near future. The Company had no loans more than 90 days delinquent and accruing at December 31, 2003 or September 30, 2003.

One loan, in the amount of $220,000 makes up the restructured other commercial loan balance.

Management believes that these non-performing loans are adequately secured by collateral and the SBA guarantee. Further, management is not aware of any factors common to these loans, which caused their non-performance or any developments that suggest an upward trend in delinquencies. Accordingly, while we will continue to monitor asset quality, management has determined that the loan loss allowance is appropriate at this time.

Comparison of Results of Operations for the Three Months Ended December 31, 2003 and 2002.

General. Our net income for the three months ended December 31, 2003 was $207,000, an increase of $109,000, or 111.2%, over our net income of $98,000 for the same period last year. The increase in net income was the combination of the following factors:

1. our net interest income increased by $128,000, as interest income increased $8,000 and interest expense decreased by $120,000,

2. non-interest income grew by $5,000 over last year's period,

3. the provision for loan losses decreased by $15,000 for the first quarter of this fiscal year versus last fiscal year,

4. non-interest expenses decreased $36,000 from last year to this year and

5. an increase of $75,000 in income taxes.

Basic and diluted earnings per share were $0.09 for this year's quarter versus $0.04 for both measures in last year's quarter.

Interest Income. Interest income increased $8,000, or 0.60%, from the three months ended December 31, 2002 to the three months ended December 31, 2003. A decrease of 40 basis points (0.40%) in the average interest rate earned on interest-earning assets from 6.48% for the quarter ending December 31, 2002 to 6.08% for the quarter ending December 31, 2003 accounted for a decrease in our interest income of $165,000, while an increase of $5.9 million in the average balance of interest-earning assets from $80.9 million to $86.8 million resulted in an increase of $173,000 in interest income.

Interest income on loans increased by $88,000. A decrease of 96 basis points (0.96%) from 7.84% in last year's quarter to 6.88% in this year's quarter in the average interest rate on loans decreased our interest income by $144,000 while an increase of $12.8 million in the average balance of loans from $55.0 million to $67.8 million resulted in an increase of $232,000 in interest income.

The decrease in the average interest rate on our securities of 35 basis points from 3.81% in last year's quarter to 3.46% in this year's quarter decreased interest income by $19,000, while a decrease of $6.4 million in the average balance of securities from $23.7 million to $17.3 million decreased interest income by $57,000, resulting in a net decrease in interest income of $76,000. A 53 basis points (0.53%) reduction in the average interest rate on other short-term investments decreased interest income by $2,000, while a decrease of $0.6 million in the average balance of other short-term investments decreased interest income by $2,000 resulting in a decrease of $4,000 in interest income.

Interest Expense. Interest expense decreased $120,000, or 22.9%, from the three months ended December 31, 2002 to the three months ended December 31, 2003. A decrease of 89 basis points in the average interest rate on interest-bearing liabilities from 3.13% in last year's quarter to 2.24% in this year's quarter accounted for a decrease in our interest expense of $145,000, while an increase of $5.1 million in the average balance of interest-bearing liabilities from $66.5 million to $71.6 million resulted in an increase of $25,000 in interest expense.

The average rates we paid decreased on savings and club accounts, on time certificates, on money market and NOW accounts and on funds we borrowed from FHLB decreased by 121 basis points (1.21%), 74 basis points (0.74%), 48 basis points (0.48%) and 64 basis points (0.64%) respectively.

Interest expense on savings and club accounts decreased by $42,000. The decrease in the average rate paid on savings and club accounts, from 2.24% last year to 1.03% this year, decreased our interest expense by $57,000 while the

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increase in the average balance of savings and club accounts by $3.0 million, from $16.3 million to $19.3 million, increased our interest expense by $15,000. Management believes that the average balance in savings accounts increased even as rates declined due to the decision of many depositors to place their funds in liquid accounts which paid interest rates only marginally less than short-term time certificates. Interest expense on time certificates decreased by $60,000. The decrease in the average rate paid on time certificates, from 3.40% last year to 2.66% this year, decreased our interest expense by $54,000 while the decrease in the average balance of time certificates by $0.7 million, from $29.2 million to $28.5 million, decreased our interest expense by $6,000. Consistent with rates paid in our local market, time certificate rates declined as those deposits repriced. Interest expense on money market and NOW accounts decreased by $6,000. The decrease in the average rate paid on money market and NOW accounts from 1.11% in the December 2002 quarter to 0.63% in the December 2003 quarter decreased our interest expense by $11,000 while the increase in the average balance of money market and NOW accounts by $2.0 million from $7.5 million to $9.5 million increased our interest expense by $11,000.

Interest expense on funds borrowed from FHLB decreased by $12,000. The decrease in the average interest rate on funds borrowed from FHLB from 4.77% for the quarter ended December 31, 2002 to 4.13% for the quarter ended December 31, 2003 decreased interest expense by $23,000, while an increase of $0.9 million in the average balance of funds borrowed from FHLB from $13.4 million in last year's quarter to $14.3 million in this year's quarter resulted a $11,000 increase in interest expense.

Net Interest Income. The result of the increase in interest income combined with the decrease in interest expense was a $128,000 increase in net interest income. Our interest rate spread (the difference between the average rate we earn and the average rate we pay) increased by 49 basis points (0.49%) from 3.35% to 3.84%, while our net interest margin increased by 32 basis points to 4.22% in the first quarter of fiscal 2004, from 3.90% for the first quarter of fiscal 2003.

Average shareholders' equity represented 20.4% of average interest-earning assets for the quarter ended December 31, 2003, while it represented 21.4% of average interest-earning assets for the same quarter in last year. Our ratio of average interest-earning assets to average interest-bearing liabilities decreased from 1.22 times in fiscal 2003 to 1.21 times in fiscal 2004.

Provision for Loan Losses. The provision for loan losses results from our analysis of the adequacy of the allowance for loan losses. If we believe that the allowance should be higher, then we increase it, with a charge to provision for loan losses, which is an expense on our income statement. In determining the appropriate provision for loan losses, management considers the level of and trend in non-performing loans, the level of and trend in net loan charge-offs, the dollar amount and mix of the loan portfolio, as well as general economic conditions and real estate trends in the Company's market area, which can impact the inherent risk of loss in the Company's portfolio. Furthermore, the OTS may disagree with our judgments regarding the risks in our loan portfolio and could require us to increase the allowance in the future.

For the three months ended December 31, 2003, we provided $25,000 for loan losses, compared to $40,000 in the same quarter last year. At December 31, 2003, the ratio of our loan allowance to total loans was 0.95% as compared to 1.20% on December 31, 2002. On September 30, 2003 the allowance was $655,000, or 1.01% of total loans, and we determined at the end of the quarter that the appropriate level for the allowance was $663,000. We had charge-offs during the quarter of $23,000 and recoveries of $6,000, so a $25,000 provision was necessary to reach the desired level for the allowance. Our level of non-accruing loans, loans 90 days and still accruing and restructured loans was $742,000, or 1.06% of total loans, at December 31, 2003 as compared to $936,000, or 1.96% of total loans, at December 31, 2002. The reduction of the ratio of the loan loss allowance to total loans from September 2003 to December 2003 is justified by the fact that all the growth in loans originated by the Bank was in real estate loans, $4.3 million in residential and $0.3 million in commercial, while other commercial and consumer loans, which have more risk than mortgages, fell $0.2 million.

Non-interest Income. Our non-interest income was $5,000 higher in the fiscal 2004 quarter as compared to the fiscal 2003 quarter. Service charges increased by $11,000, loan fees increased by $1,000, gain (loss) on sale of

securities decreased by $15,000, and ATM income increased by $6,000, while miscellaneous income increased by $2,000 from last year.

Non-interest Expenses. Our non-interest expenses decreased by $36,000 from the 2003 quarter to the 2004 quarter. Increases in salaries and employee benefits of $24,000 and data processing of $2,000 were more than offset by decreases of $3,000 in director fees, $7,000 in postage and supplies, $11,000 in professional fees, $7,000 in occupancy and equipment, $22,000 in other expense and $12,000 foreclosed assets, net. The increase in salaries and benefits is the result of performance increases to our employees. Director fees decreased since there was one less meeting this year. Occupancy and equipment expenses were reduced as depreciation expense was down by $6,000. The decrease in professional fees represents some additional costs from our exiting independent accountants during the transition period. Other expense decreased due to decreases of $18,000 for advertising expense and $5,000 for telephone expense.

At December 31, 2003, we had thirty full-time and two part-time employees, compared to twenty-nine full time and two part-time employees at the end of December 2002.

Income tax expense. Our income tax expense increased by $75,000, or 127.1%, comparing the first quarter of fiscal 2004 to the same quarter of fiscal 2003. The increased expense was the result of higher income before income tax of $184,000, or 117.2%.

Liquidity and Capital Resources

Our primary sources of funds are deposits, borrowings from FHLB, and proceeds from the principal and interest payments on loans and securities. Scheduled maturities and principal payments on loans and securities are predictable sources of funds. We can also control the funds available from borrowings. However, general economic conditions and interest rate conditions can cause increases or decreases in deposit outflows and loan pre-payments, which can also affect the level of funds we have available for investment.

In general, we manage our liquidity by maintaining a sufficient level of short-term investments so funds are readily available for investment in loans when needed. During the three months ended December 31, 2003, we decreased our cash and cash equivalents by $1,208,000.

Deposits decreased by $0.7 million during the quarter ended December 31, 2003. In addition to factors within our control, such as our deposit pricing strategies and our marketing efforts, deposit flows are affected by the level of general market interest rates, the availability of alternate investment opportunities, general economic conditions, and other factors outside our control. We borrowed an additional $5.0 million from FHLB during the quarter ended December 31, 2003 to fund the additional loan growth.

We monitor our liquidity regularly. Excess liquidity is invested in overnight federal funds sold and other short-term investments. If we need additional funds, we can borrow those funds, although the cost of borrowing money is normally higher than the average cost of deposits. As a member of the FHLB, the Bank can arrange to borrow an additional $12.3 million against our one to four family mortgage portfolio. We have used borrowed funds to help us leverage capital and grow the Bank, but have not needed borrowings to cover liquidity shortfalls. In addition to borrowings, we believe that, if we need to do so, we can attract additional deposits by increasing the rates we offer.

We had $2.5 million in outstanding commitments to make loans at December 31, 2003, along with $2.8 million of unused home equity, commercial and overdraft lines of credit. We anticipate that we will have enough funds to meet our current loan commitments and to fund draws on the lines of credit through the normal turnover of our loan and securities portfolios. At December 31, 2003, we had $17.2 million of time certificates scheduled to mature within one year. We anticipate that we can retain substantially all of those deposits if we need to do so to fund loans and other investments as part of our efforts to grow and leverage our capital.

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The Bank measures liquidity using a modified version of the formula that was formerly required by OTS regulation. Our formula classifies investments in a fund, secured by mostly mortgage assets, as a liquid asset since the investment can be converted to cash with one-day notice. The OTS calculation did not consider this investment to be liquid because of the real estate collateral. We measure liquidity on a monthly basis and want to maintain a liquidity ratio of between 5% and 15%. At December 31, 2003, the ratio was 18.8%. We will continue to monitor liquidity and adjust deposit rates or pay off borrowed funds as necessary.

The OTS has minimum capital ratio requirements applying to the Bank, but there are no comparable minimum capital requirements that apply to us as a savings and loan holding company. At December 31, 2003, the Bank exceeded all regulatory capital requirements of the OTS applicable to it, with Tier I capital of $17.1 million, or 18.1% of adjusted total assets, and risk-based capital of $17.8 million, or 33.9% of risk-weighted assets. The Bank also had tangible capital of $17.1 million, or 18.1% of average tangible assets. The Bank was classified as "well capitalized" at December 31, 2003 under OTS regulations.

Item 3. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures. The term "disclosure controls and procedures" is defined in Rule 13a-14(c) of the Securities Exchange Act of 1934, "the Exchange Act". This term refers to the controls and procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files under the Exchange Act is recorded, processed, summarized and reported within required time periods. Our Chief Executive Officer and our Chief Financial Officer have evaluated the effectiveness of our disclosure controls and procedures as of December 31, 2003, and they have concluded that as of that date, our disclosure controls and procedures were effective at ensuring that required information will be disclosed on a timely basis in our reports filed under the Exchange Act.

(b) Changes in Internal Controls. There were no significant changes to our internal controls or in other factors that could significantly affect our internal controls subsequent to the date of their evaluation by our Chief Executive Officer and our Chief Financial Officer, including any corrective actions with regard to significant deficiencies and material weaknesses.

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PART II - OTHER INFORMATION

Item 1. Legal Proceedings

In the ordinary course of business, the Company and the Bank are subject to legal actions, which involve claims for monetary relief. Management, based on the advice of counsel, does not believe that any currently known legal actions, individually or in the aggregate, will have a material effect on its consolidated financial condition or results of operation.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

31.1 Certification of Principal Executive Officer pursuant to Rule 13a - 14(a) / 15d - 14(a)

31.2 Certification of Principal Financial Officer pursuant to Rule 13a - 14(a) / 15d - 14(a)

32.1 Certification of Principal Executive Officer pursuant to Section 1350

32.2 Certification of Chief Financial Officer pursuant to Section 1350

(b) Reports on Form 8-K

A Report on Form 8-K was filed on December 10, 2003, pursuant to Item 12 of that report. It announced the Company's results for the fiscal year ended September 30, 2003, and a press release relating to the earnings was attached thereto.

SIGNATURES

In accordance with 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.

Gouverneur Bancorp, Inc.

Date: February 11, 2004

By: /s/ RICHARD F. BENNETT

Richard F. Bennett
President and Chief Executive Officer
(principal executive officer and officer duly authorized to sign on behalf of the registrant)

By: /s/ ROBERT J. TWYMAN

Robert J. Twyman
Vice President and Chief Financial Officer
(principal financial officer duly authorized to sign on behalf of the registrant)