SOUTHERN FIRST BANCSHARES INC
Form 10-Q
May 07, 2009

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

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended March 31, 2009

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 000-27719

Southern First Bancshares, Inc.
(Exact name of registrant as specified in its charter)

South Carolina	**58-2459561**
(State or other jurisdiction of incorporation)	(I.R.S. Employer Identification No.)
100 Verdae Boulevard, Suite 100	
Greenville, S.C.	**29606**
(Address of principal executive offices)	(Zip Code)

864-679-9000
(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 Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes [ ] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act).

Large accelerated filer	[ ]	Accelerated filer	[ ]
Non-accelerated filer	[ ]	Smaller Reporting Company	[X]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes [ ] No [X]

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date:
3,044,863 shares of common stock, $.01 par value per share, were issued and outstanding as of May 1, 2009.

PART I. CONSOLIDATED FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

	March 31, 2009 (Unaudited)	**December 31, 2008** (Audited)
Assets		
Cash and due from banks	$ 8,867	$ 4,360
Federal funds sold	3,668	8,800
Investment securities available for sale	75,766	64,432
Investment securities held to maturity (fair value $11,723 and $12,618)	11,484	12,519
Other investments, at cost	9,195	8,461
Loans, net	558,965	559,602
Property and equipment, net	12,762	11,701
Accrued interest receivable	2,603	2,900
Other real estate owned	3,826	2,116
Bank owned life insurance	13,492	13,369
Deferred income taxes	3,600	3,864
Other assets	776	855
Total assets	$ 705,004	$ 692,979
Liabilities		

Deposits	$ 474,797	$ 469,537
Official checks outstanding	853	1,277
Note Payable	5,000	15,000
Federal Home Loan Bank advances and related debt	149,675	149,675
Junior subordinated debentures	13,403	13,403
Accrued interest payable	2,116	2,247
Accounts payable and accrued expenses	1,187	2,054
Total liabilities	647,031	653,193
Shareholders equity		
Preferred stock, par value $.01 per share, 10,000,000 shares authorized, 17,299 shares issued and outstanding	15,814	-
Common stock, par value $.01 per share, 10,000,000 shares authorized, 3,044,863 shares issued and outstanding at March 31, 2009 and December 31, 2008, respectively	30	30
Nonvested restricted stock	(24)	(27)
Additional paid-in capital	33,286	31,850
Accumulated other comprehensive income (loss)	(674)	(1,079)
Retained earnings	9,541	9,012
Total shareholders equity	57,973	39,786
Total liabilities and shareholders equity	$ 705,004	$ 692,979

See notes to consolidated financial statements that are an integral part of these consolidated statements.

SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share data)

	For the three months ended March 31,	
	2009	**2008**
	(Unaudited)	
Interest income		
Loans	$ 7,797	$ 9,009
Investment securities	1,093	1,249
Federal funds sold	5	84
Total interest income	8,895	10,342
Interest expense		
Deposits	2,788	4,097
Borrowings	1,646	1,851

Total interest expense	4,434	5,948
Net interest income	4,461	4,394
Provision for loan losses	750	600
Net interest income after provision for loan losses	3,711	3,794
Noninterest income		
Loan fee income	38	45
Service fees on deposit accounts	175	149
Income from bank owned life insurance	123	96
Real estate owned activity	(7)	(58)
Other income	85	79
Total noninterest income	414	311
Noninterest expenses		
Compensation and benefits	1,925	1,718
Professional fees	136	114
Marketing	145	135
Insurance	153	129
Occupancy	416	348
Data processing and related costs	374	321
Telephone	51	34
Other	229	187
Total noninterest expenses	3,429	2,986
Income before income taxes expense	696	1,119
Income tax expense	209	372
Net income	$ 487	$ 747
Preferred stock dividend to be paid	78	-
Dividend accretion	42	-
Net income available to common shareholders	**$ 367**	**$ 747**
Earnings per common share		
Basic	$ .12	$ .25
Diluted	$ .12	$ .23
Weighted average common shares outstanding		
Basic	3,044,863	2,964,951
Diluted	3,053,933	3,185,827

See notes to consolidated financial statements that are an integral part of these consolidated statements.

SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY
AND COMPREHENSIVE INCOME
FOR THE THREE MONTHS ENDED MARCH 31, 2009 AND 2008
(Unaudited)

(in thousands, except share data)

	Common stock Shares	**Amount**	**Preferred stock**	**Nonvested restricted stock**	**Additional paid-in capital**	**Accumulated other comprehensive income(loss)**	**Retained Earnings**	**Total share-holders equity**
December 31, 2007	2,946,456	$ 29	$ -	$ (41)	$ 31,034	$ 96	$ 7,160	$ 38,278
Net income	-	-	-	-	-	-	747	747
Comprehensive income, net of tax - Unrealized holding gain on securities available for sale	-	-	-	-	-	204	-	204
Comprehensive income	-	-	-	-	-	-	-	951
Proceeds from exercise of stock options and warrants	28,250		-	-	171	-	-	171
Amortization of deferred compensation on restricted stock	-	-	-	3	-	-	-	3
Compensation expense related to stock options, net of tax	-	-	-	-	14	-	-	14
March 31, 2008	2,974,706	$ 29	$ -	$ (38)	$ 31,219	$ 300	$ 7,907	$ 39,417
December 31, 2008	3,044,863	$ 30	$ -	$ (27)	$ 31,850	$ (1,079)	$ 9,012	$ 39,786
Net income	-	-	-	-	-	-	487	487
Comprehensive income, net of tax - Unrealized holding gain on securities available for sale	-	-	-	-	-	405	-	405
Comprehensive income	-	-	-	-	-	-	-	892

Preferred stock transactions Proceeds from issuance of 17,299 shares of preferred stock	-	-	15,856	-	-	-	-	15,856
Proceeds from issuance of common stock warrants	-	-	-	-	1,418	-	-	1,418
Dividend accretion	-	-	(42)	-	-	-	42	-
Amortization of deferred compensation on restricted stock	-	-	-	3	-	-	-	3
Compensation expense related to stock options	-	-	-	-	18	-	-	18
March 31, 2009	**3,044,863**	**$ 30**	**$ 15,814**	**$ (24)**	**$ 33,286**	**$ (674)**	**$ 9,541**	**$ 57,973**

See notes to consolidated financial statements that are an integral part of these consolidated statements.

SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	For the three months ended March 31, 2009 (Unaudited)	2008
Operating activities		
Net income	$ 487	$ 747
Adjustments to reconcile net income to cash		
provided by (used for) operating activities:		
Provision for loan losses	750	600
Depreciation and other amortization	147	115
Accretion and amortization of securities discounts and premium, net	79	31
Loss on sale of real estate	-	38
Compensation expense related to stock options and grants	21	17
Increase in cash surrender value of bank owned life insurance	(123)	(96)
Decrease in deferred tax asset	52	462
Decrease (increase) in other assets, net	376	(62)
Decrease in other liabilities, net	(1,422)	(772)

Net cash provided by operating activities	367	1,080
Investing activities		
Increase (decrease) in cash realized from:		
Origination of loans, net	(1,823)	(29,992)
Purchase of property and equipment	(1,208)	(956)
Purchase of investment securities:		
Available for sale	(14,282)	(15,657)
Other investments	(680)	(667)
Payments and maturity of investment securities:		
Available for sale	3,494	1,932
Held to maturity	1,027	491
Other investments	(54)	1,125
Proceeds from sale of real estate acquired in settlement of loans	-	47
Net cash used for investing activities	(13,526)	(43,677)
Financing activities		
Increase in deposits, net	5,260	56,240
Proceeds from the issuance of preferred stock	15,856	-
Proceeds from the issuance of stock warrant	1,418	-
Proceeds from the exercise of stock options	-	171
Decrease in other borrowings and note payable	(10,000)	(825)
Net cash provided by financing activities	12,534	55,586
Net increase (decrease) in cash and cash equivalents	(625)	12,989
Cash and cash equivalents at beginning of the period	13,160	16,971
Cash and cash equivalents at end of the period	$ 12,535	$ 29,960
Supplemental information		
Cash paid for		
Interest	$ 4,565	$ 6,204
Income taxes	$ 127	$ 1,781
Schedule of non-cash transactions		
Foreclosure of real estate	$ 1,710	$ 1,892
Unrealized gain on securities, net of income taxes	$ 405	$ 204

See notes to consolidated financial statements that are an integral part of these consolidated statements.

SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All Dollar Amounts in Thousands, Except Per Share and Where Otherwise Indicated.)

NOTE 1. Nature of Business and Basis of Presentation

Business activity

Southern First Bancshares, Inc. (the Company) is a South Carolina corporation that owns all of the capital stock of Southern First Bank, N.A. (the Bank) and all of the stock of Greenville First Statutory Trust I and II (collectively (the Trusts)). On July 2, 2007, the Company and Bank changed their names to Southern First Bancshares, Inc. and Southern First Bank, N.A., respectively. The Bank is a national bank organized under the laws of the United States located in Greenville County, South Carolina. The Bank is primarily engaged in the business of accepting demand deposits and savings deposits insured by the Federal Deposit Insurance Corporation (the FDIC), and providing commercial, consumer and mortgage loans to the general public. The Trusts are special purpose subsidiaries organized for the sole purpose of issuing trust preferred securities.

Basis of Presentation

The accompanying financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q. Accordingly, they do not include all the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three-month period ended March 31, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009. For further information, refer to the consolidated financial statements and footnotes thereto included in the company s Form 10-K for the year ended December 31, 2008 (Registration Number 000-27719) as filed with the Securities and Exchange Commission. The consolidated financial statements include the accounts of Southern First Bancshares, Inc., and its wholly owned subsidiary Southern First Bank, N.A. In accordance with Financial Accounting Standards Board (FASB) Interpretation No. 46, the financial statements related to the special purpose subsidiaries, Greenville First Statutory Trust I and Trust II, have not been consolidated.

Cash and Cash Equivalents

For purposes of the Consolidated Statements of Cash Flows, cash and federal funds sold are included in cash and cash equivalents. These assets have contractual maturities of less than three months.

NOTE 2 Note Payable

The Company had a $15.0 million revolving line of credit with Silverton Ban k, N.A. (Silverton) for which $5.0 million was outstanding at March 31, 2009. The line of credit matures on December 28, 2012 and bears interest at prime less 1.25%, which at March 31, 2009 was 2.00%. The Company has pledged all of the stock of the Bank as collateral for this line of credit. The line of credit agreement contains various financial covenants related to net income and asset quality. As of December 31, 2008 and March 31, 2009, the Company was not in compliance with the covenant related to the nonperforming assets ratio. On April 30, 2009, the Company entered into an Amended and Restated Loan Agreement (the Amended Loan Agreement) with Silverton. The total line of credit was reduced to $9.0 million subject to limits based on a borrowing availability calculation. Had the Amended Loan Agreement been in place as of March 31, 2009, the maximum allowed to be borrowed would have been $6.7 million. The amended interest rate is the prime rate plus 0.5% with a floor rate of 4.0%. The $9.0 million line of credit consists of a $4.0 million revolving line of credit with a maturity of April 30, 2011 and a term loan with a maturity of April 30, 2014. The Amended Loan Agreement contains various financial covenants related to net income and asset quality. Had the Amended Loan Agreement been in place at March 31, 2009, the Bank would have been in compliance with all the requirements.

On May 1, 2009, Silverton was closed by the Office of the Comptroller of the Currency and the FDIC was named Receiver. The FDIC created a bridge bank to take over the operations of Silverton. The newly created bank is Silverton Bridge Bank, N.A. The creation of the bridge bank allows its client banks to transition their correspondent banking needs to other providers with the least amount of disruptions. Silverton Bridge Bank, N.A. will continue to operate business as usual through July 29, 2009. As a result of this announcement, we may not be able to make additional draws on the revolving line of credit.

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NOTE 3 Preferred Stock Issuance

On February 27, 2009, as part of the Treasury Department's Capital Purchase Program (CPP), the Company entered into a Letter Agreement and a Securities Purchase Agreement (collectively, the CPP Purchase Agreement) with the Treasury Department, pursuant to which the Company sold 17,299 shares of its Fixed Rate Cumulative Perpetual Preferred Stock, Series T (the Series T Preferred Stock) and a warrant (the CPP Warrant) to purchase 330,554 shares of the Company s common stock for an aggregate purchase price of $17.3 million in cash. The Series T Preferred Stock will qualify as Tier 1 capital and will be entitled to cumulative dividends at a rate of 5% per annum for the first five years, and 9% per annum thereafter. The Company must consult with the OCC before it may redeem the Series T Preferred Stock but, contrary to the original restrictions in the Emergency Economic Stabilization Act of 2008 (the "EESA"), will not necessarily be required to raise additional equity capital in order to redeem this stock. The CPP Warrant has a 10-year term and is immediately exercisable upon its issuance, with an exercise price, subject to anti-dilution adjustments equal to $7.85 per share of the common stock. The fair value allocation of the $17.3 million between the shares of Series T Preferred Stock and the CPP Warrant resulted in $15.9 million allocated to the shares of Series T Preferred Stock and $1.4 million allocated to the CPP Warrant.

NOTE 4 Earnings per Common Share

The following schedule reconciles the numerators and denominators of the basic and diluted earnings per share computations for the three months ended March 31, 2009 and 2008. Dilutive common shares arise from the potentially dilutive effect of the company s stock options and warrants that are outstanding. The assumed conversion of stock options and warrants can create a difference between basic and dilutive net income per common share.

At March 31, 2009 and 2008, 188,113 and 43,250 options, respectively, were anti-dilutive in the calculation of earnings per share as their exercise price exceeded the fair market value.

	Three months ended March 31, 2009		2008	
Numerator:				
Net income	$	487	$	747
Less: Preferred stock dividends to be paid	78		-	
Dividend accretion	42		-	
Net income available to common shareholders	$	367		747
Denominator:				
Weighted-average common shares outstanding basic	3,044,863		2,964,951	
Common stock equivalents	9,070		220,876	
Weighted-average common shares outstanding diluted	3,053,933		3,185,827	
Earnings per common share:				
Basic	$	0.12	$	0.25
Diluted	$	0.12	$	0.23

NOTE 5 Stock Based Compensation

The company has a stock-based employee compensation plan. On January 1, 2006, the company adopted the fair value recognition provisions of SFAS No. 123(R), Accounting for Stock-Based Compensation, to account for compensation costs under its stock option plan.

In adopting SFAS No. 123(R), the company elected to use the modified prospective method to account for the transition from the intrinsic value method to the fair value recognition method. Under the modified prospective method, compensation cost is recognized from the adoption date forward for all new stock options granted and for any outstanding unvested awards as if the fair value method had been applied to those awards as of the date of grant.

The fair value of the option grant is estimated on the date of grant using the Black-Scholes option-pricing model. The following assumptions were used for grants: expected volatility of 26.76% for 2009 and 2008, risk-free interest rate of 3.72% for 2009 and 2008, expected lives of the options 10 years, and the assumed dividend rate was zero.

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NOTE 6 Fair Value Measurement

Effective January 1, 2008, the Company adopted SFAS No. 157, Fair Value Measurements, which provides a framework for measuring and disclosing fair value under generally accepted accounting principles. SFAS No. 157 requires disclosures about the fair value of assets and liabilities recognized in the balance sheet in periods subsequent to initial recognition, whether the measurements are made on a recurring or on a nonrecurring basis.

SFAS No. 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. SFAS No. 157 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1

Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include certain debt and equity securities and derivative contracts that are traded in an active exchange market.

Level 2

Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include fixed income securities and mortgage-backed securities that are held in the Company s available-for-sale portfolio, certain derivative contracts and impaired loans.

Level 3

Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. These methodologies may result in a significant portion of the fair value being derived from unobservable data.

Assets measured at fair value on a recurring basis as of March 31, 2009 are as follows:

	Quoted market price in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Collateralized Mortgage Obligations	$ -	$ -	$ 5,098
Other securities available for sale	58	70,610	-
Other investments	-	-	9,195
Total	$ 58	$ 70,610	$ 14,293

The Company has no liabilities carried at fair value or measured at fair value on a recurring or nonrecurring basis.

The Company is predominantly an asset based lender with real estate serving as collateral on approximately 79.1% of loans. Loans which are deemed to be impaired and real estate acquired in settlement of loans are valued on a nonrecurring basis at the lower of cost or market value of the underlying real estate collateral. Such market values are generally obtained using independent appraisals, which the Company considers to be level 2 inputs. The aggregate carrying amount, net of specific reserves, of impaired loans at March 31, 2009 was $9.8 million. In addition, real estate acquired in settlement of loans is valued at $3.8 million at March 31, 2009.

FASB Staff Position No. FAS 157-2 delays the implementation of SFAS No. 157 until the first quarter of 2009 with respect to goodwill, other intangible assets, real estate and other assets acquired through foreclosure and other non-financial assets measured at fair value on a nonrecurring basis.

The table below presents a reconciliation for the period of January 1, 2009 to March 31, 2009, for all Level 3 assets that are measured at fair value on a recurring basis.

	Investment securities available for sale	Other investments
Beginning balance	$ 5,213	$ 8,461
Total realized and unrealized gains or losses:		
Included in earnings	-	-
Included in other comprehensive income	155	-
Purchases, sales and principal reductions	(270)	734
Transfers in and/or out of Level 3	-	-

Ending Balance	$ 5,098	$ 9,195

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

The following discussion reviews our results of operations and assesses our financial condition. You should read the following discussion and analysis in conjunction with the accompanying consolidated financial statements. The commentary should be read in conjunction with the discussion of forward-looking statements, the financial statements and the related notes and the other statistical information included in this report.

DISCUSSION OF FORWARD-LOOKING STATEMENTS

This report contains statements which constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements are based on many assumptions and estimates and are not guarantees of future performance. Our actual results may differ materially from those anticipated in any forward-looking statements, as they will depend on many factors about which we are unsure, including many factors which are beyond our control. The words may, would, could, will, expect, anticipate, believe, intend, plan, and estimate, as well as similar expressions, are meant to identify such forward-looking statements. Potential risks and uncertainties that could cause our actual results to differ from those anticipated in any forward-looking statements include, but are not limited to, those described in our Form 10-K for the year ended December 31, 2008 under Item 1A- Risk Factors and the following:

significant increases in competitive pressure in the banking and financial services industries;

changes in the interest rate environment which could reduce anticipated or actual margins;

changes in political conditions or the legislative or regulatory environment;

general economic conditions, either nationally or regionally and especially in our primary service area, becoming less favorable than expected resulting in, among other things, a deterioration in credit quality;

changes occurring in business conditions and inflation;

changes in technology;

changes in deposit flows;

changes in monetary and tax policies;

the level of allowance for loan loss;

the rate of delinquencies and amounts of charge-offs;

the rates of loan growth and the lack of seasoning of our loan portfolio;

adverse changes in asset quality and resulting credit risk-related losses and expenses;

loss of consumer confidence and economic disruptions resulting from terrorist activities;

changes in the securities markets; and

other risks and uncertainties detailed from time to time in our filings with the Securities and Exchange Commission.

These risks are exacerbated by the recent developments in national and international financial markets, and we are unable to predict what effect these uncertain market conditions will have on our Company. During 2008, the capital and credit markets experienced extended volatility and disruption. In the last 180 days, the volatility and disruption have reached unprecedented levels. There can be no assurance that these unprecedented recent developments will not materially and adversely affect our business, financial condition and results of operations.

We undertake no obligation to publicly update or otherwise revise any forward-looking statements, whether as a result of new information, future events, or otherwise.

Overview

We were incorporated in March 1999 to organize and serve as the holding company for Greenville First Bank, N.A. On July 2, 2007, we changed the name of our company and bank to Southern First Bancshares, Inc. and Southern First Bank, N.A., respectively. Since we opened our bank in January 2000, we have experienced consistent growth in total assets, loans, deposits, and shareholders equity.

Like most community banks, we derive the majority of our income from interest received on our loans and investments. Our primary source of funds for making these loans and investments is our deposits, on which we pay interest. Consequently, one of the key measures of our success is our amount of net interest income, or the difference between the income on our interest-earning assets, such as loans and investments, and the expense on our interest-bearing liabilities, such as deposits and borrowings. Another key measure is the spread between the yield we earn on these interest-earning assets and the rate we pay on our interest-bearing liabilities, which is called our net interest spread.

There are risks inherent in all loans, so we maintain an allowance for loan losses to absorb probable losses on existing loans that may become uncollectible. We maintain this allowance by charging a provision for loan losses against our operating earnings for each period. We have included a detailed discussion of this process, as well as several tables describing our allowance for loan losses.

In addition to earning interest on our loans and investments, we earn income through fees and other charges to our customers. We have also included a discussion of the various components of this noninterest income, as well as of our noninterest expense.

The following discussion and analysis also identifies significant factors that have affected our financial position and operating results during the periods included in the accompanying financial statements. We encourage you to read this discussion and analysis in conjunction with our financial statements and the other statistical information included in our filings with the Securities and Exchange Commission.

Critical Accounting Policies

We have adopted various accounting policies that govern the application of accounting principles generally accepted in the United States and with general practices within the banking industry in the preparation of our financial statements. Our significant accounting policies are described in the footnotes to our audited consolidated financial statements as of December 31, 2008, as filed in our annual report on Form 10-K.

Certain accounting policies involve significant judgments and assumptions by us that have a material impact on the carrying value of certain assets and liabilities. We consider these accounting policies to be critical accounting policies. The judgment and assumptions we use are based on historical experience and other factors, which we believe to be reasonable under the circumstances. Because of the nature of the judgment and assumptions we make, actual results could differ from these judgments and estimates that could have a material impact on the carrying values of our assets and liabilities and our results of operations.

We believe the allowance for loan losses is the critical accounting policy that requires the most significant judgment and estimates used in preparation of our consolidated financial statements. Some of the more critical judgments supporting the amount of our allowance for loan losses include judgments about the credit worthiness of borrowers, the estimated value of the underlying collateral, assumptions about cash flow, determination of loss factors for estimating credit losses, and the impact of current events, conditions, and other factors impacting the level of probable inherent losses. Under different conditions, the actual amount of credit losses incurred by us may be different from management s estimates provided in our consolidated financial statements. Refer to the portion of this discussion that addresses our allowance for loan losses for a more complete discussion of our processes and methodology for determining our allowance for loan losses.

Effect of Economic Trends

Following an economic decline and historically low interest rates that ended in the first six months of 2004, the Federal Reserve began increasing short-term rates as the economy showed signs of strengthening. Between July 2004 and July 2006, the Federal Reserve increased rates at 17 of their meetings for a total of 425 basis points. Between July 2006 and September 18, 2007, the Federal Reserve allowed short-term rates to remain unchanged. Beginning in July 2004 and continuing until September 18, 2007, our rates on both short-term or variable rate interest-earning assets and interest-bearing liabilities increased. The momentum of the 17 rate increases resulted in higher rates on interest-earning assets and higher interest-bearing liabilities during the first nine months of 2007; subsequently, as fixed rate loans, deposits, and borrowings have matured they have repriced at higher interest rates. In late September 2007, the Federal Reserve reversed their position and has since lowered the short-term rates by 500 basis points through December 2008, causing the rates on our short-term or variable rate assets and liabilities to decline. The majority of economic analysts predict little to no change in short-term rates throughout the remainder of 2009. The following discussion includes our analysis of the effect that we anticipate changes in interest rates will have on our financial condition. However, we can give no assurances as to the future actions of the Federal Reserve or to the anticipated results that will actually occur.

Recent Legislative and Regulatory Initiatives to Address Financial and Economic Crises

Markets in the United States and elsewhere have experienced extreme volatility and disruption for more than 12 months. These circumstances have exerted significant downward pressure on prices of equity securities and virtually all other asset classes, and have resulted in substantially increased market volatility, severely constrained credit and capital markets, particularly for financial institutions, and an overall loss of investor confidence. Loan portfolio performances have deteriorated at many institutions resulting from, among other factors, a weak economy and a decline in the value of the collateral supporting their loans. Dramatic slowdowns in the housing industry, due in part to falling home prices and increasing foreclosures and unemployment, have created strains on financial institutions. Many borrowers are now unable to repay their loans, and the collateral securing these loans has, in some cases, declined below the loan balance. In response to the challenges facing the financial services sector, several regulatory and governmental actions have recently been announced including:

- The EESA, approved by Congress and signed by President Bush on October 3, 2008, which, among other provisions, allowed the Treasury Department to purchase troubled assets from banks, authorized the Securities and Exchange Commission to suspend the application of marked-to-market accounting, and temporarily raised the basic limit of FDIC deposit insurance from $100,000 to $250,000; the legislation contemplated a return to the $100,000 limit on December 31, 2009;

- On October 7, 2008, the FDIC approved a plan to increase the rates banks pay for deposit insurance;

- On October 14, 2008, the U.S. Treasury announced the creation of the CPP which encourages and allows financial institutions to build capital through the sale of senior preferred shares to the Treasury Department on terms that are non-negotiable;

- On October 14, 2008, the FDIC announced the creation of the Temporary Liquidity Guarantee Program (TLGP), which seeks to strengthen confidence and encourage liquidity in the banking system. The TLGP has two primary components that are available on a voluntary basis to financial institutions:

§ The Transaction Account Guarantee Program (TAGP), which provides unlimited deposit insurance coverage through December 31, 2009 for noninterest-bearing transaction accounts (typically business checking accounts) and certain funds swept into noninterest-bearing savings accounts. Institutions participating in the TLGP pay a 10 basis points fee (annualized) on the balance of each covered account in excess of $250,000, while the extra deposit insurance is in place;

§ The Debt Guarantee Program (DGP), under which the FDIC guarantees certain senior unsecured debt of FDIC-insured institutions and their holding companies. The unsecured debt must be issued on or after October 14, 2008 and not later than June 30, 2009, and the guarantee is effective through the earlier of the maturity date or June 30, 2012. The DGP coverage limit is generally 125% of the eligible entity s eligible debt outstanding on September 30, 2008 and scheduled to mature on or before June 30, 2009 or, for certain insured institutions, 2% of their liabilities as of September 30, 2008. Depending on the term of the debt maturity, the nonrefundable DGP fee ranges from 50 to 100 basis points (annualized) for covered debt outstanding until the earlier of maturity or June 30, 2012. The TAGP and DGP are in effect for all eligible entities, unless the entity opted out on or before December 5, 2008.

- On February 17, 2009, the American Recovery and Reinvestment Act (the "Recovery Act") was signed into law in an effort to, among other things, create jobs and stimulate growth in the United States economy. The Recovery Act specifies appropriations of approximately $787 billion for a wide range of Federal programs and will increase or extend certain benefits payable under the Medicaid, unemployment compensation, and nutrition assistance programs. The Recovery Act also reduces individual and corporate income tax collections and makes a variety of other changes to tax laws. The Recovery Act also imposes certain limitations on compensation paid by participants in the U.S. Treasury's Troubled Asset Relief Program (TARP).

- On March 23, 2009, the U.S. Treasury, in conjunction with the FDIC and the Federal Reserve, announced the Public-Private Partnership Investment Program for Legacy Assets which consists of two separate plans, addressing two distinct asset groups:

§ The Legacy Loan Program, which the primary purpose will be to facilitate the sale of troubled mortgage loans by eligible institutions, which include FDIC-insured federal or state banks and savings associations. Eligible assets may not be strictly limited to loans; however, what constitutes an eligible asset will be determined by participating banks, their primary regulators, the FDIC and the U.S. Treasury. Additionally, the Loan Program s requirements and structure will be subject to notice and comment rulemaking, which may take some time to complete.

§ The Securities Program, which will be administered by the U.S. Treasury, involves the creation of public-private investment funds to target investments in eligible residential mortgage-backed securities and commercial mortgage-backed securities issued before 2009 that originally were rated AAA or the equivalent by two or more nationally recognized statistical rating organizations, without regard to rating enhancements (collectively, Legacy Securities). Legacy Securities must be directly secured by actual mortgage loans, leases or other assets, and may be purchased only from financial institutions that meet TARP eligibility requirements.

On February 27, 2009, as part of the CPP, we entered into the CPP Purchase Agreement with the Treasury Department under the CPP pursuant to which we sold 17,299 shares of our Series T Preferred Stock and the CPP Warrant to purchase 330,554 shares of our common stock for an aggregate purchase price of $17.3 million in cash. The Series T Preferred Stock will qualify as Tier 1 capital and will be entitled to cumulative dividends at a rate of 5% per annum for the first five years, and 9% per annum thereafter. We must consult with the OCC before we may redeem the Series T Preferred Stock but, contrary to the original restrictions in the EESA, will not necessarily be required to raise additional equity capital in order to redeem this stock. The CPP Warrant has a 10-year term and is immediately exercisable upon its issuance, with an exercise price, subject to anti-dilution adjustments equal to $7.85 per share of the common stock. The fair value allocation of the $17.3 million between the shares of Series T Preferred Stock and the CPP Warrant resulted in $15.9 million allocated to the shares of Series T Preferred Stock and $1.4 million allocated to the CPP Warrant.

We will participate in the TAGP and have opted out of the DGP.

Results of Operations

Income Statement Review

Summary

Our net income was $487,000 and $747,000 for the three months ended March 31, 2009 and 2008, respectively, a decrease of $260,000, or 34.7%. The $260,000 decrease in net income resulted primarily from increased noninterest expenses of $443,000 and a $150,000 increase in provision for loan losses, partially offset by an additional $67,000 in net interest income, $103,000 in noninterest income and a $163,000 decrease in income tax expense. Our efficiency ratio, excluding real estate owned activity, was 70.23% for the three months ended March 31, 2009 compared to 62.7% for the same period in 2008. The higher efficiency ratio relates primarily to the additional administrative costs associated with our two new retail offices.

Net Interest Income

Our level of net interest income is determined by the level of earning assets and the management of our net interest margin. During the three months ended March 31, 2009 our average earning assets increased $38.8 million compared to the average for the three months ended March 31, 2008, primarily due to a $41.2 million increase in average loans, partially offset by a $2.4 million decrease in average investments and federal funds sold.

Our decision to grow the loan portfolio during the first six months of 2008 created the need for a higher level of capital and the need to increase deposits and borrowings. During the second half of 2008, in response to the deteriorating economic conditions, and the limited amount of capital available to the financial industry, we decided to manage and limit the level of future loan growth to ensure the Bank remains well-capitalized. As a result, during the first quarter of 2009, net loans declined $637,000. Our loan growth strategy also resulted in a significant portion of our assets in the first quarter of 2009 being in higher earning loans rather than in lower yielding investments. At March 31, 2009, net loans represented 79.3% of total assets, while investments and federal funds sold represented 14.2% of total assets. In addition, as described below, we have also increased our level of deposits significantly.

During July 2008 we opened two additional retail deposit offices. We now have four retail offices in the Greenville market and two retail offices in the Columbia market. Our focus for these locations is to obtain low cost transaction accounts, resulting in an increase in both the percentage of assets being funded by in market retail deposits and to increase the percentage of low-cost transaction accounts to total deposits. We believe that this growth strategy will provide additional clients in our two market areas and will eventually provide a lower alternative cost of funding. At March 31, 2009, retail deposits represented $261.7 million, or 37.1% of total assets, borrowings represented $168.1 million, or 23.8% of total assets, and wholesale out-of-market deposits represented $213.1 million, or 30.2% of total assets.

We have included a number of tables to assist in our description of various measures of our financial performance. For example, the Average Balances, Income and Expenses, Yields and Rates table shows the average balance of each category of our assets and liabilities as well as the yield we earned or the rate we paid with respect to each category during the three months ended March 31, 2009 and 2008. A review of this table shows that our loans typically provide higher interest yields than do other types of interest-earning assets, which is why we direct a substantial percentage of our earning assets into our loan portfolio. Similarly, the Rate/Volume Analysis table demonstrates the effect of changing interest rates and changing volume of assets and liabilities on our financial condition during the periods shown. We also track the sensitivity of our various categories of assets and liabilities to changes in interest rates, and we have included tables to illustrate our interest rate sensitivity with respect to interest-earning accounts and interest-bearing accounts. Finally, we have included various tables that provide detail about our investment securities, our loans, our deposits, and other borrowings.

The following table sets forth information related to our average balance sheets, average yields on assets, and average costs of liabilities. We derived these yields by dividing income or expense by the average balance of the corresponding assets or liabilities. We derived average balances from the daily balances throughout the periods indicated. During the three month periods ended March 31, 2009 and 2008, we had no interest-bearing deposits in other banks or any securities purchased with agreements to resell. All investments were owned at an original maturity of over one year. Nonaccrual loans are included in the following tables. Loan yields have been reduced to reflect the negative impact on our earnings of loans on nonaccrual status. The net of capitalized loan costs and fees are amortized into interest income on loans.

Average Balances, Income and Expenses, Yields and Rates
For the Three Months Ended March 31,

	2009			**2008**		
	Average Balance	**Income/ Expense**	**Yield/ Rate(1)**	**Average Balance**	**Income/ Expense**	**Yield/ Rate(1)**
Earnings						
Federal funds sold	$ 8,482	$ 5	0.24%	$ 10,322	$ 84	3.27%
Investment securities, taxable	89,460	1,057	4.79%	89,980	1,213	5.42%
Investment securities, nontaxable (2)	3,793	58	6.21%	3,792	58	6.16%
Loans	566,456	7,797	5.58%	525,266	9,009	6.90%
Total earning-assets	668,191	8,917	5.41%	629,360	10,364	6.62%
Non-earning assets	37,507			22,545		
Total assets	$ 705,698			$ 651,905		
Interest-bearing liabilities						
NOW accounts	$ 41,975	71	0.69%	$ 35,960	121	1.35%
Savings & money market	88,597	257	1.18%	90,380	563	2.51%
Time deposits	312,265	2,460	3.19%	281,143	3,413	4.88%
Total interest-bearing deposits	442,837	2,788	2.55%	407,483	4,097	4.04%
Notes payable and other borrowings	164,839	1,522	3.74%	156,457	1,618	4.16%
Junior subordinated debentures	13,403	124	3.75%	13,403	233	6.99%
Total interest-bearing liabilities	621,079	4,434	2.90%	577,343	5,948	4.20%
Non-interest bearing liabilities	38,554			35,344		
Shareholders equity	46,065			39,218		
Total liabilities and shareholders equity	$ 705,698			$ 651,905		
Net interest spread			2.51%			2.42%
Net interest income (tax equivalent) / margin		$ 4,483	2.72%		$ 4,416	2.82%
Less: tax-equivalent adjustment (2)		22			22	
Net interest income		$ 4,461			$ 4,394	

(1) Annualized for the three month period.
(2) The tax-equivalent adjustment to net interest income adjusts the yield for assets earning tax-exempt income to a comparable yield on a taxable basis.

Our net interest income margin for the three months ended March 31, 2009 exceeded our net interest spread because we had more interest-earning assets than interest-bearing liabilities. Average interest-earning assets exceeded average interest-bearing liabilities by $47.1 million, and $52.0 million for the three months ended March 31, 2009 and 2008, respectively.

Our net interest spread, was 2.51% for the three months ended March 31, 2009, compared to 2.42% for the three months ended March 31, 2008. The net interest spread is the difference between the yield we earn on our interest-earning assets and the rate we pay on our interest-bearing liabilities.

The 9 basis point increase in the net interest spread is primarily due to the fact that more of our rate-sensitive liabilities repriced downward than our rate-sensitive assets during the twelve months ended March 31, 2009. Given the 500 basis point decrease in short-term rates over the past 18 months, the rates on our new and maturing loans and deposits are much lower than they were in the past. However, in response to the significant decrease in rates, we have begun instituting interest rate floors on our new and maturing loans. This action has resulted in only a 132 basis point decrease in our weighted average rate on loans compared to a 149 basis point decrease in the average weighted rate on deposits, the two largest components of net interest income.

Our net interest margin is calculated as net interest income, on an annualized basis, divided by average interest-earning assets. Our net interest margin, on a tax-equivalent basis, for the three months ended March 31, 2009 was 2.72% compared to 2.82% for the three months ended March 31, 2008. During the first quarter of 2009, interest-earning assets averaged $668.2 million compared to $629.4 million in the first quarter of 2008.

Our loan yield decreased 132 basis points for the three months ended March 31, 2009 compared to the three months ended March 31, 2008 as a result of the 500 basis point reduction in short-term rates in the past 18 months. The short-term rate reduction had an immediate impact on our variable rate loans which represent 46.5% of our total loans at March 31, 2009. Offsetting the decrease in our loan yield was a 149 basis point decrease in the cost of our interest-bearing deposits for the first quarter of 2009 compared to the same period in 2008. The decrease in the rate on interest-bearing deposits is due primarily to the 169 basis point decrease on the cost of time deposits as their renewal rates have been lower than their original rates as a result of the decreases in market rates over the year. In addition, the cost of our transaction, savings and money market accounts has decreased as we have lowered the rates we offer on these products. The cost of our savings and money market accounts has decreased by 133 basis points from March 31, 2008, while the rate on our transaction accounts has decreased 66 basis points in the same period.

In addition, the 42 basis point decrease in notes payable and other borrowings and the 324 basis point decrease in junior subordinated debt in the first quarter of 2009 compared to the same period in 2008 resulted primarily from the impact of the 500 basis point decrease in short-term market rates over the past 18 months. As of March 31, 2009, approximately 12% of our FHLB advances had variable rates, while all of our other borrowings, including notes payable and junior subordinated debt, had variable rates.

As more fully discussed in the Market Risk and Liquidity and Interest Rate Sensitivity sections below, at March 31, 2009, 46% of our loans had variable rates. During the past two years we have placed a greater emphasis on fixed rate loans; however, we recently changed our focus to increase the amount of variable rate loans in our portfolio. Our variable rate loans as a percentage of total loans increased from 38% at March 31, 2008 to 46% at March 31, 2009. We believe that interest rates are at or near their lowest levels and that this change in focus will position us to benefit from future increases in the short-term rates.

At March 31, 2009, 80.4% of our interest-bearing liabilities were either variable rate or had a maturity of less than one year. Of the $312.9 million of interest-bearing liabilities set to reprice within three months, 40.8% are transaction, money market or savings accounts which are already at or near their lowest rates and provide little opportunity for benefit should market rates continue to decline or stay constant. However, certificates of deposit that are currently maturing or renewing are repricing at lower rates. We expect to benefit as these deposits reprice, even if market rates increase slightly. At March 31, 2009, we had $135.8 million more liabilities than assets that reprice within the next twelve months.

Included in our other borrowings are a number of FHLB advances and structured repurchase agreements with callable features as of March 31, 2009. We believe that the optionality on many of these borrowings will not be exercised until interest rates increase significantly. In addition, we believe that the interest rates that we pay on the majority of our interest-bearing transaction accounts, would only be impacted by a portion of any change in market rates. This key assumption is utilized in our overall evaluation of our level of interest sensitivity.

Rate/Volume Analysis

Net interest income can be analyzed in terms of the impact of changing interest rates and changing volume. The following table sets forth the effect which the varying levels of interest-earning assets and interest-bearing liabilities and the applicable rates have had on changes in net interest income for the periods presented.

	Three Months Ended							
	March 31, 2009 vs. 2008				**March 31, 2008 vs. 2007**			
	Increase (Decrease) Due to				**Increase (Decrease) Due to**			
	Volume	**Rate**	**Rate/ Volume**	**Total**	**Volume**	**Rate**	**Rate/ Volume**	**Total**
Interest income								
Loans	$ 761	$ (1,829)	$ (144)	$ (1,212)	$ 2,171	$ (737)	$ (190)	$ 1,244
Investment securities	(8)	(149)	1	(156)	215	-	-	215
Federal funds sold	(15)	(78)	14	(79)	(33)	(57)	12	(78)
Total interest income	738	(2,056)	(129)	(1,447)	2,353	(794)	(178)	1,381
Interest expense								
Deposits	372	(1,544)	(137)	(1,309)	805	(290)	(58)	457
Other borrowings	100	(186)	(10)	(96)	491	(130)	(47)	314
Junior subordinated debt	-	(109)	-	(109)	-	-	-	-
Total interest expense	472	(1,839)	(147)	(1,514)	1,296	(420)	(105)	771
Net interest income	**$** 266	$ (217)	$ 18	$ 67	$ 1,057	$ (374)	$ (73)	$ 610

Net interest income, the largest component of our income, was $4.5 million and $4.4 million for the three months ended March 31, 2009 and 2008, respectively. The slight increase in the first quarter of 2009 related primarily to the net effect of higher levels of both average interest-earning assets and interest-bearing liabilities. Average interest-earning assets were $38.8 million higher during the three months ended March 31, 2009 compared to the same period in 2008. During the same period, average interest-bearing liabilities increased $43.7 million. The higher average balances resulted in $266,000 of additional net interest income for the three months ended March 31, 2009, while lower rates on the average balances reduced net interest income by $217,000.

Interest income for the three months ended March 31, 2009 was $8.9 million, consisting of $7.8 million on loans, $1.1 million on investments, and $5,000 on federal funds sold. Interest income for the three months ended March 31, 2008 was $10.3 million, consisting of $9.0 million on loans, $1.3 million on investments, and $84,000 on federal funds sold. Interest on loans for the three months ended March 31, 2009 and 2008 represented 87.7% and 87.1%, respectively, of total interest income, while income from investments and federal funds sold represented only 12.3% and 12.9%, respectively, of total interest income. The high percentage of interest income from loans relates to our strategy to maintain a significant portion of our assets in higher earning loans compared to lower yielding investments. Average loans represented 84.8% and 83.5% of average interest-earning assets for the three months ended March 31, 2009 and 2008, respectively. Included in interest income on loans for the three months ended March 31, 2009 and 2008 was $168,000 and $196,000, respectively, related to the net amortization of loan fees and capitalized loan origination costs.

Interest expense for the three months ended March 31, 2009 was $4.4 million, consisting of $2.8 million related to deposits and $1.6 million related to other borrowings. Interest expense for the three months ended March 31, 2008 was $6.0 million, consisting of $4.1 million related to deposits and $1.9 million related to other borrowings. Interest expense on deposits for the three months ended March 31, 2009 and 2008 represented 62.9% and 68.9%, respectively, of total interest expense, while interest expense on other borrowings represented 37.1% and 31.1%, respectively, of total interest expense for the same three month periods. During the three months ended March 31, 2009, average interest-bearing deposits increased by $35.4 million over the same period in 2008, while our notes payable and other borrowings increased $8.4 million during the three months ended March 31, 2009 over the same period in 2008. The note payable and other borrowings provide us with the opportunity to obtain low cost funding with various maturities similar to the maturities on our loans and investments.

Provision for Loan Losses

We have established an allowance for loan losses through a provision for loan losses charged as an expense on our statement of income. We review our loan portfolio periodically to evaluate our outstanding loans and to measure both the performance of the portfolio and the adequacy of the allowance for loan losses. Please see the discussion below under Balance Sheet Review - Provision and Allowance for Loan Losses for a description of the factors we consider in determining the amount of the provision we expense each period to maintain this allowance.

For the three months ended March 31, 2009 and 2008, we incurred a noncash expense related to the provision for loan losses of $750,000 and $600,000, respectively, bringing the allowance for loan losses to $7.4 million and $6.2 million, respectively, or 1.31% and 1.16% of gross loans for the respective periods. During the three months ended March 31, 2009 and 2008, we reported net charge-offs of $326,000 and $127,000, respectively, which represented an annualized 0.23% and 0.10% of the average outstanding loan portfolio for the respective periods.

At March 31, 2009, the allowance for loan losses represented less than one time the amount of non-performing loans, compared to 2.1 times at March 31, 2008. The coverage level of the allowance at March 31, 2009 decreased from the coverage level at March 31, 2008 due to an increase in non-performing loans. A significant portion, or 82.9%, of nonperforming loans at March 31, 2009 are secured by real estate. We have evaluated the underlying collateral on these loans and believe that the collateral on these loans is sufficient to minimize future losses. As a result of this level of coverage on non-performing loans, we believe that the provision of $750,000 for the three months ended March 31, 2009 to be adequate.

Noninterest Income

The following table sets forth information related to our noninterest income.

		Three months ended March 31, 2009		2008
Loan fee income	$	38	$	45
Service fees on deposit accounts		175		149
Income from bank owned life insurance		123		96
Real estate owned activity		(7)		(58)
Other income		85		79
Total noninterest income	$	414	$	311

Noninterest income for the three month period ended March 31, 2009 was $414,000, an increase of 33.1% over noninterest income of $311,000 for the same period of 2008. The $103,000 increase in 2009 was primarily related to a $26,000 increase in service fees on deposit accounts, $27,000 in income from bank owned life insurance and a $51,000 decrease in the loss on real estate owned.

Loan fee income was $38,000 and $45,000 for the three months ended March 31, 2009 and 2008, respectively, consisting primarily of late charge fees, fees from issuance of lines and letters of credit, and mortgage origination fees we receive on residential loans funded and closed by a third party. The $7,000 decrease for the three months ended March 31, 2009 compared to the same period in 2008 related primarily to a $5,000 decrease in late charge fees and a $3,000 decrease in mortgage origination fees, partially offset by a $1,000 increase in fees related to lines and letters of credit. Late charge fees were $24,000 and $29,000 for the three months ended March 31, 2009 and 2008, respectively, while mortgage origination fees were $3,000 and $6,000 for the first quarter of 2009 and 2008, respectively. Income related to lines and letters of credit was $11,000 and $10,000 for the three months ended March 31, 2009 and 2008, respectively.

Service fees on deposit accounts consist primarily of service charges on our checking, money market, and savings accounts and the fee income received from client non-sufficient funds (NSF) transactions. Deposit fees were $175,000 and $149,000 for the three months ended March 31, 2009, and 2008, respectively. The $26,000 increase is primarily related to a $21,000 increase in deposit related fees such as service charges and a $14,000 increase in overdraft and stop payment fees, partially offset by a $9,000 decrease in NSF fees. Service charge fees were $57,000 and $36,000 for the periods ended March 31, 2009 and 2008, respectively, and other fees such as overdraft and returned item fees were $15,000 and $1,000 for the same periods in 2009 and 2008, respectively. NSF income was $103,000 and $112,000 for the three months ended March 31, 2009 and 2008, respectively, representing 59.0% of total service fees on deposits in the 2009 period compared to 75.4% of total service fees on deposits in the 2008 period.

We purchased an additional $4.0 million of bank owned life insurance during the second half of 2008. Income derived from life insurance was $123,000 and $96,000 for the three months ended March 31, 2009 and 2008.

Real estate owned activity includes income and expenses from property held for sale and other real estate we own, including real estate acquired in settlement of loans. For the three months ended March 31, 2009 and 2008, our expenses related to owning the real estate exceeded income received on the properties by $7,000 and $58,000, respectively.

Other income consisted primarily of fees received on debit card transactions, sale of customer checks, and wire transfers. Other income was $85,000 and $79,000 for the three months ended March 31, 2009 and 2008, respectively. The $6,000 increase relates primarily to a $9,000 increase in debit card transaction fees, partially offset by a $3,000 decrease in other client service related fees. Debit card transaction fees were $59,000 and $50,000 for the three months ended March 31, 2009 and 2008, respectively and represented 68.9% and 63.4% of total other income for the first quarters of 2009 and 2008, respectively. The corresponding transaction costs associated with debit card transactions are included in noninterest data processing and related costs. The debit card transaction costs were $23,000 and $20,000 for the three months ended March 31, 2009 and 2008, respectively. The net impact of the fees received and the related cost of the debit card transactions on earnings for the three months ended March 31, 2009 and 2008 was $36,000 and $30,000, respectively.

Noninterest expenses

The following table sets forth information related to our noninterest expenses.

	Three months ended March 31, 2009	2008
Compensation and benefits	$ 1,925	$ 1,718
Professional fees	136	114
Marketing	145	135
Insurance	153	129
Occupancy	416	348
Data processing and related costs	374	321
Telephone	51	34
Other	229	187
Total noninterest expenses	$ 3,429	$ 2,986

We incurred noninterest expenses of $3.4 million for the three months ended March 31, 2009 compared to $3.0 million for the three months ended March 31, 2008, an increase of $443,000 or 14.9%.

Noninterest expense as a percentage of noninterest income and net interest income, or the efficiency ratio, was 70.2% for the three months ended March 31, 2009 compared to 62.7% for the same period in 2008, excluding real estate owned activity. Management believes that the appropriate measure of the effectiveness of noninterest expenses in comparison to the overall operations of the company excludes any non-recurring items, such as the income or loss from real estate owned activity. The primary reason for the higher efficiency ratio in the 2009 period is due to the additional retail offices and their related expenses. The initial operating costs for these two locations in their first year of operations exceed the benefits from obtaining additional low cost deposits. As these branch offices increase their retail deposits, we anticipate that our efficiency ratio will begin to improve; however, no assurance can be given that the levels of deposits will cover the additional expenses or that other costs will not increase.

For the three months ended March 31, 2009, compensation and benefits, occupancy, and data processing and related costs represented 79.2% of the total noninterest expense compared to 79.9% for the same period in 2008.

The following table sets forth information related to our compensation and benefits.

	Three months ended March 31,	
	2009	**2008**
Base compensation	$1,336	$1,159
Incentive compensation	209	247
Total compensation	1,545	1,406
Benefits	415	348
Capitalized loan origination costs	(35)	(36)
Total compensation and benefits	$1,925	$1,718

Compensation and benefits expense was $1.9 million and $1.7 million for the three months ended March 31, 2009 and 2008, respectively. Compensation and benefits represented 56.1% and 57.5% of our total noninterest expense for the three months March 31, 2009 and 2008, respectively. The $207,000 increase in compensation and benefits in the first quarter of 2009 compared to the same period in 2008 resulted from increases of $177,000 in base compensation and $67,000 in benefits expense, partially offset by a reduction of $38,000 in incentive compensation. In addition, loan origination compensation expense, which is required to be capitalized and amortized over the life of the loan as a reduction of loan interest income, decreased by $1,000.

The $177,000 increase in base compensation expense related to the cost of 12 additional employees as well as annual salary increases. Ten of the new employees were hired to staff our two new retail office locations, one employee was hired as a mortgage loan originator and another to support the accounting and human resource functions. Incentive compensation represented 10.9% and 14.4% of total compensation and benefits for the three months ended March 31, 2009 and 2008, respectively. The incentive compensation expense recorded for the first quarter of 2009 and 2008 represented an accrual of the estimated incentive compensation earned during the first quarter of the respective year. Benefits expense increased $67,000 in the first quarter of 2009 compared to the same period in 2008. Benefits expense represented 26.9% and 24.8% of the total compensation for the three months ended March 31, 2009 and 2008, respectively.

The following tables set forth information related to our data processing and related costs.

	Three months ended March 31,			
		2009		2008
Data processing costs	$	294	$	249
Debit card transaction expense		23		20
Courier expense		27		24
Other expenses		30		28
Total data processing and related costs	$	374	$	321

Data processing and related costs were $374,000 and $321,000 for the three months ended March 31, 2009 and 2008, respectively. During the three months ended March 31, 2009, our data processing costs for our core processing system were $294,000 compared to $249,000 for the three months ended March 31, 2008. We have contracted with an outside computer service company to provide our core data processing services.

Data processing costs increased $45,000, or 18.3%, for the three months ended March 31, 2009 compared to the same period in 2008. The increases in costs are primarily related to a higher number of loan and deposit accounts. A significant portion of the fee charged by the third party processor is directly related to the number of loan and deposit accounts and the related number of transactions. We receive income from debit card transactions performed by our clients. Since we outsource this service, we are charged related transaction expenses from our merchant service provider. Debit card transaction expense was $23,000 and $20,000 for the three months ended March 31, 2009 and 2008, respectively.

Occupancy expense represented 12.1% and 11.6% of total noninterest expense for the three months ended March 31, 2009 and 2008, respectively. Occupancy expense for the three months ended March 31, 2009 and 2008 was $416,000 and $348,000, respectively, an increase of $68,000. The increase is primarily due to the increased costs of depreciation and maintenance associated with the two retail offices opened in July 2008.

The remaining $115,000 increase in noninterest expense for the three month period ended March 31, 2009 compared to the same period in 2008 resulted primarily from increases of $22,000 in professional fees, $10,000 in marketing expenses, $24,000 in insurance, $17,000 in telephone expenses, and $42,000 in other expenses. The increase in professional fees relates primarily to increased legal and accounting fees, while the increase in insurance costs is related to the growth in deposits and the FDIC deposit insurance expense which is based on our deposit balances. The increases in marketing and telephone expenses are largely due to the two new retail offices added in July 2008. In addition, the $42,000 increase in other expenses is primarily due to an additional $79,000 in collection expenses and $12,000 in office supplies during the first quarter of 2009, partially offset by a $21,000 decrease in travel and business meals expenses and a $28,000 decrease in deposit account losses

Income tax expense was $209,000 for the three months ended March 31, 2009 compared to $372,000 during the same period in 2008. Our effective tax rate was 29.9% and 33.3%, respectively, for the first quarters of 2009 and 2008, respectively. The lower net income during the first quarter of 2009 increased the impact that our tax-exempt income had in lowering our effective tax rate from the same period in the prior year.

Balance Sheet Review

General

At March 31, 2009, we had total assets of $705.0 million, consisting principally of $566.4 million in loans, $96.5 million in investments, $3.7 million in federal funds sold, $8.9 million in cash and due from banks and $13.5 million in bank owned life insurance. Our liabilities at March 31, 2009 totaled $647.0 million, which consisted principally of $474.8 million in deposits, $154.7 million in notes payable and other borrowings, and $13.4 million in junior subordinated debentures. At March 31, 2009, our shareholders equity was $58.0 million.

At December 31, 2008, we had total assets of $693.0 million, consisting principally of $566.6 million in loans, $85.4 million in investments, $8.8 million in federal funds sold, $4.4 million in cash and due from banks and $13.4 million in bank owned life insurance. Our liabilities at December 31, 2008 totaled $653.2 million, consisting principally of $469.5 million in deposits, $164.7 million in notes payable and other borrowings, and $13.4 million of junior subordinated debentures. At December 31, 2008, our shareholders equity was $39.8 million.

Federal Funds Sold

At March 31, 2009, our federal funds sold were $3.7 million, or 0.5% of total assets. At December 31, 2008, our $8.8 million in short-term investments in federal funds sold on an overnight basis comprised 1.3% of total assets. As short-term market rates have decreased in the past 18 months, we have lowered the balances in our overnight federal funds sold accounts.

Investments

At March 31, 2009, the $96.5 million in our investment securities portfolio represented approximately 13.7% of our total assets. We held Government sponsored enterprise securities, municipal securities, and mortgage-backed securities with a fair value of $87.5 million and an amortized cost of $88.3 million for an unrealized loss of $769,000.

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Contractual maturities and yields on our investments that are available for sale and are held to maturity at March 31, 2009 are shown in the following table. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. We had no securities with maturities less than one year at March 31, 2009.

	One to Five Years		Five to Ten Years		Over Ten Years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Available for Sale								
Government sponsored enterprises	$ -	- %	$ 11,164	5.20 %	$ 7,604	5.06 %	$ 18,768	5.14 %
State and political subdivisions	-	- %	2,941	3.79 %	829	3.82 %	3,770	3.80 %
Mortgage-backed securities	375	4.74 %	4,614	4.50 %	48,181	5.21 %	53,170	5.15 %
Preferred stock	-	- %	-	- %	58	- %	58	- %
Total	$ 375	4.74 %	$ 18,719	4.80 %	$ 56,672	5.17 %	$ 75,766	5.23 %
Held to Maturity								
Mortgage-backed securities	$ 217	3.94 %	2,217	4.39 %	$ 9,050	4.52 %	$ 11,484	4.49 %

Other investments at March 31, 2009, consisted of Federal Reserve Bank stock with a cost of $1.3 million, investment in Greenville First Statutory Trust I and II of $186,000 and $217,000, respectively, and Federal Home Loan Bank stock with a cost of $7.4 million. At March 31, 2009, our investments included securities issued by Federal Home Loan Mortgage Corporation and Federal National Mortgage Association with carrying values of $23.2 million, and $31.9 million, respectively.

The amortized costs and the fair value of our investments at March 31, 2009 and December 31, 2008 are shown in the following table.

	March 31, 2009		December 31, 2008	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value

Available for Sale				
Government sponsored enterprises	$ 18,483	$ 18,768	$ 18,482	$ 18,708
State and political subdivisions	3,790	3,770	3,790	3,772
Mortgage-backed securities	54,418	53,170	43,700	41,886
Preferred stock	84	58	84	66
Total	$ 76,775	$ 75,766	$ 66,056	$ 64,432
Held to Maturity				
Mortgage-backed securities	$ 11,484	$ 11,723	$ 12,519	$ 12,618

At March 31, 2009, the Company had unrealized losses on 4 of its individual investments in government sponsored enterprises, state and political subdivisions, and FNMA preferred stock. The Company believes, based on industry analyst reports and credit ratings that the deterioration in the value of these investments is attributed to market turmoil and liquidity and not the credit quality of the issuer. The Company has the ability and intent to hold these securities until such time as the value recovers or the securities mature. In addition, the Company held 2 collateralized mortgage obligations (CMOs) that were in an unrealized loss position at March 31, 2009. The Company utilized the guidance provided by the FASB staff position number FAS 157-3, in determining that these CMOs had not incurred a market value loss that was other than temporary. The purpose of FAS 157-3 is to Determine the Fair Value of a Financial Asset When the Market for That Asset Is Not Active. FAS 157-3 allows us to use our own assumptions about the expected future cash flows to apply a risk-adjusted discount rate to the cash flows. Our assumptions as to the expected cash flows were based on the historical cash flows experience for each security, and then modified for the impact of the change in current market rates.

At December 31, 2008, the $85.4 million in our investment securities portfolio represented approximately 12.3% of our total assets. We held Government sponsored enterprise securities, municipal securities, and mortgage-backed securities with a fair value of $77.1 million and an amortized cost of $78.6 million for an unrealized loss of $1.5 million.

Contractual maturities and yields on our investments at December 31, 2008 are shown in the following table. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. At December 31, 2008, we had no securities with a maturity of less than one year.

	One to Five Years		Five to Ten Years		Over Ten Years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Available for Sale								
Government sponsored enterprises	$ -	- %	$ 11,238	5.19 %	$ 7,470	5.06%	$ 18,708	5.14 %
State and political subdivisions	-	- %	645	3.81%	3,127	3.79 %	3,772	3.80 %
Mortgage-backed securities	414	4.69 %	4,838	4.51 %	36,634	5.74 %	41,886	5.59 %
Preferred Stock	-	- %	-	- %	66	- %	66	- %
Total	$ 414	4.69 %	$ 16,721	4.94 %	$ 47,297	5.48 %	$ 64,432	5.50 %

Held to Maturity								
Mortgage-backed securities	$ 238	3.95%	$ 2,333	4.45 %	$ 9,948	4.70 %	$ 12,519	4.64 %

Other investments at December 31, 2008 consisted of Federal Reserve Bank stock with a cost of $1.3 million, investments in Greenville First Statutory Trust I and II of $186,000 and $217,000, respectively, and Federal Home Loan Bank stock with a cost of $6.7 million. At December 31, 2007, we owned Federal Reserve Bank stock with a cost of $1.0 million, Federal Home Loan Bank stock with a cost of $7.2 million, and investments in Greenville First Statutory Trust I and II of $186,000 and $217,000, respectively.

Loans

Since loans typically provide higher interest yields than other types of interest earning assets, a substantial percentage of our earning assets are invested in our loan portfolio. For the three months ended March 31, 2009 and 2008, average loans were $566.5 million and $525.3 million, respectively. Before the allowance for loan losses, total loans outstanding at March 31, 2009 were $566.4 million. Average loans for the year ended December 31, 2008 were $547.7 million. Before the allowance for loan losses, total loans outstanding at December 31, 2008 were $566.6 million.

The principal component of our loan portfolio is loans secured by real estate mortgages. Most of our real estate loans are secured by residential or commercial property. We do not generally originate traditional long-term residential mortgages, but we do issue traditional second mortgage residential real estate loans and home equity lines of credit. We obtain a security interest in real estate whenever possible, in addition to any other available collateral. This collateral is taken to increase the likelihood of the ultimate repayment of the loan. Generally, we limit the loan-to-value ratio on loans we make to 80%. We attempt to maintain a relatively diversified loan portfolio to help reduce the risk inherent in concentration in certain types of collateral.

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The following table summarizes the composition of our loan portfolio at March 31, 2009 and December 31, 2008.

	March 31, 2009		**December 31, 2008**	
	Amount	**% of Total**	**Amount**	**% of Total**
Real estate:				
Commercial:				
Owner occupied	$ 124,756	22.0 %	$ 113,370	20.0 %
Non-owner occupied	156,613	27.7 %	151,274	26.7 %
Construction	32,942	5.8 %	52,981	9.4 %
Total commercial real estate	314,311	55.5 %	317,625	56.1 %
Consumer:				
Residential	60,293	10.7 %	60,336	10.7 %
Home equity	67,035	11.8 %	62,987	11.1 %
Construction	6,335	1.1 %	8,905	1.5 %
Total consumer real estate	133,663	23.6 %	132,228	23.3 %

Total real estate	447,974	79.1 %	449,853	79.4 %
Commercial business	109,619	19.4 %	106,479	18.8 %
Consumer-other	9,660	1.7 %	11,194	2.0 %
Deferred origination fees, net	(859)	(0.2)%	(919)	(0.2)%
Total gross loans, net of deferred fees	566,394	100.0 %	566,607	100.0 %
Less allowance for loan losses	(7,429)		(7,005)	
Total loans, net	$ 558,965		$ 559,602	

Maturities and Sensitivity of Loans to Changes in Interest Rates

The information in the following tables is based on the contractual maturities of individual loans, including loans which may be subject to renewal at their contractual maturity. Renewal of such loans is subject to review and credit approval, as well as modification of terms upon maturity. Actual repayments of loans may differ from the maturities reflected below because borrowers have the right to prepay obligations with or without prepayment penalties.

The following table summarizes the loan maturity distribution by type and related interest rate characteristics at March 31, 2009.

	One year or less	After one but within five years	After five years	Total
Real estate mortgage	$ 73,179	$ 260,813	$ 74,705	$ 408,697
Real estate construction	21,056	12,920	5,301	39,277
Total real estate	94,235	273,733	80,006	447,974
Commercial business	56,949	47,683	4,987	109,619
Consumer-other	4,498	4,593	569	9,660
Deferred origination fees, net	(253)	(473)	(133)	(859)
Total gross loans, net of deferred fees	$ 155,429	$ 325,536	$ 85,429	$ 566,394
Loans maturing after one year with:				
Fixed interest rates				$ 219,866
Floating interest rates				$ 191,099

The following table summarizes the loan maturity distribution by type and related interest rate characteristics at December 31, 2008.

		One year or less		After one but within five years		After five years		Total
Real estate- mortgage	$	68,356		253,325		66,286		387,967
Real estate- construction		30,555		13,390		17,941		61,886
Total real estate		98,911		266,715		84,227		449,853
Commercial business		56,291		46,275		3,913		106,479
Consumer- other		4,260		6,318		616		11,194
Deferred origination fees, net		(290)		(455)		(174)		(919)
Total gross loan, net of								
deferred fees	$	159,172		318,853		88,582		566,607
Loans maturing after one year with								
Fixed interest rates							$	232,645
Floating interest rates							$	174,790

Provision and Allowance for Loan Losses

We have established an allowance for loan losses through a provision for loan losses charged to expense on our statement of income. The allowance for loan losses represents an amount which we believe will be adequate to absorb probable losses on existing loans that may become uncollectible. Our judgment as to the adequacy of the allowance for loan losses is based on a number of assumptions about future events, which we believe to be reasonable, but which may or may not prove to be accurate. Our determination of the allowance for loan losses is based on evaluations of the collectibility of loans, including consideration of factors such as the balance of impaired loans, the quality, mix, and size of our overall loan portfolio, economic conditions that may affect the borrower s ability to repay, the amount and quality of collateral securing the loans, our historical loan loss experience, and a review of specific problem loans. We also consider subjective issues such as changes in the lending policies and procedures, changes in the local/national economy, changes in volume or type of credits, changes in volume/severity of problem loans, quality of loan review and board of director oversight, concentrations of credit, and peer group comparisons. Due to our limited operating history, the provision for loan losses has been made primarily as a result of our assessment of general loan loss risk compared to banks of similar size and maturity. Due to the rapid growth of our Bank over the past several years and our short operating history, a large portion of the loans in our loan portfolio and of our lending relationships are of relatively recent origin. In general, loans do not begin to show signs of credit deterioration or default until they have been outstanding for some period of time, a process known as seasoning. As a result, a portfolio of older loans will usually behave more predictably than a newer portfolio. Because our loan portfolio is relatively new, the current level of delinquencies and defaults may not be representative of the level that will prevail when the portfolio becomes more seasoned, which may be higher than current levels. If delinquencies and defaults increase, we may be required to increase our provision for loan losses, which would adversely affect our results of operations and financial condition. Periodically, we adjust the amount of the allowance based on changing circumstances. We charge recognized losses to the allowance and add subsequent recoveries back to the allowance for loan losses. There can be no assurance that charge-offs of loans in future periods will not exceed the allowance for loan losses as estimated at any point in time or that provisions for loan losses will not be significant to a particular accounting period.

The following table summarizes the activity related to our allowance for loan losses for the three months ended March 31, 2009 and 2008:

	March 31, 2009	2008
Balance, beginning of period	$ 7,005	$ 5,751
Loans charged-off	(327)	(127)
Recoveries of loans previously charged-off	1	-
Net loans (charged-off) recovery	$ (326)	$ (127)
Provision for loan losses	750	600
Balance, end of period	$ 7,429	$ 6,224
Allowance for loan losses to gross loans	1.31 %	1.16 %
Net charge-offs to average loans (annualized)	0.23 %	0.10 %

We do not allocate the allowance for loan losses to specific categories of loans. Instead, we evaluate the adequacy of the allowance for loan losses on an overall portfolio basis utilizing our credit grading system which we apply to each loan. We have retained an independent consultant to review the loan files on a test basis to assess the grading of our loans.

The allowance for loan losses was $7.4 million and $7.0 million at March 31, 2009 and December 31, 2008, respectively or 1.31% and 1.24% of outstanding loans, respectively. During the year ended December 31, 2008, we had net charged-off loans of $1.9 million. During the three months ended March 31, 2009 and 2008 we had net charge-offs of $326,000 and $127,000, respectively.

Nonperforming Assets

The following table shows the nonperforming assets, percentages of net charge-offs, and the related percentage of allowance for loan losses for the three months ended March 31, 2009 and the year ended December 31, 2008. Generally, a loan is placed on nonaccrual status when it becomes 90 days past due as to principal or interest, or when we believe, after considering economic and business conditions and collection efforts, that the borrower s financial condition is such that collection of the loan is doubtful. A payment of interest on a loan that is classified as nonaccrual is recognized as a reduction in principal when received.

	March 31, 2009	December 31, 2008
Loans on nonaccrual:		
Mortgage	$ 8,103	6,818
Commercial	1,660	868
Consumer	10	13
Total nonaccrual loans	9,773	7,699
Total of nonperforming loans	9,773	7,699
Other nonperforming assets	3,826	2,116
Total nonperforming assets	$ 13,599	9,815
Loans over 90 days past due (1)	$ 6,560	7,008
Nonperforming assets as a percentage of:		
Total assets	1.93 %	1.42 %
Gross loans	2.40 %	

(1)Loans over 90 days are included in nonaccrual loans

At March 31, 2009 nonperforming assets were $13.6 million, or 1.93% of total assets and 2.40% of gross loans. Comparatively, nonperforming assets were $9.8 million, or 1.42% of total assets and 1.73% of gross loans at December 31, 2008. Nonaccrual loans increased $2.1 million to $9.8 million at March 31, 2009 from $7.7 million at December 31, 2008. This increase is primarily related to commercial real estate and business loans. The amount of foregone interest income on the nonaccrual loans in the first three months of 2009 was approximately $67,000. The amount of interest income recorded in the first three months of 2009 for loans that were on nonaccrual at March 31, 2009 was approximately $21,000.

Other nonperforming assets include real estate acquired in settlement of loans. These assets increased $1.7 million to $3.8 million at March 31, 2009 from $2.1 million at December 31, 2008. The balance at March 31, 2009 includes 6 commercial properties totaling $3.7 million and 2 pieces of residential real estate for $151,000. We believe that these properties are appropriately valued at the lower of cost or market as of March 31, 2009.

At March 31, 2009, impaired loans amounted to approximately $9.8 million for which a $1.1 million reserve was allocated in the allowance.

Deposits and Other Interest-Bearing Liabilities

Our primary source of funds for loans and investments is our deposits, advances from the FHLB, and short-term repurchase agreements. National and local market trends over the past several years suggest that consumers have moved an increasing percentage of discretionary savings funds into investments such as annuities, stocks, and fixed income mutual funds. Accordingly, it has become more difficult to attract deposits. We have chosen to obtain a portion of our certificates of deposits from areas outside of our market. The deposits obtained outside of our market area generally have comparable rates compared to rates being offered for certificates of deposits in our local market. We also utilize out-of-market deposits in certain instances to obtain longer-term deposits than are readily available in our local market. The amount of out-of-market deposits was $213.1 million at March 31, 2009 and $200.9 million at December 31, 2008.

We generally obtain out-of-market time deposits of $100,000 or more through brokers with whom we maintain ongoing relationships. We have adopted guidelines regarding our use of brokered CDs that limit our brokered CDs to 50% of total deposits and dictate that our current interest rate risk profile determines the terms. In addition, we do not obtain time deposits of $100,000 or more through the Internet. These guidelines allow us to take advantage of the attractive terms that wholesale funding can offer while mitigating the inherent related risk.

We anticipate being able to either renew or replace these out-of-market deposits when they mature, although we may not be able to replace them with deposits with the same terms or rates. Our loan-to-deposit ratio was 119% and 121% at March 31, 2009 and December 31, 2008, respectively.

The following table shows the average balance amounts and the average rates paid on deposits held by us for the three months ended March 31, 2009 and 2008.

		2009 Amount	**Rate**		**2008 Amount**	**Rate**
Noninterest bearing demand deposits	$	33,403	- %	$	29,958	- %
Interest bearing demand deposits		41,975	0.69 %		35,960	1.35 %
Money market accounts		86,606	1.20 %		88,609	2.55 %
Saving accounts		1,991	0.18 %		1,771	0.48 %
Time deposits less than $100,000		45,396	3.33 %		42,579	4.80 %
Time deposits greater than $100,000		266,869	3.00 %		238,564	4.90 %
Total deposits	$	476,240	2.28 %	$	437,441	3.77 %

The increase in time deposits of $100,000 or more for the three months ended March 31, 2009 compared to the 2008 period resulted from a $29.0 million increase in wholesale deposits.

Core deposits, which exclude out-of-market deposits and time deposits of $100,000 or more, provide a relatively stable funding source for our loan portfolio and other earning assets. Our core deposits were $201.5 million and $205.9 million at March 31, 2009 and December 31, 2008, respectively.

All of our time deposits are certificates of deposits. The maturity distribution of our time deposits of $100,000 or more at March 31, 2009 was as follows:

	March 31, 2009
Three months or less	$ 67,755
Over three through six months	97,869
Over six through twelve months	43,415
Over twelve months	62,368
Total	$ 271,407

Capital Resources

Total shareholders equity at March 31, 2009 was $58.0 million. At December 31, 2008, total shareholders equity was $39.8 million. The $18.2 million increase during the first three months of 2009 resulted primarily from the $17.3 million issuance of preferred stock as well as $487,000 from net income earned and $405,000 from an unrealized gain on securities available for sale.

On February 27, 2009, as part of the CPP, the Company entered into the CPP Purchase Agreement with the Treasury Department, pursuant to which we sold 17,299 shares of our Series T Preferred Stock and the CPP Warrant to purchase 330,554 shares of our common stock for an aggregate purchase price of $17.3 million in cash. The Series T Preferred Stock will be entitled to cumulative dividends at a rate of 5% per annum for the first five years, and 9% per annum thereafter. The CPP Warrant has a 10-year term and is immediately exercisable upon its issuance, with an exercise price, subject to anti-dilution adjustments equal to $7.85 per share of the common stock.

The following table shows the return on average assets (net income divided by average total assets), return on average equity (net income divided by average equity), and equity to assets ratio (average equity divided by average total assets) annualized for the three months ended March 31, 2009 and the year ended December 31, 2008. Since our inception, we have not paid cash dividends.

	March 31, 2009	December 31, 2008
Return on average assets	0.46 %	0.27 %
Return on average equity	4.29 %	4.70 %
Return on average common equity	4.13 %	4.70 %

Equity to total assets ratio	6.02 %	5.73 %
Common equity to total assets ratio	5.70 %	5.73 %

Our return on average assets was 0.46% for the three months ended March 31, 2009, an increase from 0.27% for the year ended December 31, 2008. In addition, our return on average equity decreased to 4.29% from 4.70% for the first quarter ended March 31, 2009 and the year ended December 31, 2008, respectively. The increase in the equity to total assets ratio from December 31, 2008 is primarily related to the $17.3 million received in conjunction with the issuance of preferred stock. In addition, our return on average common equity was 4.13% and our common equity to total assets ratio was 5.70% for the three months ended March 31, 2009.

Under the capital adequacy guidelines, regulatory capital is classified into two tiers. These guidelines require an institution to maintain a certain level of Tier 1 and Tier 2 capital to risk-weighted assets. Tier 1 capital consists of common shareholders equity, excluding the unrealized gain or loss on securities available for sale, minus certain intangible assets. In determining the amount of risk-weighted assets, all assets, including certain off-balance sheet assets, are multiplied by a risk-weight factor of 0% to 100% based on the risks believed to be inherent in the type of asset. Tier 2 capital consists of Tier 1 capital plus the general reserve for loan losses, subject to certain limitations. We are also required to maintain capital at a minimum level based on total average assets, which is known as the Tier 1 leverage ratio.

At both the holding company and bank level, we are subject to various regulatory capital requirements administered by the federal banking agencies. To be considered adequately capitalized under these capital guidelines, we must maintain a minimum total risk-based capital of 8%, with at least 4% being Tier 1 capital. In addition, we must maintain a minimum Tier 1 leverage ratio of at least 4%. To be considered well-capitalized, we must maintain total risk-based capital of at least 10%, Tier 1 capital of at least 6%, and a leverage ratio of at least 5%.

In October, 2008, President Bush signed in law the EESA in response to the financial crises affecting the banking system. The Treasury Department and banking regulators are implementing a number of programs under this legislation to address capital and liquidity issues in the banking system. Under the Treasury Department s CPP, we received $17.3 million through issuance of Series T Preferred Stock and the CPP Warrant for common stock to the Treasury Department. The Series T Preferred Stock issuance and the related CPP Warrant both qualify for Tier 1 capital and added approximately 300 basis points to that measure. The fair value allocation of the $17.3 million between the shares of Series T Preferred Stock and the CPP Warrant resulted in $15.9 million allocated to the shares of Series T Preferred Stock and $1.4 million allocated to the CPP Warrant. See discussion of shareholders equity above for additional details.

The following table sets forth the Company s and the Bank s various capital ratios at March 31, 2009 and at December 31, 2008. For all periods, the Bank was considered well capitalized and the Company met or exceeded its applicable regulatory capital requirements.

	March 31, 2009		**December 31, 2008**	
	Holding Company	**Bank**	**Holding Company**	**Bank**
Total risk-based capital	13.4 %	12.9 %	10.4 %	12.8 %
Tier 1 risk-based capital	12.2 %	11.7 %	9.2 %	11.6 %
Leverage capital	10.1 %	9.7 %	7.7 %	9.8 %

Effect of Inflation and Changing Prices

The effect of relative purchasing power over time due to inflation has not been taken into account in our consolidated financial statements. Rather, our financial statements have been prepared on an historical cost basis in accordance with generally accepted accounting principles.

Unlike most industrial companies, our assets and liabilities are primarily monetary in nature. Therefore, the effect of changes in interest rates will have a more significant impact on our performance than will the effect of changing prices and inflation in general. In addition, interest rates may generally increase as the rate of inflation increases, although not necessarily in the same magnitude. As discussed previously, we seek to manage the relationships between interest sensitive assets and liabilities in order to protect against wide rate fluctuations, including those resulting from inflation.

Off-Balance Sheet Risk

Commitments to extend credit are agreements to lend to a client as long as the client has not violated any material condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require the payment of a fee. At March 31, 2009, unfunded commitments to extend credit were $84.4 million, of which $11.0 million was at fixed rates and $73.4 million was at variable rates. At December 31, 2008, unfunded commitments to extend credit were $89.0 million, of which approximately $13.8 million was at fixed rates and $75.1 million was at variable rates. A significant portion of the unfunded commitments related to consumer equity lines of credit. Based on historical experience, we anticipate that a significant portion of these lines of credit will not be funded. We evaluate each client s credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by us upon extension of credit, is based on our credit evaluation of the borrower. The type of collateral varies but may include accounts receivable, inventory, property, plant and equipment, and commercial and residential real estate.

At March 31, 2009, there was a $5.4 million commitment under letters of credit. The credit risk and collateral involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Since most of the letters of credit are expected to expire without being drawn upon, they do not necessarily represent future cash requirements.

Except as disclosed in this document, we are not involved in off-balance sheet contractual relationships, unconsolidated related entities that have off-balance sheet arrangements or transactions that could result in liquidity needs or other commitments that significantly impact earnings.

Market Risk and Interest Rate Sensitivity

Market risk is the risk of loss from adverse changes in market prices and rates, which principally arises from interest rate risk inherent in our lending, investing, deposit gathering, and borrowing activities. Other types of market risks, such as foreign currency exchange rate risk and commodity price risk, do not generally arise in the normal course of our business.

We actively monitor and manage our interest rate risk exposure in order to control the mix and and maturities of our assets and liabilities utilizing a process we call asset/liability management. The essential purposes of asset/liability management are to ensure adequate liquidity and to maintain an appropriate balance between interest sensitive assets and liabilities in order to minimize potentially adverse impacts on earnings from changes in market interest rates. Our asset/liability management committee (ALCO) monitors and considers methods of managing exposure to interest rate risk. We have both an internal ALCO consisting of senior management that meets at various times during each month and a board ALCO that meets monthly. The ALCOs are responsible for maintaining the level of interest rate sensitivity of our interest sensitive assets and liabilities within board-approved limits.

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Our interest rate risk exposure is managed principally by measuring our interest sensitivity gap, which is the positive or negative dollar difference between assets and liabilities that are subject to interest rate repricing within a given period of time. Interest rate sensitivity can be managed by repricing assets or liabilities, selling securities available for sale, replacing an asset or liability at maturity, or adjusting the interest rate during the life of an asset or liability. Managing the amount of assets and liabilities repricing in this same time interval helps to hedge the risk and minimize the impact on net interest income of rising or falling interest rates. We generally would benefit from increasing market rates of interest when we have an asset-sensitive gap position and generally would benefit from decreasing market rates of interest when we are liability-sensitive.

The following table sets forth information regarding our rate sensitivity as of March 31, 2009 for each of the time intervals indicated.

	Within three months	**After three but within twelve months**	**After one but within five years**	**After five years**	**Total**
Interest-earning assets:					
Federal funds sold	$ 3,668	$ -	$ -	$ -	$ 3,668
Investment securities	5,104	31,036	33,531	17,579	87,250
Loans	276,667	38,479	184,205	55,828	555,178
Total earning assets	$ 285,439	$ 69,515	$ 217,736	$ 73,406	$ 646,096
Interest-bearing liabilities:					
Money market and NOW	$ 125,738	$ -	$ -	$ -	$ 125,738
Regular savings	2,045	-	-	-	2,045
Time deposits	79,660	170,834	64,150	-	314,644
Note payable and other borrowings	92,100	6,975	45,600	10,000	154,675
Junior subordinated debentures	13,403	-	-	-	13,403
Total interest-bearing liabilities	$ 312,946	$ 177,809	$ 109,750	$ 10,000	$ 610,505
Period gap	$ (27,507)	$ (108,294)	$ 107,986	$ 63,406	