SOUTHERN FIRST BANCSHARES INC
Form 10-Q
May 12, 2008

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, 2008

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 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:
2,992,031 shares of common stock, $.01 par value per share, were issued and outstanding as of May 1, 2008.

SOUTHERN FIRST BANCSHARES, INC.
PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

The financial statements of Southern First Bancshares, Inc. and its Subsidiary are set forth in the following pages.

SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

	March 31, 2008 (Unaudited)	December 31, 2007 (Audited)
Assets		
Cash and due from banks	$ 8,201,247	$ 7,714,494
Federal funds sold	21,759,317	9,256,679
Investment securities available for sale	78,022,838	64,010,163
Investment securities held to maturity- (fair value $14,340,462 and $14,572,918)	14,319,364	14,819,092
Other investments, at cost	8,219,150	8,677,682
Loans, net	530,598,149	503,098,382
Property and equipment, net	6,231,315	5,390,724
Accrued interest receivable	3,228,510	3,324,361
Other real estate owned	2,074,981	267,733
Bank owned life insurance	9,003,402	8,907,402
Deferred income taxes	1,540,290	2,002,604
Other assets	817,976	659,545
Total assets	$ 684,016,539	$ 628,128,861
Liabilities		
Deposits	$ 469,060,476	$ 412,820,468
Official checks outstanding	1,155,062	818,885
Federal Home Loan Bank advances and related debt	157,695,000	158,520,000
Junior subordinated debentures	13,403,000	13,403,000
Accrued interest payable	2,483,584	2,739,270
Accounts payable and accrued expenses	802,113	1,549,465
Total liabilities	644,599,235	589,851,088
Shareholders' equity		
Preferred stock, par value $.01 per share, 10,000,000 shares authorized, no shares issued	-	-
Common stock, par value $.01 per share 10,000,000 shares authorized, 2,974,706 and 2,946,456 issued and outstanding at March 31, 2008 and December 31, 2007, respectively	29,747	29,465
Nonvested restricted stock	(37,176)	(40,556)
Additional paid-in capital	31,218,509	31,033,558

Accumulated other comprehensive gain		300,118		95,830
Retained earnings		7,906,106		7,159,476
Total shareholders' equity		39,417,304		38,277,773
Total liabilities and shareholders' equity	$	684,016,539	$	628,128,861

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

	For the three months ended March 31, 2008	2007
	(Unaudited)	
Interest income		
Loans	$ 9,009,173	$ 7,765,104
Investment securities	1,248,817	1,034,147
Federal funds sold	83,884	161,834
Total interest income	10,341,874	8,961,085
Interest expense		
Deposits	4,097,445	3,640,488
Borrowings	1,850,951	1,536,891
Total interest expense	5,948,396	5,177,379
Net interest income	4,393,478	3,783,706
Provision for loan losses	600,000	460,000
Net interest income after provision for loan losses	3,793,478	3,323,706
Noninterest income		
Loan fee income	45,143	37,379
Service fees on deposit accounts	148,642	75,478
Income from bank owned life insurance	96,000	96,000
Real estate owned activity	(57,779)	328,593
Other income	79,029	55,950
Total noninterest income	311,035	593,400
Noninterest expenses		
Compensation and benefits	1,718,191	1,422,532
Professional fees	114,541	124,520
Marketing	134,981	105,598
Insurance	128,762	51,336
Occupancy	347,806	395,947
Data processing and related costs	321,127	258,346
Telephone	33,715	34,767
Other	186,660	114,487
Total noninterest expenses	2,985,783	2,507,533
Income before income taxes expense	1,118,730	1,409,573
Income tax expense	372,100	451,517
Net income	$ 746,630	$ 958,056
Earnings per common share		
Basic	$ .25	$ .33
Diluted	$ .23	$ .30
Weighted average common shares outstanding		
Basic	2,964,951	2,933,868
Diluted	3,185,827	3,245,226

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, 2008 AND 2007
(Unaudited)

	Common stock Shares	Common stock Amount	Nonvested restricted stock	Additional paid-in capital	Accumulated other comprehensive income(loss)	Retained Earnings	Total share-holders' equity
December 31, 2006	2,933,868	$ 29,339	$ -	$ 30,846,538	$ (16,465)	$ 3,724,034	$ 34,583,446
Net income	-	-	-	-	-	958,056	958,056
Comprehensive income, net of tax -							
Unrealized holding gain on securities available for sale	-	-	-	-	87,760	-	87,760
Comprehensive income	-	-	-	-	-	-	1,045,816
Compensation expense related to stock options, net of tax	-	-	-	4,506	-	-	4,506
March 31, 2007	2,933,868	$ 29,339	$ -	$ 30,851,044	$ 71,295	$ 4,682,090	$ 35,633,768
December 31, 2007	2,946,456	$ 29,465	$ (40,556)	$ 31,033,558	$ 95,830	$ 7,159,476	$ 38,277,773
Net income	-	-	-	-	-	746,630	746,630
Comprehensive income, net of tax -							
Unrealized holding gain on securities available for sale	-	-	-	-	204,288	-	204,288
Comprehensive income	-	-	-	-	-	-	950,918
Proceeds from exercise of stock options and warrants	28,250	282	-	170,913	-	-	171,195
Amortization of deferred compensation on restricted stock	-	-	3,380	-	-	-	3,380
Compensation expense related to stock options	-	-	-	14,038	-	-	14,038
March 31, 2008	**2,974,706**	**$ 29,747**	**$ (37,176)**	**$ 31,218,509**	**$ 300,118**	**$ 7,906,106**	**$ 39,417,304**

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

	For the three months ended March 31, 2008	2007
	(Unaudited)	
Operating activities		
Net income	$ 746,630	$ 958,056
Adjustments to reconcile net income to cash provided by (used for) operating activities:		
Provision for loan losses	600,000	460,000
Depreciation and other amortization	115,132	117,583
Accretion and amortization of securities discounts and premium, net	30,961	18,171
Loss on sale of real estate	38,146	51,791
Increase in market value of property held for sale	-	(375,000)
Compensation expense related to stock options and grants	17,418	4,506
Increase in cash surrender value of bank owned life insurance	(96,000)	(96,000)
Decrease in deferred tax asset	462,314	839,288
(Increase) decrease in other assets, net	(62,580)	37,573
Decrease in other liabilities, net	(772,101)	(1,254,339)
Net cash provided by operating activities	1,079,920	761,629
Investing activities		
Increase (decrease) in cash realized from:		
Origination of loans, net	(29,992,015)	(30,226,734)
Purchase of property and equipment	(955,723)	(837,619)
Purchase of investment securities:		
Available for sale	(15,657,029)	(10,090,812)
Other investments	(666,700)	(917,400)
Payments and maturity of investment securities:		
Available for sale	1,931,623	1,982,672
Held to maturity	491,026	377,638
Other investments	1,125,232	360,000
Proceeds from sale of real estate acquired in settlement of loans	46,854	228,527
Net cash used for investing activities	(43,676,732)	(39,123,728)
Financing activities		
Increase in deposits, net	56,240,008	38,426,035
Proceeds from the exercise of stock options	171,195	-
Increase (decrease) in Federal Home Loan Bank advances and related debt	(825,000)	10,000,000
Net cash provided by financing activities	55,586,203	48,426,035
Net increase in cash and cash equivalents	12,989,391	10,063,936
Cash and cash equivalents at beginning of the period	16,971,173	16,579,133
Cash and cash equivalents at end of the period	$ 29,960,564	$ 26,643,069
Supplemental information		
Cash paid for		
Interest	$ 6,204,082	$ 4,386,314
Income taxes	$ 1,781,011	$ 35,186
Schedule of non-cash transactions		
Transfer of property and equipment to property held for sale	$ -	$ 2,035,373

Foreclosure of real estate	$ 1,892,248	$ -
Unrealized gain on securities, net of income taxes	$ 204,288	$ 87,760

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

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, 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, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008. 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, 2007 (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 - Property Held for Sale

In February 2007, we decided to actively market the sale of our former main office and corporate headquarters building. We accordingly, reclassified the building from property and equipment to property held for sale, in accordance with Statement of Financial Accounting Standards ("SFAS") No. 144 "Accounting for the Impairment and Disposal of Long-Lived Assets," and ceased depreciation of the building. In March 2007 we received a sales contract on the building. Based on the sales contract, adjusted for estimated commissions and other selling costs, we recorded a $375,000 gain in the carrying value of the building at the end of the first quarter of 2007. The $375,000 gain was partially offset by other unrelated real estate operating expenses of $46,407. The net gain on real estate operations recorded in the three months ended March 31, 2007 was $328,593.

On April 13, 2007, we completed the sale of the former main office building. Based on the higher carrying value established at March 31, 2007, we incurred a loss of approximately $55,000 on the sale which was recorded in the second quarter of 2007.

Note 3 - Earnings per 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, 2008 and 2007. 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, 2008 and 2007, 43,250 and 13,000 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, 2008	Three months ended March 31, 2007
Basic Earnings Per Share		
Average common shares	2,964,951	2,933,868
Net income	$ 746,630	$ 958,056
Earnings per share	$ 0.25	$ 0.33
Diluted Earnings Per Share		
Average common shares	2,964,951	2,933,868
Average dilutive common shares	220,876	311,358
Adjusted average common shares	3,185,827	3,245,226
Net income	$ 746,630	$ 958,056
Earnings per share	$ 0.23	$ 0.30

Note 4 - 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. On December 20, 2005, the Board of Directors approved accelerating the vesting of 45,813 unvested stock options effective December 28, 2005. The decision to accelerate vesting of these options was made so as to reduce compensation expense upon the adoption of SFAS No. 123(R) by approximately $68,000 and $52,000 in the years ended December 31, 2006 and 2007, respectively, and $4,000 in each of the years ended December 31, 2008 and 2009.

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 10.00% for 2008 and 2007, risk-free interest rate of 4.60% for 2008 and 2007, expected lives of the options 10 years, and the assumed dividend rate was zero.

Note 5 - Fair Value Measurement

Effective January 1, 2008, the Company adopted SFAS No. 157, "Fair Value Measurements" ("SFAS 157") which provides a framework for measuring and disclosing fair value under generally accepted accounting principles. SFAS 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 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 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, 2008 are as follows:

	Quoted market price in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
		(Dollars in thousands)	
Investment securities available for sale	$ 1,811	$ 68,090	$ 8,122
Other investments	-	-	8,219
Total	$ 1,811	$ 68,090	$ 16,241

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 79.8% of loans. Loans which are deemed to be impaired 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, 2008 was $2.1 million.

FASB Staff Position No. FAS 157-2 delays the implementation of SFAS 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, 2008 to March 31, 2008, for all Level 3 assets that are measured at fair value on a recurring basis.

Investment

	securities available for sale	Other investments
	(Dollars in thousands)	
Beginning balance	$ 8,244	$ 8,678
Total realized and unrealized gains or losses:		
Included in earnings	-	-
Included in other comprehensive income	(122)	-
Purchases and sales	-	(459)
Transfers in and/or out of Level 3	-	-
Ending Balance	$ 8,122	$ 8,219

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, 2007 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.

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, 2007, 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 lowered the short-term rates initially by 50 basis points and by an additional 50 basis points in the fourth quarter of 2007. The Federal Reserve has continued to aggressively decrease rates by lowering the short-term rate 200 basis points in the first quarter of 2008 which has caused the rates on our short-term or variable rate assets and liabilities to decline in 2008. 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.

Results of Operations

Income Statement Review

Summary

Our net income was $746,630 and $958,056 for the three months ended March 31, 2008, and 2007, respectively, a decrease of $211,426, or 22.1%. The $211,426 decrease in net income resulted primarily from a $375,000 gain on property held for sale, or $255,000 net of taxes, which occurred in the first quarter of 2007.

Due to the gain on property held for sale in 2007, noninterest income decreased $282,365 in the first three months of 2008 compared to the same period in 2007. Excluding the gain on property held for sale in 2007, noninterest income increased $92,635 in the first three months of 2008 compared to the same period in 2007. In addition, net interest income increased $609,772 from the 2007 period, offset by an increase of $140,000 in the provision for loan losses and $478,250 of additional noninterest expense. Our efficiency ratio, excluding the gain on property held for sale in 2007, remained virtually unchanged at 63.5% for the three months ended March 31, 2008, compared to 62.7% for the same period in 2007.

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. The continuous growth in our loan portfolio is the primary driver of the increase in net interest income. During the three months ended March 31, 2008, our average loan portfolio increased $107.5 million compared to the average for the three months ended March 31, 2007. The loan growth in the first three months of 2008 was $28.0 million. We anticipate the growth in loans will continue to drive the growth in assets and the growth in net interest income. However, we anticipate lower levels of growth during the remainder of 2008. In an effort to maximize our utilization of capital, we anticipate managing the level of loan growth to ensure the bank remains well-capitalized. We expect to have lower levels of loan growth in the remainder of 2008 in comparison to the loan growth experienced in the first quarter.

Our decision to grow the loan portfolio created the need for a higher level of capital and the need to increase deposits and borrowings. This loan growth strategy also resulted in a significant portion of our assets being in higher earning loans rather than in lower yielding investments. At March 31, 2008, net loans represented 77.6% of total assets. However, as described below, we have also increased our level of deposits significantly. While we plan to continue our focus on increasing the loan portfolio, as rates on investment securities rose during the past twelve months and we obtained additional deposits, we increased the size of the investment portfolio. Our investment portfolio increased by $17.8 million from March 31, 2007 to March 31, 2008. At March 31, 2008, investments and federal funds sold represented 17.9% of total assets.

The historically low interest rate environment experienced between January of 2000 and July of 2004 allowed us to obtain short-term borrowings and wholesale certificates of deposit at rates that were lower than certificate of deposit rates being offered in our local market. Therefore, we decided not to begin our retail deposit office expansion program until the beginning of 2005. This funding strategy allowed us to continue to operate in one location until 2005, maintain a smaller staff, and not incur marketing costs to advertise deposit rates, which in turn allowed us to focus on the fast growing loan portfolio.

We opened two retail deposit offices in 2005. During the third quarter of 2007, we converted our Columbia loan production office into a full service branch facility. Our focus for these three locations has been to obtain low cost transaction accounts. Our goal is to increase 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 anticipate opening two additional retail deposit offices during the second and third quarters of 2008, one in the Columbia market and one in the Greenville market. These offices will assist us in meeting the previously stated objectives. 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, 2008, retail deposits represented $260.8 million, or 38.1% of total assets, borrowings represented $171.1 million, or 25.0% of total assets, and wholesale out-of-market deposits represented $208.2 million, or 30.4% of total assets.

Our net interest income margin for the three months ended March 31, 2008 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 $52.0 million, and $48.0 million for the three months ended March 31, 2008 and 2007, respectively.

In addition to the growth in both assets and liabilities, and the ratio of interest-earning assets to interest-bearing liabilities, net interest income is also affected by the timing of the repricing of our assets and liabilities and the changes in interest rates earned on our assets and interest rates paid on our liabilities. Until September 18, 2007, our yields on interest earning assets and the rates that we paid for our deposits and borrowings continued to increase primarily as a result of the actions taken by the Federal Reserve to raise short-term rates prior to July 30, 2006. Our fixed rate loans were being originated or renewed at higher rates, while the rates on new or maturing interest-bearing liabilities were also higher than in the past. Our net interest spread declined due to the fact that more of our rate-sensitive liabilities repriced than our rate-sensitive assets during the twelve month period ended March 31, 2008. Given the fact that the Federal Reserve increased short-term rates by 425 basis points between July 2004 and July 2006 and allowed rates to remain unchanged until September 18, 2007, we believed during most of 2006 and the first nine months of 2007 that short-term interest rates were at or near their peak. Therefore, we chose to increase the amount of fixed rate loans in our loan portfolio and we targeted to have a significant portion of our liabilities to reprice within a twelve month period. On September 18, 2007, the Federal Reserve began to decrease short-term rates with an initial 50 basis point reduction and continued the decrease with an additional 250 basis points through the end of 2007 and the first quarter of 2008. While the bank had more assets than liabilities that repriced down during the three months ended March 31, 2008, we anticipate that the amount of liabilities that will reprice over the next three months will "neutralize" the immediate downward negative impact, and then we believe will begin to have a positive impact on our net interest income for the next nine months. This assumption is based on no additional rate change for the remainder of 2008.

As more fully discussed in the - "Market Risk" and - "Liquidity and Interest Rate Sensitivity" sections below, at March 31, 2008, 62.3% of our loans had fixed rates. For the past two years, we have placed more emphasis on fixed rate loans. Our fixed rate loans as a percentage of total loans increased from 53.6% at March 31, 2007 to 62.3% at March 31, 2008. While our percentage of fixed rate loans has increased, our focus during the past three years has been to obtain short-term liabilities to fund our asset growth. This strategy has resulted in our ability to move from being asset sensitive to being liability sensitive for the next twelve months.

At March 31, 2008, 80.6% of our interest-bearing liabilities were either variable rate or had a maturity of less than one year. Therefore, we believe that we are positioned to benefit from future decreases in short-term rates. Conversely, future increases in short-term rates would likely have a negative effect on our earnings. At March 31, 2008, we had $167.7 million more liabilities than assets that reprice within the next twelve months. Included in our FHLB advances and related debt, are a number of borrowings with callable features as of March 31, 2008. 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.

We have included a number of tables to assist in our description of various measures of our financial performance. For example, the "Average Balances" 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, 2008 and 2007. 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, 2008 and 2007, 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,
(Dollars in thousands)

	2008 Average Balance	2008 Income/ Expense	2008 Yield/ Rate(1)	2007 Average Balance	2007 Income/ Expense	2007 Yield/ Rate(1)
Earnings						
Federal funds sold	$ 10,322	$ 84	3.27%	$ 12,984	$ 162	5.06%
Investment securities, taxable	89,980	1,213	5.42%	74,723	998	5.42%
Investment securities, nontaxable (2)	3,792	54	5.72%	3,746	53	5.73%
Loans	525,266	9,009	6.90%	417,754	7,765	7.54%
Total earning-assets	629,360	10,360	6.62%	509,207	8,978	7.15%
Non-earning assets	22,545			23,769		
Total assets	$ 651,905			$ 532,976		
Interest-bearing liabilities						
NOW accounts	$ 35,960	121	1.35%	$ 33,480	140	1.70%
Savings & money market	90,380	563	2.51%	84,073	735	