Solera National Bancorp, Inc.
Form 10-Q
May 13, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark one)

x **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2010

o **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number 000-53181

SOLERA NATIONAL BANCORP, INC.

(Exact name of registrant as specified in its charter)

Delaware	**02-0774841**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

319 S. Sheridan Blvd.

Lakewood, CO 80226

303-209-8600

(Address and telephone number of principal executive offices and principal place of business)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (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 o

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

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 last practicable date: As of May 11, 2010, 2,553,671 shares of the registrant s common stock, $0.01 par value, were issued and outstanding.

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SOLERA NATIONAL BANCORP, INC.

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INTRODUCTORY NOTE. CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION AND RISK FACTORS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 about Solera National Bancorp, Inc. (the Company) and our subsidiary, Solera National Bank (the Bank, collectively with the Company, sometimes referred to as we, us and our) that are subject to risks and uncertainties. Forward-looking statements include information concerning future financial performance, business strategy, projected plans and objectives. Statements preceded by, followed by or that otherwise include the words anticipates, believes, estimates, expects, intends, plans, may increase, may fluctuate and similar expressions of future or c verbs such as will, should, would, and could are generally forward-looking in nature and not historical facts. Actual results may differ material from those projected, implied, anticipated or expected in the forward-looking statements. Readers of this quarterly report should not rely solely on the forward-looking statements and should consider all uncertainties and risks throughout this report. The statements are representative only as of the date they are made, and Solera National Bancorp, Inc. undertakes no obligation to update any forward-looking statement.

These forward-looking statements, implicitly and explicitly, include the assumptions underlying the statements and other information with respect to the Company s beliefs, plans, objectives, goals, expectations, anticipations, estimates, financial condition, results of operations, future performance and business, including management s expectations and estimates with respect to revenues, expenses, return on equity, return on assets, efficiency ratio, asset quality and other financial data and capital and performance ratios.

Although the Company believes that the expectations reflected in the forward-looking statements are reasonable, these statements involve risks and uncertainties that are subject to change based on various important factors, some of which are beyond the control of the Company. The following factors, among others, could cause the Company s results or financial performance to differ materially from its goals, plans, objectives, intentions, expectations and other forward-looking statements:

- the Company s business may be adversely affected by conditions in the financial markets and economic conditions generally;

- continuation of the economic downturn could reduce our customer base, our level of deposits and demand for financial products such as loans;

- emergency measures designed to stabilize the U.S. financial system are beginning to wind down and the effect of that wind down is unpredictable;

- management of Solera National Bank may be unable to adequately measure and limit credit risk associated with the Bank s loan portfolio, which would affect our profitability;

- we are exposed to higher credit risk by commercial real estate, commercial business, and construction lending;

- our allowance for probable loan losses may be insufficient;
- interest rate volatility could significantly harm our business;
- funding to provide liquidity may not be available to us on favorable terms or at all;
- we may not be able to raise additional capital on terms favorable to us;
- the liquidity of our common stock is affected by its limited trading market;
- the departures of key personnel or directors may impair our operations;
- the Bank s legal lending limits may impair its ability to attract borrowers;

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- the Company is subject to extensive government regulation which may have an adverse effect on the Company s profitability and growth;
- managing reputational risk is important to attracting and maintaining customers, investors and employees;
- monetary policy and other economic factors could adversely affect the Company s profitability;
- the Company s certificate of incorporation and bylaws, and the employment agreements of our Executive Officers, contain provisions that could make a takeover more difficult;
- our directors and executive officers could have the ability to influence stockholder actions in a manner that may be adverse to your personal investment objectives;
- the effects of competition from other commercial banks, thrifts, mortgage banking firms, consumer finance companies, credit unions, securities brokerage firms, insurance companies, money market and other mutual funds, and other financial institutions operating in our market area and elsewhere, including institutions operating regionally, nationally, and internationally, together with such competitors offering banking products and services by mail, telephone, computer, and the Internet; and
- management s ability to manage these and other risks.

For a discussion of these and other risks and uncertainties that could cause actual results to differ from those contained in the forward-looking statements, see Risk Factors in Item 1A of the Company s 2009 Annual Report filed on Form 10-K with the SEC, which is available on the SEC s website at www.sec.gov. All forward-looking statements are qualified in their entirety by this cautionary statement, and the Company undertakes no obligation to revise or update this Quarterly Report on Form 10-Q to reflect events or circumstances after the date hereof. New factors emerge from time to time, and it is not possible for us to predict which factors, if any, will arise. In addition, the Company cannot assess the impact of each factor on the Company s business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS (Unaudited)

Solera National Bancorp, Inc.

Balance Sheets as of March 31, 2010 and December 31, 2009

(Unaudited)

($ in thousands, except share data)	**March 31, 2010**	**December 31, 2009**
ASSETS		
Cash and due from banks	$ 1,114	$ 1,696
Federal funds sold	4,605	820
Total cash and cash equivalents	5,719	2,516
Interest-bearing deposits with banks	1,848	3,784
Investment securities, available-for-sale	71,302	73,441
Gross loans	56,331	50,504
Net deferred (fees)/expenses	(123)	(114)
Allowance for loan losses	(945)	(830)
Net loans	55,263	49,560
Federal Home Loan Bank (FHLB) and Federal Reserve Bank stocks	1,113	1,131
Premises and equipment, net	841	875
Accrued interest receivable	675	814
Prepaid FDIC Insurance	419	471
Other assets	353	248
Total assets	$ 137,533	$ 132,840
LIABILITIES AND STOCKHOLDERS EQUITY		
Deposits		
Noninterest-bearing demand	$ 2,640	$ 2,624
Interest-bearing demand	5,864	6,830
Savings and money market	59,366	55,318
Time deposits	42,248	39,629
Total deposits	110,118	104,401
Federal funds purchased and securities sold under agreements to repurchase	110	326
Accrued interest payable	83	82
Accounts payable and other liabilities	220	344
Federal Home Loan Bank advances	7,750	8,750
Deferred rent liability	90	85
Capital lease liability	107	118

Total liabilities	$	118,478	$	114,106
COMMITMENTS AND CONTINGENCIES (see Note 10)				
STOCKHOLDERS EQUITY				
Common stock, $0.01 par value; 5,000,000 shares authorized; 2,553,671 shares issued and outstanding at March 31, 2010 and December 31, 2009	$	26	$	26
Additional paid-in capital		25,814		25,768
Accumulated deficit		(7,913)		(8,016)
Accumulated other comprehensive income		1,128		956
Total stockholders equity	$	19,055	$	18,734
Total liabilities and stockholders equity	$	137,533	$	132,840

See Notes to Consolidated Financial Statements.

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Solera National Bancorp, Inc.

Statements of Operations for the Three Months Ended March 31, 2010 and 2009

(Unaudited)

($ in thousands, except share data)	For the Three Months Ended March 31, 2010	2009
Interest and dividend income:		
Interest and fees on loans	$ 726	$ 314
Interest on federal funds sold	1	1
Interest on investment securities	829	598
Other interest income	5	
Dividends on FHLB and Federal Reserve Bank stocks	12	10
Total interest income	1,573	923
Interest expense:		
Deposits	518	294
Federal Home Loan Bank advances	76	92
Federal funds purchased and securities sold under agreements to repurchase	2	3
Other borrowings	3	4
Total interest expense	599	393
Net interest income	974	530
Provision for loan losses	115	117
Net interest income after provision for loan losses	859	413
Noninterest income:		
Service charges and fees	17	69
Sublease income		4
Gain on sale of securities	263	77
Total noninterest income	280	150
Noninterest expense:		
Salaries and employee benefits	544	612
Occupancy	139	136
Professional fees	130	116
Other general and administrative	223	181
Total noninterest expense	1,036	1,045
Income (loss) before income taxes	103	(482)
Income taxes		
Net income (loss)	$ 103	$ (482)
Basic earnings (loss) per share	0.04	(0.19)
Diluted earnings (loss) per share	0.04	(0.19)
Weighted-average common shares		
Basic	2,553,671	2,553,671

Diluted	2,553,671	2,553,671

See Notes to Consolidated Financial Statements.

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Solera National Bancorp, Inc.

Statements of Changes in Stockholders Equity for the Three Months Ended March 31, 2010 and 2009

(Unaudited)

($ in thousands, except share data)	Shares Outstanding	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Total
Balance at December 31, 2008	**2,553,671**	**$ 26**	**$ 25,558**	**$ (6,740)**	**$ 148**	**$ 18,992**
Stock-based compensation			49			49
Comprehensive income (loss):						
Net loss				(482)		(482)
Net change in unrealized gains on investment securities available-for-sale					107	107
Less: reclassification adjustment for net gains included in income					(77)	(77)
Total comprehensive income (loss)						(452)
Balance at March 31, 2009	**2,553,671**	**$ 26**	**$ 25,607**	**$ (7,222)**	**$ 178**	**$ 18,589**
Balance at December 31, 2009	**2,553,671**	**$ 26**	**$ 25,768**	**$ (8,016)**	**$ 956**	**$ 18,734**
Stock-based compensation			46			46
Comprehensive income (loss):						
Net income				103		103
Net change in unrealized gains on investment securities available-for-sale					435	435
Less: reclassification adjustment for net gains included in income					(263)	(263)
Total comprehensive income						275
Balance at March 31, 2010	**2,553,671**	**$ 26**	**$ 25,814**	**$ (7,913)**	**$ 1,128**	**$ 19,055**

See Notes to Consolidated Financial Statements.

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Solera National Bancorp, Inc.

Statements of Cash Flows for the Three Months Ended March 31, 2010 and 2009

(Unaudited)

($ in thousands)	**For the Three Months Ended March 31, 2010**	**2009**
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	$ 103	$ (482)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	42	37
Provision for loan losses	115	117
Net (accretion) amortization of deferred loan fees/expenses	(5)	(12)
Net amortization of premiums on investment securities	87	20
Gain on sale of investment securities	(263)	(77)
Federal Home Loan Bank stock dividend	(4)	(3)
Recognition of stock-based compensation on stock options	46	49
Changes in operating assets and liabilities:		
Interest receivable	139	(85)
Other assets	(108)	(22)
Prepaid FDIC Insurance	52	
Accrued interest payable	1	29
Accounts payable and other liabilities	(124)	396
Deferred loan fees/expenses, net	14	75
Deferred rent liability	5	7
Net cash provided by operating activities	$ 100	$ 49
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investment securities, available-for-sale	$ (17,420)	$ (20,631)
Proceeds from sales of investment securities, available-for-sale	14,250	6,862
Proceeds from maturities/calls/pay downs of investment securities, available-for-sale	5,656	3,940
Originated loans, net of pay downs	(5,827)	(9,654)
Purchase of premises and equipment	(4)	(3)
Proceeds from redemption of Federal Reserve Bank stock	22	13
Purchase of interest-bearing deposits with banks	(498)	
Maturity of interest-bearing deposits with banks	2,434	
Net cash used in investing activities	$ (1,387)	$ (19,473)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits	$ 5,717	$ 17,826
Net increase in federal funds purchased and securities sold under agreements to repurchase	(216)	783
Repayment of FHLB advances	(1,000)	
Principal payments on capital lease	(11)	(9)
Net cash provided by financing activities	$ 4,490	$ 18,600
Net increase (decrease) in cash and cash equivalents	$ 3,203	$ (824)
CASH AND CASH EQUIVALENTS		
Beginning of period	2,516	2,401

End of period	$	5,719	$	1,577

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Solera National Bancorp, Inc.

Statements of Cash Flows for the Three Months Ended March 31, 2010 and 2009, (continued)

(Unaudited)

($ in thousands)	For the Three Months Ended March 31, 2010	2009
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid during the period for:		
Interest	$ 598	$ 364
Non-cash investing transactions:		
Unrealized gain on investment securities, available-for-sale	$ 172	$ 31
Available-for-sale investment securities purchased, but not yet settled	$	$ 1,009

See Notes to Consolidated Financial Statements.

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SOLERA NATIONAL BANCORP, INC.

UNAUDITED CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF ORGANIZATION

Solera National Bancorp, Inc. (the Company), is a Delaware corporation that was incorporated in 2006 to organize and serve as the holding company for Solera National Bank (the Bank), a national bank that opened for business on September 10, 2007. Solera National Bank is a full-service community, commercial bank headquartered in Lakewood, Colorado serving the Denver metropolitan area.

NOTE 2 BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting only of normal recurring adjustments) which, in the opinion of management, are necessary to present fairly the financial position of the Company as of March 31, 2010, and the results of its operations for the three months ended March 31, 2010 and 2009. Cash flows are presented for the three months ended March 31, 2010 and 2009. Certain reclassifications have been made to the consolidated financial statements and related notes of prior periods to conform to the current presentation. These reclassifications had no impact on stockholders equity or net income (loss) for the periods. Additionally, certain information and footnote disclosures normally included in financial statements have been condensed or omitted pursuant to rules and regulations of the U.S. Securities and Exchange Commission. The Company believes that the disclosures in the unaudited condensed consolidated financial statements are adequate to make the information presented not misleading. However, these unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and footnotes thereto included in the Company s Annual Report on Form 10-K as of and for the year ended December 31, 2009.

The Company received approval as a bank in organization in the first quarter of 2007, conducted an initial closing of its common stock offering and commenced banking operations during the third quarter of 2007. Successful completion of the Company s development program and, ultimately, the attainment of sustained profitable operations are dependent on future events, including the successful execution of the Company s business plan and achieving a level of revenue adequate to support the Company s cost structure.

Critical Accounting Policies

The following is a description of the Company s significant accounting policies used in the preparation of the accompanying consolidated financial statements.

Allowance for loan losses: Implicit in the Company s lending activities is the fact that loan losses will be experienced and that the risk of loss will vary with the type of loan being made and the creditworthiness of the borrower over the term of the loan. The allowance for loan losses represents the Company s recognition of the risks of extending credit and its evaluation of the loan portfolio. The allowance for loan losses is maintained at a level considered adequate to provide for probable loan losses based on management s assessment of various factors affecting the loan portfolio, including a review of problem loans, business conditions, historical loss experience, evaluation of the quality of the underlying collateral, and holding and disposal costs. In addition, because the Bank has limited history on which to base future loan losses, a comparison of peer group allowance ratios to gross loans is made with the intention of maintaining similar levels during the Bank s de novo period of operation. The allowance for loan losses is increased by provisions charged to expense and reduced by loans charged off, net of recoveries. Loan losses are charged against the allowance for loan losses when management believes the loan balance is uncollectible.

The Company has established a formal process for determining an adequate allowance for loan losses. The allowance for loan losses calculation has two components. The first component represents the allowance for loan losses for impaired loans; that is loans where the Company believes collection of the contractual principal and interest payments is not probable. To determine this component of the calculation, collateral-dependent impaired loans are evaluated using internal analyses as well as third-party information, such as appraisals. If an

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impaired loan is unsecured, it is evaluated using a discounted cash flow of the payments expected over the life of the loan using the loan s effective interest rate and giving consideration to currently existing factors that would impact the amount or timing of the cash flows. The second component of the allowance for loan losses represents contingent losses the estimated probable losses inherent within the portfolio due to uncertainties. Factors considered by management to estimate inherent losses include, but are not limited to, 1) historical and current trends in downgraded loans; 2) the level of the allowance in relation to total loans; 3) the level of the allowance in relation to the Bank s peer group; 4) the levels and trends in non-performing and past due loans; and 5) management s assessment of economic conditions and certain qualitative factors as defined by bank regulatory guidance, including but not limited to, changes in the size, composition and concentrations of the loan portfolio, changes in the legal and regulatory environment, and changes in lending management. The recorded allowance for loan losses is the aggregate of the impaired loans component and the contingent loss component.

At March 31, 2010, the Company had an allowance for loan losses of $945,000. Management believes that this allowance for loan losses is adequate to cover probable losses based on all currently available evidence. Future additions to the allowance for loan losses may be required based on management s continuing evaluation of the inherent risks in the portfolio. Additional provisions for loan losses may need to be recorded if the economy declines, asset quality deteriorates, or the loss experience changes. Also, federal regulators, when reviewing the Bank s loan portfolio in the future, may require the Bank to increase the allowance for loan losses.

Share-based compensation: The Company grants stock options as incentive compensation to employees and directors. The cost of employee/director services received in exchange for an award of equity instruments is based on the grant-date fair value of the award, which is determined using a Black-Scholes-Merton model. This cost, net of estimated forfeitures, is expensed to salaries and employee benefits over the period which the recipient is required to provide services in exchange for the award, generally the vesting period.

Estimation of fair value: The estimation of fair value is significant to a number of the Company s assets, including available-for-sale investment securities. These are all recorded at either fair value or at the lower of cost or fair value. Furthermore, accounting principles generally accepted in the United States require disclosure of the fair value of financial instruments as a part of the notes to the consolidated financial statements. Fair values are volatile and may be influenced by a number of factors, including market interest rates, prepayment speeds, discount rates and the shape of yield curves.

Impairment of investment securities: Investment securities are evaluated for impairment on at least a quarterly basis and more frequently when economic or market conditions warrant such an evaluation to determine whether a decline in their value below amortized cost is other-than-temporary. Securities are evaluated for impairment utilizing criteria such as the magnitude and duration of the decline, current market conditions, payment history, the credit worthiness of the obligator, the intent of the Company to retain the security or whether it is more likely than not that the Company will be required to sell the security before recovery of the value, as well as other qualitative factors. If a decline in value below amortized cost is determined to be other-than-temporary, which does not necessarily indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value is not favorable, the security is reviewed in more detail in order to determine the portion of the impairment that relates to credit (resulting in a charge to earnings) versus the portion of the impairment that is noncredit related (resulting in a charge to accumulated other comprehensive income). A credit loss is determined by comparing the amortized cost basis to the present value of cash flows expected to be collected, computed using the original yield as the discount rate.

Recently Issued Accounting Pronouncements

In June 2009, the FASB issued Accounting Standards Update (ASU) No. 2009-16, *Transfers and Servicing (Topic 860): Accounting for Transfers of Financial Assets,* which amended previous guidance relating to transfers of financial assets and eliminated the concept of a qualifying special purpose entity. This guidance is effective for fiscal years beginning after November 15, 2009. ASU No. 2009-16 must be applied to transfers occurring on or after the effective date. This update also clarifies the requirements for isolation and limitations on portions of financial assets that are eligible for sale accounting. The term participating interest is defined to establish specific conditions for reporting a transfer of a portion of a financial asset as a sale. The amendment requires transferred assets and liabilities incurred to be recognized and measured at fair value. The disclosure provisions were also amended and apply to transfers that occurred both before and after the effective date of this guidance. The adoption

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of this new guidance did not have a material impact on the Company s consolidated financial position, results of operations or cash flows.

In January 2010, the FASB issued guidance requiring increased fair value disclosures. There are two components to the increased disclosure requirements set forth in the update: (1) a description of, as well as the disclosure of, the dollar amount of transfers in or out of level one or level two (2) in the reconciliation for fair value measurements using significant unobservable inputs (level 3), a reporting entity should present separately information about purchases, sales, issuances and settlements (that is, gross amounts shall be disclosed as opposed to a single net figure). Increased disclosures regarding the transfers in/out of level one and two are required for interim and annual periods beginning after December 15, 2009. The adoption of this portion of the standard did not have a material impact on the Company s consolidated financial position, results of operations or cash flows. Increased disclosures regarding the level three fair value reconciliation are required for fiscal years beginning after December 15, 2010. The adoption of this portion of the standard is not expected to have a material impact on the Company s consolidated financial position, results of operations or cash flows.

NOTE 3 INVESTMENTS

The amortized costs and estimated fair values of investment securities as of March 31, 2010 and December 31, 2009 are as follows:

	March 31, 2010			
($ in thousands)	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Estimated Fair Value**
Securities available-for-sale:				
U.S. government agencies	$ 8,156	$ 50	$ (2)	$ 8,204
Corporate	10,188	247	(38)	10,397
State and municipal	17,411	329	(143)	17,597
Agency mortgage-backed securities (MBS)	34,419	741	(56)	35,104
Total securities available-for-sale	$ 70,174	$ 1,367	$ (239)	$ 71,302

	December 31, 2009			
($ in thousands)	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Estimated Fair Value**
Securities available-for-sale:				
U.S. government agencies	$ 5,176	$ 28	$ (35)	$ 5,169
Corporate	9,822	306	(5)	10,123
State and municipal	22,101	395	(295)	22,201
Agency MBS	35,386	760	(198)	35,948
Total securities available-for-sale	$ 72,485	$ 1,489	$ (533)	$ 73,441

The amortized cost and estimated fair value of debt securities by contractual maturity at March 31, 2010 and December 31, 2009 are shown below. Agency mortgage-backed securities are classified in accordance with their contractual lives. Expected maturities may differ from contractual maturities because borrowers may have the right to prepay obligations with or without call or prepay penalties. Additionally, accelerated principal payments are routinely received on agency mortgage-backed securities making it common for them to mature prior to the contractual maturity date.

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($ in thousands)	March 31, 2010 Amortized Cost	March 31, 2010 Estimated Fair Value	December 31, 2009 Amortized Cost	December 31, 2009 Estimated Fair Value
Securities available-for-sale				
Due within one year	$ 995	$ 1,020	$ 1,538	$ 1,560
Due after one year through five years	5,098	5,277	5,602	5,823
Due after five years through ten years	25,729	25,949	19,566	19,735
Due after ten years	38,352	39,056	45,779	46,323
Total securities available-for-sale	$ 70,174	$ 71,302	$ 72,485	$ 73,441

The following tables show the estimated fair value and gross unrealized losses, aggregated by investment category and length of time the individual securities have been in a continuous loss position as of March 31, 2010 and December 31, 2009.

	March 31, 2010								
	Less than 12 months			12 months or more			Total		
($ in thousands)	Estimated Fair Value	Unrealized Losses	# of Securities	Estimated Fair Value	Unrealized Losses	# of Securities	Estimated Fair Value	Unrealized Losses	# of Securities
Description of securities:									
U.S. government agencies	$ 1,498	$ (2)	2	$	$		$ 1,498	$ (2)	2
Corporate	2,729	(38)	5				2,729	(38)	5
State and municipal	7,381	(128)	12	473	(15)	1	7,854	(143)	13
Agency MBS	12,864	(56)	12				12,864	(56)	12
Total temporarily-impaired	$ 24,472	$ (224)	31	$ 473	$ (15)	1	$ 24,945	$ (239)	32

	December 31, 2009								
	Less than 12 months			12 months or more			Total		
($ in thousands)	Estimated Fair Value	Unrealized Losses	# of Securities	Estimated Fair Value	Unrealized Losses	# of Securities	Estimated Fair Value	Unrealized Losses	# of Securities
Description of securities:									
U.S. government agencies	$ 3,726	$ (35)	7	$	$		$ 3,726	$ (35)	7
Corporate	517	(5)	1				517	(5)	1
State and municipal	7,768	(243)	10	945	(52)	3	8,713	(295)	13
Agency MBS	10,520	(198)	21				10,520	(198)	21
Total temporarily-impaired	$ 22,531	$ (481)	39	$ 945	$ (52)	3	$ 23,476	$ (533)	42

Management evaluates investment securities for other-than-temporary impairment taking into consideration the extent and length of time the fair value has been less than cost, the financial condition of the issuer, whether the Company has the intent to retain the security and whether it is more-likely-than-not that the Company will be required to sell the security before recovery of the value, as well as other qualitative factors. The one security that has been in a continuous unrealized loss position for 12 months or longer at March 31, 2010, has fluctuated in value since the purchase date as a result of changes in market interest rates and not as a result of the underlying issuer s ability to repay. Management has reviewed the credit rating for this security, noting that it is highly rated. Additionally, the Company has the intent to hold this security and the Company does not anticipate that this security will be required to be sold before recovery of value, which may be upon maturity. Accordingly, as of March 31, 2010, no decline in value was deemed to be other than temporary. Similarly, management s evaluation of the three securities in a continuous unrealized loss position for 12 months or longer at December 31, 2009, determined these securities were not other than temporarily impaired.

The Company recorded a net unrealized gain in the investment portfolio of $1.1 million at March 31, 2010. This was an increase over the $956,000 unrealized gain at December 31, 2009.

In an effort to both capitalize on current market conditions, while funding our loan portfolio growth, as well as to clean-up some odd-lots within the investment portfolio, the Company sold twenty-five securities for gross realized gains of $281,000 and nine securities for gross realized losses of $18,000 during the first quarter of 2010. The Company sold thirteen securities during the first quarter 2009 for a net realized gain of $77,000. Realized gains and losses on sales are computed on a specific identification basis based on amortized cost on the date of sale.

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Securities with carrying values of $19.2 million at March 31, 2010 and $16.9 million at December 31, 2009, were pledged as collateral to secure public deposits, borrowings from the FHLB, repurchase agreements and for other purposes as required or permitted by law.

NOTE 4 LOANS

The composition of the loan portfolio follows:

($ in thousands)		March 31, 2010	December 31, 2009
Real estate commercial		$ 36,641	$ 26,063
Real estate residential		8,220	8,059
Construction and land development		2,678	7,067
Commercial and industrial		8,209	8,324
Consumer		583	991
Gross loans		56,331	50,504
Less:	Deferred loan (fees) / expenses, net	(123)	(114)
	Allowance for loan losses	(945)	(830)
Loans, net		$ 55,263	$ 49,560

During the first three months of 2010 one loan for $1.0 million was placed on nonaccrual and is considered impaired, no loans were transferred to foreclosed properties and no loans were past due more than 90 days and still accruing interest. During all of 2009, no loans were impaired, no loans were transferred to foreclosed properties and one loan, with a principal balance of approximately $3,000, was past due more than 90 days but still accruing interest.

In the ordinary course of business, and only if consistent with permissible exceptions to Section 402 of the Sarbanes- Oxley Act of 2002, the Bank may make loans to directors, executive officers, principal stockholders (holders of more than five percent of the outstanding common shares) and the businesses with which they are associated. In the Company s opinion, all loans and loan commitments to such parties are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons.

There were approximately $2.2 million and $2.6 million in loans receivable from related parties at March 31, 2010 and December 31, 2009, respectively.

NOTE 5 ALLOWANCE FOR LOAN LOSSES

Activity in the allowance for loan losses for the first three months of 2010 and 2009 is summarized as follows:

($ in thousands)	Quarter Ended March 31, 2010		Quarter Ended March 31, 2009	
Balance, beginning of period	$	830	$	268
Loans charged off				
Recoveries on loans previously charged off				
Provision for loan losses		115		117
Balance, end of period	$	945	$	385

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The following table details information regarding impaired loans at the dates indicated:

($ in thousands)		March 31, 2010		December 31, 2009
Impaired loans with a valuation allowance:	$	1,000	$	
Impaired loans without a valuation allowance:				
Total impaired loans	$	1,000	$	
Valuation allowance related to impaired loans	$	185	$	

No interest income was recognized while the loan has been classified as impaired. The gross interest income that would have been recorded for the quarter ended March 31, 2010 if the impaired loan had been current throughout the quarter in accordance with its original terms was approximately $2,000.

NOTE 6 DEPOSITS

Deposits are summarized as follows:

	March 31, 2010			December 31, 2009		
		Amount	% of Total		Amount	% of Total
Noninterest-bearing demand	$	2,640	2%	$	2,624	2%
Interest-bearing demand		5,864	5		6,830	7
Money market accounts		5,090	5		3,555	3
Savings accounts		54,276	49		51,763	50
Certificates of deposit, less than $100,000		13,160	12		16,624	16
Certificates of deposit, greater than $100,000		29,088	27		23,005	22
Total deposits	$	110,118	100%	$	104,401	100%

In the ordinary course of business, certain officers, directors, stockholders, and employees of the Bank have deposits with the Bank. In the Bank s opinion, all deposit relationships with such parties are made on substantially the same terms including interest rates and maturities, as those prevailing at the time for comparable transactions with other persons. The balance of related party deposits at March 31, 2010 and December 31, 2009 was approximately $4.1 million and $4.0 million, respectively.

NOTE 7 STOCK-BASED COMPENSATION

The Company s 2007 Stock Incentive Plan (the Plan) was approved by the Company s Board of Directors (the Board) with an effective date of September 10, 2007 and was approved by the Company s stockholders at the annual meeting held on June 17, 2008. Under the terms of the Plan, officers and key employees may be granted both nonqualified and incentive stock options and directors and other consultants, who are not also officers or employees, may only be granted nonqualified stock options. The Board reserved 510,734 shares of common stock for issuance under the Plan. The Plan provides for options to purchase shares of common stock at a price not less than 100% of the fair market value of the stock on the date of grant. Stock options expire no later than ten years from the date of the grant and generally vest over four years. The Plan provides for accelerated vesting if there is a change of control, as defined in the Plan. The Company recognized stock-based compensation cost of approximately $46,000 and $49,000 during the three months ended March 31, 2010 and 2009, respectively.

The Company accounts for its stock-based compensation under the provisions of ASC 718-20 *Stock Compensation Awards Classified as Equity*. The fair value of each option grant is estimated on the date of grant using the Black-Scholes-Merton option pricing model. The Company granted 17,750 options during the first quarter 2010 as incentive compensation to existing and newly hired employees. Similarly, the Company granted 13,000 options as incentive compensation to two Bank officers during the first quarter of 2009.

During the three months ended March 31, 2010, 4,406 options were forfeited and 2,813 vested options expired unexercised. No options were exercised during the three months ended March 31, 2010. The Company recognized expense for approximately 20,000 options, representing a pro-rata amount of the options earned during the first

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quarter 2010 that are expected to vest. As of March 31, 2010, there was approximately $332,000 of total unrecognized compensation cost related to the outstanding stock options that will be recognized over a weighted-average period of 1.6 years.

The following is a summary of the Company s outstanding stock options at March 31, 2010:

	Options	Weighted-Average Grant Date Fair Value	Weighted-Average Exercise Price
Outstanding at January 1, 2010	305,353	$ 2.44	$ 9.19
Granted	17,750	1.21	5.29
Exercised			
Forfeited	(4,406)	1.84	7.84
Expired	(2,813)	2.75	10.00
Outstanding at March 31, 2010	315,884	$ 2.38	$ 8.98

NOTE 8 NONINTEREST EXPENSE

The following table details the items comprising other general and administrative expenses:

	Three Months Ended March 31,	
($ in thousands)	**2010**	**2009**
Data processing	$ 68	$ 66
FDIC assessment	42	16
Other regulatory and reporting fees	26	18
Marketing and promotions	16	21
Telephone/communication	11	11
Dues and memberships	11	10
Travel and entertainment	9	7
Printing, stationery and supplies	8	7
Franchise taxes	7	2
ATM processing fees	6	4
Insurance	6	5
Postage and shipping	5	6
Training and education	2	2
Miscellaneous	6	6
Total	$ 223	$ 181

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NOTE 9 INCOME TAXES

Deferred taxes are a result of differences between income tax accounting and generally accepted accounting principles with respect to income and expense recognition. The following is a summary of the components of the net deferred tax asset account recognized in the accompanying consolidated statements of financial condition:

($ in thousands)		March 31, 2010		December 31, 2009
Deferred tax assets:				
Start-up and organizational expenses	$	1,098	$	1,120
Net operating loss carryforward		1,295		1,368
Allowance for loan losses		327		284
Non-qualified stock options		31		28
Other		68		77
Total deferred tax assets		2,819		2,877
Deferred tax liabilities:				
Net unrealized gain on securities available-for-sale		(418)		(354)
Federal Home Loan Bank stock dividend		(11)		(9)
Tax over book depreciation				(26)
Total deferred tax liabilities		(429)		(389)
Net deferred tax assets		2,390		2,488
Valuation allowance		(2,390)		(2,488)
Net deferred taxes	$		$	

The Company has provided a 100% valuation allowance for its net deferred tax asset due to uncertainty of realization during the carryforward period. As of March 31, 2010, the Company has net operating loss carryforwards of approximately $3.5 million for federal income tax purposes. Federal net operating loss carryforwards, to the extent not used, will expire beginning in 2027.

The income tax provision differs from the amount of income tax determined by applying the U.S. federal income tax rate of 35% to pretax income from continuing operations for the three months ended March 31, 2010 and the twelve months ended December 31, 2009 due to the following:

($ in thousands)		March 31, 2010		December 31, 2009		March 31, 2009
Computed expected tax expense (benefit)	$	36	$	(447)	$	(169)
Change in income taxes resulting from:						
Change in valuation allowance		(34)		434		158
Other		(2)		13		11
Income tax provision	$		$		$	

NOTE 10 COMMITMENTS AND CONTINGENCIES

The Company is a party to credit related financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheet. The Company s exposure to credit loss is represented by the contractual amount of these commitments. The Company follows the same credit policies in making commitments as it does for on-balance-sheet instruments.

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At March 31, 2010 and December 31, 2009 the following financial instruments were outstanding whose contract amounts represent credit risk:

($ in thousands)		March 31, 2010		December 31, 2009
Financial instruments whose contractual amounts represent credit risk:				
Commitments to extend credit	$	8,571	$	7,182
Letters of credit				
Total commitments	$	8,571	$	7,182

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the commitments do not necessarily represent future cash requirements. The Company evaluates each customer s creditworthiness on a case-by-case basis. The amount of collateral obtained is based on management s credit evaluation. Collateral held varies, but may include accounts receivable, inventory, property, plant and equipment and income producing commercial properties.

Letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

NOTE 11 FAIR VALUE

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the most advantageous market for the asset or liability in an orderly transaction between market participants. The fair value hierarchy 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 values:

Level 1 inputs are unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.

Level 2 inputs are other than quoted prices included in Level 1 that are observable for the asset or liability either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3 valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

The Company carries its available-for-sale securities at fair value. Fair value measurement is obtained from independent pricing services which utilize observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bonds terms and conditions, among other things.As of March 31, 2010 and December 31, 2009, all of the Company s available-for-sale securities were valued using Level 2 inputs.

Impaired loans are valued at the lower of cost or fair value and are generally classified as Level 3 in the fair value hierarchy. Fair value is measured based on the value of the collateral securing the loan or discounting estimated future cash flows. Collateral is valued based on appraisals performed by qualified licensed appraisers. Such appraisal values may be discounted based on management s historical knowledge, changes in market conditions from the time of valuation and/or similar factors. Impaired loans that are not secured by collateral are valued by using the discounted estimated future cash flows at the loans effective interest rate. The cash flow estimates are made by management using historical knowledge, market conditions, and knowledge of the borrower s business, among other factors.

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Assets and Liabilities Measured on a Recurring Basis

Assets and liabilities measured at fair value on a recurring basis are summarized below:

($ in thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Assets at March 31, 2010				
Investment securities, available-for-sale:				
U.S. government agencies	$	$ 8,204	$	$ 8,204
Corporate		10,397		10,397
State and municipal		17,597		17,597
Agency MBS		35,104		35,104
Total	$	$ 71,302	$	$ 71,302
Assets at December 31, 2009				
Investment securities, available-for-sale:				
U.S. government agencies	$	$ 5,169	$	$ 5,169
Corporate		10,123		10,123
State and municipal		22,201		22,201
Agency MBS		35,948		35,948
Total	$	$ 73,441	$	$ 73,441

Assets and Liabilities Measured on a Nonrecurring Basis

Assets and liabilities measured at fair value on a nonrecurring basis are summarized below:

($ in thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Assets at March 31, 2010				
Impaired loans	$	$	$ 815	$ 815
Assets at December 31, 2009				
Impaired loans	$	$	$	$

Fair Value of Financial Instruments

Disclosure of fair value information about financial instruments, whether or not recognized in the consolidated balance sheet, for which it is practicable to estimate that value is required. Fair value estimates are made at a specific point in time based on relevant market information and information about the financial instrument. Because no market value exists for a significant portion of the financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature, involve uncertainties and matters of judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value information is not required to be disclosed for certain financial instruments and all nonfinancial instruments. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company. Fair value estimates are based on financial instruments both on and off the balance sheet without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Additionally, tax consequences related to the realization of the unrealized gains and losses can have a potential effect on fair value estimates and have not been considered in many of the estimates.

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The following methods and assumptions were used to estimate the fair value of significant financial instruments:

Cash and cash equivalents: The carrying amounts of cash and due from banks and federal funds sold approximate their fair values.

Interest-bearing deposits with banks: The carrying amount of interest-bearing deposits with banks approximates fair values due to the relatively stable level of short-term interest rates.

Investment securities: Fair value measurement is obtained from independent pricing services which utilize observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bonds terms and conditions, among other things.

Loans, net: The fair value of fixed rate loans is estimated by discounting the future cash flows using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are estimated to be equivalent to carrying values. Variable rate loans that are currently priced at their contractual floor or ceiling, and thus similar to fixed rate loans, are reviewed to determine the interest rate that would be currently offered on similar credits. If the current floor/ceiling rate is equivalent to current market rates, fair value is estimated to be equivalent to carrying value. If the current market rates differ from the loan s current rate, the contractual cash flows are discounted using the current market rate to derive the loan s estimated fair value. Both the estimated fair value and the carrying value have been reduced by specific and general reserves for loan losses.

Investment in FHLB and Federal Reserve Bank (FRB) stocks: It is not practical to determine the fair value of bank stocks due to the restrictions placed on the transferability of FHLB stock and FRB stock.

Interest receivable: The carrying value of interest receivable approximates fair value due to the short period of time between accrual and receipt of payment.

Deposits: The fair value of noninterest-bearing demand deposits, interest-bearing demand deposits and savings and money market accounts is determined to be the amount payable on demand at the reporting date. The fair value of fixed rate time deposits is estimated using a discounted cash flow calculation that utilizes interest rates currently being offered for deposits of similar remaining maturities. Carrying value is assumed to approximate fair value for all variable rate time deposits.

Federal funds purchased and securities sold under agreements to repurchase: The carrying amount of federal funds purchased and securities sold under agreements to repurchase approximates fair value due to the short-term nature of these agreements, which generally mature within one to four days from the transaction date.

Capital lease liability: Management did not fair value the capital lease liability as it is specifically excluded from the disclosure requirements.

Federal Home Loan Bank advances: Fair value of the Federal Home Loan Bank advances is estimated using a discounted cash flow model that utilizes current market rates for similar types of borrowing arrangements with similar remaining maturities.

Interest payable: The carrying value of interest payable approximates fair value due to the short period of time between accrual and payment.

Loan commitments and letters of credit: The fair values of commitments are estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. The difference between the carrying value of commitments to fund loans or

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standby letters of credit and their fair values are not significant and, therefore, are not included in the following table.

The carrying amounts and estimated fair values of financial instruments are summarized as follows:

	March 31, 2010		December 31, 2009	
($ in thousands)	**Carrying Value**	**Estimated Fair Value**	**Carrying Value**	**Estimated Fair Value**
Financial Assets:				
Cash and cash equivalents	$ 5,719	$ 5,719	$ 2,516	$ 2,516
Interest-bearing deposits with banks	1,848	1,848	3,784	3,784
Investment securities	71,302	71,302	73,441	73,441
Loans, net				