
2009 Annual Report

Table of Contents

President's Letter	2
Balance Sheet	4
Statements of Operations.....	5
Statements of Changes in Shareholders' Equity.....	6
Statements of Cash Flows	7
Notes to Financial Statements	8
Independent Auditor's Report.....	28
Board of Directors and Bank Management	29

This Annual Report to Shareholders contains forward-looking statements. These statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those anticipated in the forward-looking statements. Factors that might cause such a difference include, but are not limited to, changes in economic conditions, the financial condition of our customers, interest rate fluctuations, competitive product and pricing pressure within our markets, technological changes, changes in laws and regulations, changes in fiscal, monetary, regulatory and tax policies, monetary fluctuations, actions of government regulators, and the availability of capital and personnel.

Readers should not place undue reliance on forward-looking statements, which reflect management's view only as of the date hereof. The Bank undertakes no obligation to publicly revise these forward-looking statements to reflect subsequent events or circumstances.



Shareholder Information

To the Shareholders of Premier Commercial Bank:

With your continued support, the momentum we established in 2008 carried over into 2009, our first full year of operation. It was a good year that was marked with several accomplishments:

- We grew the Bank's balance sheet to \$79 million in assets from \$30 million in 2008.
- Solid loan production accounted for the bulk of this growth. We built net loans to just under \$50 million from \$13 million in 2008.
- Importantly, we grew the Bank's base of deposits to \$57 million from \$12 million in 2008.

Our results—and the strong reception we have had in the market—encourage us that, in a climate still characterized by uncertainty, we are on the right track. The market's reception encouraged us to open a loan production office in High Point during the fall of 2009, and we expect to file an application with the appropriate regulatory agencies to convert the office to a branch in 2010.

Most importantly, we are pleased to report that the Bank remains in a strong, healthy financial condition. The Bank's prospects continue to be very favorable. Capital and liquidity ratios are in good shape. Loan production is steady, and we continue to lend prudently, patiently, and with appropriate discipline to customers who value Premier Commercial's customized approach to banking. Our experienced bankers are building full-service relationships with business owners and executives who value the full range of services and solutions Premier Commercial provides.

Your Bank's senior executives and Board of Directors have a clear vision of Premier Commercial's future. With early accomplishments and results to-date, we are pleased with the Bank's position in the market and its prospects for the future. Questions related to the unprecedented disruptions to our financial system and economy notwithstanding, we take confidence from Premier Commercial's strong position. We are determined to hew to the traditional community banking model—in which relationships and customer knowledge are unsurpassed in importance—and to the time-tested disciplines of conservative banking. We clearly understand the importance of, and are directing our energies and resources toward, building relationships in markets where we live and work, knowing our clients and, in so doing, serving them well by tailoring solutions prudently *to meet their needs*.

In our letter to shareholders last year, we cited the four strategies underpinning our plan to achieve long-term success and to become a great financial institution serving the Triad communities. Your Board of Directors and senior leadership team consistently review, and evaluate decisions in light of, these strategies. We re-visit them briefly here:

Grow a high-quality asset base, while preserving the Bank's capital. Our job is to manage the risk of a growing portfolio of loans to an expanding base of new Premier Commercial clients. In this recessionary environment, we are being extra prudent in evaluating loans and managing loan-portfolio risk.

Develop a properly-structured funding base. The key here is building a strong base of core deposits. Premier Commercial has in place all the necessary resources to ensure the Bank's success in this area. A strong, properly structured deposit base is essential to funding the Bank's growth. If you are not already one, we ask you to consider becoming a depositor at your Bank in 2010.

Develop a loyal base of "ideal clients". Our banking staff is taking advantage of extensive knowledge of the markets in which the Bank operates and their prior relationships. We are also targeting new banking relationships, where clients' needs align with the customized, solutions-oriented approach Premier Commercial brings to the small- to mid-sized commercial market.

Create a high-performance culture throughout all areas of the bank. An organization's success is ensured, above all, by the people who comprise the organization and by how effectively and purposefully they operate as a team.

Annual Meeting

The annual meeting of shareholders will be held on Tuesday, May 19, 2010 at 4:00 p.m. at the Bank.

Requests for Information

Requests for information should be directed to Mr. William E. Swing, Jr., Corporate Secretary, at Premier Commercial Bank, 701 Green Valley Road, Suite 102, Greensboro, North Carolina 27408, (336) 323-1115.

Independent Auditors

Elliott Davis, PLLC
Certified Public Accountants
Post Office Box 760
Galax, Virginia 24333

Corporate Counsel

Brooks, Pierce, McLendon,
Humphrey, & Leonard, LLP
2000 Renaissance Plaza
230 North Elm Street
Greensboro, North Carolina 27401

Stock Transfer Agent

First Shareholder Services
4300 Six Forks Road
Mail Code FCC61
Raleigh, North Carolina 27609

Federal Deposit Insurance Corporation

The Bank is a member of the Federal Deposit Insurance Corporation. This financial statement has not been reviewed, or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

Offices

701 Green Valley Road
Suite 102
Greensboro, North Carolina 27408

<http://www.premierbanknc.com/>

Board of Directors and Bank Management

Board of Directors

R. Sterling Kelly, III *Chairman, Premier Commercial Bank, President, Burkely Communities, LLC*

Dr. Patrick L. Ballen *Medical Director of the Moses Cone Health System Wound Care and Hyperbaric Center*

Jan Rowe Capps *Retired, Former President of the Moses Cone-Wesley Long
Community Health Foundation*

James L. Einstein *Retired, Former EVP and General Manager, Alliance Division, Rock – Tenn Company*

Paul Fulton *Chairman, Bassett Furniture Industries, Inc.*

Francis X. Gavigan, Jr. *President and CEO, Premier Commercial Bank*

J. Gilmour Lake *Retired, Former President, Computer Credit, Inc.*

Frank R. Mascia *President, Mascia Associates*

L. Lane Schiffman *Co-Owner/Vice President, Schiffman's Jewelers*

Arthur Robinson Tyler *Commercial Real Estate Broker, NAI Piedmont Triad*

Dr. Ronda S. White *Partner, Pinewest OB-GYN*

Coy O. Williard, Jr. *President, Williard-Stewart, Inc.*

Bank Management

Francis X. Gavigan, Jr. *President and Chief Executive Officer*

William E. Swing, Jr. *Executive Vice President and Chief Financial Officer*

James J. Harris *Executive Vice President, Senior Lender and Market Manager*

Assembling and developing a great team has been Premier Commercial's primary focus during the Bank's early going. Nothing is more important over the long term. We have built a great group of banking professionals and now have the staff to lead the Bank through its the next phase of its growth. It is the foundation of Premier Commercial's future success.

We made significant progress in 2009. We are determined, in 2010, to build on Premier Commercial's early achievements. In the end, our work will be measured by the extent to which we build shareholder value, as it should be. We remain enthusiastic and confident in our ability to succeed on that measure over time. Thank you for your confidence in, and support of, all of us who are associated with Premier Commercial Bank.

We hope to see you at the annual shareholder meeting on May 19 at 4:00 PM at the Premier Commercial Bank office.

Sincerely,



Frank Gavigan
President and CEO



R. Sterling Kelly III
Chairman

Balance Sheets

December 31, 2009 and 2008

	2009	2008
Assets		
Cash and due from banks	\$ 2,321,159	\$ 464,578
Interest-bearing deposits with other banks	7,192,501	3,505,128
Federal funds sold	-	2,623,000
Cash and cash equivalents	<u>9,513,660</u>	<u>6,592,706</u>
Securities available for sale	18,098,854	10,096,789
Restricted equity securities	279,300	36,300
Loans	50,380,529	12,938,055
Allowance for loan losses	(657,524)	(168,314)
Net loans	<u>49,723,005</u>	<u>12,769,741</u>
Trading assets	168,765	-
Premises and equipment, net of accumulated depreciation	473,403	479,637
Accrued interest receivable	260,543	120,022
Other assets	445,917	53,547
Total assets	<u>\$ 78,963,447</u>	<u>\$ 30,148,742</u>
Liabilities and Shareholders' Equity		
Liabilities		
Deposits:		
Noninterest-bearing deposits	5,026,334	959,042
NOW accounts	2,345,260	343,201
Savings and interest-checking	23,460,683	3,949,671
Certificates of deposit	<u>26,603,180</u>	<u>6,346,060</u>
Total deposits	57,435,457	11,597,974
FHLB borrowings	5,000,000	-
Accrued interest payable	31,758	5,710
Trading liabilities	168,765	-
Other liabilities	<u>114,610</u>	<u>111,510</u>
Total liabilities	<u>62,750,590</u>	<u>11,715,194</u>
Commitments and contingencies	-	-
Shareholders' equity		
Preferred stock, 5,000,000 shares authorized; none issued	-	-
Common stock, \$5 par value; 20,000,000 shares authorized; 1,925,247 shares issued and outstanding at December 31, 2009 and 2008	9,626,235	9,626,235
Surplus	10,056,674	10,039,782
Retained deficit	(3,783,145)	(1,446,802)
Accumulated other comprehensive income	<u>313,093</u>	<u>214,333</u>
Total shareholders' equity	<u>16,212,857</u>	<u>18,433,548</u>
Total liabilities and shareholders' equity	<u>\$ 78,963,447</u>	<u>\$ 30,148,742</u>

See Notes to Financial Statements

Independent Auditor's Report

Board of Directors and Shareholders
 Premier Commercial Bank
 Greensboro, North Carolina

We have audited the balance sheets of Premier Commercial Bank as of December 31, 2009 and 2008 and the related statements of operations, changes in shareholders' equity, and cash flows for the year ended December 31, 2009 and the period from May 12, 2008 (opening date) through December 31, 2008. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Premier Commercial Bank as of December 31, 2009 and 2008, and the results of its operations and its cash flows for the year ended December 31, 2009 and the period from May 12, 2008 (opening date) through December 31, 2008, in conformity with accounting principles generally accepted in the United States of America.

Elliott Davis, PLLC
 Galax, Virginia
 April 19, 2010

Statements of Operations

For the year ended December 31, 2009 and the period from May 12, 2008 (opening date) through December 31, 2008

	<u>2009</u>	<u>2008</u>
Interest income		
Interest and fees on loans	\$ 1,600,763	\$ 174,957
Interest on federal funds sold	5,668	144,974
Interest on investment securities, taxable	448,394	139,922
Interest on trading assets	61,353	-
Interest on interest-bearing deposits with other banks	34,736	15,883
Dividends	463	-
Total interest income	<u>2,151,377</u>	<u>475,736</u>
Interest expense		
Deposits	581,579	97,753
Trading liabilities	101,020	-
Other borrowings	33,706	501
Total interest expense	<u>716,305</u>	<u>98,254</u>
Net interest income	1,435,072	377,482
Provision for loan losses		
Net interest income after provision for loan losses	<u>1,005,347</u>	<u>168,314</u>
	429,725	209,168
Noninterest income		
Service charges and other fees	15,132	363
Trading income	113,139	-
Loss on disposal of assets	(31,292)	-
Gain on sale of securities	13,575	-
Total noninterest income	<u>110,554</u>	<u>363</u>
Noninterest expense		
Personnel expense	1,812,313	1,001,996
Occupancy and equipment expense	340,190	199,180
Data processing expense	109,705	35,533
Marketing expense	86,129	50,617
Professional fees	180,629	199,854
FDIC insurance premiums	64,892	529
State franchise tax	25,204	-
Other expense	257,560	168,624
Total noninterest expense	<u>2,876,622</u>	<u>1,656,333</u>
Net loss	<u>\$ (2,336,343)</u>	<u>\$ (1,446,802)</u>
Basic (loss) per share	<u>\$ (1.21)</u>	<u>\$ (.75)</u>
Diluted (loss) per share	<u>\$ (1.21)</u>	<u>\$ (.75)</u>
Weighted average shares outstanding, basic	<u>1,925,247</u>	<u>1,925,247</u>
Weighted average shares outstanding, diluted	<u>1,925,247</u>	<u>1,925,247</u>

See Notes to Financial Statements

Statements of Changes in Shareholders' Equity

For the year ended December 31, 2009 and the period from May 12, 2008 (opening date) through December 31, 2008

	Common Stock		Surplus	Retained Earnings (Deficit)	Accumulated Other Comprehensive Income (Loss)	Total
	Shares	Amount				
Comprehensive loss						
Net loss	-	\$ -	\$ -	\$(1,446,802)	\$ -	\$(1,446,802)
Unrealized appreciation on available for sale investment securities	-	-	-	-	214,333	214,333
Total comprehensive loss						(1,232,469)
Sale of common stock	1,925,247	9,626,235	11,551,482	-	-	21,177,717
Pre-opening expenses	-	-	(852,707)	-	-	(852,707)
Other offering costs	-	-	(658,993)	-	-	(658,993)
Balance, December 31, 2008	<u>1,925,247</u>	<u>9,626,235</u>	<u>10,039,782</u>	<u>(1,446,802)</u>	<u>214,333</u>	<u>18,433,548</u>
Comprehensive loss						
Net loss				(2,336,343)		(2,336,343)
Net change in unrealized appreciation on available for sale investment securities					98,760	98,760
Total comprehensive loss						(2,237,583)
Non-cash stock option expense			16,892			16,892
Balance, December 31, 2009	<u>1,925,247</u>	<u>\$ 9,626,235</u>	<u>\$ 10,056,674</u>	<u>\$(3,783,145)</u>	<u>\$ 313,093</u>	<u>\$ 16,212,857</u>

See Notes to Financial Statements

Notes to Financial Statements

Note 15. Derivative Instruments, Continued

The Bank is exposed to credit-related losses in the event of nonperformance by the counterparties to these agreements. The Bank controls the credit risk of its financial contracts through credit approvals, limits and monitoring procedures, and does not expect any counterparties to fail to meet their obligations.

Derivative instruments are generally negotiated Over the Counter ("OTC") contracts or standardized contracts executed on a recognized exchange. Negotiated OTC derivative contracts are generally entered into between two counterparties that negotiate specific agreement terms, including the underlying instrument, amount, exercise prices and maturity.

At December 31, 2009, the Bank was party to two interest rate swap agreements which were not designated as hedging instruments.

In July 2009, the Bank entered into an agreement whereby a commercial loan was hedged by selling a receive fixed-pay floating swap agreement to another party. In order to offset the fixed rate interest rate risk, the Bank purchased an offsetting swap agreement with a primary dealer whereby the Bank paid a fixed rate in return for a floating rate. The notional amount of the swap agreements were \$1.6 million with an average life of 6.6 years. The difference between the Bank's interest and expense are offsetting, as are the changes in the swap agreement fair values, which are reported as trading assets and liabilities on the balance sheet and totaled \$18,474 at December 31, 2009.

In July 2009, the Bank entered into an agreement whereby a commercial loan was hedged by selling a zero cost collar to another party which was offset by purchasing a pay fixed-receive floating swap from a primary dealer. The notional amounts of the collar and swaps was \$4.2 million with an average life of 4.6 years. The Banks rate on the collar is fixed at 6.74%. The Bank's rate on the fixed payment is 6.74%. Alternatively, the Bank's receive rate on the swap floats at one- month Libor plus 250 basis points, which was 2.73% at December 31, 2009. Both the collar and the swap are carried on the balance sheet at fair value, and are offsetting. The balances at December 31, 2009 totaled \$150,291.

Notes to Financial Statements

Note 13. Regulatory Restrictions, Continued

The Bank's actual capital amounts and ratios are also presented in the table (dollars in thousands).

	Actual		Minimum Capital Requirement		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2009						
Total Capital						
(to Risk-Weighted Assets)	\$ 16,557	28.18%	\$ 4,700	8.00%	\$ 5,875	10.00%
Tier I Capital						
(to Risk-Weighted Assets)	\$ 15,900	27.06%	\$ 2,350	4.00%	\$ 3,525	6.00%
Tier I Capital						
(to Average Assets)	\$ 15,900	20.89%	\$ 3,045	4.00%	\$ 3,806	5.00%
December 31, 2008						
Total Capital						
(to Risk-Weighted Assets)	\$ 18,387	103.89%	\$ 1,416	8.00%	\$ 1,770	10.00%
Tier I Capital						
(to Risk-Weighted Assets)	\$ 18,219	102.94%	\$ 708	4.00%	\$ 1,062	6.00%
Tier I Capital						
(to Average Assets)	\$ 18,219	60.13%	\$ 1,212	4.00%	\$ 1,515	5.00%

Note 14. Transactions with Related Parties

The Bank has entered into transactions with its directors, significant shareholders and their affiliates (related parties). Such transactions were made in the ordinary course of business on substantially the same terms and conditions, including interest rates and collateral, as those prevailing at the same time for comparable transactions with other customers, and did not, in the opinion of management, involve more than normal credit risk or present other unfavorable features.

Aggregate loan transactions with related parties were as follows:

	2009	2008
Balance, beginning	\$ 2,011,434	\$ -
New loans and advances	1,662,451	2,350,000
Repayments	(1,107,213)	(338,566)
Balance, ending	<u>\$ 2,566,672</u>	<u>\$ 2,011,434</u>

Note 15. Derivative Instruments

The Bank uses derivative instruments to manage and mitigate interest rate risk as well as facilitate asset and liability management strategies. The Bank has utilized stand-alone derivative financial instruments in the form of interest rate swap agreements and interest rate collars, which derive their value from underlying interest rates. These transactions involve both credit and market risk. The notional amounts are the amounts which calculations, payments, and the value of the derivative are based. Notional amounts do not represent direct credit exposures. Direct credit exposure is limited to the net difference between the calculated amounts to be received and paid, if any. Derivatives are recorded on the balance sheet at fair value.

Statements of Cash Flows

For the year ended December 31, 2009 and the period from May 12, 2008 (opening date) through December 31, 2008

	2009	2008
Cash flows from operating activities		
Net loss	\$ (2,336,343)	\$ (1,446,802)
Adjustments to reconcile net loss to net cash used in operating activities:		
Provision for loan losses	1,005,347	168,314
Depreciation	146,727	81,834
Noncash compensation expenses	16,892	-
Investment security accretion, net of premium amortization	94,691	4,582
Gain on sale of available for sale securities	(13,575)	-
Changes in assets and liabilities:		
Accrued interest receivable	(140,521)	(120,022)
Other assets	(392,370)	(53,547)
Accrued interest payable	26,048	5,710
Other liabilities	3,100	111,510
Net cash used in operating activities	<u>(1,590,004)</u>	<u>(1,248,421)</u>
Cash flows from investing activities		
Purchases of investment securities	(15,857,055)	(13,226,456)
Purchases of restricted equity securities	(243,000)	(36,300)
Proceeds from maturities, calls, and principal paydown of securities available for sale	6,145,729	3,339,418
Proceeds from sale of securities available for sale	1,726,905	-
Loan originations, net of principal collected	(37,958,611)	(12,938,055)
Purchases of premises and equipment	(140,493)	(561,471)
Net cash used in investing activities	<u>(46,326,525)</u>	<u>(23,422,864)</u>
Cash flows from financing activities		
Sale of common stock, net	-	19,666,017
Net increase in deposits	45,837,483	11,597,974
Increase in short term borrowings	1,250,000	-
Increase in long term borrowings	3,750,000	-
Net cash provided by financing activities	<u>50,837,483</u>	<u>31,263,991</u>
Net change in cash and due from banks	2,920,954	6,592,706
Cash and due from banks at beginning of period	<u>6,592,706</u>	<u>-</u>
Cash and due from banks at end of period	<u>\$ 9,513,660</u>	<u>\$ 6,592,706</u>
Cash paid for interest	<u>\$ 690,257</u>	<u>\$ 92,544</u>
Cash paid for income taxes	<u>\$ -</u>	<u>\$ -</u>

See Notes to Financial Statements

Notes to Financial Statements

Note 1. Organization and Summary of Significant Accounting Policies

Organization

Premier Commercial Bank (the “Bank”) is incorporated under the laws of the State of North Carolina, and commenced operations on May 12, 2008. The Bank currently serves the Piedmont Triad region of North Carolina and surrounding areas through its banking office in Greensboro, North Carolina and a loan production office in High Point, North Carolina. As a state chartered bank, Premier Commercial Bank is subject to regulation by the Commissioner of Banks of the State of North Carolina and the Federal Deposit Insurance Corporation. The Bank is not a member of the Federal Reserve Bank.

The accounting and reporting policies of the Bank follow generally accepted accounting principles and general practices within the financial services industry. Following is a summary of the more significant policies:

Critical Accounting Policies

Policies with respect to the methodology for determination of the allowance for loan losses, and asset impairment judgments involve a high degree of complexity. Management must make difficult and subjective judgments, which require assumptions or estimates about highly uncertain matters. Changes in these judgments, assumptions, or estimates could cause reported results to differ materially. Periodically, the Audit Committee reviews these critical policies and their application.

Pre-opening Expenses

In accordance with applicable North Carolina banking regulations, the Bank charged its results of operations prior to the opening date to surplus. Generally Accepted Accounting Principles (“GAAP”) require such operating results be charged to retained earnings. Total pre-opening revenue and expenses equaled \$82,526 and \$935,233, respectively. The net expense amount of \$852,707 was charged to surplus. North Carolina banking regulations require the classification of net pre-opening expenses in surplus rather than retained earnings. The difference between GAAP and the method required by North Carolina’s banking regulations does not affect total shareholders’ equity and is not considered material.

Business Segments

The Bank reports its activities as a single business segment. In determining the appropriateness of segment definition, the Bank considers the materiality of a potential segment and components of the business about which financial information is available and regularly evaluated relative to resource allocation and performance assessment.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses.

The majority of the Bank’s loan portfolio consists of loans in the Piedmont Triad region of North Carolina, its primary market area. Accordingly, the ultimate collectibility of a substantial portion of the Bank’s loan portfolio is susceptible to changes in local market conditions. The regional economy is diverse and influenced to an extent by state government, major educational institutions, and activities in the Piedmont Triad.

Notes to Financial Statements

Note 12. Commitments and Contingencies, Continued

Other Commitments

The Bank has entered into an employment agreement with its Chief Executive Officer covering duties, salary, benefits, and provisions for termination and Bank obligations in the event of merger or acquisition.

Note 13. Regulatory Restrictions

Dividends

The Bank, as a North Carolina chartered bank, may pay dividends only out of undivided profits (retained earnings) as determined pursuant to North Carolina General Statutes Section 53-87. However, regulatory authorities may limit payment of dividends by any bank when it is determined that such a limitation is in the public interest and is necessary to ensure financial soundness of the bank. Additionally, dividends for the first three years of operations of new banks are explicitly prohibited by the Commissioner of Banks of the state of North Carolina and the Federal Deposit Insurance Corporation, unless prior written approval is obtained.

Capital Requirements

The Bank is subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory (and possibly additional discretionary) actions by regulators that, if undertaken, could have a direct material effect on the Bank’s financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank’s assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank’s capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital to risk-weighted assets, and of Tier I capital to average assets, as all those terms are defined in the applicable regulations. As of December 31, 2009, the Bank met all capital adequacy requirements to which it was subject.

As of December 31, 2009, the most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the following table. There are no conditions or events since the notification that management believes have changed the Bank’s category.

Notes to Financial Statements

Note 12. Commitments and Contingencies, Continued

Financial Instruments with Off-Balance Sheet Risk, Continued

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as for on-balance sheet instruments. A summary of the Bank's commitments at December 31, 2009 and 2008 are as follows:

	<u>2009</u>	<u>2008</u>
Commitments to extend credit	\$ 7,341,500	3,876,900
Standby letters of credit	123,000	-
Other commitments	<u>638,000</u>	<u>-</u>
	<u>\$ 8,102,500</u>	<u>3,876,900</u>

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 total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the customer. Collateral held varies, but may include accounts receivable, inventory, property and equipment, residential real estate and income-producing commercial properties.

Standby letters of credit are conditional commitments issued by the Bank to support the promise of performance of a customer to a third party. Those standby letters of credit are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Collateral held varies as specified above and is required in instances which the Bank deems necessary.

The Bank is an investor in a private equity limited partnership which was formed in 2009 to invest in middle market companies throughout the southeastern United States. The partnership has been licensed by the Small Business Administration ("SBA") to operate as a Small Business Investment Company under the authority of the SBA. The Bank's investment commitment is \$750,000, of which \$112,000 had been invested at December 31, 2009 and is included in other assets. The Bank's unfunded commitment at December 31, 2009 was \$638,000.

Concentrations of Credit Risk

Substantially all of the Bank's loans and commitments to extend credit have been granted to customers in the Bank's market area and such customers are generally depositors of the Bank. The concentrations of credit by type of loan are set forth in Note 4. The distribution of commitments to extend credit approximates the distribution of loans outstanding. The Bank's primary focus is toward commercial and small business transactions, and accordingly, it does not have a significant number of credits to any single borrower or group of related borrowers in excess of \$2.5 million.

The Bank from time to time may have cash and cash equivalents on deposit with financial institutions that exceed federally-insured limits.

The Bank from time to time may have cash and cash equivalents on deposit with financial institutions that exceed federally-insured limits.

Notes to Financial Statements

Note 1. Organization and Summary of Significant Accounting Policies, continued

Use of Estimates, continued

While management uses available information to recognize loan losses, future additions to the allowance may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as a part of their routine examination process, will review the Bank's allowance for loan losses. Such agencies may require the Bank to recognize additions to the allowance based on their judgments about information available to them at the time of their examinations. Because of these factors, it is reasonably possible that the allowance for loan losses will change materially in the near term.

Cash and Cash Equivalents

For the purpose of presentation in the statement of cash flows, cash and cash equivalents are defined as those amounts included in the balance sheet captions "cash and due from banks", "interest-bearing deposits with other banks", and "federal funds sold."

Trading Securities

The Bank does not hold securities for short-term resale and, therefore, does not maintain a trading securities portfolio.

Securities Held to Maturity

Bonds, notes, and debentures for which the Bank has the positive intent and ability to hold to maturity are reported at cost, adjusted for premiums and discounts that are recognized in interest income using the interest method over the period to maturity or to call dates. The Bank did not classify any securities as held to maturity at either December 31, 2009 or 2008.

Securities Available for Sale

Available for sale securities are reported at fair value and may consist of bonds, notes, and debentures not classified as trading securities or as held to maturity securities.

Unrealized holding gains and losses on available for sale securities are reported as a net amount in a separate component of shareholders' equity. Realized gains and losses on the sale of available for sale securities are determined using the specific-identification method. Premiums and discounts are recognized in interest income using the interest method over the period to maturity or to call dates.

Declines in the fair value of individual held to maturity and available for sale securities below cost that are other than temporary would be reflected as write-downs of the individual securities to fair value. Related write-downs would be included in earnings as realized losses.

Loans Receivable

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding principal amount adjusted for any charge-offs and the allowance for loan losses. Loan origination fees, net of certain direct origination costs, are deferred and recognized as a yield adjustment of the related loan. Discounts and premiums on any purchased loans are amortized to income using the interest method over the remaining period to contractual maturity, adjusted for anticipated prepayments.

Notes to Financial Statements

Note 1. Organization and Summary of Significant Accounting Policies, continued

Loans Receivable, continued

Interest is accrued and credited to income based on the principal amount outstanding. The accrual of interest on impaired loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due. When interest accrual is discontinued, all unpaid accrued interest for the current year is reversed. Interest income is subsequently recognized on the cash basis or cost recovery method, as appropriate. When facts and circumstances indicate the borrower has regained the ability to meet the required payments, the loan is returned to accrual status. Past due status of loans is determined based on contractual terms.

Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

Additionally, the allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as impaired. For such loans an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. To estimate a reasonable general component, management reviewed loan losses at other North Carolina banks including newly organized banks and banks with assets of \$25 million to \$100 million. The Bank's general component is based on the loss experience at these banks, the requirements of the Bank's regulators, and other general factors that might result in loan losses for the Bank. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating losses in the portfolio.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status and other circumstances impacting the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify individual consumer and residential loans for impairment disclosures, unless such loans are the subject of a restructuring agreement.

Notes to Financial Statements

Note 11. Income Taxes, Continued

Deferred Income Tax Analysis

The significant components of net deferred tax assets at December 31, 2009 and 2008 is summarized as follows:

	<u>2009</u>	<u>2008</u>
Deferred tax assets		
Allowance for loan losses	\$ (18,482)	\$ 31,732
Net operating losses	1,504,845	519,676
Pre-opening expenses	308,283	336,292
Stock based compensation	2,794	-
Amortization of investment premiums	6,703	-
Contributions	7,655	1,041
Deferred tax asset	<u>1,811,798</u>	<u>888,741</u>
Deferred tax liabilities		
Prepaid expenses	22,253	10,898
Deferred loan costs	27,237	6,148
Unrealized gain on securities available for sale	120,697	82,634
Depreciation	22,685	20,438
Accretion of discounts on bonds	-	732
Deferred tax liability	<u>192,872</u>	<u>120,850</u>
Deferred tax asset valuation allowance	<u>(1,739,623)</u>	<u>(850,525)</u>
Net deferred tax asset (liability)	<u>\$ (120,697)</u>	<u>\$ (82,634)</u>

The Bank has analyzed the tax positions taken or expected to be taken in its tax returns and concluded it has no liability related to uncertain tax positions. Tax returns filed since opening remain open for audit and for all major jurisdictions.

Note 12. Commitments and Contingencies

Litigation

From time to time, the Bank may become involved in legal proceedings occurring in the ordinary course of business. However, subject to uncertainties in any litigation, management believes there currently are no pending or threatened proceedings that are reasonably likely to result in a material adverse change in the Bank's financial condition or operations.

Financial Instruments with Off-Balance Sheet Risk

The Bank is party to 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 standby letters of credit. These instruments involve, to varying degrees, credit risk in excess of the amount recognized in the balance sheet.

Notes to Financial Statements

Note 11. Income Taxes

Operating Loss Carryforwards

The Bank has loss carryforwards of approximately \$3.9 million for federal and state income tax purposes that may be used to offset future taxable income. If not previously utilized, the federal and state loss carryforwards will begin to expire in 2028 and 2023, respectively.

Current and Deferred Income Tax Components

The components of income tax expense for the period ended December 31, 2009 and 2008 are as follows:

	<u>2009</u>	<u>2008</u>
Current	\$ -	\$ -
Deferred	889,098	514,233
Deferred tax asset valuation allowance change	(889,098)	(514,233)
	<u>\$ -</u>	<u>\$ -</u>

Rate Reconciliation

A reconciliation of income tax expense (benefit) computed at the statutory federal income tax rate to income tax expense included in the statement of operations for the period ended December 31, 2009 and 2008 are as follows:

	<u>2009</u>	<u>2008</u>
Tax at statutory federal rate	\$ (794,356)	\$ (491,913)
State income tax benefit	(106,304)	(61,380)
Permanent differences	10,220	28,060
Other	1,342	11,000
Deferred tax asset valuation allowance change	889,098	514,233
	<u>\$ -</u>	<u>\$ -</u>

Notes to Financial Statements

Note 1. Organization and Summary of Significant Accounting Policies, continued

Premises and Equipment

Leasehold improvements, furniture and fixtures, and computers and software are carried at cost, less accumulated depreciation and amortization computed by the straight-line method over the following estimated useful lives:

	<u>Years</u>
Leasehold improvements	5
Furniture and fixtures	3-10
Computers and software	2-5

Derivative Financial Instruments

Derivative financial instruments not designated as hedging instruments are recognized as trading assets and trading liabilities on the balance sheet and measured at fair value. Derivative financial instruments designated as hedging instruments are recognized as assets and liabilities on the balance sheet and are also measured at fair value.

Interest Rate Swap Agreements

For asset/liability management purposes, the Bank periodically uses interest rate swap agreements to hedge various exposures or to modify interest rate characteristics of various balance sheet accounts. Interest rate swaps are contracts in which a series of interest rate flows are exchanged over a prescribed period. The notional amount on which the interest payments are based is not exchanged. These swap agreements are derivative instruments and generally convert a portion of the Bank's fixed loans to a variable rate.

The gain or loss on a derivative designated and qualifying as a fair value hedging instrument, as well as the offsetting gain or loss on the hedged item attributable to the risk being hedged, is recognized currently in earnings in the same accounting period. The effective portion of the gain or loss on a derivative designated and qualifying as a cash flow hedging instrument is initially reported as a component of other comprehensive income and subsequently reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The ineffective portion of the gain or loss on the derivative instrument, if any, is recognized currently in earnings.

For cash flow hedges, the net settlement (upon close-out or termination) that offsets changes in the value of the hedged asset or liability is deferred and amortized into net interest income over the life of the hedged asset or liability. For fair value hedges, the net settlement (upon close-out or termination) that offsets changes in the value of the loans adjusts the basis of the loans and is deferred and amortized to loan interest income over the life of the loans. The portion, if any, of the net settlement amount that did not offset changes in the value of the hedged asset or liability is recognized immediately in non-interest income. Interest rate derivative financial instruments receive hedge accounting treatment only if they are designated as a hedge and are expected to be, and are, effective in substantially reducing interest rate risk arising from the assets and liabilities identified as exposing the Bank to risk. Those derivative financial instruments that do not meet specified hedging criteria would be recorded at fair value with changes in fair value recorded in income. If periodic assessment indicated derivatives no longer provide an effective hedge, the derivative contracts would be closed out and settled, or classified as a trading activity.

Cash flows resulting from the derivative financial instruments that are accounted for as hedges of assets and liabilities are classified in the cash flow statement in the same category as the cash flows of the item being hedged.

Notes to Financial Statements

Note 1. Organization and Summary of Significant Accounting Policies, continued

Foreclosed Properties

Real estate properties acquired through, or in lieu of, loan foreclosure are to be sold and are initially recorded at fair value less anticipated cost to sell at the date of foreclosure establishing a new cost basis. After foreclosure, valuations are periodically performed by management, and the real estate is carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in loss on foreclosed real estate when applicable. The Bank held no foreclosed properties at December 31, 2009 or 2008, respectively.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Bank, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Advertising Expense

The Bank expenses advertising costs as they are incurred. These costs are included in marketing expense, as presented in the statement of operations.

Income Taxes

Provision for income taxes is based on amounts reported in the statements of income (after exclusion of non-taxable income such as interest on state and municipal securities) and consists of taxes currently due plus deferred taxes on temporary differences in the recognition of income and expense for tax and financial statement purposes. Deferred tax assets and liabilities are included in the financial statements at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws. Due to a lack of history of operating income, the entire net deferred tax asset is offset by a valuation allowance.

Tax positions are analyzed in accordance with generally accepted accounting principles. Interest recognized as a result of the analysis of tax positions would be classified as interest expense. Penalties would be classified as noninterest expense.

Basic Earnings (Loss) per Share

Basic earnings (loss) per share is computed by dividing income or loss available to common shareholders by the weighted average number of common shares outstanding during the period, after giving retroactive effect to stock splits and dividends.

Notes to Financial Statements

Note 10. Benefit Plans, Continued

Stock Option Plans, Continued

A summary of option activity under the stock option plans for the years ended December 31, 2009 is presented below:

	Employee Plan		Director Plan	
	Available for Grant	Granted	Available for Grant	Granted
<i>Balance at December 31, 2008</i>	192,524	-	192,524	\$ -
Forfeited	-	-	-	-
Granted	(170,800)	170,800	(128,400)	128,400
Exercised	-	-	-	-
<i>Balance at December 31, 2009</i>	<u>21,724</u>	<u>170,800</u>	<u>64,124</u>	<u>\$ 128,400</u>

Additional information relating to Bank plans is detailed below:

	<u>2009</u>
<i>Outstanding options</i>	
Weighted average exercise price, beginning of the year	-
Weighted average exercise price, end of the year	\$ 11
Range of exercise prices, end of year:	
From	\$ 11
To	\$ 11
Remaining weighted average life in months	120
<i>Exercisable options outstanding at December 31</i>	
Number	-
Weighted average exercise price	\$ -
<i>Weighted average exercise price of options</i>	
Granted during the year	\$ 11
Exercised during the year	\$ -
Forfeited during the year	\$ -
Expired during the year	\$ -
<i>Significant assumptions used in determining fair value of options granted</i>	
Risk-free interest rate	3.34%
Expected life in years	7
Expected dividends	0.00%
Expected volatility	20.00%
<i>Grant-date fair value</i>	
Options granted during the year	\$ 1,013,390
Options granted during the year, weighted average	\$ 3.39

There was no expense relating to stock options for the year ended December 31, 2008. The aggregate intrinsic value of all stock options and exercisable stock options at December 31, 2009 was \$0.

Notes to Financial Statements

Note 9. Earnings (Loss) Per Share

The following table presents the computation of loss per share for the period ended December 31, 2009 and 2008:

	<u>2009</u>	<u>2008</u>
Net loss attributable to common shareholders	\$ (2,336,343)	\$ (1,446,802)
Weighted average shares outstanding	<u>1,925,247</u>	<u>1,925,247</u>
Weighted average shares outstanding, diluted	<u>1,925,247</u>	<u>1,925,247</u>
Basic loss per share	\$ (1.21)	\$ (.75)
Diluted loss per share	\$ (1.21)	\$ (.75)

At December 31, 2009, there were 299,200 options that were not included in the calculation of diluted earnings per share because their effect would be anti-dilutive.

Note 10. Benefit Plans

The Bank maintains a defined contribution plan (the "Plan") pursuant to Section 401(k) of the Code. The Plan covers substantially all employees who are 21 years of age. Employees are eligible immediately upon employment. Participants may contribute up to 100% of their base salary to the Plan, subject to limits imposed under the Internal Revenue Code. The Bank matches 100% of the first 6% of a participant's base salary. For the period ended December 31, 2009, the Bank contributed \$71,360 to the Plan. The Bank's contributions vest over a three year period. The Bank also maintains a Flexible Benefits Plan which covers substantially all employees. Participants may set aside pre-tax dollars to provide for future expenses such as insurance, dependent care, or health care.

Stock Option Plans

In 2008 the Bank adopted both an Employee Stock Option Plan and a Director Stock Option Plan. Under each plan up to 192,524 shares may be issued for a total of 385,048 shares. Options granted under both plans expire no more than 10 years from date of grant. Option exercise prices under both plans shall be set by the Board of Directors at the date of grant, but shall not be less than 100% of fair market value of the common stock at the date of the grant. Options vest at a rate determined by the Board.

Compensation cost relating to share-based payment transactions is recognized in the financial statements with measurement based upon the fair value of the equity or liability instruments issued for the years in which grants have been made. For the year ended December 31, 2009, the Bank recognized \$17,000 in compensation expense for stock options. No options were granted in 2008. Accordingly, there was no option related compensation expense during 2008.

At December 31, 2009, unrecognized compensation costs amounted to \$997,000 which will be expensed over the next five years.

The weighted average fair value of each stock option grant is estimated on the date of grant using the Black-Scholes option-pricing model. The expected volatility is based on historical volatility. The risk-free interest rates for periods within the contractual life of the awards are based on the U.S. Treasury yield curve in effect at the time of the grant. The expected life is based on historical exercise experience. The dividend yield assumption is based on the Bank's history and expectation of dividend payouts.

Notes to Financial Statements

Note 1. Organization and Summary of Significant Accounting Policies, continued

Diluted Earnings (Loss) per Share

The computation of diluted earnings (loss) per share is similar to the computation of basic earnings per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if dilutive potential common shares had been issued, unless their inclusion would be anti-dilutive. The numerator is adjusted for any changes in income or loss that would result from the assumed conversion of those potential common shares.

Comprehensive Income

Annual comprehensive income reflects the change in the Bank's equity during the reporting period arising from transactions and events other than investment by and distributions to shareholders. It consists of net income plus certain other changes in assets and liabilities that are reported as separate components of shareholders' equity rather than as income or expense.

Employee Benefit Plans

The Bank has a defined contribution plan qualifying under Section 401(k) of the Internal Revenue Code of 1986, as amended (the "Code"). Employee contributions are matched one-hundred percent by the Bank up to the first six percent of the employee's base compensation. Employees may contribute up to 100% of their base salary, subject to limits imposed under the Code. The Bank's match is expensed as incurred.

Stock Compensation Plans

The Bank recognizes compensation cost relating to share-based payment transactions in accordance with generally accepted accounting principles. That cost is measured based on the fair value of the equity or liability instruments issued. The expense measures the cost of employee services received in exchange for stock options based on the grant-date fair value of the award and recognizes the cost over the period the employee is required to provide services for the award.

Fair Value of Financial Instruments

GAAP 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. The Bank determines the fair values of its financial instruments based on the fair value hierarchy established per GAAP which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Investment securities available-for-sale are recorded at fair value on a recurring basis. Certain impaired loans are carried at fair value on a non-recurring basis.

Reclassification

Certain amounts in the prior year financial statements have been reclassified to conform to the current year presentation. Net income and shareholders' equity previously reported were not affected by these reclassifications.

Subsequent Events

These financial statements have not been updated for subsequent events occurring after April 19, 2010 which is the date these financial statements were available to be issued.

Notes to Financial Statements

Note 1. Organization and Summary of Significant Accounting Policies, continued

Recent Accounting Pronouncements

The following is a summary of recent authoritative pronouncements that could impact the accounting, reporting, and/or disclosure of financial information by the Bank.

In June 2009, the Financial Accounting Standards Board ("FASB") issued guidance which restructured GAAP and simplified access to all authoritative literature by providing a single source of authoritative nongovernmental GAAP. The guidance is presented in a topically organized structure referred to as the FASB Accounting Standards Codification ("ASC"). The new structure is effective for interim or annual periods ending after September 15, 2009. All existing accounting standards have been superseded and all other accounting literature not included is considered nonauthoritative.

The FASB issued new accounting guidance on accounting for transfers of financial assets in June 2009. The guidance limits the circumstances in which a financial asset should be derecognized when the transferor has not transferred the entire financial asset by taking into consideration the transferor's continuing involvement. The standard requires that a transferor recognize and initially measure at fair value all assets obtained (including a transferor's beneficial interest) and liabilities incurred as a result of a transfer of financial assets accounted for as a sale. The concept of a qualifying special-purpose entity is no longer applicable. The standard is effective for the first annual reporting period that begins after November 15, 2009, for interim periods within the first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application is prohibited. The Bank does not expect the guidance to have any impact on the Bank's financial statements. The ASC was amended in December, 2009, to include this guidance.

In July 2006, guidance was issued related to accounting for uncertainty in income taxes. The guidance prescribes a recognition threshold and measurement attributable for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Guidance was also provided on derecognition, classification, interest and penalties, accounting in interim periods, disclosures and transitions. An update to the guidance issued on September, 2009, eliminated certain disclosure requirements for nonpublic companies. The Bank adopted the guidance on January 1, 2009 with no material impact to the financial statements.

Guidance was issued in April 2009 on categorizing other-than-temporarily impaired losses on debt securities into losses due to credit issues or losses related to other factors (such as interest rates). Other-than-temporary impairment (OTTI) exists when it is more likely than not that a security will mature or be sold before its amortized cost basis can be recovered. An OTTI related to credit losses should be recognized through earnings. An OTTI related to other factors should be recognized in other comprehensive income. The guidance is effective for the Bank for the year ended December 31, 2009 and had no impact on the financial statements.

Guidance providing when a subsequent event should be recognized in the financial statements was issued in June 2009. Subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet should be recognized at the balance sheet date. Subsequent events that provide evidence about conditions that arose after the balance sheet date but before financial statements are issued, or are available to be issued, are not required to be recognized. The date through which subsequent events have been evaluated must be disclosed as well as whether it is the date the financial statements were issued or the date the financial statements were available to be issued. The guidance is effective for the year ending December 31, 2009 and the required disclosure has been included in the notes to the financial statements.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies are not expected to have a material impact on the Bank's financial position, results of operations and cash flows.

Notes to Financial Statements

Note 8. Fair Value of Financial Instruments

Fair Value Hierarchy

There are three levels of inputs in the fair value hierarchy that may be used to measure fair value. Financial instruments are considered *Level 1* when valuation can be based on quoted prices in active markets for identical assets or liabilities. *Level 2* financial instruments are valued using quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or models using inputs that are observable or can be corroborated by observable market data of substantially the full term of the assets or liabilities. Financial instruments are considered *Level 3* when their values are determined using pricing models, discounted cash flow methodologies or similar techniques and at least one significant model assumption or input is unobservable and when determination of the fair value requires significant management judgment or estimation. The following sections provide a description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the fair value hierarchy:

Financial Instruments Measured at Fair Value

Securities: Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities would include highly liquid government bonds, mortgage products and exchange traded equities. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics, or discounted cash flow. Level 2 securities would include U.S. agency securities, mortgage-backed agency securities, obligations of states and political subdivisions and certain corporate, asset backed and other securities. In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified within Level 3 of the valuation hierarchy.

Impaired Loans: Where impairment of a loan is based on a loan's observable market price or the fair value of the collateral of a collateral-dependent loan. Fair value of the loan's collateral, when the loan is dependent on collateral, is determined by appraisals or independent valuation which is then adjusted for the cost related to liquidation of the collateral.

Trading Assets and Liabilities: The fair value of the interest rate swap agreements are determined using multiple market inputs including interest rates, prices, and indices to generate continuous yield or pricing curves and volatility factors, which are used to value the position.

Recurring Fair Value

The table below presents the recorded amount of assets and liabilities measured at fair value on a recurring basis.

December 31, 2009	Total	Level 1	Level 2	Level 3
Investment securities available for sale	\$ 18,098,854	\$ -	\$ 18,098,854	\$ -
Trading assets	168,765	-	168,765	-
Total assets measured at fair value	\$ 18,267,619	\$ -	\$ 18,267,619	\$ -
Trading liabilities	\$ 168,765	\$ -	\$ 168,765	\$ -
Total liabilities measured at fair value	\$ 168,765	\$ -	\$ 168,765	\$ -
December 31, 2008	Total	Level 1	Level 2	Level 3
Investment securities available for sale	\$ 10,096,789	\$ -	\$ 10,096,789	\$ -
Total assets at fair value	\$ 10,096,789	\$ -	\$ 10,096,789	\$ -
Total liabilities at fair value	\$ -	\$ -	\$ -	\$ -

Notes to Financial Statements

Note 7. Borrowings

The Bank uses borrowings in conjunction with deposits to fund lending and investing activities. Borrowings include funding of a short-term and long-term nature. Short-term funding includes secured overnight borrowings from the FHLB as well as unsecured borrowings from other correspondent banks. Long-term borrowings are obtained through the FHLB. As of December 31, 2009, the Bank had investment securities with an amortized cost of \$5.9 million pledged to the FHLB. The following information is provided for borrowings balances, rates, and maturities with the FHLB (dollars in thousands):

	As of December 31,	
	2009	2008
Short-term:		
Daily rate advances	\$ 1,250	\$ -
Maximum month-end outstanding balance	\$ 5,000	\$ -
Average outstanding balance during the year	\$ 925	\$ -
Average interest rate during the year	.41%	0.00%
Average interest rate at end of year	.36%	0.00%
Long-term:		
Federal Home Loan Bank advances	\$ 3,750	\$ -
Maximum month-end outstanding balance	\$ 3,750	\$ -
Average outstanding balance during the year	\$ 1,757	\$ -
Average interest rate during the year	1.65%	-
Average interest rate at end of year	1.65%	-

Maturities of fixed rate long-term debt at December 31, 2009 are as follows:

2010	\$ -
2011	2,250
2012	1,500
2013	-
2014	-
Thereafter	-
Total	\$ 3,750

The Bank has unsecured lines of credit with correspondent banks available for overnight borrowing totaling approximately \$8,700,000. The Bank has credit availability of approximately \$5,300,000 through a secured borrowing facility.

Notes to Financial Statements

Note 2. Restrictions on Cash

To comply with banking regulations, the Bank is required to maintain certain minimum average cash reserve balances. Cash on hand and in banks of approximately \$1,700,000 and \$281,000 was restricted to comply with such regulations at December 31, 2009 and 2008, respectively.

Note 3. Securities

Following is a summary of investment securities as of December 31, 2009 and 2008, all of which are classified as available for sale:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
2009				
U.S. Government sponsored enterprises	\$ 1,791,505	\$ -	\$ (1,556)	\$ 1,789,949
Mortgage-backed securities	15,994,256	352,064	(37,415)	16,308,905
Total available for sale	\$ 17,785,761	\$ 352,064	\$ (38,971)	\$ 18,098,854
2008				
U.S. Government sponsored enterprises	\$ 2,501,870	\$ 12,726	\$ -	\$ 2,514,596
Mortgage-backed securities	7,380,586	204,995	(3,388)	7,582,193
Total available for sale	\$ 9,882,456	\$ 217,721	\$ (3,388)	\$ 10,096,789

All of the Bank's mortgage-backed securities are issued and guaranteed by U.S. Government sponsored enterprises.

Restricted equity securities consist of investments in common stock of the Federal Home Loan Bank of Atlanta ("FHLB"). The FHLB requires member financial institutions to make equity investments in the FHLB in order to borrow money. The Bank is required to hold that stock as long as it borrows from the FHLB, in addition to stock owned under membership requirements. The FHLB has suspended all redemptions of this stock.

Investment securities with an amortized cost of \$6.3 million at December 31, 2009 were pledged as collateral.

There were gross realized gains of \$13,575 and \$0 for the years ended December 31, 2009 and 2008, respectively.

The fair value, by contractual maturity, of available for sale securities at December 31, 2009 follows:

	Within 1 Year	After 1 Year Through 5 Years	After 5 Years Through 10 Years	After 10 Years	Total
U.S. Government sponsored enterprises	\$ -	\$ -	\$ 1,789,949	\$ -	\$ 1,789,949
Mortgage-backed securities		1,019,118	6,527,088	8,762,699	16,308,905
Total available for sale	\$ -	\$ 1,019,118	\$ 8,317,037	\$ 8,762,699	\$ 18,098,854

The maturities of mortgage-backed securities are presented according to the date underlying mortgages in the pool are due. However, the Bank receives regular payments of principal on the securities in addition to prepayments of principal arising from repayment of the mortgages in advance of their scheduled due dates. During the period ended December 31, 2009, the Bank received principal payments of \$3.9 million. When the Bank receives prepayments on mortgage loans, the discount associated with such prepayment is recognized as revenue.

Notes to Financial Statements

Note 3. Securities, Continued

The following table details unrealized losses and related fair values in the Bank's available for sale investment securities portfolio. This information is aggregated by the length of time that individual securities have been in a continuous unrealized loss position as of December 31, 2009 and 2008.

	Less Than 12 Months		12 Months or greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
2009						
U.S. Government sponsored enterprises	\$ 1,789,949	\$ (1,556)	\$ -	\$ -	\$ 1,789,949	\$ (1,556)
Mortgage-backed securities	3,073,542	(37,415)	-	-	3,073,542	(37,415)
Total available for sale	<u>\$ 4,863,491</u>	<u>\$ (38,971)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 4,863,491</u>	<u>\$ (38,971)</u>
2008						
Mortgage-backed securities	<u>\$ 763,055</u>	<u>\$ (3,388)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 763,055</u>	<u>\$ (3,388)</u>

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. At December 31, 2009, the Bank's securities consisted of Government sponsored entities, and mortgage-backed securities guaranteed by U.S. Government sponsored enterprises. There are no known impairments to such securities.

Note 4. Loans

The major components of loans in the balance sheet at December 31, 2009 and 2008 are as follows:

	2009	2008
Commercial and agricultural	\$ 8,493,428	\$ 1,951,110
Real estate construction and land development	2,541,879	2,230,500
Real estate mortgage loans		
Residential	7,516,869	1,126,794
Nonresidential	29,857,717	7,634,270
Multi family residential	1,486,974	-
Consumer loans	534,570	2,691
Deferred loan fees (net)	(50,908)	(7,310)
Total loans	50,380,529	12,938,055
Allowance for loan losses	(657,524)	(168,314)
Net loans	<u>\$ 49,723,005</u>	<u>\$ 12,769,741</u>

An analysis of the allowance for loan losses is as follows:

	2009	2008
Balance at beginning of period	\$ 168,314	\$ -
Provision for loan losses	1,005,347	168,314
Amounts charged off	(516,137)	-
Balance at end of period	<u>\$ 657,524</u>	<u>\$ 168,314</u>

There were no impaired, nonaccrual, or loans past due 90 days or more and still accruing at December 31, 2009 or 2008. The Bank's average investment in impaired loans was approximately \$133,000 for 2009.

Notes to Financial Statements

Note 5. Premises and Equipment

Components of property and equipment and total accumulated depreciation at December 31, 2009 and 2008 are as follow

	2009	2008
Leasehold improvements	\$ 118,819	\$ 100,788
Furniture and fixtures	303,774	222,570
Computers and software	279,372	238,113
	701,965	561,471
Accumulated depreciation and amortization	(228,562)	(81,834)
Net premises and equipment	<u>\$ 473,403</u>	<u>\$ 479,637</u>

Depreciation and amortization expense for the periods ended December 31, 2009 and 2008 was \$146,727 and \$81,834, respectively.

The Bank has entered into an operating lease on its banking office in Greensboro, North Carolina. The initial term of this lease commenced on February 1, 2008 and will remain in effect through January 31, 2013. The Bank's total rent expense for this office for 2009 and 2008 was \$137,592 and \$91,728.

The Bank has entered into an operating lease on a loan production office in High Point, North Carolina. The initial term of this lease commenced on August 17, 2009 and will remain in effect through August 31, 2014. The Bank's rent expense for this office during 2009 was \$7,053.

Future minimum payments under non-cancelable operating lease agreements are as follows:

Year	Amount
2010	\$ 165,804
2011	165,804
2012	165,804
2013	39,678
2014	18,808
Total	<u>\$ 555,898</u>

Note 6. Deposits

The aggregate amount of time deposits in denominations of one hundred thousand dollars or more was \$14.1 million and \$855,255 at December 31, 2009 and 2008, respectively. At December 31, 2009 the scheduled maturities of time deposits are as follows:

	Less Than \$100,000	\$100,000 or More	Total
2010	\$ 5,664,206	\$ 6,972,656	\$ 12,636,862
2011 thru 2013	6,803,000	7,163,318	13,966,318
	<u>\$ 12,467,206</u>	<u>\$ 14,135,974</u>	<u>\$ 26,603,180</u>

Certificates of deposit classified as less than \$100,000 include brokered deposits of \$9.03 million.