



**Annual Report**  
**December 31, 2010**

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## 2010 Annual Report

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*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.*



To the Shareholders of Premier Commercial Bank:

Your bank experienced another year of solid, safe, and sound growth in 2010 despite continuing difficulties at all levels of the economy and challenges for the banking industry, in particular. The Bank's development remains on the right path. We continue to be guided by the four strategies that our board and senior management set three years ago. We review our progress on each strategy for you here:

**Grow a high-quality asset base, while preserving the bank's capital** – During the year, we grew assets by 28% to \$101 million and loans by 33% to \$67 million while also preserving our asset quality. At year-end, there were no non-performing assets and no past-due loans. The Bank's core strength is its strong credit culture.

**Develop a properly-structured funding base.** – We continued to invest the necessary resources in developing the organizational capacity to build a strong deposit base. During 2010, the Bank's core deposits grew by 55% to \$48 million. More work remains, but we are confident in our prospects. If you are not already a deposit client, we ask that you consider becoming one at your bank during 2011.

**Develop a loyal base of ideal clients.** – Our experienced staff continues to develop client relationships based on Premier Commercial's commitment to customized client solutions. It is central to the Bank's value proposition. At year-end, we surveyed our clients to gauge their experience of, and satisfaction with, Premier's approach to high-quality client service. The strong response confirmed that we are on the right path in meeting customers' needs in ways we are convinced will create customer loyalty.

**Create a high-performance culture throughout all areas of the bank.** – We strengthened our organization in several areas during the year. We added several strong people to our business development team in both the lending and deposit-gathering areas.

- In August, we hired Warren D. (Rocky) Herring, Jr. as our Chief Credit Officer. Mr. Herring brings a wealth of credit administration, analysis, risk management, and regulatory compliance skills to the bank.
- In October, G. Munroe Cobey joined our Board of Directors. Mr. Cobey retired from Tudor Investment Corporation in 2007, after eleven years as a Senior Portfolio Manager. Prior to that, he was a Managing Director for Bankers Trust Co., New York, with responsibility for asset/liability and portfolio management.

2011 will be another challenging year for the economy. Look for continued moderate, disciplined growth from Premier Commercial. It will position us to take advantage of opportunities. We remain confident that our continued focus on quality in everything we do will enhance shareholder value over time. Thank you for your continued support.

Sincerely,

A handwritten signature in black ink that reads "Frank Gavigan".

Frank Gavigan  
President and CEO

A handwritten signature in black ink that reads "R. Sterling Kelly III".

R. Sterling Kelly III  
Chairman

## Balance Sheets

For the years ended December 31, 2010 and 2009

	<u>2010</u>	<u>2009</u>
<b>Assets</b>		
Cash and due from banks	\$ 3,074,493	\$ 2,321,159
Interest-bearing deposits with other banks	<u>8,200,882</u>	<u>7,192,501</u>
Cash and cash equivalents	<u>11,275,375</u>	<u>9,513,660</u>
Securities available for sale	21,519,633	18,098,854
Restricted equity securities	411,000	279,300
Loans	67,057,994	50,380,529
Allowance for loan losses	<u>(873,314)</u>	<u>(657,524)</u>
Net loans	<u>66,184,680</u>	<u>49,723,005</u>
Trading assets	254,614	168,765
Premises and equipment, net of accumulated depreciation	387,690	473,403
Accrued interest receivable	324,092	260,543
Other assets	<u>591,987</u>	<u>445,917</u>
Total assets	<u>\$ 100,949,071</u>	<u>\$ 78,963,447</u>
<b>Liabilities and Shareholders' Equity</b>		
<b>Liabilities</b>		
Deposits:		
Noninterest-bearing deposits	7,707,998	5,026,334
NOW accounts	1,350,823	2,345,260
Savings and interest-checking	39,166,182	23,460,683
Certificates of deposit	<u>30,154,037</u>	<u>26,603,180</u>
Total deposits	78,379,040	57,435,457
FHLB borrowings	6,500,000	5,000,000
Accrued interest payable	23,988	31,758
Derivative instruments	313,013	-
Trading liabilities	254,614	168,765
Other liabilities	<u>233,900</u>	<u>114,610</u>
Total liabilities	<u>85,704,555</u>	<u>62,750,590</u>
Commitments and contingencies	-	-
<b>Shareholders' equity</b>		
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, 2010 and 2009	9,626,235	9,626,235
Surplus	10,241,004	10,056,674
Retained deficit	(4,933,076)	(3,783,145)
Accumulated other comprehensive income	<u>310,353</u>	<u>313,093</u>
Total shareholders' equity	<u>15,244,516</u>	<u>16,212,857</u>
Total liabilities and shareholders' equity	<u>\$ 100,949,071</u>	<u>\$ 78,963,447</u>

See Notes to Financial Statements

## Statements of Operations

For the years ended December 31, 2010 and 2009

	<u>2010</u>	<u>2009</u>
<b>Interest income</b>		
Interest and fees on loans	\$ 2,936,342	\$ 1,600,763
Interest on investment securities, taxable	564,582	448,394
Interest on trading assets	130,604	61,353
Interest on interest-bearing deposits with other banks	26,949	40,404
Dividends	<u>1,086</u>	<u>463</u>
Total interest income	<u>3,659,563</u>	<u>2,151,377</u>
<b>Interest expense</b>		
Deposits	831,207	581,579
Trading liabilities	215,988	101,020
Other borrowings	<u>68,028</u>	<u>33,706</u>
Total interest expense	<u>1,115,223</u>	<u>716,305</u>
Net interest income	2,544,340	1,435,072
<b>Provision for loan losses</b>		
Net interest income after provision for loan losses	<u>500,545</u>	<u>1,005,347</u>
	<u>2,043,795</u>	<u>429,725</u>
<b>Noninterest income</b>		
Service charges and other fees	46,791	15,132
Trading income	-	113,139
Loss on disposal of assets	-	(31,292)
Mortgage loan income	43,250	-
Net gain on fair value swap	11,545	-
Gain on sale of securities	<u>2,362</u>	<u>13,575</u>
Total noninterest income	<u>103,948</u>	<u>110,554</u>
<b>Noninterest expense</b>		
Personnel expense	2,036,757	1,812,313
Occupancy and equipment expense	415,136	340,190
Data processing expense	145,870	109,705
Marketing expense	53,287	86,129
Professional fees	205,667	180,629
FDIC insurance premiums	91,115	64,892
State franchise tax	25,818	25,204
Other expense	<u>324,024</u>	<u>257,560</u>
Total noninterest expense	<u>3,297,674</u>	<u>2,876,622</u>
Net loss	<u>\$ (1,149,931)</u>	<u>\$ (2,336,343)</u>
<b>Basic (loss) per share</b>	<u>\$ (0.60)</u>	<u>\$ (1.21)</u>
<b>Diluted (loss) per share</b>	<u>\$ (0.60)</u>	<u>\$ (1.21)</u>
<b>Weighted average shares outstanding, basic</b>	<u>1,925,247</u>	<u>1,925,247</u>
<b>Weighted average shares outstanding, diluted</b>	<u>1,925,247</u>	<u>1,925,247</u>

See Notes to Financial Statements



## Statements of Changes in Shareholders' Equity

For the years ended December 31, 2010 and 2009

	<u>Common Stock</u>		<u>Surplus</u>	<u>Retained Earnings (Deficit)</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total</u>
	<u>Shares</u>	<u>Amount</u>				
<b>Balance, December 31, 2008</b>	1,925,247	\$ 9,626,235	\$ 10,039,782	\$ (1,446,802)	\$ 214,333	\$ 18,433,548
<b>Comprehensive loss</b>						
Net loss				(2,336,343)		(2,336,343)
Net change in unrealized appreciation on available for sale investment securities					112,335	112,335
Reclassification of gains recognized in net loss					(13,575)	(13,575)
<b>Total comprehensive loss</b>						(2,237,583)
Non-cash stock option expense			16,892			16,892
<b>Balance, December 31, 2009</b>	1,925,247	9,626,235	10,056,674	(3,783,145)	313,093	16,212,857
<b>Comprehensive loss</b>						
Net loss				(1,149,931)		(1,149,931)
Net change in unrealized appreciation on available for sale investment securities					(378)	(378)
Reclassification of gains recognized in net loss					(2,362)	(2,362)
<b>Total comprehensive loss</b>						(1,152,671)
Non-cash stock option expense			184,330			184,330
<b>Balance, December 31, 2010</b>	<u>1,925,247</u>	<u>\$ 9,626,235</u>	<u>\$ 10,241,004</u>	<u>\$ (4,933,076)</u>	<u>\$ 310,353</u>	<u>\$15,244,516</u>

See Notes to Financial Statements

## Statements of Cash Flows

For the years ended December 31, 2010 and 2009

	<u>2010</u>	<u>2009</u>
<b><i>Cash flows from operating activities</i></b>		
Net loss	\$ (1,149,931)	\$ (2,336,343)
Adjustments to reconcile net loss to net cash used in operating activities:		
Provision for loan losses	500,545	1,005,347
Depreciation	165,135	146,727
Noncash compensation expenses	184,330	16,892
Investment security accretion, net of premium amortization	271,462	94,691
Change in fair market value of derivative instruments	313,013	-
Gain on sale of available for sale securities	(2,362)	(13,575)
Changes in assets and liabilities:		
Accrued interest receivable	(63,549)	(140,521)
Other assets	(146,070)	(392,370)
Accrued interest payable	(7,770)	26,048
Other liabilities	119,290	3,100
Net cash provided (used) in operating activities	<u>184,093</u>	<u>(1,590,004)</u>
<b><i>Cash flows from investing activities</i></b>		
Purchases of investment securities	(12,109,618)	(15,857,055)
Purchases of restricted equity securities	(131,700)	(243,000)
Proceeds from maturities, calls, and principal paydown of securities available for sale	8,033,087	6,145,729
Proceeds from sale of securities available for sale	383,916	1,726,905
Loan originations, net of principal collected	(16,962,220)	(37,958,611)
Purchases of premises and equipment	(79,426)	(140,493)
Net cash used in investing activities	<u>(20,865,961)</u>	<u>(46,326,525)</u>
<b><i>Cash flows from financing activities</i></b>		
Net increase in deposits	20,943,583	45,837,483
Increase in short term borrowings	-	1,250,000
Increase in long term borrowings	1,500,000	3,750,000
Net cash provided by financing activities	<u>22,443,583</u>	<u>50,837,483</u>
Net change in cash and due from banks	1,761,715	2,920,954
<b><i>Cash and due from banks at beginning of period</i></b>	<u>9,513,660</u>	<u>6,592,706</u>
<b><i>Cash and due from banks at end of period</i></b>	<u>\$ 11,275,375</u>	<u>\$ 9,513,660</u>
<b><i>Cash paid for interest</i></b>	<u>\$ 1,122,933</u>	<u>\$ 690,257</u>
<b><i>Cash paid for income taxes</i></b>	<u>\$ -</u>	<u>\$ -</u>

See Notes to Financial Statements

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## Notes to Financial Statements

For the years ended December 31, 2010 and 2009

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### 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 (the “Piedmont”) and surrounding areas through its banking office in Greensboro, North Carolina, a loan production office in High Point, North Carolina, and two mortgage origination offices located in Greensboro and Charlotte, 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 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.

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## Notes to Financial Statements

For the years ended December 31, 2010 and 2009

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### **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 may 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, 2010 or 2009.

#### *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.

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## Notes to Financial Statements

For the years ended December 31, 2010 and 2009

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### 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, it is unlikely that the borrower will be able 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 and is maintained at a level appropriate in light of the risk inherent in the loan portfolio. 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 industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality, recent economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available regarding the performance of the Bank's loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications.

The Bank's allowance for possible loan losses consists of three elements. First, there is a specific valuation allowance determined in accordance with Accounting Standards Certification ("ASC") Topic 310, *Receivables*, which is based on probable losses on specific loans. Second, the Bank calculates a historical valuation allowance determined in accordance with ASC Topic 450, *Contingencies*. Since the Bank has limited loss experience on which to base an estimate, its historical analysis is based on peer group data from banks operating within the same lending business as the Bank with similar portfolios and has developed an appropriate range of historical loss data. Third, a general valuation allowance is determined in accordance with ASC Topic 450 and is based on general conditions and other qualitative risk factors both internal and external to 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.

General valuation allowances are based on general economic conditions and other qualitative risk factors both internal and external to the Bank. In general, such valuation allowances are determined by evaluating among other things; (i) local, state and national economic outlook; (ii) concentrations of credit; (iii) interest rate risk, (iv) trends in volume, mix and size of loans; (v) seasoning of the loan portfolio; (vi) experience of the staff, and (vii) levels and trends of delinquencies. Management evaluates the degree of risk that each one of these components has on the quality of the loan portfolio on a quarterly basis. Each component is assigned a high, moderate and low risk factor which is applied to the entire non-impaired loan portfolio. The results are then input into a loan loss model to determine an appropriate general valuation allowance.

## Notes to Financial Statements

For the years ended December 31, 2010 and 2009

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

#### *Allowance for Loan Losses, continued*

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.

#### *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.

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## Notes to Financial Statements

For the years ended December 31, 2010 and 2009

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

#### *Interest Rate Swap Agreements, continued*

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.

#### *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, 2010 or 2009, 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.

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## Notes to Financial Statements

For the years ended December 31, 2010 and 2009

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

#### *Income Taxes, continued*

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.

#### *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.

## Notes to Financial Statements

For the years ended December 31, 2010 and 2009

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

#### *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, 2011 which is the date these financial statements were available to be issued.

#### *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 January 2010, fair value guidance was amended to require disclosures for significant amounts transferred in and out of Levels 1 and 2 and the reasons for such transfers and to require that gross amounts of purchases, sales, issuances and settlements be provided in the Level 3 reconciliation. Disaggregation of classes of assets and liabilities is also required. The new disclosures are effective for the Bank for the current year and have been reflected in Note 8.

In March 2010, guidance related to derivatives and hedging was amended to exempt embedded credit derivative features related to the transfer of credit risk from potential bifurcation and separate accounting. Embedded features related to other types of risk and other embedded credit derivative features are not exempt from potential bifurcation and separate accounting. The amendments were effective for the Bank on July 1, 2010. These amendments will have no impact on the financial statements.

In July 2010, the Receivables topic of the ASC was amended to require expanded disclosures related to the allowance for credit losses and the credit quality of its financing receivables. The amendments will require the allowance disclosures to be provided on a disaggregated basis. The Bank is required to begin to comply with the disclosures in its financial statements for the year ended December 31, 2011.

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), which significantly changes the regulation of financial institutions and the financial services industry. The Dodd-Frank Act includes several provisions that will affect how community banks, thrifts, and small bank and thrift holding companies will be regulated in the future. Among other things, these provisions abolish the Office of Thrift Supervision and transfer its functions to the other federal banking agencies, relax rules regarding interstate branching, allow financial institutions to pay interest on business checking accounts, change the scope of federal deposit insurance coverage, and impose new capital requirements on bank and thrift holding companies.

## Notes to Financial Statements

For the years ended December 31, 2010 and 2009

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

#### Recent Accounting Pronouncements, continued

The Dodd-Frank Act also establishes the Bureau of Consumer Financial Protection as an independent entity within the Federal Reserve, which will be given the authority to promulgate consumer protection regulations applicable to all entities offering consumer financial services or products, including banks. Additionally, the Dodd-Frank Act includes a series of provisions covering mortgage loan origination standards affecting originator compensation, minimum repayment standards, and pre-payments. Management is actively reviewing the provisions of the Dodd-Frank Act and assessing its probable impact on our business, financial condition, and results of operations.

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.

From time to time the FASB issues exposure drafts for proposed statements of financial accounting standards. Such exposure drafts are subject to comment from the public, to revisions by the FASB and to final issuance by the FASB as statements of financial accounting standards. Management considers the effect of the proposed statements on the financial statements of the Bank and monitors the status of changes to and proposed effective dates of exposure drafts.

### 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 \$2,300,000 and \$1,700,000 was restricted to comply with such regulations at December 31, 2010 and 2009, respectively.

### Note 3. Securities

Following is a summary of investment securities as of December 31, 2010 and 2009, all of which are classified as available for sale:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
<b>2010</b>				
U.S. Government sponsored enterprises	\$ 1,306,146	\$ -	\$ (9,255)	\$ 1,296,891
Mortgage-backed securities	<u>19,903,134</u>	<u>393,925</u>	<u>(74,317)</u>	<u>20,222,742</u>
Total available for sale	<u>\$ 21,209,280</u>	<u>\$ 393,925</u>	<u>\$ (83,572)</u>	<u>\$ 21,519,633</u>
<b>2009</b>				
U.S. Government sponsored enterprises	\$ 1,791,505	\$ -	\$ (1,556)	\$ 1,789,949
Mortgage-backed securities	<u>15,994,256</u>	<u>352,064</u>	<u>(37,415)</u>	<u>16,308,905</u>
Total available for sale	<u>\$ 17,785,761</u>	<u>\$ 352,064</u>	<u>\$ (38,971)</u>	<u>\$ 18,098,854</u>

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

## Notes to Financial Statements

For the years ended December 31, 2010 and 2009

### Note 3. Securities, Continued

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.

Investment securities with an amortized cost of \$7.4 million at December 31, 2010 were pledged as collateral.

There were gross realized gains of \$2,362 and \$13,575 for the years ended December 31, 2010 and 2009, respectively.

The fair value, by contractual maturity, of available for sale securities at December 31, 2010 follows:

	<u>Within 1 Year</u>	<u>After 1 Year Through 5 Years</u>	<u>After 5 Years Through 10 Years</u>	<u>After 10 Years</u>	<u>Total</u>
U.S. Government sponsored enterprises	\$ -	\$ 788,496	\$ 508,395	\$ -	\$ 1,296,891
Mortgage-backed securities	232,870	-	9,203,647	10,786,225	20,222,742
Total available for sale	<u>\$ 232,870</u>	<u>\$ 788,496</u>	<u>\$ 9,712,042</u>	<u>\$ 10,786,225</u>	<u>\$ 21,519,633</u>

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, 2010, the Bank received principal payments of \$6.3 million. When the Bank receives prepayments on mortgage loans, the discount associated with such prepayment is recognized as revenue.

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, 2010 and 2009.

	<u>Less Than 12 Months</u>		<u>12 Months or greater</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>
<b>2010</b>						
U.S. Government sponsored enterprises	\$ 1,296,891	\$ (9,255)	\$ -	\$ -	\$ 1,296,891	\$ (9,255)
Mortgage-backed securities	5,397,794	(74,317)	-	-	5,397,794	(74,317)
Total available for sale	<u>\$ 6,694,685</u>	<u>\$ (83,572)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 6,694,685</u>	<u>\$ (83,572)</u>
<b>2009</b>						
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>

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, 2010, 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.

## Notes to Financial Statements

For the years ended December 31, 2010 and 2009

### Note 4. Loans

The major components of loans in the balance sheet at December 31, 2010 and 2009 are as follows:

	<u>2010</u>	<u>2009</u>
Commercial and agricultural	\$ 11,481,056	\$ 8,493,428
Real estate construction and land development	3,790,806	2,541,879
Real estate mortgage loans		
Residential	12,550,238	7,516,869
Nonresidential	35,110,040	29,857,717
Multi family residential	3,700,155	1,486,974
Consumer loans	495,971	534,570
Deferred loan fees (net)	<u>(70,272)</u>	<u>(50,908)</u>
Total loans	67,057,994	50,380,529
Allowance for loan losses	<u>(873,314)</u>	<u>(657,524)</u>
Net loans	<u>\$ 66,184,680</u>	<u>\$ 49,723,005</u>

An analysis of the allowance for loan losses is as follows

	<u>2010</u>	<u>2009</u>
Balance at beginning of period	\$ 657,524	\$ 168,314
Provision for loan losses	500,545	1,005,347
Amounts charged off	<u>(284,755)</u>	<u>(516,137)</u>
Balance at end of period	<u>\$ 873,314</u>	<u>\$ 657,524</u>

There were no impaired, nonaccrual, or loans past due 90 days or more and still accruing at December 31, 2010 or 2009. The Bank's average investment in impaired loans was approximately \$306,000 for 2010 and \$133,000 in 2009. No interest was recognized on impaired loans in 2010 or 2009.

### Note 5. Premises and Equipment

Components of property and equipment and total accumulated depreciation at December 31, 2010 and 2009 are as follow

	<u>2010</u>	<u>2009</u>
Leasehold improvements	\$ 136,621	\$ 118,819
Furniture and fixtures	346,698	303,774
Computers and software	<u>298,068</u>	<u>279,372</u>
	781,387	701,965
Accumulated depreciation and amortization	<u>(393,697)</u>	<u>(228,562)</u>
Net premises and equipment	<u>\$ 387,690</u>	<u>\$ 473,403</u>

Depreciation and amortization expense for the periods ended December 31, 2010 and 2009 was \$165,135 and \$146,727, 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, 2015. The Bank's total rent expense for this office for 2010 and 2009 was \$144,002 and \$137,592, respectively.

## Notes to Financial Statements

For the years ended December 31, 2010 and 2009

### Note 5. Premises and Equipment, continued

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 for 2010 and 2009 was \$23,511 and \$7,053, respectively.

The Bank has entered into an operating lease on mortgage origination offices in Greensboro and Charlotte, North Carolina. The Bank's obligation on both leases commenced in September 2010. The Charlotte lease remains in effect until April 2013, and the Greensboro lease remains in effect until September 2012. The Bank's rent expense for these offices during 2010 was \$11,800.

The Bank has entered into an operating lease for phone equipment. The Bank's obligation under the lease commenced in September 2010 and remains in effect until August 2013. The Bank's expense was \$1,600 in 2010.

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

<u>Year</u>	<u>Amount</u>
2011	\$ 242,861
2012	228,991
2013	187,912
2014	156,400
2015	<u>137,592</u>
Total	<u>\$ 953,756</u>

### Note 6. Deposits

The aggregate amount of time deposits in denominations of one hundred thousand dollars or more was \$11.3 million and \$14.1 million at December 31, 2010 and 2009, respectively. At December 31, 2010 the scheduled maturities of time deposits are as follows:

	<u>Less Than \$100,000</u>	<u>\$100,000 or More</u>	<u>Total</u>
2011	\$ 2,687,020	\$ 245,000	\$ 2,932,020
2012 thru 2014	3,686,279	11,027,294	14,713,573
2015 and beyond	<u>12,508,444</u>	<u>-</u>	<u>12,508,444</u>
	<u>\$ 18,881,743</u>	<u>\$ 11,272,294</u>	<u>\$ 30,154,037</u>

Certificates of deposit classified as less than \$100,000 include brokered deposits of \$17.6 million.

### 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, 2010, the Bank had investment securities with an amortized cost of \$7.1 million pledged to the FHLB. The following information is provided for borrowings balances, rates, and maturities with the FHLB (dollars in thousands):

## Notes to Financial Statements

For the years ended December 31, 2010 and 2009

### Note 7. Borrowings, continued

	<b>As of December 31,</b>	
	<b>2010</b>	<b>2009</b>
	<u>          </u>	<u>          </u>
<b>Short-term:</b>		
Daily rate advances	\$ 1,250	\$ 1,250
Maximum month-end outstanding balance	\$ 1,250	\$ 5,000
Average outstanding balance during the year	\$ 1,250	\$ 925
Average interest rate during the year	.42%	.41%
Average interest rate at end of year	.47%	.36%
<b>Long-term:</b>		
Federal Home Loan Bank advances	\$ 5,250	\$ 3,750
Maximum month-end outstanding balance	\$ 5,250	\$ 3,750
Average outstanding balance during the year	\$ 3,877	\$ 1,757
Average interest rate during the year	1.66%	1.65%
Average interest rate at end of year	1.74%	1.65%

Maturities of fixed rate long-term debt at December 31, 2010 are as follows:

2011	\$ 2,250
2012	1,500
2013	750
2014	-
2015	750
Thereafter	-
Total	<u>\$ 5,250</u>

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 \$11,800,000 through a secured borrowing facility.

### Note 8. Fair Value of Financial Instruments

#### *Fair Value Hierarchy*

The Bank utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Securities available-for-sale, trading assets and liabilities, and derivatives are recorded at fair value on a recurring basis. While the Bank does not record loans at fair value on a recurring basis, impaired loans if present are recorded at fair value on a recurring basis. Additionally, from time to time, the Bank may be required to record at fair value other assets and liabilities on a nonrecurring basis, such as loans held for sale, loans held for investment and certain other assets. These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets and liabilities.

Under FASB ASC 820, *Fair Value Measurements and Disclosures*, the Bank groups assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

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## Notes to Financial Statements

For the years ended December 31, 2010 and 2009

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### Note 8. Fair Value of Financial Instruments, *continued*

- Level 1: Valuation is based upon quoted prices for identical instruments traded in active markets.
- Level 2: Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and 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.

Following is a description of valuation methodologies used for assets and liabilities recorded at fair value.

#### Investments Securities Available-for-Sale

Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions.

The Bank utilizes a third party vendor to provide fair value data for purposes of determining the fair value of its securities available for sale portfolio. The third party vendor uses a reputable pricing company for security market data. The third party vendor has controls and edits in place for month-to month market checks and zero pricing and an AICPA Statement on Auditing Standard Number 70 (SAS 70) report is obtained from the third party vendor on an annual basis. The Bank makes no adjustments to the pricing service data received for its securities available for sale.

Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. Securities classified as Level 3 may include asset-backed securities in less liquid markets.

#### Derivative Assets and Liabilities

Substantially all derivative instruments held or issued by the Bank for risk management or customer-initiated activities are traded in over-the-counter markets where quoted market prices are not readily available. For those derivatives, the Bank measures fair value using models that use primarily market observable inputs, such as yield curves and option volatilities, and include the value associated with counterparty credit risk. The Bank classifies derivatives instruments held or issued for risk management or customer-initiated activities as Level 2.

#### Certificates of Deposit

Certificates of deposit totaling \$4.75 million have been hedged through a fair value hedge whereby the change in the fair value of the deposits is effectively offset by the change in the fair value of the interest rates swap. For that derivative, the Bank measures fair value using models that use primarily market observable inputs, such as yield curves and option volatilities, and include the value associated with counterparty credit risk. The Bank classifies derivatives instruments held or issued for risk management or customer-initiated activities as Level 2. Fair value of derivatives are primarily estimated by discounting estimated cash flows using interest rates approximating the current market rate for similar terms and credit risk.

## Notes to Financial Statements

For the years ended December 31, 2010 and 2009

### Note 8. Fair Value of Financial Instruments, *continued*

#### Assets and Liabilities Recorded at Fair Value on a Recurring Basis

The following tables present the recorded amount of assets and liabilities measured at fair value on a recurring basis:

<u>December 31, 2010</u>	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
U.S. Government sponsored enterprises	\$ 1,296,891	\$ -	\$ 1,296,891	\$ -
Mortgage backed securities	<u>20,222,742</u>	<u>-</u>	<u>20,222,742</u>	<u>-</u>
Total securities available for sale	21,519,633	-	21,519,633	-
Trading assets	<u>254,614</u>	<u>-</u>	<u>254,614</u>	<u>-</u>
Total assets measured at fair value	<u>\$ 21,774,247</u>	<u>\$ -</u>	<u>\$ 21,774,247</u>	<u>\$ -</u>
Certificates of deposit	\$ 4,425,305	\$ -	\$ 4,425,305	\$ -
Derivative financial instruments	313,013	-	313,013	-
Trading liabilities	<u>254,614</u>	<u>-</u>	<u>254,614</u>	<u>-</u>
Total liabilities measured at fair value	<u>\$ 4,992,932</u>	<u>\$ -</u>	<u>\$ 4,992,932</u>	<u>\$ -</u>
<u>December 31, 2009</u>	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
U.S. Government sponsored enterprises	\$ 1,789,949	\$ -	\$ 1,789,949	\$ -
Mortgage backed securities	<u>16,308,905</u>	<u>-</u>	<u>16,308,905</u>	<u>-</u>
Total securities available for sale	18,098,854	-	18,098,854	-
Trading assets	<u>168,765</u>	<u>-</u>	<u>168,765</u>	<u>-</u>
Total assets measured at fair value	<u>\$ 18,267,619</u>	<u>\$ -</u>	<u>\$ 18,267,619</u>	<u>\$ -</u>
Certificates of deposit	\$ -	\$ -	\$ -	\$ -
Trading liabilities	<u>168,765</u>	<u>-</u>	<u>168,765</u>	<u>-</u>
Total liabilities measured at fair value	<u>\$ 168,765</u>	<u>\$ -</u>	<u>\$ 168,765</u>	<u>\$ -</u>

There have been no transfers between either asset or liability levels during 2009 or 2010.

There were no assets or liabilities recorded at fair value on a non-recurring basis at December 31, 2010 or 2009.

#### Financial Instruments

Fair value estimates are made by management at a specific point in time, based on relevant information about the financial instrument and the market. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Bank's entire holdings of a particular financial instrument nor are potential taxes and other expenses that would be incurred in an actual sale considered. 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 and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions and/or the methodology used could significantly affect the estimates disclosed. Similarly, the fair values disclosed could vary significantly from amounts realized in actual transactions.

## Notes to Financial Statements

For the years ended December 31, 2010 and 2009

### Note 8. Fair Value of Financial Instruments, *continued*

The fair value of net loans is based on estimated cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. This does not include consideration of liquidity that market participants would use to value such loans. The estimated fair values of deposits and FHLB advances at December 31 are based on estimated cash flows discounted at market interest rates. The carrying values of other financial instruments, including various receivables and payables, approximate fair value. Securities available-for-sale are valued as discussed above. The fair value of off-balance sheet financial instruments is considered immaterial. As discussed in note 12, these off-balance sheet financial instruments are commitments to extend credit and are either short-term in nature or subject to immediate repricing.

Following is a summary of the carrying amounts and fair values of the Bank's financial assets and liabilities (dollars in thousands):

	<b>2010</b>	
	<b>Carrying Amount</b>	<b>Fair Value</b>
<b><i>Financial assets</i></b>		
Cash and due from banks	\$ 11,275	\$ 11,275
Securities available-for-sale	21,520	21,520
Loans, net	66,185	67,332
Trading assets	255	255
Restricted equity	411	411
<b><i>Financial liabilities</i></b>		
Deposits	\$ 78,380	\$ 78,920
Trading liabilities	255	255
FHLB advances	6,500	6,555
Derivative instruments	313	313
Commitments and contingencies	-	-
	<b>2009</b>	
	<b>Carrying Amount</b>	<b>Fair Value</b>
<b><i>Financial assets</i></b>		
Cash and due from banks	\$ 9,514	\$ 9,514
Securities available-for-sale	18,099	18,099
Loans, net	49,723	49,110
Trading assets	169	169
<b><i>Financial liabilities</i></b>		
Deposits	\$ 57,435	\$ 58,323
Trading liabilities	169	169
FHLB advances	5,000	4,992
Commitments and contingencies	-	-

## Notes to Financial Statements

For the years ended December 31, 2010 and 2009

### Note 9. Earnings (Loss) Per Share

The following table presents the computation of loss per share for the period ended December 31, 2010 and 2009:

	<u>2010</u>	<u>2009</u>
Net loss attributable to common shareholders	\$ (1,149,931)	\$ (2,336,343)
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	\$ (.60)	\$ (1.21)
Diluted loss per share	\$ (.60)	\$ (1.21)

At December 31, 2010, there were 269,400 options that were not included in the calculation of diluted earnings per share because their effect would be anti-dilutive compared with 299,200 at December 31, 2009.

### 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 periods ended December 31, the Bank contribution to the Plan totaled \$56,880 and \$71,360 in 2010 and 2009, respectively. 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 years ended December 31, 2010 and 2009, the Bank recognized \$184,000 and \$17,000 in compensation expense for stock options.

At December 31, 2010, unrecognized compensation costs amounted to \$715,000 which will be expensed over the next four years. At December 31, 2009, the Bank had unrecognized compensation costs of \$997,000 to be expensed over five years.

## Notes to Financial Statements

For the years ended December 31, 2010 and 2009

### Note 10. Benefit Plans, *continued*

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.

A summary of option activity under the stock option plans for the years ended December 31, 2010 is presented below:

	<u>Employee Plan</u>		<u>Director Plan</u>	
	<u>Available for Grant</u>	<u>Granted</u>	<u>Available for Grant</u>	<u>Granted</u>
<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>	21,724	170,800	64,124	128,400
Forfeited	29,800	(29,800)	-	-
Granted	-	-	-	-
Exercised	-	-	-	-
<i>Balance at December 31, 2010</i>	<u>51,524</u>	<u>141,000</u>	<u>64,124</u>	<u>128,400</u>

Additional information relating to Bank plans is detailed below:

	<u>2010</u>	<u>2009</u>
<i>Outstanding options</i>		
Weighted average exercise price, beginning of the year	\$ 11.00	\$ -
Weighted average exercise price, end of the year	\$ 11.00	\$ 11.00
Range of exercise prices, end of year:		
From	\$ 11.00	\$ 11.00
To	\$ 11.00	\$ 11.00
Remaining weighted average life in months	108	120
<i>Exercisable options outstanding at December 31</i>		
Number	53,880	-
Weighted average exercise price	\$ 11.00	\$ -
<i>Weighted average exercise price of options</i>		
Granted during the year	\$ -	\$ 11
Exercised during the year	\$ -	\$ -
Forfeited during the year	\$ 11	\$ -
Expired during the year	\$ -	\$ -

## Notes to Financial Statements

For the years ended December 31, 2010 and 2009

### Note 10. Benefit Plans, *continued*

	<u>2010</u>	<u>2009</u>
<i>Significant assumptions used in determining fair value of options granted</i>		
Risk-free interest rate	n/a	3.34%
Expected life in years	n/a	7
Expected dividends	n/a	0.00%
Expected volatility	n/a	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

The aggregate intrinsic value of all stock options and exercisable stock options at December 31, 2010 and 2009 was \$0 as the market value of the Bank's stock did not exceed the fair value of the stock options.

### Note 11. Income Taxes

#### *Operating Loss Carryforwards*

The Bank has loss carryforwards of approximately \$5.1 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, 2010 and 2009 are as follows:

	<u>2010</u>	<u>2009</u>
Current	\$ -	\$ -
Deferred	394,041	889,098
Deferred tax asset valuation allowance change	(394,041)	(889,098)
	<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, 2010 and 2009 are as follows:

	<u>2010</u>	<u>2009</u>
Tax at statutory federal rate	\$ (390,977)	\$ (794,356)
State income tax benefit	(52,322)	(106,304)
Permanent differences	41,786	10,220
Other	7,472	1,342
Deferred tax asset valuation allowance change	394,041	889,098
	<u>\$ -</u>	<u>\$ -</u>

## Notes to Financial Statements

For the years ended December 31, 2010 and 2009

### Note 11. Income Taxes, *continued*

#### *Deferred Income Tax Analysis*

The significant components of net deferred tax assets at December 31, 2010 and 2009 is summarized as follows:

	<u>2010</u>	<u>2009</u>
<i>Deferred tax assets</i>		
Allowance for loan losses	\$ (77,096)	\$ (18,482)
Net operating losses	1,936,052	1,504,845
Pre-opening expenses	285,211	308,283
Stock based compensation	36,328	2,794
Amortization of investment premiums	20,346	6,703
Contributions	<u>12,740</u>	<u>7,655</u>
Deferred tax asset	<u>2,213,581</u>	<u>1,811,798</u>
<i>Deferred tax liabilities</i>		
Prepaid expenses	29,673	22,253
Deferred loan costs	19,916	27,237
Unrealized gain on securities available for sale	119,641	120,697
Depreciation	<u>30,328</u>	<u>22,685</u>
Deferred tax liability	199,558	192,872
Deferred tax asset valuation allowance	<u>(2,014,023)</u>	<u>(1,618,926)</u>
Net deferred tax asset (liability)	<u>\$ -</u>	<u>\$ -</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.

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

For the years ended December 31, 2010 and 2009

### Note 12. Commitments and Contingencies, *continued*

#### *Financial Instruments with Off-Balance Sheet Risk*

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, 2010 and 2009 are as follows:

	<u>2010</u>	<u>2009</u>
Commitments to extend credit	\$ 12,396,000	\$ 7,341,500
Standby letters of credit	773,000	123,000
Other commitments	<u>487,500</u>	<u>638,000</u>
	<u>\$ 13,656,500</u>	<u>\$ 8,102,500</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 \$262,500 had been invested at December 31, 2010 and is included in other assets. The Bank's unfunded commitment at December 31, 2010 was \$487,500.

#### *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.

#### *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.

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## Notes to Financial Statements

*For the years ended December 31, 2010 and 2009*

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### **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, 2010, the Bank met all capital adequacy requirements to which it was subject.

As of December 31, 2010, 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.

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

## Notes to Financial Statements

For the years ended December 31, 2010 and 2009

### Note 13. Regulatory Restrictions, continued

	<u>Actual</u>		<u>Minimum Capital Requirement</u>		<u>Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
<b>December 31, 2010</b>						
Total Capital						
(to Risk-Weighted Assets)	\$ 15,807	20.54%	\$ 6,156	8.00%	\$ 7,695	10.00%
Tier I Capital						
(to Risk-Weighted Assets)	\$ 14,934	19.41%	\$ 3,078	4.00%	\$ 4,617	6.00%
Tier I Capital						
(to Average Assets)	\$ 14,934	15.52%	\$ 3,849	4.00%	\$ 4,812	5.00%
<b>December 31, 2009</b>						
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%

### 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:

	<u>2010</u>	<u>2009</u>
<b>Balance, beginning</b>	\$ 2,566,672	\$ 2,011,434
New loans and advances	496,927	1,662,451
Repayments	<u>(310,102)</u>	<u>(1,107,213)</u>
<b>Balance, ending</b>	<u>\$ 2,753,497</u>	<u>\$ 2,566,672</u>

### Note 15. Derivative Instruments

The Bank is exposed to certain risks relating to its ongoing business operations. The primary risk managed by using derivative instruments is interest rate risk. Interest rate swaps are entered into to manage interest rate risk associated with the Bank's fixed rate lending and deposit activity. The derivatives and hedging accounting guidance (FASB ASC 815-10) requires that the Bank recognize all derivative instruments as either assets or liabilities at fair value in the statement of financial position. In accordance with this guidance, the Bank designates those interest rate swaps on fixed-rate loans and deposits as fair value hedges or in the event the transaction does not qualify for hedge accounting, as trading assets and liabilities.

## Notes to Financial Statements

For the years ended December 31, 2010 and 2009

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### Note 15. Derivative Instruments, *continued*

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. 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.

For derivative instruments that are designated and qualify as a fair value hedge, the hedge documentation specifies the terms of the hedged items and the interest rate swaps. The documentation also indicates that the derivative is hedging a fixed-rate item, that the hedge exposure is to the changes in the fair value of the hedged item, and that the strategy is to eliminate fair value variability by converting fixed-rate interest payments to LIBOR. The gain or loss on the derivative as well as the offsetting loss or gain on the hedged item attributable to the hedged risk are recognized in current earnings. The impact at December 31, 2010 was accretive to income by \$11,545, and is reported as net gain on fair value swap in non-interest income.

At December 31, 2010, the Bank has hedged \$4.75 million of fixed rate deposits with an original maturity of September 2020. The deposits are callable quarterly with 15 days notice beginning in September 2012. The initial rate on the deposits is 1.25% until the initial call, at which time it increases to 1.5% for 12 months, and increases 50 basis points per year through September 2016. The rate at September 2016 increases 25 basis points, to 3.25%, and increases in September of each year by 25 basis points until September 2019, when the rate is capped at 4% until the deposits mature in September 2020. These deposits are hedged with “receive fixed rate, pay variable rate” swaps of similar maturity, repricing and fixed rate coupon. The Bank pays the counterparty a rate equal to 1-month Libor minus 25 basis points, which was .01% at December 31, 2010.

The hedge is tested for effectiveness each quarter, and was found to be highly effective in hedging the exposure to changes in the fair value of the deposits. The hedging item is reported on the balance sheet at fair value of \$313,000. The deposits are carried at fair value of \$4,425,305 and are classified on the balance sheet in certificates of deposit. The hedge reduced interest expense \$17,000 during 2010.

At December 31, 2010, 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 \$50,000 and \$18,500 at December 31, 2010 and 2009, respectively.

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 Bank’s 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 2.77% at December 31, 2010. Both the collar and the swap are carried on the balance sheet at fair value, and are offsetting. The balances at December 31 totaled \$205,000 and \$150,000 in 2010 and 2009, respectively.

## Notes to Financial Statements

*For the years ended December 31, 2010 and 2009*

### Note 15. Derivative Instruments, *continued*

The Bank has pledged \$285,000 in mortgage-back securities as collateral for these transactions.

### Note 16. Acquisitions

On September 30, 2010, the Bank acquired the assets and assumed the obligations under operating leases of a borrower as a result of the discharge of the credit. In addition, the Bank simultaneously extended offers of employment and subsequently hired the employees of the borrower. While there was no exchange of equity, current accounting guidance (FASB ASC 805) defines a business combination as an event in which one entity obtains control of one or more businesses of another entity. In that the Bank obtained the borrower's operating equipment and engaged the employees, the Bank met the standards for acquiring control of the business and accounted for the transaction as a business combination.

The assets acquired consisted of the following:

Deposits on leases	\$	5,161
Leasehold improvements		7,870
Furniture and equipment		<u>27,214</u>
Total	\$	<u>40,245</u>

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## Management's Discussion and Analysis

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### Overview

The following discussion and analysis is presented to assist in the understanding and evaluation of Premier Commercial Bank's financial condition and results of operations as of December 31, 2010 and 2009. The following discussion should be read in conjunction with the Bank's audited financial statements and the related footnotes which are included elsewhere in this Annual Report.

This discussion may contain certain forward-looking statements consisting of estimates with respect to the financial condition, results of operations and other business of the Bank that are subject to various factors which could cause actual results to differ materially from those estimates. Factors which could influence the estimates include changes in national, regional and local market conditions, legislative and regulatory conditions, and the interest rate environment.

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, a loan production office in High Point, North Carolina, and two mortgage origination offices located in Greensboro and Charlotte, North Carolina. As a state chartered bank, the Bank is subject to regulation by the Commissioner of Banks of the State of North Carolina and the Federal Deposit Insurance Corporation.

The Bank offers a wide range of banking services including checking and savings accounts; commercial, installment, mortgage and personal loans; and other associated services. The Bank's primary sources of revenue are interest income from its commercial and real estate lending activities and, to a lesser extent, from its investment portfolio. The Bank also earns fees from lending and deposit activities. The major expenses of the Bank are interest on deposit accounts and general and administrative expenses, such as salaries, occupancy and related expenses.

### Critical Accounting Policies

The Bank's financial statements are prepared in accordance with accounting principles generally accepted in the United States (GAAP). The notes to the audited financial statements included in the Bank's Annual Report for the year ended December 31, 2010 contain a summary of its significant accounting policies. Management believes the Bank's policy with respect to the methodology for the determination of the allowance for loan losses involves a high degree of complexity and requires management to make difficult and subjective judgments that often require assumptions or estimates about highly uncertain matters. Accordingly, the Bank considers the policy related to this area as critical.

### Net Interest Income

Net interest income, the principal source of income for the Bank, is the amount of income generated by earning assets (primarily loans and investment securities) less the interest expense incurred on interest-bearing liabilities .

Increased loan demand and higher average investment securities resulted in an increase to interest income of \$1.5 million from 2009 to 2010. Average earning assets increased \$33 million during 2010, due to a \$25.5 million increase in gross average loans as well as a \$7.3 million increase in average investments. Interest expense also increased from \$716 thousand in 2009 to \$1.1 million for 2010 due primarily to an increase in average money market account balances, which gained \$18.8 million in 2010. Net interest margins increased 23 basis points, from 2.72% to 2.95% in 2010. The improvement is due to growth in earning assets combined with an 18 basis point increase in yields on earning assets as well as a 42 basis point decrease in funding costs. The increases to interest income and interest expense resulted in a \$1.1 million increase to net interest income for the year.

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## Management's Discussion and Analysis

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### Provision for Loan Losses

The provision for loan losses is charged to income in an amount necessary to maintain an allowance for loan losses adequate to provide for expected losses in the Bank's loan portfolio. Generally, loan losses and recoveries are charged or credited directly to the allowance for loan losses. The level of the allowance for loan losses is determined by management's assessment of a variety of factors, including the collectability of past due loans, volume of new loans, composition of the loan portfolio, and general economic outlook. The provision for loan loss expense decreased \$505 thousand in 2010, from slightly over \$1 million in 2009 to \$500 thousand in 2010. The Bank's allowance for loan losses as a percentage of gross loans was 1.3% at both December 31, 2010 and 2009. Net loan charge offs were \$285 thousand in 2010, a decrease of \$231 thousand from 2009. The Bank has no impaired loans, nonaccrual loans or loans past due greater than 90 days at December 31, 2010 or 2009.

### Financial Condition

The Bank's total assets were \$100.95 million at December 31, 2010 as compared to \$78.96 million at December 31, 2009. Total deposits during the year increased 36.46% to \$78.4 million. Total deposits were \$57.4 million at December 31, 2009. The Bank used these resources to fund loans and investments. The Bank's net loans increased to \$66.2 million at the end of 2010, an increase of \$16.5 million over the 2009 amount of \$49.7 million. Investment securities increased \$3.4 million during the year.

### Loans

Gross loans increased during the year from \$50.4 million in 2009 to \$67.1 million in 2010 due to increased demand. The Bank's portfolio primarily consists of loans secured by real estate. At December 31, 2010, real estate loans represented 82.17% of the loan portfolio compared to 82.10% at December 31, 2009. Commercial and industrial loans were 17.10% of the portfolio for December 31, 2010 and 16.84% for December 31, 2009. Consumer loans made up approximately 1% for both years.

### Deposits

Money markets and savings accounts were \$39.2 million, or 50% of deposits at December 31, 2010, compared with balances in 2009 of \$23.5 million, or 41% of total deposits. CDs totaled \$30.2 million, or 38% of deposits at December 31, 2010, compared with \$26.6 million at December 31, 2009, which comprised 46% of total deposits. Included in CDs are \$28 million of deposits purchased from correspondent banks less unamortized discounts of \$91 thousand. CDs purchased at December 31, 2009 were \$23 million less unamortized discounts of \$34 thousand.

### Stockholders' Equity

Stockholders' equity decreased from \$16.2 million at December 31, 2009 to \$15.2 million at December 31, 2010. The change is due to the net loss of \$1.1 million, offset by accounting of stock option expense.

Regulatory guidelines relating to capital adequacy provide minimum risk-based ratios which assess capital adequacy while encompassing all credit risks, including those related to off-balance sheet activities. Capital ratios under these guidelines are computed by weighing the relative risk of each asset category to derive risk-adjusted assets. The risk-based capital guidelines require minimum ratios of core (Tier 1) capital (common stockholders' equity) to risk-weighted assets of 4.0% and total regulatory capital (core capital plus allowance for loan losses up to 1.25% of risk-weighted assets) to risk-weighted assets of 8.0%. As of December 31, 2010, the Bank had a ratio of Tier 1 capital to risk-weighted assets of 19.41% and a ratio of total capital to risk-weighted assets of 20.54%. All capital ratio levels indicate that the Bank is well capitalized. Additional information related to the Bank's regulatory capital and capital ratios can be found in the Regulatory Restrictions note to the financial statements.

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## Management's Discussion and Analysis

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### **Asset/Liability Management and Interest Rate Risk**

In its asset/liability management or interest rate risk management process, the Bank attempts to match, in so far as is practical, the maturity and/or repricing of its interest-earning assets and interest-bearing liabilities. Due to the mostly floating rate characteristics of other interest-bearing liabilities such as money market accounts, the Bank attempts to extend maturities of purchased funds and grant loans with floating rate characteristics and/or short maturities in order to maintain its interest spread and net interest margin. Factors beyond the Bank's control, such as market interest rates and competition, may also have an impact on the Bank's interest income and interest expense.



## 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, 2010 and 2009 and the related statements of operations, changes in shareholders' equity, and cash flows for the years ended December 31, 2010 and 2009. 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, 2010 and 2009, and the results of its operations and its cash flows for the years ended December 31, 2010 and 2009, in conformity with accounting principles generally accepted in the United States of America.

*Elliott Davis, PLLC*

Elliott Davis, PLLC  
Galax, Virginia  
April 25, 2011

## 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
- G. Munroe Cobey** ..... Retired, Former Partner with Tudor Investment Corporation
- 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
- Warren D. Herring, Jr.** ..... Executive Vice President and Chief Credit Officer
- James J. Harris** .....Executive Vice President, Senior Lender and Market Manager



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## Shareholder Information

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### Annual Meeting

The annual meeting of shareholders will be held on May 17, 2011 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/>