

SOUTHERN FIRST BANCSHARES INC  
Form 10-Q  
November 04, 2009

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, D.C. 20549

**FORM 10-Q**

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

For the Quarterly Period Ended September 30, 2009

OR

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

For the Transition Period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 000-27719

**SOUTHERN FIRST BANCSHARES, INC.**

(Exact name of registrant as specified in its charter)

**South Carolina**

(State or other jurisdiction of incorporation)

**58-2459561**

(I.R.S. Employer Identification No.)

**100 Verdae Boulevard, Suite 100**

**Greenville, S.C.**

(Address of principal executive offices)

**29606**

(Zip Code)

**864-679-9000**

(Registrant's telephone number, including area code)

**Not Applicable**

(Former name, former address, and former fiscal year, if changed since last report)

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

(or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

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

Large accelerated filer

Non-accelerated filer

Accelerated filer

Smaller Reporting Company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 3,078,695 shares of common stock, \$.01 par value per share, were issued and outstanding as of November 1, 2009.

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### PART I. CONSOLIDATED FINANCIAL INFORMATION

#### Item 1. Consolidated Financial Statements

##### *SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY*

##### *CONSOLIDATED BALANCE SHEETS*

*(dollars in thousands, except share data)*

	<b>September 30, 2009</b> (Unaudited)	<b>December 31, 2008</b> (Audited)
<b>ASSETS</b>		
Cash and cash equivalents:		
Cash and due from banks	\$ 6,916	\$ 4,360
Federal funds sold	21,963	8,800
Total cash and cash equivalents	28,879	13,160
Investment securities:		
Investment securities available for sale	80,775	64,432
Investment securities held to maturity (fair value \$10,132 and \$12,618)	9,795	12,519
Other investments, at cost	9,088	8,461
Total investment securities	99,658	85,412
Loans	569,687	566,607
Less allowance for loan losses	(7,916)	(7,005)
Loans, net	561,771	559,602

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Property and equipment, net	16,120	11,701
Bank owned life insurance	13,828	13,369
Deferred income taxes	3,108	3,864
Other assets	9,305	5,871
Total assets	\$ 732,669	\$ 692,979

**LIABILITIES AND SHAREHOLDERS EQUITY**

Deposits	\$ 494,816	\$ 469,537
Short-term repurchase agreements	5,000	-
Note payable	4,750	15,000
Federal Home Loan Bank advances and related debt	149,675	149,675
Junior subordinated debentures	13,403	13,403
Other liabilities	4,793	5,578
Total liabilities	672,437	653,193

Shareholders equity:

Preferred stock, par value \$.01 per share, 10,000,000 shares authorized, 17,299 shares issued and outstanding	15,559	-
Common stock, par value \$.01 per share, 10,000,000 shares authorized, 3,069,760 and 3,044,863 shares issued and outstanding at September 30, 2009 and December 31, 2008, respectively	31	30
Nonvested restricted stock	(17)	(27)
Additional paid-in capital	33,794	31,850
Accumulated other comprehensive income (loss)	990	(1,079)
Retained earnings	9,875	9,012
Total shareholders equity	60,232	39,786
Total liabilities and shareholders equity	\$ 732,669	\$ 692,979

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

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

(dollars in thousands, except share data)

	For the three months ended September 30, 2009		For the nine months ended September 30, 2009	
	2008		2008	
	(Unaudited)			
<b>Interest income</b>				

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Loans	\$ 7,977	\$ 8,720	\$ 23,685	\$ 26,630
Investment securities	1,129	1,282	3,390	3,837
Federal funds sold	9	57	17	238
<b>Total interest income</b>	<b>9,115</b>	<b>10,059</b>	<b>27,092</b>	<b>30,705</b>
<b>Interest expense</b>				
Deposits	2,386	3,531	7,621	11,495
Borrowings	1,779	1,685	5,141	5,195
<b>Total interest expense</b>	<b>4,165</b>	<b>5,216</b>	<b>12,762</b>	<b>16,690</b>
<b>Net interest income</b>	<b>4,950</b>	<b>4,843</b>	<b>14,330</b>	<b>14,015</b>
Provision for loan losses	1,085	650	2,810	1,950
<b>Net interest income after provision for loan losses</b>	<b>3,865</b>	<b>4,193</b>	<b>11,520</b>	<b>12,065</b>
<b>Noninterest income (loss)</b>				
Loan fee income	138	38	297	126
Service fees on deposit accounts	199	177	551	468
Income from bank owned life insurance	213	114	459	312
Gain on sale of securities	34	7	34	7
Other than temporary impairment on investment securities	-	(1,841)	-	(1,841)
Real estate owned activity	(148)	(7)	(152)	(58)
Other income	97	85	277	245
<b>Total noninterest income (loss)</b>	<b>533</b>	<b>(1,427)</b>	<b>1,466</b>	<b>(741)</b>
<b>Noninterest expenses</b>				
Compensation and benefits	1,980	1,625	5,867	5,149
Professional fees	186	127	478	368
Marketing	176	154	495	450
Insurance	352	141	1,143	413
Occupancy	550	437	1,407	1,134
Data processing and related costs	358	347	1,077	1,012
Telephone	76	50	186	126
Other	187	159	605	560
<b>Total noninterest expenses</b>	<b>3,865</b>	<b>3,040</b>	<b>11,258</b>	<b>9,212</b>
<b>Income (loss) before income tax expense</b>	<b>533</b>	<b>(274)</b>	<b>1,728</b>	<b>2,112</b>
<b>Income tax expense (benefit)</b>	<b>109</b>	<b>(148)</b>	<b>461</b>	<b>630</b>
<b>Net income (loss)</b>	<b>\$ 424</b>	<b>\$ (126)</b>	<b>\$ 1,267</b>	<b>\$ 1,482</b>
Preferred stock dividend to be paid	218	-	512	-
Dividend accretion	127	-	297	-
<b>Net income (loss) available to common shareholders</b>	<b>\$ 79</b>	<b>\$ (126)</b>	<b>\$ 458</b>	<b>\$ 1,482</b>
<b>Earnings (loss) per common share</b>				
Basic	\$ 0.03	\$ (0.04)	\$ 0.15	\$ 0.50
Diluted	\$ 0.03	\$ (0.04)	\$ 0.15	\$ 0.47
<b>Weighted average common shares outstanding</b>				
Basic	3,048,959	3,002,205	3,046,228	2,984,947
Diluted	3,109,708	3,002,205	3,069,794	3,175,274

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

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**SOUTHERN FIRST BANCSHARES, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY**  
**AND COMPREHENSIVE INCOME**  
**FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2009 AND 2008**  
*(Unaudited)*

*(dollars in thousands, except share data)*

	Common stock Shares	Common stock Amount	Preferred stock	Nonvested restricted stock	Additional paid-in capital	Accumulated other comprehensive income(loss)	Retained Earnings	Total shareholders equity
<b>December 31, 2007</b>	2,946,456	\$ 29	\$ -	\$ (41)	\$ 31,034	\$ 96	\$ 7,160	\$ 38,278
Net income	-	-	-	-	-	-	1,482	1,482
Comprehensive income, net of tax	-	-	-	-	-	-	-	-
Unrealized holding loss on securities available for sale	-	-	-	-	-	(2,593)	-	(2,593)
Total comprehensive income	-	-	-	-	-	-	-	(1,111)
Proceeds from exercise of stock options and warrants	69,662	1	-	-	428	-	-	429
Amortization of deferred compensation on restricted stock	-	-	-	11	-	-	-	11
Compensation expense related to stock options, net of tax	-	-	-	-	42	-	-	42
<b>September 30, 2008</b>	3,096,118	\$ 30	\$ -	\$ (30)	\$ 31,504	\$ (2,497)	\$ 8,642	\$ 37,649
<b>December 31, 2008</b>	3,044,863	\$ 30	\$ -	\$ (27)	\$ 31,850	\$ (1,079)	\$ 9,012	\$ 39,786
Net income	-	-	-	-	-	-	1,267	1,267
Comprehensive income, net of tax	-	-	-	-	-	-	-	-
Unrealized holding gain on securities available for sale	-	-	-	-	-	2,069	-	2,069
Total comprehensive income	-	-	-	-	-	-	-	3,336
Preferred stock transactions:	-	-	15,856	-	-	-	-	15,856

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Proceeds from issuance of 17,299 shares of preferred stock								
Proceeds from issuance of common stock warrants	-	-	-	-	1,418	-	-	1,418
Cash dividends on Series T preferred at annual dividend rate of 5%	-	-	-	-	-	-	(404)	(404)
Dividend accretion	-	-	(297)	-	297	-	-	-
Proceeds from exercise of stock warrants	24,897	1	-	-	150	-	-	151
Amortization of deferred compensation on restricted stock	-	-	-	10	-	-	-	10
Compensation expense related to stock options	-	-	-	-	79	-	-	79
<b>September 30, 2009</b>	<b>3,069,760</b>	<b>\$ 31</b>	<b>\$ 15,559</b>	<b>\$ (17)</b>	<b>\$ 33,794</b>	<b>\$ 990</b>	<b>\$ 9,875</b>	<b>\$ 60,232</b>

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

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

(dollars in thousands)

	<b>For the nine months ended September 30, 2009</b>		<b>2008</b>
	(Unaudited)		
<b>Operating activities</b>			
Net income		\$ 1,267	\$ 1,482
Adjustments to reconcile net income to cash provided by (used for) operating activities:			
Provision for loan losses		2,810	1,950
Depreciation and other amortization		494	389
Accretion and amortization of securities discounts and premium, net		286	111
Loss (gain) on sale of real estate		(4)	67
Write-down of real estate owned		202	-
Gain on sale of investment securities		(34)	(7)
Other than temporary impairment on investment securities		-	1,841
Compensation expense related to stock options and grants		89	53
Increase in cash surrender value of bank owned life insurance		(459)	(312)
Decrease (increase) in deferred tax asset		(302)	17

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Decrease in other assets, net	243	430
Increase (decrease) in other liabilities, net	(784)	880
Net cash provided by operating activities	3,808	6,901
<b>Investing activities</b>		
Increase (decrease) in cash realized from:		
Origination of loans, net	(9,242)	(55,541)
Purchase of property and equipment	(4,913)	(4,918)
Purchase of investment securities:		
Available for sale	(37,118)	(27,666)
Other investments	(894)	(909)
Payments and maturity of investment securities:		
Available for sale	23,675	17,130
Held to maturity	2,698	1,936
Other investments	266	1,125
Purchase of life insurance policies	-	(2,500)
Proceeds from sale of real estate acquired in settlement of loans	389	47
Net cash used for investing activities	(25,139)	(71,296)
<b>Financing activities</b>		
Increase (decrease) in cash realized from:		
Increase in deposits, net	25,279	65,007
Increase in short-term repurchase agreements, net	5,000	-
Decrease in note payable	(10,250)	-
Increase in Federal Home Loan Bank advances and related debt	-	3,180
Proceeds from the issuance of preferred stock	15,856	-
Proceeds from the issuance of stock warrant	1,418	-
Cash dividend on preferred stock	(404)	-
Proceeds from the exercise of stock options and warrants	151	429
Net cash provided by financing activities	37,050	68,616
Net increase in cash and cash equivalents	15,719	4,221
<b>Cash and cash equivalents at beginning of the period</b>	13,160	16,971
<b>Cash and cash equivalents at end of the period</b>	\$ 28,879	\$ 21,192
<b>Supplemental information</b>		
<b>Cash paid for</b>		
Interest	\$ 13,052	\$ 17,366
Income taxes	\$ 605	\$ 1,317
<b>Schedule of non-cash transactions</b>		
Real estate acquired in settlement of loans	\$ 4,263	\$ 1,907
Unrealized gain (loss) on securities, net of income taxes	\$ 2,069	\$ (2,593)

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

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

**NOTE 1. Nature of Business and Basis of Presentation**

*Business activity*

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

*Basis of Presentation*

The accompanying financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q. Accordingly, they do not include all the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine-month periods ended September 30, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009. For further information, refer to the consolidated financial statements and footnotes thereto included in the company's Form 10-K for the year ended December 31, 2008 (Registration Number 000-27719) as filed with the Securities and Exchange Commission. The consolidated financial statements include the accounts of Southern First Bancshares, Inc., and its wholly owned subsidiary Southern First Bank, N.A. In accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 810, Consolidation, the financial statements related to the special purpose subsidiaries, Greenville First Statutory Trust I and Trust II, have not been consolidated.

*Cash and Cash Equivalents*

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

*Reclassifications*

Certain amounts, previously reported, have been reclassified to state all periods on a comparable basis that had no effect on shareholders' equity or net income.



*Subsequent Events*

In accordance with FASB ASC 855, *Subsequent Events*, issued in May 2009 and effective for periods ending after June 15, 2009, management performed an evaluation to determine whether or not there have been any subsequent events since the balance sheet date. The evaluation was performed through November 4, 2009, the date on which the Company's 10-Q was issued as filed with the Securities and Exchange Commission.

**NOTE 2. Note Payable**

The Company had a \$4.8 million term note with Silverton Bridge Bank, N.A. ( Silverton ) at September 30, 2009. The note matures on April 30, 2014 and bears interest at the prime rate plus 0.5% with a floor rate of 4.0%. The Company has pledged all of the stock of the Bank as collateral for this note. The loan agreement contains various financial covenants related to net income and asset quality.

**NOTE 3. Preferred Stock Issuance**

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

**NOTE 4. Earnings per Common Share**

The following schedule reconciles the numerators and denominators of the basic and diluted earnings per share computations for the three and nine month periods ended September 30, 2009 and 2008 (dollars in thousands, except share data). Dilutive common shares arise from the potentially dilutive effect of the company's stock options and warrants that are outstanding. The assumed conversion of stock options and warrants can create a difference between basic and dilutive net income per common share.

At September 30, 2009 and 2008, 442,079 and 59,750 options and warrants, respectively, were anti-dilutive in the calculation of earnings per share as their exercise price exceeded the fair market value.

	<b>Three months ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
<b>Numerator:</b>		
Net income (loss)	\$ 424	\$ (126)
Less: Preferred stock dividends to be paid	218	-
Dividend accretion (1)	127	-
Net income (loss) available to common shareholders	\$ 79	\$ (126)
<b>Denominator:</b>		
Weighted-average common shares outstanding basic	3,048,959	3,002,205
Common stock equivalents	60,749	-
Weighted-average common shares outstanding diluted	3,109,708	3,002,205
<b>Earnings (loss) per common share:</b>		
Basic	\$ 0.03	\$ (0.04)
Diluted	\$ 0.03	\$ (0.04)

	<b>Nine months ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
<b>Numerator:</b>		
Net income	\$ 1,267	\$ 1,482
Less: Preferred stock dividends to be paid	512	-
Dividend accretion (1)	297	-
Net income available to common shareholders	\$ 458	\$ 1,482

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Denominator:			
Weighted-average common shares outstanding	basic	3,046,228	2,984,947
Common stock equivalents		23,566	190,327
Weighted-average common shares outstanding	diluted	3,069,794	3,175,274
Earnings per common share:			
Basic		\$ 0.15	\$ 0.50
Diluted		\$ 0.15	\$ 0.47

(1) Preferred stock dividend required to be accreted over estimated life of warrant issued in conjunction with preferred stock.

**NOTE 5. Stock Based Compensation**

The Company has a stock-based employee compensation plan. On January 1, 2006, the Company adopted the fair value recognition provisions of FASB ASC 718, Compensation - Stock Compensation, to account for compensation costs under its stock option plan.

In adopting FASB ASC 718, the Company elected to use the modified prospective method to account for the transition from the intrinsic value method to the fair value recognition method. Under the modified prospective method, compensation cost is recognized from the adoption date forward for all new stock options granted and for any outstanding unvested awards as if the fair value method had been applied to those awards as of the date of grant.

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

**NOTE 6. Fair Value Accounting**

Effective January 1, 2008, the Company adopted FASB ASC 820, Fair Value Measurement and Disclosures, which provides a framework for measuring and disclosing fair value under generally accepted accounting principles. FASB ASC 820 requires disclosures about the fair value of assets and liabilities recognized in the balance sheet in periods subsequent to initial recognition, whether the measurements are made on a recurring or on a nonrecurring basis.

As of June 30, 2009, the Company adopted FASB ASC 820, Fair Value Measurement and Disclosures, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly. FASB ASC 820, Fair Value Measurement and Disclosures, is intended to determine the fair value when there is no active market or where the inputs being used represent distressed sales.

FASB ASC 820, Fair Value Measurement and Disclosures, 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. FASB ASC 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

**Level 1**

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

**Level 2**

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

**Level 3**

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

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

### *Investment Securities*

Securities available for sale are valued on a recurring basis at quoted market prices where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable securities. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange or 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 and debentures issued by government sponsored entities, municipal bonds and corporate debt securities. In certain cases where there is limited activity or less transparency around inputs to valuations, securities are classified as Level 3 within the valuation hierarchy. Securities held to maturity are valued at quoted market prices or dealer quotes similar to securities available for sale. The carrying value of Other Investments, such as Federal Reserve Bank and Federal Home Loan Bank stock, approximates fair value based on their redemption provisions.

### *Loans*

The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan may be considered impaired and an allowance for loan losses may be established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with FASB ASC 310, Receivables. The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At September 30, 2009, substantially all of the impaired loans were evaluated based on the fair value of the collateral. In accordance with FASB ASC 820, Fair Value Measurement and Disclosures, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company considers the impaired loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company considers the impaired loan as nonrecurring Level 3.

### *Other Real Estate Owned ( OREO )*

OREO, consisting of properties obtained through foreclosure or in satisfaction of loans, is reported at the lower of cost or fair value, determined on the basis of current appraisals, comparable sales, and other estimates of value obtained principally from independent sources, adjusted for estimated selling costs (Level 2). At the time of foreclosure, any excess of the loan balance over the fair value of the real estate held as collateral is treated as a charge against the allowance for loan losses. Gains or losses on sale and generally any subsequent adjustments to the value are recorded as a component of OREO expense.

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

The table below presents the recorded amount of assets and liabilities measured at fair value on a recurring basis as of September 30, 2009 (dollars in thousands).

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	<b>Quoted market price in active markets (Level 1)</b>	<b>Significant other observable inputs (Level 2)</b>	<b>Significant unobservable inputs (Level 3)</b>
<b>Securities available for sale:</b>			
Government sponsored enterprises	\$ -	\$ 7,497	\$ -
State and political subdivisions	-	4,018	-
Mortgage-backed securities	-	62,468	6,792
<b>Other investments</b>	<b>-</b>	<b>-</b>	<b>9,088</b>
<b>Total</b>	<b>\$ -</b>	<b>\$ 73,983</b>	<b>\$ 15,880</b>

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

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The table below presents a reconciliation for the period of January 1, 2009 to September 30, 2009, for all Level 3 assets that are measured at fair value on a recurring basis (dollars in thousands).

	<b>Collateralized mortgage obligations</b>	<b>Other investments</b>
Beginning balance	\$ 5,213	\$ 8,461
Total realized and unrealized gains or losses:		
Included in earnings	-	-
Included in other comprehensive income	2,259	-
Purchases, sales and principal reductions	(680)	627
Transfers in and/or out of Level 3	-	-
Ending Balance	\$ 6,792	\$ 9,088

*Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis*

The Company is predominantly an asset based lender with real estate serving as collateral on approximately 78.7% of loans. Loans which are deemed to be impaired and real estate acquired in settlement of loans are valued on a nonrecurring basis at the lower of cost or market value of the underlying real estate collateral. Such market values are generally obtained using independent appraisals, which the Company considers to be level 2 inputs. The table below presents the recorded amount of assets and liabilities measured at fair value on a nonrecurring basis as of September 30, 2009 (dollars in thousands).

	<b>Quoted market price in active markets (Level 1)</b>	<b>Significant other observable inputs (Level 2)</b>	<b>Significant unobservable inputs (Level 3)</b>
Impaired loans	\$ -	\$ 9,876	\$ -
Other Real Estate Owned	-	4,093	-

*Fair Value of Financial Instruments*

FASB ASC 825, Financial Instruments, requires disclosure of fair value information, whether or not recognized in the consolidated balance sheets, when it is practical to estimate the fair value. FASB ASC 825 defines a financial instrument as cash, evidence of an ownership interest in an entity or contractual obligations which require the exchange of cash or other financial instruments. Certain items are specifically excluded from the disclosure requirements, including the Company's common stock, premises and equipment and other assets and liabilities.

Following is a description of valuation methodologies used to estimate fair value for certain other financial instruments.

Fair value approximates carrying value for the following financial instruments due to the short-term nature of the instrument: cash and due from banks, federal funds sold, federal funds purchased, securities sold under agreement to repurchase.

*Bank Owned Life Insurance* - The cash surrender value of bank owned life insurance policies held by the Bank approximates fair values of the policies.

*Deposit Liabilities* - Fair value for demand deposit accounts and interest-bearing accounts with no fixed maturity date is equal to the carrying value. The fair value of certificate of deposit accounts are estimated by discounting cash flows from expected maturities using current interest rates on similar instruments.

*FHLB Advances and Other Borrowings*- Fair value for FHLB advances and other borrowings are estimated by discounting cash flows from expected maturities using current interest rates on similar instruments.

The Company has used management's best estimate of fair value based on the above assumptions. Thus, the fair values presented may not be the amounts that could be realized in an immediate sale or settlement of the instrument. In addition, any income taxes or other expenses, which would be incurred in an actual sale or settlement, are not taken into consideration in the fair value presented.



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The estimated fair values of the Company's financial instruments at September 30, 2009 and December 31, 2008 are as follows:

	September 30, 2009		December 31, 2008	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<b>Financial Assets:</b>				
Cash and cash equivalents	\$ 28,879	\$ 28,879	\$ 13,160	\$ 13,160
Investment securities available for sale	80,775	80,775	64,432	64,432
Investment securities held to maturity	9,795	10,132	12,519	12,618
Other investments	9,088	9,088	8,461	8,461
Loans, net	561,771	571,789	559,602	564,573
Bank owned life insurance	13,828	13,828	13,369	13,369
<b>Financial Liabilities:</b>				
Deposits	494,816	465,129	469,537	447,427
Short-term repurchase agreements	5,000	5,000	-	-
Federal Home Loan Bank advances and related debt	149,675	167,994	149,675	158,216
Note payable	4,750	4,875	15,000	15,000
Junior subordinated debentures	13,403	13,403	13,403	13,403

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

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

#### DISCUSSION OF FORWARD-LOOKING STATEMENTS

This report contains statements which constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements are based on many assumptions and estimates and are not guarantees of future performance. Although we believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove to be inaccurate. Therefore, we can give no assurance that the results contemplated in the forward-looking statements will be realized. Our actual results may differ materially from those anticipated in any forward-looking statements, as they will depend on many factors about which we are unsure, including many factors which are beyond our control. The words *may*, *would*, *could*, *will*, *expect*, *anticipate*, *believe*, *intend*, *plan*, and *estimate*, as well as similar expressions, are meant to identify such forward-looking statements. Potential risks and uncertainties that could cause our actual results to differ from those anticipated in any forward-looking statements include, but are not limited to, those described in our Form 10-K for the year ended December 31, 2008 under Item 1A- Risk Factors and the following:

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

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

changes in political conditions or the legislative or regulatory environment;

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

changes occurring in business conditions and inflation;

changes in technology;

changes in deposit flows;

changes in monetary and tax policies;

the adequacy of level of our allowance for loan loss;

the rate of delinquencies and amounts of charge-offs;

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

increased funding costs due to market illiquidity, increased competition for funding, and/or regulatory requirements;

our ability to retain our existing customers, including our deposit relationships;

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

the amount of our real estate-based loans, and the weakness in the commercial real estate market;

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

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changes in the securities markets; and

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

We have based our forward looking statements on our current expectations about future events. Although we believe that the expectations reflected in our forward-looking statements are reasonable, we cannot guarantee you that these expectations will be achieved. We undertake no obligation to publicly update or otherwise revise any forward-looking statements, whether as a result of new information, future events, or otherwise.

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These risks are exacerbated by the recent developments in national and international financial markets, and we are unable to predict what effect these uncertain market conditions will have on our Company. During 2008 and continuing through the third quarter of 2009, the capital and credit markets experienced unprecedented levels of volatility and disruption. There can be no assurance that these unprecedented developments will not materially and adversely affect our business, financial condition and results of operations.

### Overview

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

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

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

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

Economic conditions, competition, and the monetary and fiscal policies of the Federal government significantly affect most financial institutions, including Southern First. Lending and deposit activities and fee income generation are influenced by levels of business spending and investment, consumer income, consumer spending and savings, capital market activities, and competition among financial institutions, as well as customer preferences, interest rate conditions and prevailing market rates on competing products in our market areas.

Our business model continues to be client-focused, utilizing relationship teams to provide our clients with a specific banker contact and support team responsible for all of their banking needs. The purpose of this structure is to provide a consistent and superior level of professional service, and we believe it provides us with a distinct competitive advantage. We consider exceptional client service to be a critical part of our culture, which we refer to as ClientFIRST.

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

**Critical Accounting Policies**

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

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

*Allowance for Loan Losses*

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

*Real Estate Acquired in Settlement of Loans*

Real estate acquired through foreclosure is initially recorded at the lower of cost or estimated fair value. Subsequent to the date of acquisition, it is carried at the lower of cost or fair value, adjusted for net selling costs. Fair values of real estate owned are reviewed regularly and writedowns are recorded when it is determined that the carrying value of real estate exceeds the fair value less estimated costs to sell. Costs relating to the development and improvement of such property are capitalized, whereas those costs relating to holding the property are expensed.

*Income Taxes*

The financial statements have been prepared on the accrual basis. When income and expenses are recognized in different periods for financial reporting purposes versus for the purposes of computing income taxes currently payable, deferred taxes are provided on such temporary differences. The Company accounts for income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes* and FASB Interpretation No. 48 ( *FIN 48* ), *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109*. Under SFAS No. 109 and FIN 48, deferred tax assets and liabilities are recognized for the expected future tax consequences of events that have been recognized in the consolidated financial statements or tax returns. Deferred tax assets and liabilities are measured using the enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be realized or settled. The Company believes that its income tax filing positions taken or expected to be taken in its tax returns will more likely than not be sustained upon audit by the taxing authorities and does not anticipate any adjustments that will result in a material adverse impact on the Company's financial condition, results of operations, or cash flow. Therefore, no reserves for uncertain income tax positions have been recorded pursuant to FIN 48.

### **Effect of Economic Trends**

The first nine months of 2009 continue to reflect the tumultuous economic conditions which have negatively impacted liquidity and credit quality. Concerns regarding increased credit losses from the weakening economy have negatively affected capital and earnings of most financial institutions. Financial institutions have experienced significant declines in the value of collateral for real estate loans, heightened credit losses, which have resulted in record levels of non-performing assets, charge-offs and foreclosures. In addition, certain financial institutions failed or merged with other institutions during 2008 and during the first nine months of 2009, and two of the government sponsored housing enterprises were placed into conservatorship with the U.S. Government.

Liquidity in the debt markets remains low in spite of efforts by the U.S. Department of the Treasury ( *Treasury* ) and the Federal Reserve Bank ( *Federal Reserve* ) to inject capital into financial institutions. The federal funds rate set by the Federal Reserve has remained at 0.25% since December 2008, following a decline from 4.25% to 0.25% during 2008 through a series of seven rate reductions.

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Treasury, the FDIC and other governmental agencies continue to enact rules and regulations to implement the EESA, the Troubled Asset Relief Program ( *TARP* ), the Financial Stability Plan, the American Recovery and Reinvestment Act ( *ARRA* ) and related economic recovery programs, many of which contain limitations on the ability of financial institutions to take certain actions or to engage in certain activities if the financial institution is a participant in the TARP Capital Purchase Program or related programs. Future regulations, or enforcement of the terms of programs already in place, may require financial institutions to raise additional capital and result in the conversion of preferred equity issued under TARP or other programs to common equity. There can be no assurance as to the actual impact of the EESA, the FDIC programs or any other governmental program on the financial markets.

The weak economic conditions are expected to continue through the remainder of 2009. Financial institutions likely will continue to experience heightened credit losses and higher levels of non-performing assets, charge-offs and foreclosures. In light of these conditions, financial institutions also face heightened levels of scrutiny from federal and state regulators. These factors negatively influenced, and likely will continue to negatively influence, earning asset yields at a time when the market for deposits is intensely competitive. As a result, financial institutions experienced, and are expected to continue to experience, pressure on credit costs, loan yields, deposit and other borrowing costs, liquidity, and capital.

**Recent Legislative and Regulatory Initiatives to Address Financial and Economic Crises**

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

The EESA, approved by Congress and signed by President Bush on October 3, 2008, which, among other provisions, allowed the Treasury Department to purchase troubled assets from banks, authorized the Securities and Exchange Commission to suspend the application of marked-to-market accounting, and raised the basic limit of FDIC deposit insurance from \$100,000 to \$250,000 through December 31, 2013;

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

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

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

The Transaction Account Guarantee Program ( TAGP ), which provides unlimited deposit insurance coverage for noninterest-bearing transaction accounts (typically business checking accounts) and certain funds swept into noninterest-bearing savings accounts. The FDIC has extended the TAGP until June 30, 2010. Institutions participating in the TLGP pay a 10 basis points fee (annualized) on the balance of each covered account in excess of \$250,000, while the extra deposit insurance is in place;

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

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

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

The Legacy Loan Program facilitates the sale of troubled mortgage loans by eligible institutions, which include FDIC-insured federal or state banks and savings associations. Eligible assets may not be strictly limited to loans; however, what constitutes an eligible asset will be determined by participating banks, their primary regulators, the FDIC and the U.S. Treasury. The first sale under this Program was made in the third quarter of 2009.

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

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

We have chosen to participate in the TAGP through June 30, 2010 and have opted out of the DGP.

### RESULTS OF OPERATIONS

*Summary*

*Three months ended September 30, 2009 and 2008*

Our net income was \$424,000 for the three months ended September 30, 2009, an increase of \$550,000, over a net loss of \$126,000 for the same period in 2008. The increase in net income resulted primarily from the \$1.8 million pre-tax impairment charge on Fannie Mae preferred stock during the three months ended September 30, 2008. Partially offsetting the impairment charge were increases of \$825,000 in noninterest expenses, \$435,000 in provision for loan losses, and \$257,000 in income tax expense. Our efficiency ratio, excluding real estate owned activity and the impairment charge, was 69.1% for the three months ended September 30, 2009 compared to 57.8% for the same period in 2008. The higher efficiency ratio relates primarily to the additional FDIC insurance costs during the third quarter of 2009 as well as administrative costs associated with our two new retail offices.

*Nine months ended September 30, 2009 and 2008*

Our net income was \$1.3 million and \$1.5 million for the nine months ended September 30, 2009 and 2008, respectively, a decrease of \$215,000, or 14.5%. The decrease in net income resulted primarily from increases of \$2.1 million in noninterest expenses and \$860,000 in the provision for loan losses, partially offset by increases of \$315,000 in net interest income and \$2.2 million in noninterest income and a decrease of \$169,000 in income tax expense. Our efficiency ratio, excluding real estate owned activity and the impairment charge, was 70.8% for the nine months ended September 30, 2009 from 60.8% for the same period in 2008. The higher efficiency ratio relates primarily to the additional FDIC insurance costs during 2009 as well as administrative costs associated with our two new retail offices.

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*Net Interest Income*

Our level of net interest income is determined by the level of earning assets and the management of our net interest margin. For the three months ended September 30, 2009 and 2008, our net interest income was \$5.0 million and \$4.8 million, respectively. Our average earning assets increased \$30.8 million during the three months ended September 30, 2009 compared to the average for the three months ended September 30, 2008, while our interest bearing liabilities increased only \$15.4 million. The lesser increase in average interest bearing liabilities is due to the utilization of \$17.3 million received for the issuance of preferred stock under the Treasury's Capital Purchase Program.

Our net interest income was \$14.3 million and \$14.0 million for the nine month periods ended September 30, 2009 and 2008, respectively. During the nine months ended September 30, 2009, our average earning assets increased \$27.6 million and our average interest bearing liabilities increased \$21.0 million compared to the nine months ended September 30, 2008. The increase in average earning assets is primarily related to a \$25.2 million increase in our average loans, while the increase in average interest-bearing liabilities is related to an increase in our time deposits, specifically, wholesale certificates of deposit.



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We have included a number of tables to assist in our description of various measures of our financial performance. For example, the Average Balances, Income and Expenses, Yields and Rates table shows the average balance of each category of our assets and liabilities as well as the yield we earned or the rate we paid with respect to each category during the three and nine month periods ended September 30, 2009 and 2008. A review of this table shows that our loans typically provide higher interest yields than do other types of interest-earning assets, which is why we direct a substantial percentage of our earning assets into our loan portfolio. Similarly, the Rate/Volume Analysis table demonstrates the effect of changing interest rates and changing volume of assets and liabilities on our financial condition during the periods shown. We also track the sensitivity of our various categories of assets and liabilities to changes in interest rates, and we have included tables to illustrate our interest rate sensitivity with respect to interest-earning accounts and interest-bearing accounts. Finally, we have included various tables that provide detail about our investment securities, our loans, our deposits, and other borrowings.

The following tables set forth information related to our average balance sheets, average yields on assets, and average costs of liabilities (dollars in thousands). We derived these yields by dividing income or expense by the average balance of the corresponding assets or liabilities. We derived average balances from the daily balances throughout the periods indicated. During the three month and nine month periods ended September 30, 2009 and 2008, we had only \$100,000 in interest-bearing deposits at another bank and had no securities purchased with agreements to resell. All investments owned have an original maturity of over one year. Nonaccrual loans are included in the following tables. Loan yields have been reduced to reflect the negative impact on our earnings of loans on nonaccrual status. The net of capitalized loan costs and fees are amortized into interest income on loans.

### Average Balances, Income and Expenses, Yields and Rates For the Three Months Ended September 30,

	2009			2008		
	Average Balance	Income/ Expense	Yield/ Rate(1)	Average Balance	Income/ Expense	Yield/ Rate(1)
<b>Earnings</b>						
Federal funds sold	\$ 18,228	\$ 9	0.20%	\$ 11,684	\$ 57	1.94%
Investment securities, taxable	96,754	1,093	4.48%	90,420	1,246	5.48%
Investment securities, nontaxable (2)	3,774	58	6.10%	3,689	60	6.44%
Loans	570,244	7,977	5.55%	552,450	8,720	6.28%
Total interest-earning assets	689,000	9,137	5.26%	658,243	10,083	6.09%
Noninterest-earning assets	39,539			29,767		
Total assets	\$ 728,539			\$ 688,010		
<b>Interest-bearing liabilities</b>						
NOW accounts	\$ 44,001	77	0.69%	\$ 41,363	99	0.95%
Savings & money market	86,181	241	1.11%	91,634	398	1.73%
Time deposits	317,059	2,068	2.59%	303,476	3,034	3.98%
Total interest-bearing deposits	447,241	2,386	2.12%	436,473	3,531	3.22%
Note payable and other borrowings	164,318	1,681	4.06%	159,713	1,513	3.77%
Junior subordinated debentures	13,403	98	2.90%	13,403	172	5.11%
Total interest-bearing liabilities	624,962	4,165	2.64%	609,589	5,216	3.40%
Noninterest-bearing liabilities	43,436			39,368		
Shareholders equity	60,141			39,053		
Total liabilities and shareholders equity	\$ 728,539			\$ 688,010		
Net interest spread			2.62%			2.69%
Net interest income (tax equivalent) / margin		\$ 4,972	2.86%		\$ 4,867	2.94%
Less: tax-equivalent adjustment (2)		22			24	
Net interest income		\$ 4,950			\$ 4,843	

(1) Annualized for the three month period.

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

Our net interest margin is calculated as net interest income, on an annualized basis, divided by average interest-earning assets. Our net interest margin, on a tax-equivalent basis, for the three months ended September 30, 2009 was 2.86% compared to 2.94% for the three months ended September 30, 2008. During the third quarter of 2009, interest-earning assets averaged \$689.0 million compared to \$658.2 million in the third quarter of 2009.

Our net interest spread was 2.62% for the three months ended September 30, 2009 compared to 2.69% for the three months ended September 30, 2008. The net interest spread is the difference between the yield we earn on our interest-earning assets and the rate we pay on our interest-bearing liabilities.

The 7 basis point decrease in the net interest spread is primarily due to the fact that more of our rate-sensitive assets repriced downward than our rate-sensitive liabilities during the twelve months ended September 30, 2009. Given the 500 basis point decrease in short-term rates over the past two years, the rates on our new and maturing loans and deposits are much lower than they were in the past. However, in response to the significant decrease in rates, we began instituting interest rate floors on our new and maturing loans during the second half of 2008 and have recently changed our focus to increasing the amount of variable rate loans in our portfolio. Our variable rate loans as a percentage of total loans increased from 42% at September 30, 2008 to 50% at September 30, 2009. We believe that interest rates are at or near their lowest levels and that this change in focus will position us to benefit from future increases in the short-term rates.

Despite a 175 basis point decline in short-term rates in the past 12 months, our loan yield decreased only 73 basis points for the three months ended September 30, 2009 compared to the three months ended September 30, 2008. Offsetting the decrease in our loan yield was a 110 basis point decrease in the cost of our interest-bearing deposits for the third quarter of 2009 compared to the same period in 2008, primarily related to the cost of our time deposits which have renewed at rates much lower than their original rates. In addition, our investment and federal funds sold yields combined decreased by 123 basis points for the 2009 period compared to the same three months in 2008.

The cost of our borrowings, specifically our junior subordinated debt, has declined in the third quarter of 2009 compared to the same period in 2008 due to the variable rates of the debt. As of September 30, 2009, all of our FHLB advances were at fixed rates, while all of our other borrowings, including notes payable and junior subordinated debt, had variable rates.

The \$9.8 million increase in average noninterest-earning assets during the three months ended September 30, 2009 compared to the same period in 2008 is due primarily to a \$6.5 million increase in property and equipment related to the construction of our new regional headquarters facility in Columbia, SC. In addition, the \$21.1 million increase in average shareholders' equity during the 2009 period is primarily related to the \$17.3 million received for the issuance of preferred stock under the Treasury's Capital Purchase Program.

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**Average Balances, Income and Expenses, Yields and Rates**

**For the Nine Months Ended September 30,**

**2009**

**2008**

	<b>Average Balance</b>	<b>Income/ Expense</b>	<b>Yield/ Rate(1)</b>	<b>Average Balance</b>	<b>Income/ Expense</b>	<b>Yield/ Rate(1)</b>
<b>Earnings</b>						
Federal funds sold	\$ 12,713	\$ 17	0.18%	\$ 13,805	\$ 238	2.30%
Investment securities, taxable	95,357	3,282	4.61%	91,935	3,729	5.42%
Investment securities, nontaxable (2)	3,791	174	6.16%	3,746	174	6.21%
Loans	567,921	23,685	5.59%	542,729	26,630	6.55%
Total interest earning assets	679,782	27,158	5.36%	652,215	30,771	6.30%
Non-interest earning assets	38,153			25,607		
Total assets	\$ 717,935			\$ 677,822		
<b>Interest bearing liabilities</b>						
NOW accounts	\$ 43,015	220	0.69%	\$ 39,135	318	1.09%
Savings & money market	85,639	723	1.13%	90,125	1,331	1.97%
Time deposits	317,516	6,678	2.82%	300,373	9,846	4.38%
Total interest-bearing deposits	446,170	7,621	2.29%	429,633	11,495	3.57%
Note payable and other borrowings	162,489	4,803	3.96%	157,991	4,626	3.91%
Junior subordinated debentures	13,403	338	3.38%	13,403	569	5.67%
Total interest bearing liabilities	622,062	12,762	2.75%	601,027	16,690	3.71%
Non-interest bearing liabilities	40,803			37,447		
Shareholders equity	55,070			39,348		
Total liabilities and shareholders equity	\$ 717,935			\$ 677,822		
Net interest spread			2.61%			2.59%
Net interest income (tax equivalent) / margin		\$ 14,396	2.84%	\$ 14,081		2.88%
Less: tax-equivalent adjustment (2)		66		66		
Net interest income / margin	\$	14,330		\$	14,015	

(1) Annualized for the nine month period.

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

Our net interest margin, on a tax-equivalent basis, for the nine months ended September 30, 2009 was 2.84% compared to 2.88% for the nine months ended September 30, 2008. During the first nine months of 2009, interest-earning assets averaged \$679.8 million compared to \$652.2 million during the same period of 2008. Our net interest spread, was 2.61% for the nine months ended September 30, 2009 compared to 2.59% for the nine months ended September 30, 2008.

The slight increase in the net interest spread is primarily due to the fact that more of our rate-sensitive liabilities repriced downward than our rate-sensitive assets during the twelve months ended September 30, 2009. Given the 500 basis point decrease in short-term rates over the past two years, the rates on our new and maturing loans and deposits are much lower than they were in the past. However, in response to the significant decrease in rates, we have begun instituting interest rate floors on our new and maturing loans and have recently changed our focus to increasing the amount of variable rate loans in our portfolio. We believe that interest rates are at or near their lowest levels and that this change in focus will position us to benefit from future increases in the short-term rates.

Despite a 175 basis point decline in short-term rates in the past 12 months, our loan yield decreased only 96 basis points for the nine months ended September 30, 2009 compared to the same period in 2008. Offsetting the decrease in our loan yield was a 128 basis point decrease in the

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cost of our interest-bearing deposits for the first nine months of 2009 compared to the nine months ended September 30, 2008, primarily related to the cost of our time deposits which have renewed at rates much lower than their original rates. In addition, our investment and federal funds sold yields combined decreased by 90 basis points for the 2009 period compared to the same three months in 2008.

The cost of our borrowings, specifically our junior subordinated debt, has declined during the nine month period ended September 30, 2009 compared to the same period in 2008 due to the variable rates of the debt. As of September 30, 2009, all of our FHLB advances were at fixed rates, while all of our other borrowings, including notes payable and junior subordinated debt, had variable rates.

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The \$12.6 million increase in noninterest-earning assets during the nine months ended September 30, 2009 compared to the same period in 2008 is due primarily to a \$6.6 million increase in property and equipment related to the construction of our new regional headquarters facility in Columbia, SC as well as increases of \$4.0 million in bank-owned life insurance and \$2.2 million in other real estate owned. In addition, the \$15.7 million increase in average shareholders' equity during the 2009 period is primarily related to the \$17.3 million received on February 27, 2009 for the issuance of preferred stock under the Treasury's Capital Purchase Program.

### *Rate/Volume Analysis*

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

	<b>Three Months Ended September 30, 2009 vs. 2008 Increase (Decrease) Due to</b>				<b>September 30, 2008 vs. 2007 Increase (Decrease) Due to</b>			
	<b>Volume</b>	<b>Rate</b>	<b>Rate/ Volume</b>	<b>Total</b>	<b>Volume</b>	<b>Rate</b>	<b>Rate/ Volume</b>	<b>Total</b>
<b>Interest income</b>								
Loans	\$ 273	\$ (984)	\$ (32)	\$ (743)	\$ 1,631	\$ (1,719)	\$ (289)	\$ (377)
Investment securities	86	(224)	(15)	(153)	185	(8)	(1)	176
Federal funds sold	32	(51)	(29)	(48)	77	(49)	(48)	(20)
Total interest income	391	(1,259)	(76)	(944)	1,893	(1,776)	(338)	(221)
<b>Interest expense</b>								
Deposits	108	(1,216)	(37)	(1,145)	1,285	(1,347)	(423)	(485)
Note payable and other	45	120	3	168	315	(309)	(58)	(52)
Junior subordinated debt	-	(74)	-	(74)	(33)	(80)	9	(104)
Total interest expense	153	(1,170)	(34)	(1,051)	1,567	(1,736)	(472)	(641)

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Net interest income    \$ 238        \$ (89)        \$ (42)        \$ 107        \$ 326        \$ (40)        \$ 134        \$ 420

	Nine Months Ended September 30, 2009 vs. 2008 Increase (Decrease) Due to				September 30, 2008 vs. 2007 Increase (Decrease) Due to			
	Volume	Rate	Rate/ Volume	Total	Volume	Rate	Rate/ Volume	Total
<b>Interest income</b>								
Loans	\$ 1,274	\$ (4,032)	\$ (187)	\$ (2,945)	\$ 5,207	\$ (3,198)	\$ (694)	\$ 1,315
Investment securities	143	(569)	(21)	(447)	608	1	-	609
Federal funds sold	(19)	(219)	17	(221)	102	(248)	(57)	(203)
Total interest income	1,398	(4,820)	(191)	(3,613)	5,917	(3,445)	(751)	1,721
<b>Interest expense</b>								
Deposits	497	(4,191)	(180)	(3,874)	2,466	(2,048)	(456)	(38)
Note payable and other	119	56	2	177	1,045	(589)	(149)	307
Junior subordinated debt	-	(231)	-	(231)	(39)	(175)	8	(206)
Total interest expense	616	(4,366)	(178)	(3,928)	3,472	(2,812)	(597)	63
Net interest income	\$ 782	\$ (454)	\$ (13)	\$ 315	\$ 2,445	\$ (633)	\$ (154)	\$ 1,658

Net interest income, the largest component of our income, was \$4.9 million and \$4.8 million for the three months ended September 30, 2009 and 2008, respectively. The slight increase in the third quarter of 2009 related primarily to the net effect of higher levels of both average interest-earning assets and interest-bearing liabilities. Average interest-earning assets were \$30.8 million higher during the three months ended September 30, 2009 compared to the same period in 2008. During the same period, average interest-bearing liabilities increased \$15.4 million. The higher average balances resulted in \$238,000 of additional net interest income for the three months ended September 30, 2009, while lower rates on the average balances reduced net interest income by \$89,000.

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In addition, net interest income was \$14.3 million and \$14.0 million for the nine months ended September 30, 2009 and 2008, respectively. The small increase in the 2009 period related primarily to the net effect of higher levels of both average interest-earning assets and interest-bearing liabilities. Average interest-earning assets were \$27.6 million higher during the nine months ended September 30, 2009 compared to the same period in 2008. During the same period, average interest-bearing liabilities increased \$21.0 million. The higher average balances resulted in \$782,000 of additional net interest income for the nine months ended September 30, 2009, while lower rates on the average balances reduced net interest income by \$454,000.

*Three months ended September 30, 2009 and 2008*

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Interest income for the three months ended September 30, 2009 was \$9.1 million, consisting of \$8.0 million on loans, \$1.1 million on investments, and \$9,000 on federal funds sold. Interest income for the three months ended September 30, 2008 was \$10.1 million, consisting of \$8.7 million on loans, \$1.3 million on investments, and \$57,000 on federal funds sold. Interest on loans for the three months ended September 30, 2009 and 2008 represented 87.5% and 86.7%, respectively, of total interest income, while income from investments and federal funds sold represented only 12.5% and 13.3%, respectively, of total interest income. The high percentage of interest income from loans relates to our strategy to maintain a significant portion of our assets in higher earning loans compared to lower yielding investments. Average loans represented 82.8% and 83.9% of average interest-earning assets for the three months ended September 30, 2009 and 2008, respectively. Included in interest income on loans for the three months ended September 30, 2009 and 2008 was \$146,000 and \$148,000, respectively, related to the net amortization of loan fees and capitalized loan origination costs.

Interest expense for the three months ended September 30, 2009 was \$4.2 million, consisting of \$2.4 million related to deposits and \$1.8 million related to other borrowings. Interest expense for the three months ended September 30, 2008 was \$5.2 million, consisting of \$3.5 million related to deposits and \$1.7 million related to other borrowings. Interest expense on deposits for the three months ended September 30, 2009 and 2008 represented 57.3% and 67.7%, respectively, of total interest expense, while interest expense on other borrowings represented 42.7% and 32.3%, respectively, of total interest expense for the same three month periods. During the three months ended September 30, 2009, average interest-bearing deposits increased by \$10.8 million over the same period in 2008, while our average notes payable and other borrowings increased \$4.6 million during the three months ended September 30, 2009 over the same period in 2008. The note payable and other borrowings provide us with the opportunity to obtain low cost funding with various maturities similar to the maturities on our loans and investments.

### *Nine months ended September 30, 2009 and 2008*

Interest income for the nine months ended September 30, 2009 was \$27.1 million, consisting of \$23.7 million on loans, \$3.4 million on investments, and \$17,000 on federal funds sold. Interest income for the nine months ended September 30, 2008 was \$30.7 million, consisting of \$26.6 million on loans, \$3.8 million on investments, and \$238,000 on federal funds sold. Interest income on loans for the nine months ended September 30, 2009 and 2008 represented 87.4% and 86.7%, respectively, of total interest income, while income from investments and federal funds sold represented only 12.6% and 13.3%, respectively, of total interest income. The high percentage of interest income from loans relates to our strategy to maintain a significant portion of our assets in higher earning loans compared to lower yielding investments. Average loans represented 83.5% and 83.2% of average interest-earning assets for the nine months ended September 30, 2009 and 2008, respectively. Included in interest income on loans for the nine months ended September 30, 2009 and 2008 was \$462,000 and \$583,000, respectively, related to the net amortization of loan fees and capitalized loan origination costs.

Interest expense for the nine months ended September 30, 2009 was \$12.8 million, consisting of \$7.6 million related to deposits and \$5.1 million related to borrowings. Interest expense for the nine months ended September 30, 2008 was \$16.7 million, consisting of \$11.5 million related to deposits and \$5.2 million related to borrowings. Interest expense on deposits for the nine months ended September 30, 2009 and 2008 represented 59.7% and 68.9%, respectively, of total interest expense, while interest expense on other borrowings represented 40.3% and 31.1%, respectively, of total interest expense for the same nine month periods. During the nine months ended September 30, 2009, average interest-bearing deposits increased by \$16.5 million over the same period in 2008, while our notes payable and other borrowings increased \$4.5 million during the nine months ended September 30, 2009 over the same period in 2008. The note payable and other borrowings provide us with the opportunity to obtain low cost funding with various maturities similar to the maturities on our loans and investments.

### *Provision for Loan Losses*

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

*Three and nine months ended September 30, 2009 and 2008*

For the three months ended September 30, 2009 and 2008, we incurred a noncash expense related to the provision for loan losses of \$1.1 million and \$650,000, respectively, bringing the allowance for loan losses to \$7.9 million and \$6.5 million, respectively. The allowance represented 1.39% of gross loans at September 30, 2009 and 1.16% of gross loans at September 30, 2008. During the three months ended September 30, 2009, we charged-off \$1.0 million of loans and recorded \$91,000 of recoveries on loans previously charged-off. During the three months ended September 30, 2008, we charged-off \$621,000 of loans and recorded virtually no recoveries on loans previously charged-off. The \$909,000 and \$621,000 net charge-offs during the third quarters of 2009 and 2008, respectively, represented an annualized rate of 0.63% and 0.45% of the average outstanding loan portfolio for the three months ended September 30, 2009 and 2008, respectively.

For the nine months ended September 30, 2009, we incurred a noncash expense related to the provision for loan losses of \$2.8 million, bringing the allowance for loan losses to \$7.9 million, or 1.39% of gross loans, as of September 30, 2009. The \$2.8 million provision for the nine months ended September 30, 2009 related primarily to the \$2.0 million in charge-offs that occurred during this period. In contrast, for the nine months ended September 30, 2008, we added \$2.0 million to the provision for loan losses, resulting in an allowance of \$6.5 million at September 30, 2008. We charged-off \$1.2 million of loans and recorded \$10,000 of recoveries on loans previously charged-off during the nine months ended September 30, 2008. The \$1.9 million and \$1.2 million net charge-offs during the first nine months of 2009 and 2008, respectively, represented 0.45% and 0.30% of the average outstanding loan portfolio for the nine months ended September 30, 2009 and 2008, respectively.

At September 30, 2009, the allowance for loan losses represented less than one time the amount of non-performing loans, compared to 1.9 times at September 30, 2008. The coverage level of the allowance at September 30, 2009 decreased from the coverage level at September 30, 2008 due to an increase in non-performing loans. A significant portion, or 79.6%, of nonperforming loans at September 30, 2009 are secured by real estate. We have evaluated the underlying collateral on these loans and believe that the collateral on these loans is sufficient to minimize future losses. As a result of this level of coverage on non-performing loans, we believe the provision of \$2.8 million for the nine months ended September 30, 2009 to be adequate.

*Noninterest Income*

The following table sets forth information related to our noninterest income (dollars in thousands).

	<b>Three months ended September 30,</b>		<b>Nine months ended September 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Loan fee income	\$ 138	\$ 38	\$ 297	\$ 126
Service fees on deposit accounts	199	177	551	468
Income from bank owned life insurance	213	114	459	312
Gain on sale of securities	34	7	34	7
Loss on other than temporary impairment	-	(1,841)	-	(1,841)

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Real estate owned activity	(148)	(7)	(152)	(58)
Other income	97	85	277	245
Total noninterest income (loss)	\$ 533	\$ (1,427)	\$ 1,466	\$ (741)

Three months ended September 30, 2009 and 2008

Noninterest income for the three month period ended September 30, 2009 was \$533,000, an increase of \$2.0 million over a loss of \$1.4 million for the same period of 2008. The \$2.0 million increase during the 2009 period is related primarily to a pre-tax impairment charge of \$1.8 million on Fannie Mae preferred stock as well as increases of \$100,000 in loan fee income and \$99,000 in income from bank owned life insurance, partially offset by a \$141,000 increase in real estate owned expenses.

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Loan fee income was \$138,000 and \$38,000 for the three months ended September 30, 2009 and 2008, respectively, consisting primarily of late charge fees, fees from issuance of lines and letters of credit, and mortgage origination fees we receive on residential loans funded and closed by a third party. The \$100,000 increase for the three months ended September 30, 2009 compared to the same period in 2008 related primarily to a \$96,000 increase in mortgage origination fees, as well as a \$5,000 increase in late fees. Mortgage origination fees were \$96,000 for the three months ended September 30, 2009 compared to \$0 for the same period in 2008. Income related to fees received from the issuance of lines and letters of credit was \$12,000 and \$11,000 for the third quarters of 2009 and 2008, respectively, while late charge fees were \$30,000 and \$25,000 for the three month periods ended September 30, 2009 and 2008, respectively.

Service fees on deposit accounts consist primarily of service charges on our checking, money market, and savings accounts and the fee income received from client non-sufficient funds ( NSF ) transactions. Deposit fees were \$199,000 and \$177,000 for the three months ended September 30, 2009 and 2008, respectively. The \$22,000 increase is primarily related to a \$24,000 increase in deposit related fees such as service charges, partially offset by a \$4,000 decrease in NSF fee income. Service charge fees were \$67,000 and \$43,000 for the three months ended September 30, 2009 and 2008, respectively, while other fees such as overdraft and returned item fees were \$14,000 and \$13,000 for the same periods in 2009 and 2008, respectively. NSF fee income was \$118,000 and \$122,000 for the third quarters of 2009 and 2008, respectively, representing 59.3% of total service fees on deposits in the 2009 period compared to 68.9% of total service fees on deposits in the 2008 period.

We purchased an additional \$4.0 million of bank owned life insurance during the second half of 2008. Income derived from life insurance was \$213,000 and \$114,000 for the three months ended September 30, 2009 and 2008, respectively.

Real estate owned activity includes income and expenses from property held for sale and other real estate we own, including real estate acquired in settlement of loans. For the three months ended September 30, 2009 and 2008, our income received on the properties exceeded expenses related to owning the real estate by \$44,000 and \$8,000, respectively. However, we also recorded a write-down on real estate owned of \$192,000 and \$15,000 during the respective 2009 and 2008 periods. This net activity on real estate owned resulted in a loss of \$148,000 and \$7,000 for the three months ending September 30, 2009 and 2008, respectively.



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Other income consists primarily of fees received on debit card transactions, sale of customer checks, and wire transfers. Other income was \$97,000 and \$85,000 for the three months ended September 30, 2009 and 2008, respectively. The \$12,000 increase relates primarily to a \$9,000 increase in debit card transaction fees and a \$4,000 increase in other client service related fees. Debit card transaction fees were \$70,000 and \$61,000 for the three months ended September 30, 2009 and 2008, respectively, and represented 72.2% and 71.8% of total other income for the third quarters of 2009 and 2008, respectively. The corresponding transaction costs associated with debit card transactions are included in noninterest data processing and related costs. The debit card transaction costs were \$27,000 and \$25,000 for the three months ended September 30, 2009 and 2008, respectively. The net impact of the fees received and the related cost of the debit card transactions on earnings for the three months ended September 30, 2009 and 2008 was \$43,000 and \$36,000, respectively. Wire transfer and other deposit related fees were \$27,000 and \$24,000 for the third quarters ended September 30, 2009 and 2008, respectively.

### *Nine months ended September 30, 2009 and 2008*

Noninterest income for the nine month period ended September 30, 2009 was \$1.5 million, an increase of \$2.2 million over a loss of \$741,000 for the same period of 2008. The \$2.2 million increase during the 2009 period is related primarily to a pre-tax impairment charge of \$1.8 million on Fannie Mae preferred stock as well as increases of \$171,000 in loan fee income, \$83,000 in service fees on deposit accounts, and \$147,000 in income from bank owned life insurance, partially offset by a \$94,000 increase in real estate owned expenses.

Loan fee income was \$297,000 and \$126,000 for the nine months ended September 30, 2009 and 2008, respectively, consisting primarily of late charge fees, fees from issuance of lines and letters of credit, and mortgage origination fees we receive on residential loans funded and closed by a third party. The \$171,000 increase for the nine months ended September 30, 2009 compared to the same period in 2008 related primarily to an increase of \$178,000 in mortgage origination fees, partially offset by decreases of \$2,000 in late charge fees and \$5,000 in fees from issuance of lines and letters of credit. Mortgage origination fees were \$185,000 and \$7,000 for the nine months ended September 30, 2009 and 2008, respectively. Late charge fees were \$77,000 and \$79,000 for the nine months ended September 30, 2009 and 2008, respectively, while income related to issuance of lines and letters of credit was \$35,000 and \$40,000 for the same periods in 2009 and 2008, respectively.

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Service fees on deposit accounts consist primarily of service charges on our checking, money market, and savings accounts and the fee income received from client non-sufficient funds ( NSF ) transactions. Deposit fees were \$551,000 and \$468,000 for the nine months ended September 30, 2009 and 2008, respectively. The \$83,000 increase is primarily related to increases of \$56,000 in deposit related fees such as service charges, \$17,000 in overdraft and returned item fees, and \$10,000 in NSF fees. Service charge fees were \$183,000 and \$127,000 for the nine months ended September 30, 2009 and 2008, respectively, while other fees such as overdraft and returned item fees were \$39,000 and \$22,000, respectively. NSF income increased \$10,000 to \$329,000 for the nine months ended September 30, 2009 from \$319,000 for the same period in 2008, representing 59.7% of total service fees on deposits in the 2009 period compared to 68.2% of total service fees on deposits in the 2008 period.

We purchased an additional \$4.0 million of bank owned life insurance during the second half of 2008. Income derived from life insurance was \$459,000 and \$312,000 for the nine months ended September 30, 2009 and 2008, respectively.

Real estate owned activity includes income and expenses from property held for sale and other real estate we own, including real estate acquired in settlement of loans. For the nine months ended September 30, 2009 and 2008, our income received on the properties exceeded expenses

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related to owning the real estate by \$40,000 and \$52,000, respectively. However, we also recorded a write-down on real estate owned of \$192,000 and \$110,000 during the respective 2009 and 2008 periods. This net activity on real estate owned resulted in a loss of \$152,000 and \$58,000 for the three months ending September 30, 2009 and 2008, respectively.

Other income consists primarily of fees received on debit card transactions, sale of customer checks, and wire transfers. Other income was \$277,000 and \$245,000 for the nine months ended September 30, 2009 and 2008, respectively. The \$32,000 increase relates primarily to a \$27,000 increase in debit card transaction fees and a \$7,000 increase in other client service related fees. Debit card transaction fees were \$197,000 and \$170,000 for the nine months ended September 30, 2009 and 2008, respectively and represented 71.1% and 69.4% of total other income for the first nine months of 2009 and 2008, respectively. The corresponding transaction costs associated with debit card transactions are included in noninterest data processing and related costs. The debit card transaction costs were \$75,000 and \$69,000 for the nine months ended September 30, 2009 and 2008, respectively. The net impact of the fees received and the related cost of the debit card transactions on earnings for the nine months ended September 30, 2009 and 2008 was \$122,000 and \$101,000, respectively.

### *Noninterest expenses*

The following table sets forth information related to our noninterest expenses (dollars in thousands).

	<b>Three months ended September 30,</b>		<b>Nine months ended September 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Compensation and benefits	\$ 1,980	\$ 1,625	\$ 5,867	\$ 5,149
Professional fees	186	127	478	368
Marketing	176	154	495	450
Insurance	352	141	1,143	413
Occupancy	550	437	1,407	1,134
Data processing and related costs	358	347	1,077	1,012
Telephone	76	50	186	126
Other	187	159	605	560
<b>Total noninterest expenses</b>	<b>\$ 3,865</b>	<b>\$ 3,040</b>	<b>\$ 11,258</b>	<b>\$ 9,212</b>

### *Three months ended September 30, 2009 and 2008*

We incurred noninterest expenses of \$3.9 million for the three months ended September 30, 2009 compared to \$3.0 million for the three months ended September 30, 2008, an increase of \$825,000 or 27.1%.

Our efficiency ratio was 69.1% for the three months ended September 30, 2009 compared to 57.8% for the three months ended September 30, 2008. The efficiency ratio is computed as noninterest expense as a percentage of noninterest income and net interest income, excluding real estate owned activity and the impairment charge. The primary reason for the elevated efficiency ratio in the 2009 period is due to the increased FDIC insurance premiums and expenses related to our new regional headquarters building opened in August 2009. The significant increase in insurance expense is primarily related to a general increase in the assessment rate used to calculate FDIC insurance premiums as well as the special assessment of approximately \$300,000 charged by the FDIC.

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For the three months ended September 30, 2009, compensation and benefits, occupancy, and data processing and related costs represented 74.7% of the total noninterest expense compared to 79.2% for the same period in 2008.

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### *Nine months ended September 30, 2009 and 2008*

We incurred noninterest expenses of \$11.3 million for the nine months ended September 30, 2009 compared to \$9.2 million for the nine months ended September 30, 2008, an increase of \$2.1 million, or 22.2%

Our efficiency ratio was 70.8% for the nine months ended September 30, 2009 compared to 60.8% for the same period in 2008. The efficiency ratio is computed as noninterest expense as a percentage of noninterest income and net interest income, excluding real estate owned activity and the impairment charge. Increased FDIC insurance premiums and expenses related to the additional two retail offices opened in July 2008 and our new regional headquarters building contributed to the elevated efficiency ratio for the 2009 period.

For the nine months ended September 30, 2009, compensation and benefits, occupancy, and data processing and related costs represented 74.2% of the total noninterest expense compared to 79.2% for the same period in 2008.

The following table sets forth information related to our compensation and benefits (dollars in thousands).

	<b>Three months ended September 30, 2009    2008</b>		<b>Nine months ended September 30, 2009    2008</b>	
Base compensation	\$ 1,536	\$ 1,293	\$ 4,284	3,695
Incentive compensation	121	73	563	638
Total compensation	1,657	1,366	4,847	4,333
Benefits	360	299	1,126	940
Capitalized loan origination costs	(37)	(40)	(106)	(124)
Total compensation and benefits	\$ 1,980	\$ 1,625	\$ 5,867	5,149

### *Three months ended September 30, 2009 and 2008*

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Total compensation and benefits expense was \$2.0 million and \$1.6 million for the three months ended September 30, 2009 and 2008, respectively. Compensation and benefits represented 51.2% and 53.5% of our total noninterest expense for the three months ended September 30, 2009 and 2008, respectively. The \$355,000 increase in compensation and benefits in the third quarter of 2009 compared to the same period in 2008 resulted from increases of \$243,000 in base compensation, \$48,000 in incentive compensation, and \$61,000 in benefits expense. In addition, loan origination compensation expense, which is required to be capitalized and amortized over the life of the loan as a reduction of loan interest income, decreased by \$3,000.

The \$243,000 increase in base compensation expense related to the cost of 12 additional employees as well as the employees hired in mid-June 2008 to staff our two new office locations. We hired 6 additional employees during the third quarter of 2009 in relation to the opening of our new regional headquarters in Columbia, South Carolina. In addition, we have added positions in mortgage origination, credit, client services and accounting and human resources. Incentive compensation represented 6.1% and 4.5% of total compensation and benefits for the three months ended September 30, 2009 and 2008, respectively. The incentive compensation expense recorded for the third quarters of 2009 and 2008 represented an accrual of the estimated incentive compensation earned during the third quarter of the respective year. Benefits expense increased \$61,000 in the third quarter of 2009 compared to the same period in 2008. Benefits expense represented 21.7% and 21.9% of the total compensation for the three months ended September 30, 2009 and 2008, respectively.

### *Nine months ended September 30, 2009 and 2008*

Total compensation and benefits expense was \$5.9 million and \$5.2 million for the nine months ended September 30, 2009 and 2008, respectively. Compensation and benefits represented 52.1% and 55.9% of our total noninterest expense for the nine months ended September 30, 2009 and 2008, respectively. The \$718,000 increase in compensation and benefits in the first nine months of 2009 compared to the same period in 2008 resulted from increases of \$589,000 in base compensation and \$186,000 in benefits expense, partially offset by a reduction of \$75,000 in incentive compensation. In addition, loan origination compensation expense, which is required to be capitalized and amortized over the life of the loan as a reduction of loan interest income, decreased by \$18,000.

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The \$589,000 increase in base compensation expense related to the cost of 12 additional employees as well as the employees hired in mid-June 2008 to staff our two new office locations. We hired 6 additional employees during the third quarter of 2009 in relation to the opening of our new regional headquarters in Columbia, South Carolina. In addition, we have added positions in mortgage origination, credit, client services and accounting and human resources. Incentive compensation represented 9.6% and 12.4 % of total compensation and benefits for the nine months ended September 30, 2009 and 2008, respectively. The incentive compensation expense recorded for the first nine months of 2009 and 2008 represented an accrual of the estimated incentive compensation earned during the first nine months of the respective year. Benefits expense increased \$186,000 in the first nine months of 2009 compared to the same period in 2008. Benefits expense represented 23.2% and 21.7% of the total compensation for the nine months ended September 30, 2009 and 2008, respectively.

The following tables set forth information related to our data processing and related costs (dollars in thousands).

**Three months ended**

**Nine months ended**

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	September 30,		September 30,	
	2009	2008	2009	2008
Data processing costs	\$ 259	\$ 266	\$ 810	\$ 776
Debit card transaction expense	27	25	75	69
Courier expense	28	26	82	73
Other expenses	44	30	110	94
Total data processing and related costs	\$ 358	\$ 347	\$ 1,077	\$ 1,012

*Three and nine months ended September 30, 2009 and 2008*

Total data processing and related costs were \$358,000 and \$347,000, an increase of \$11,000 for the three months ended September 30, 2009 and 2008, respectively. During the first nine months of 2009 and the same period of 2008, our data processing and related costs were \$1.1 million and \$1.0 million, respectively, an increase of \$65,000, or 6.4%.

We have contracted with an outside computer service company to provide our core data processing services. Data processing costs decreased \$7,000, or 2.6%, from \$266,000 to \$259,000 for the three months ended September 30, 2009 compared to the same period in 2008. While a significant portion of the fee charged by the third party processor is directly related to the number of loan and deposit accounts and the related number of transactions, the \$7,000 decrease is primarily related to services provided by a third party during the 2008 period for certain IT technical support and assistance. During the nine months ended September 30, 2009 and 2008, data processing costs for our core processing system were \$810,000 and \$776,000, respectively, an increase of \$34,000, or 4.4%.

We receive income from debit card transactions performed by our clients. Since we outsource this service, we are charged related transaction expenses from our merchant service provider. Debit card transaction expense was \$27,000 and \$25,000 for the three months ended September 30, 2009 and 2008, respectively, and \$75,000 and \$69,000 for the nine months ended September 30, 2009 and 2008, respectively.

Occupancy expense represented 14.2% and 14.4% of total noninterest expense for the three months ended September 30, 2009 and 2008, respectively. Occupancy expense increased by \$113,000 for the three months ended September 30, 2009 and 2008 from \$437,000 to \$550,000, respectively. The increase is primarily due to the costs of depreciation and maintenance associated with our new regional headquarters building in Columbia, South Carolina which opened in August 2009. For the nine months ended September 30, 2009, occupancy expense increased \$273,000 to \$1.4 million from \$1.1 million for the same period ended September 30, 2008. The increase is primarily due to the increased costs of depreciation and maintenance associated with the two retail offices which opened in July 2008 and our new regional headquarters building which opened in August 2009. Occupancy expense represented 12.5% and 12.3% of total noninterest expense for the first nine months of 2009 and 2008, respectively.

The remaining \$346,000 increase in noninterest expense for the three month period ended September 30, 2009 compared to the same period in 2008 resulted primarily from increases of \$211,000 in insurance expense, \$59,000 in professional fees, \$22,000 in marketing expenses, \$26,000 in telephone expense, and \$28,000 in other noninterest expenses. The significant increase in insurance expense for the three month period is related to a general increase in the assessment rate used to calculate FDIC insurance premiums. The increase in professional fees relates primarily to increased legal, accounting, and directors fees, while the increases in marketing and telephone expenses are due to increased community support and basic communication costs. In addition, the \$28,000 increase in other expense is primarily due to a \$16,000 increase in collection expenses.

For the nine month period ended September 30, 2009, remaining noninterest expenses increased \$990,000 from the same period in 2008. Of this amount, \$730,000 was related to insurance expense, \$110,000 to professional fees, \$45,000 to marketing expenses, \$60,000 to telephone expenses, and \$45,000 to other expenses. The significant increase in insurance expense is primarily related to a general increase in the assessment rate used to calculate FDIC insurance premiums as well as the special assessment of approximately \$300,000 charged by the FDIC. The increase in professional fees relates primarily to increased legal, accounting, and directors fees, while the increases in marketing and telephone expenses are due to increased community support and basic communication costs. In addition, the \$45,000 increase in other expense is primarily due to a \$110,000 increase in collection expenses, partially offset by decreases of \$31,000 in office supplies, \$29,000 in deposit account losses, and \$21,000 in travel and business meal expenses.

Income tax expense was \$109,000 for the three months ended September 30, 2009 compared to a tax benefit of \$148,000 during the same period in 2008. For the nine months ended September 30, 2009, income tax expense was \$461,000 compared to \$630,000 for the same period in 2008. Our effective tax rate was 20.5% and (54.0%), respectively, for the three month periods ended September 30, 2009 and 2008, respectively, and 26.7% and 29.8% for the nine month periods ended September 30, 2009 and 2008, respectively. The lower net income before taxes during the first nine months of 2009 increased the impact that our tax-exempt income had in lowering our effective tax rate from the same periods in the prior year.

## **Balance Sheet Review**

### **General**

At September 30, 2009, we had total assets of \$732.7 million, consisting principally of \$569.7 million in loans, \$99.7 million in investments, \$22.0 million in federal funds sold, \$6.9 million in cash and due from banks and \$13.8 million in bank owned life insurance. Our liabilities at September 30, 2009 totaled \$672.4 million, which consisted principally of \$494.8 million in deposits, \$5.0 million in short-term repurchase agreements, \$154.4 million in notes payable and other borrowings, and \$13.4 million in junior subordinated debentures. At September 30, 2009, our shareholders' equity was \$60.2 million.

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

### *Federal Funds Sold*

At September 30, 2009, our federal funds sold were \$22.0 million, or 3.0% of total assets. At December 31, 2008, our \$8.8 million in short-term investments in federal funds sold on an overnight basis comprised 1.3% of total assets.

*Investments*

At September 30, 2009, the \$99.7 million in our investment securities portfolio represented approximately 13.6% of our total assets. We held Government sponsored enterprise securities, municipal securities, and mortgage-backed securities with a fair value of \$90.9 million and an amortized cost of \$89.1 million for an unrealized gain of \$1.8 million.

Contractual maturities and yields on our investments that are available for sale and are held to maturity at September 30, 2009 are shown in the following table (dollars in thousands). Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. We had no securities with maturities less than one year at September 30, 2009.

	One to Five Years		Five to Ten Years		Over Ten Years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
<b>Available for Sale</b>								
Government sponsored enterprises	\$ -	-	\$ -	-	\$ 7,497	5.06 %	\$ 7,497	5.06 %
State and political subdivisions	-	-	3,112	3.79 %	906	3.82 %	4,018	3.80 %
Mortgage-backed securities	293	4.72 %	4,123	4.53 %	64,844	4.91 %	69,260	4.90 %
<b>Total</b>	<b>\$ 293</b>	<b>4.72 %</b>	<b>\$ 7,235</b>	<b>4.21 %</b>	<b>\$ 73,247</b>	<b>4.81 %</b>	<b>\$ 80,775</b>	<b>4.76 %</b>
<b>Held to Maturity</b>								
Mortgage-backed securities	\$ 173	3.92 %	1,948	4.30 %	\$ 7,674	4.64 %	\$ 9,795	4.56 %

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Other investments at September 30, 2009, consisted of Federal Reserve Bank stock with a cost of \$1.5 million, investments in Greenville First Statutory Trust I and II of \$186,000 and \$217,000, respectively, and Federal Home Loan Bank stock with a cost of \$7.1 million. At September 30, 2009, our investments included securities issued by Federal Home Loan Mortgage Corporation, Federal National Mortgage Association, and Government National Mortgage Association with carrying values of \$27.1 million, \$40.4 million, and \$6.5 million, respectively.

The amortized costs and the fair value of our investments at September 30, 2009 and December 31, 2008 are shown in the following table (dollars in thousands).

	September 30, 2009		December 31, 2008	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
<b>Available for Sale</b>				
Government sponsored enterprises	\$ 7,483	\$ 7,497	\$ 18,482	\$ 18,708

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State and political subdivisions	3,789	4,018	3,790	3,772
Mortgage-backed securities	68,003	69,260	43,700	41,886
FNMA Preferred stock	-	-	84	66
Total	\$ 79,275	\$ 80,775	\$ 66,056	\$ 64,432
<b>Held to Maturity</b>				
Mortgage-backed securities	\$ 9,795	\$ 10,132	\$ 12,519	\$ 12,618

At September 30, 2009, the Company had an unrealized loss on one of its individual investments in mortgage-backed securities. The Company believes, based on industry analyst reports and credit ratings that the deterioration in the value of this investment is attributed to market turmoil and liquidity and not the credit quality of the issuer. The Company has the ability and intent to hold this security until such time as the value recovers or the security matures. In addition, the Company held one collateralized mortgage obligation ( CMO ) that was in an unrealized loss position at September 30, 2009. The Company has the ability and intent to hold all securities within the portfolio until the maturity or until the value recovers; therefore, we do not consider these investments to be other-than-temporarily impaired at September 30, 2009.

Effective April 1, 2009, the Company adopted FASB ASC 820, Fair Value Measurement and Disclosures, which allows fair value to be based on internal calculations or external fair value models that use market participant data, independently sourced market observable data or unobserved inputs that are corroborated by market data if listed prices or active market quotes are not readily available. Our private label CMOs, which are non-agency securities, were priced based on an internally developed cash flow model due to market illiquidity. To determine our pricing valuation, the Company obtained fair values for its private label Collateralized Mortgage Obligations ( CMO ) investments from third party pricing vendors. In addition, we evaluated recent transaction volumes, price quotations and related price variability, broker information available to us, and market liquidity to the extent possible. We noted that this market has had little, if any, new issuance since the credit crisis began. The company determined that most sales are forced and do not reflect the true economic value of these securities.

The two major components in the bank's internal model are the prepayment speeds of the securities and the dollar amount of loan defaults compared to the excess collateral amounts in each pool. The prepayment speeds utilized in the model are based on the prior prepayment rates for the specific securities and the anticipated future prepayment speeds for like securities. The default rates are based on both the historical loss rates for each security and an analysis of the current loan delinquency amounts in each portfolio. Anticipated loss amounts are determined based on the various levels of delinquency, with higher percentages being assigned to loans over 90 days or loans in foreclosure. The anticipated loss amounts are then compared to the dollar amount of the excess collateral included in each pool. Based on the bank's calculations and assumptions, management anticipates receiving all of the outstanding principal and the related interest for each security. The valuation change has been recorded as a change in the unrealized gain/loss recognized in other comprehensive income.

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

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



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	One to Five Years		Five to Ten Years		Over Ten Years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
<b>Available for Sale</b>								
Government sponsored enterprises	\$ -	- %	\$ 11,238	5.19 %	\$ 7,470	5.06%	\$ 18,708	5.14 %
State and political subdivisions	-	- %	645	3.81%	3,127	3.79 %	3,772	3.80 %
Mortgage-backed securities	414	4.69 %	4,838	4.51 %	36,634	5.74 %	41,886	5.59 %
FNMA Preferred Stock	-	- %	-	- %	66	- %	66	- %
Total	\$ 414	4.69 %	\$ 16,721	4.94 %	\$ 47,297	5.48 %	\$ 64,432	5.50 %
<b>Held to Maturity</b>								
Mortgage-backed securities	\$ 238	3.95%	\$ 2,333	4.45 %	\$ 9,948	4.70 %	\$ 12,519	4.64 %

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

*Loans*

Since loans typically provide higher interest yields than other types of interest earning assets, a substantial percentage of our earning assets are invested in our loan portfolio. For the nine months ended September 30, 2009 and 2008, average loans were \$567.9 million and \$542.7 million, respectively. Before the allowance for loan losses, total loans outstanding at September 30, 2009 were \$569.7 million. Average loans for the year ended December 31, 2008 were \$547.7 million. Before the allowance for loan losses, total loans outstanding at December 31, 2008 were \$566.6 million.

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

The following table summarizes the composition of our loan portfolio at September 30, 2009 and December 31, 2008 (dollars in thousands). The \$28.9 million decrease in construction loans is primarily due to projects being completed and the loan restructured into a permanent loan either with our bank or another financial institution.

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	September 30, 2009		December 31, 2008	
	Amount	% of Total	Amount	% of Total
<b>Real estate:</b>				
<b>Commercial:</b>				
Owner occupied	\$ 129,014	22.6 %	\$ 113,370	20.0 %
Non-owner occupied	160,995	28.3 %	151,274	26.7 %
Construction	24,133	4.2 %	52,981	9.4 %
Total commercial real estate	314,142	55.1 %	317,625	56.1 %
<b>Consumer:</b>				
Residential	55,788	9.8 %	60,336	10.7 %
Home equity	73,112	12.8 %	62,987	11.1 %
Construction	5,685	1.0 %	8,905	1.5 %
Total consumer real estate	134,585	23.6 %	132,228	23.3 %
Total real estate	448,727	78.7 %	449,853	79.4 %
Commercial business	111,420	19.6 %	106,479	18.8 %
Consumer-other	10,305	1.8 %	11,194	2.0 %
Deferred origination fees, net	(765)	(0.1)%	(919)	(0.2)%
Total gross loans, net of deferred fees	569,687	100.0 %	566,607	100.0 %
Less allowance for loan losses	(7,916)		(7,005)	
Total loans, net	\$ 561,771		\$ 559,602	

*Maturities and Sensitivity of Loans to Changes in Interest Rates*

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

The following table summarizes the loan maturity distribution by type and related interest rate characteristics at September 30, 2009 (dollars in thousands).

	One year or less	After one but within five years	After five years	Total
Real estate mortgage	\$ 78,715	\$ 257,022	\$ 83,172	\$ 418,909
Real estate construction	14,101	14,139	1,578	29,818
Total real estate	92,816	271,161	84,750	448,727
Commercial business	61,251	47,871	2,298	111,420
Consumer-other	6,325	3,430	550	10,305

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Deferred origination fees, net	(208)	(437)	(120)	(765)
Total gross loans, net of deferred fees	\$ 160,184	\$ 322,025	\$ 87,478	\$ 569,687
Loans maturing after one year with:				
Fixed interest rates				\$ 206,840
Floating interest rates				\$ 202,663

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

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

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*Provision and Allowance for Loan Losses*

We have established an allowance for loan losses through a provision for loan losses charged to expense on our statement of income. The allowance for loan losses represents an amount which we believe will be adequate to absorb probable losses on existing loans that may become uncollectible. Our judgment as to the adequacy of the allowance for loan losses is based on a number of assumptions about future events, which we believe to be reasonable, but which may or may not prove to be accurate. Our determination of the allowance for loan losses is based on evaluations of the collectibility of loans, including consideration of factors such as the balance of impaired loans, the quality, mix, and size of our overall loan portfolio, economic conditions that may affect the borrower's ability to repay, the amount and quality of collateral securing the loans, our historical loan loss experience, and a review of specific problem loans. We also consider subjective issues such as changes in the

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lending policies and procedures, changes in the local/national economy, changes in volume or type of credits, changes in volume/severity of problem loans, quality of loan review and board of director oversight, concentrations of credit, and peer group comparisons. Due to our limited operating history, the provision for loan losses has been made primarily as a result of our assessment of general loan loss risk compared to banks of similar size and maturity. Due to the growth of our bank over the past several years and our short operating history, a large portion of the loans in our loan portfolio and of our lending relationships are of relatively recent origin. In general, loans do not begin to show signs of credit deterioration or default until they have been outstanding for some period of time, a process known as seasoning. As a result, a portfolio of older loans will usually behave more predictably than a newer portfolio. Because our loan portfolio is relatively new, the current level of delinquencies and defaults may not be representative of the level that will prevail when the portfolio becomes more seasoned, which may be higher than current levels. If delinquencies and defaults increase, we may be required to increase our provision for loan losses, which would adversely affect our results of operations and financial condition. Periodically, we adjust the amount of the allowance based on changing circumstances. We charge recognized losses to the allowance and add subsequent recoveries back to the allowance for loan losses. There can be no assurance that charge-offs of loans in future periods will not exceed the allowance for loan losses as estimated at any point in time or that provisions for loan losses will not be significant to a particular accounting period.

The following table summarizes the activity related to our allowance for loan losses for the nine months ended September 30, 2009 and 2008 (dollars in thousands):

	<b>September 30,</b>	
	<b>2009</b>	<b>2008</b>
Balance, beginning of period	\$ 7,005	\$ 5,751
Loans charged-off	(1,995)	(1,219)
Recoveries of loans previously charged-off	96	10
Net loans (charged-off) recovery	\$ (1,899)	\$ (1,209)
Provision for loan losses	2,810	1,950
Balance, end of period	\$ 7,916	\$ 6,492
Allowance for loan losses to gross loans	1.39%	1.16%
Net charge-offs to average loans	0.45%	0.30%

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

The allowance for loan losses was \$7.9 million and \$7.0 million at September 30, 2009 and December 31, 2008, respectively, or 1.39% and 1.24% of outstanding loans, respectively. During the year ended December 31, 2008, we had net charged-off loans of \$1.9 million. During the nine months ended September 30, 2009 and 2008 we had net charge-offs of \$1.9 million and \$1.2 million, respectively.

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The following table shows the nonperforming assets and the related percentage of nonperforming assets to total assets and gross loans as of September 30, 2009 and December 31, 2008 (dollars in thousands). Generally, a loan is placed on nonaccrual status when it becomes 90 days past due as to principal or interest, or when we believe, after considering economic and business conditions and collection efforts, that the borrower's financial condition is such that collection of the loan is doubtful. A payment of interest on a loan that is classified as nonaccrual is recognized as a reduction in principal when received.

	September 30, 2009	December 31, 2008
<b>Loans on nonaccrual:</b>		
Mortgage	\$ 7,863	6,818
Commercial	1,955	868
Consumer	58	13
<b>Total nonaccrual loans</b>	<b>9,876</b>	<b>7,699</b>
<b>Total of nonperforming loans</b>	<b>9,876</b>	<b>7,699</b>
<b>Other nonperforming assets</b>	<b>4,093</b>	<b>2,116</b>
<b>Total nonperforming assets</b>	<b>\$ 13,969</b>	<b>9,815</b>
<b>Loans over 90 days past due (1)</b>	<b>\$ 4,830</b>	<b>7,008</b>
<b>Nonperforming assets as a percentage of:</b>		
Total assets	1.91 %	1.42 %
Gross loans	2.45 %	1.73 %

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

At September 30, 2009 nonperforming assets were \$14.0 million, or 1.91% of total assets and 2.45% of gross loans. Comparatively, nonperforming assets were \$9.8 million, or 1.42% of total assets and 1.73% of gross loans at December 31, 2008. Nonaccrual loans increased \$2.2 million to \$9.9 million at September 30, 2009 from \$7.7 million at December 31, 2008. This increase is primarily related to 2 residential real estate properties and several commercial business loans. The amount of foregone interest income on the nonaccrual loans in the first nine months of 2009 was approximately \$467,000. The amount of interest income recorded in the first nine months of 2009 for loans that were on nonaccrual at September 30, 2009 was approximately \$87,000.

Other nonperforming assets include real estate acquired in settlement of loans. These assets increased \$2.0 million to \$4.1 million at September 30, 2009 from \$2.1 million at December 31, 2008. The balance at September 30, 2009 includes six commercial properties totaling \$3.5 million and four pieces of residential real estate for \$562,000. We believe that these properties are appropriately valued at the lower of cost or market as of September 30, 2009.

At September 30, 2009 and 2008, impaired loans amounted to approximately \$9.9 million and \$3.4 million. Specific reserves allocated to these impaired loans totaled \$1.2 million and \$400,000 at September 30, 2009 and 2008, respectively. At September 30, 2009, there were approximately \$3.4 million of impaired loans with specific reserves and approximately \$6.5 million in impaired loans for which no specific reserve had been recognized. The average recorded investment in impaired loans for the quarters ended September 30, 2009 and 2008 was \$9.3 million and \$2.9 million, respectively.

*Deposits and Other Interest-Bearing Liabilities*

Our primary source of funds for loans and investments is our deposits, advances from the FHLB, and short-term repurchase agreements. National and local market trends over the past several years suggest that consumers have moved an increasing percentage of discretionary savings funds into investments such as annuities, stocks, and fixed income mutual funds. Accordingly, it has become more difficult to attract deposits. We have chosen to obtain a portion of our certificates of deposits from areas outside of our market. The deposits obtained outside of our market area generally have comparable rates compared to rates being offered for certificates of deposits in our local market. We also utilize out-of-market deposits in certain instances to obtain longer-term deposits than are readily available in our local market. The amount of out-of-market deposits was \$184.9 million at September 30, 2009 and \$200.9 million at December 31, 2008.

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

We anticipate being able to either renew or replace these out-of-market deposits when they mature, although we may not be able to replace them with deposits with the same terms or rates. Our loan-to-deposit ratio was 115% and 121% at September 30, 2009 and December 31, 2008, respectively.

The following table shows the average balance amounts and the average rates paid on deposits held by us for the nine months ended September 30, 2009 and 2008 (dollars in thousands).

	<b>2009</b>		<b>2008</b>	
	<b>Amount</b>	<b>Rate</b>	<b>Amount</b>	<b>Rate</b>
Noninterest bearing demand deposits	\$ 35,663	- %	\$ 32,369	- %
Interest bearing demand deposits	43,015	0.69 %	39,135	1.08 %
Money market accounts	83,501	1.16 %	88,284	2.01 %
Savings accounts	2,138	0.17 %	1,841	0.35 %
Time deposits less than \$100,000	45,386	3.11 %	47,770	4.05 %
Time deposits greater than \$100,000	272,130	2.77 %	252,603	4.44 %
Total deposits	\$ 481,833	2.12 %	\$ 462,002	3.32 %

The increase in time deposits of \$100,000 or more for the nine months ended September 30, 2009 compared to the 2008 period resulted primarily from a \$20.9 million increase in average wholesale deposits during the 2009 period.

Core deposits, which exclude out-of-market deposits and time deposits of \$100,000 or more, provide a relatively stable funding source for our loan portfolio and other earning assets. Our core deposits were \$227.1 million and \$205.9 million at September 30, 2009 and December 31, 2008, respectively.

All of our time deposits are certificates of deposits. The maturity distribution of our time deposits of \$100,000 or more at September 30, 2009 was as follows (dollars in thousands):

Three months or less	\$ 58,927
Over three through six months	49,988
Over six through twelve months	57,640
Over twelve months	99,766
Total	\$ 266,321

### Capital Resources

Total shareholders' equity at September 30, 2009 was \$60.2 million. At December 31, 2008, total shareholders' equity was \$39.8 million. The \$20.5 million increase during the first nine months of 2009 resulted primarily from the \$17.3 million issuance of preferred stock as well as \$2.1 million from an unrealized gain on securities available for sale.

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

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The following table shows the return on average assets (net income divided by average total assets), return on average equity (net income divided by average equity), and equity to assets ratio (average equity divided by average total assets) annualized for the nine months ended September 30, 2009 and the year ended December 31, 2008. Since our inception, we have not paid cash dividends.

	September 30, 2009	December 31, 2008
Return on average assets	0.24 %	0.27 %

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Return on average equity	3.07 %	4.70 %
Return on average common equity	1.38 %	4.70 %
Equity to total assets ratio	7.67 %	5.73 %
Common equity to total assets ratio	6.16 %	5.73 %

Our return on average assets was 0.24% for the nine months ended September 30, 2009, a slight decrease from 0.27% for the year ended December 31, 2008. In addition, our return on average equity decreased to 3.07% from 4.70% for the nine months ended September 30, 2009 and the year ended December 31, 2008, respectively. The increase in the equity to total assets ratio from December 31, 2008 is primarily related to the \$17.3 million received in conjunction with the issuance of preferred stock. In addition, our return on average common equity was 1.38% and our common equity to total assets ratio was 6.16% for the nine months ended September 30, 2009.

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

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

In October, 2008, President Bush signed in law the EESA in response to the financial crises affecting the banking system. The Treasury Department and banking regulators are implementing a number of programs under this legislation to address capital and liquidity issues in the banking system. Under the Treasury Department's CPP, we received \$17.3 million through issuance of Series T Preferred Stock and the CPP Warrant for common stock to the Treasury Department. The Series T Preferred Stock issuance and the related CPP Warrant both qualify for Tier 1 capital and added approximately 300 basis points to that measure. The fair value allocation of the \$17.3 million between the shares of Series T Preferred Stock and the CPP Warrant resulted in \$15.9 million allocated to the shares of Series T Preferred Stock and \$1.4 million allocated to the CPP Warrant. See discussion of shareholders' equity above for additional details.

The following table sets forth the holding company's and the bank's various capital ratios at September 30, 2009 and at December 31, 2008. For all periods, the bank was considered well-capitalized and the holding company met or exceeded its applicable regulatory capital requirements.

	September 30, 2009		December 31, 2008	
	Holding Company	Bank	Holding Company	Bank
Total risk-based capital	13.4 %	12.9 %	10.4 %	12.8 %
Tier 1 risk-based capital	12.1 %	11.7 %	9.2 %	11.6 %
Leverage capital	9.9 %	9.6 %	7.7 %	9.8 %



**Effect of Inflation and Changing Prices**

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

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

**Off-Balance Sheet Risk**

Commitments to extend credit are agreements to lend money to a client as long as the client has not violated any material condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require the payment of a fee. At September 30, 2009, unfunded commitments to extend credit were \$83.4 million, of which \$10.0 million was at fixed rates and \$73.4 million was at variable rates. At December 31, 2008, unfunded commitments to extend credit were \$89.0 million, of which approximately \$13.8 million was at fixed rates and \$75.1 million was at variable rates. A significant portion of the unfunded commitments related to consumer equity lines of credit. Based on historical experience, we anticipate that a significant portion of these lines of credit will not be funded. We evaluate each client's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by us upon extension of credit, is based on our credit evaluation of the borrower. The type of collateral varies but may include accounts receivable, inventory, property, plant and equipment, and commercial and residential real estate.

At September 30, 2009 there was a \$5.2 million commitment under letters of credit. At December 31, 2008 there was a \$4.8 million commitment under letters of credit. The credit risk and collateral involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Since most of the letters of credit are expected to expire without being drawn upon, they do not necessarily represent future cash requirements.

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

**Market Risk and Interest Rate Sensitivity**

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

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

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

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The following table sets forth information regarding our rate sensitivity as of September 30, 2009 for each of the time intervals indicated (dollars in thousands).

	<b>Within three months</b>	<b>After three but within twelve months</b>	<b>After one but within five years</b>	<b>After five years</b>	<b>Total</b>
<b>Interest-earning assets:</b>					
Federal funds sold	\$ 21,963	\$ -	\$ -	\$ -	\$ 21,963
Investment securities	4,950	13,167	39,457	32,996	90,570
Loans	297,810	38,700	169,040	51,889	557,439
<b>Total earning assets</b>	<b>\$ 324,723</b>	<b>\$ 51,867</b>	<b>\$ 208,497</b>	<b>\$ 84,885</b>	<b>\$ 669,972</b>
<b>Interest-bearing liabilities:</b>					
Money market and NOW	\$ 129,168	\$ -	\$ -	\$ -	\$ 129,168
Regular savings	2,143	-	-	-	2,143
Time deposits	74,865	139,885	112,049	-	326,799
Short-term repurchase agreements	5,000	-	-	-	5,000
Note payable and other borrowings	79,850	26,975	32,600	15,000	154,425
Junior subordinated debentures	13,403	-	-	-	13,403
<b>Total interest-bearing liabilities</b>	<b>\$ 304,429</b>	<b>\$ 166,860</b>	<b>\$ 144,649</b>	<b>\$ 15,000</b>	<b>\$ 630,938</b>

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Period gap	\$ 20,294	\$ (114,993)	\$ 63,848	\$ 69,885
Cumulative gap	20,294	(94,699)	(30,851)	39,034
Ratio of cumulative gap to total earning assets	3.0%	(14.1%)	(4.6 %)	5.8 %

The following table sets forth information regarding our rate sensitivity, as of December 31, 2008, at each of the time intervals (dollars in thousands).

	Within three months	After three but within twelve months	After one but within five years	After five years	Total
<b>Interest-earning assets:</b>					
Federal funds sold	\$ 8,800	-	-	-	8,800
Investment securities	4,673	22,187	26,209	23,882	76,951
Loans	262,203	41,558	191,387	64,269	559,417
Total earning assets	\$ 275,676	63,745	217,596	88,151	645,168
<b>Interest-bearing liabilities:</b>					
Money market and NOW	\$ 122,608	-	-	-	122,608
Regular savings	1,918	-	-	-	1,918
Time deposits	101,083	135,611	73,549	-	310,243
Note payable and other borrowings	94,575	14,500	45,600	10,000	164,675
Junior subordinated debentures	13,403	-	-	-	13,403
Total interest-bearing liabilities	\$ 333,587	150,111	119,149	10,000	612,847
Period gap	\$ (57,911)	(86,366)	98,447	78,151	
Cumulative Gap	(57,911)	(144,277)	(45,830)	32,321	
Ratio of cumulative gap to total earning assets	(9.0%)	(22.4%)	(7.1%)	5.0%	

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We were liability sensitive at both December 31, 2008 and September 30, 2009. Our variable rate loans and a majority of our deposits reprice over a 12-month period. Approximately 50% and 43% of our loans were variable rate loans at September 30, 2009 and December 31, 2008, respectively. The ratio of cumulative gap to total earning assets after 12 months is (14.1%) because \$94.7 million more liabilities will reprice in a 12 month period than assets. However, our gap analysis is not a precise indicator of our interest sensitivity position. The analysis presents only a static view of the timing of maturities and repricing opportunities, without taking into consideration that changes in interest rates do not affect all assets and liabilities equally. For example, rates paid on a substantial portion of core deposits may change contractually within a relatively short time frame, but those rates are viewed by us as significantly less interest-sensitive than market-based rates such as those paid on noncore deposits. Net interest income may be affected by other significant factors in a given interest rate environment, including changes in the volume and mix of interest-earning assets and interest-bearing liabilities.

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At September 30, 2009, 74.7% of our interest-bearing liabilities were either variable rate or had a maturity of less than one year. Of the \$304.4 million of interest-bearing liabilities set to reprice within three months, 43.1% are transaction, money market or savings accounts which are already at or near their lowest rates and provide little opportunity for benefit should market rates continue to decline or stay constant. However, certificates of deposit that are currently maturing or renewing are repricing at lower rates. We expect to benefit as these deposits reprice, even if market rates increase slightly. At September 30, 2009, we had \$94.7 million more liabilities than assets that reprice within the next twelve months. Included in our other borrowings are a number of FHLB advances and structured repurchase agreements with callable features as of September 30, 2009. We believe that the optionality on many of these borrowings will not be exercised until interest rates increase significantly. In addition, we believe that the interest rates that we pay on the majority of our interest-bearing transaction accounts, would only be impacted by a portion of any change in market rates. This key assumption is utilized in our overall evaluation of our level of interest sensitivity.

### Liquidity Risk

Liquidity represents the ability of a company to convert assets into cash or cash equivalents without significant loss, and the ability to raise additional funds by increasing liabilities. Liquidity management involves monitoring our sources and uses of funds in order to meet our day-to-day cash flow requirements while maximizing profits. Liquidity management is made more complicated because different balance sheet components are subject to varying degrees of management control. For example, the timing of maturities of our investment portfolio is fairly predictable and subject to a high degree of control at the time investment decisions are made. However, net deposit inflows and outflows are far less predictable and are not subject to the same degree of control.

At September 30, 2009 and December 31, 2008, our liquid assets, consisting of cash and due from banks and federal funds sold, amounted to \$28.9 million and \$13.2 million, or 3.9% and 1.9% of total assets, respectively. Our investment securities at September 30, 2009 and December 31, 2008 amounted to \$99.7 million and \$85.4 million, or 13.6% and 12.3% of total assets, respectively. Investment securities traditionally provide a secondary source of liquidity since they can be converted into cash in a timely manner. However, a substantial portion of these securities are pledged against outstanding debt. Therefore, the related debt would need to be repaid prior to the securities being sold in order for these securities to be converted to cash.

Our ability to maintain and expand our deposit base and borrowing capabilities serves as our primary source of liquidity. We plan to meet our future cash needs through the liquidation of temporary investments, the generation of deposits, and from additional borrowings. In addition, we will receive cash upon the maturity and sale of loans and the maturity of investment securities. We maintain three federal funds purchased lines of credit with correspondent banks totaling \$38.0 million for which there were no borrowings against the lines at September 30, 2009.

We are also a member of the Federal Home Loan Bank of Atlanta (FHLB), from which applications for borrowings can be made. The FHLB requires that securities, qualifying mortgage loans, and stock of the FHLB owned by the bank be pledged to secure any advances from the FHLB. The unused borrowing capacity currently available from the FHLB at September 30, 2009 was \$6.3 million, based on the bank's \$7.1 million investment in FHLB stock, as well as qualifying mortgages available to secure any future borrowings. However, we are able to pledge additional securities to the FHLB in order to increase our available borrowing capacity.

We signed a ten-year, five-month lease on our main office building in 2005. The lease provides for annual lease rate escalations based on cost of living adjustments.

We believe that our existing stable base of core deposits, borrowings from the FHLB, and short-term repurchase agreements will enable us to successfully meet our long-term liquidity needs.

As a result of the Treasury's Capital Purchase Program, we received \$17.3 million of capital on February 27, 2009 in exchange for 17,299 shares of preferred stock. This additional capital should allow us to remain well-capitalized and provide additional liquidity on our balance sheet.

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## Accounting, Reporting, and Regulatory Matters

### *Recently Issued Accounting Standards*

The following is a summary of recent authoritative pronouncements that affect accounting, reporting, and disclosure of financial information by us:

In June 2009, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 168, *The FASB Accounting Standards Codification*<sup>TM</sup> and the Hierarchy of Generally Accepted Accounting Principles a replacement of FASB Statement No. 162, (SFAS 168). SFAS 168 establishes the *FASB Accounting Standards Codification* (Codification) as the source of authoritative generally accepted accounting principles (GAAP) for nongovernmental entities. The Codification does not change GAAP. Instead, it takes the thousands of individual pronouncements that currently comprise GAAP and reorganizes them into approximately 90 accounting Topics, and displays all Topics using a consistent structure. Contents in each Topic are further organized first by Subtopic, then Section and finally Paragraph. The Paragraph level is the only level that contains substantive content. Citing particular content in the Codification involves specifying the unique numeric path to the content through the Topic, Subtopic, Section and Paragraph structure. FASB suggests that all citations begin with FASB ASC, where ASC stands for *Accounting Standards Codification*. Changes to the ASC subsequent to June 30, 2009 are referred to as Accounting Standards Updates (ASU).

In conjunction with the issuance of SFAS 168, the FASB also issued its first Accounting Standards Update No. 2009-1, Topic 105 Generally Accepted Accounting Principles (ASU 2009-1) which includes SFAS 168 in its entirety as a transition to the ASC. ASU 2009-1 is effective for interim and annual periods ending after September 15, 2009 and will not have an impact on the Company's financial position or results of operations but will change the referencing system for accounting standards. Certain of the following pronouncements were issued prior to the issuance of the ASC and adoption of the ASUs. For such pronouncements, citations to the applicable Codification by Topic, Subtopic and Section are provided where applicable in addition to the original standard type and number.

The FASB issued ASU 2009-05, Fair Value Measurements and Disclosures (Topic 820) Measuring Liabilities at Fair Value in August, 2009 to provide guidance when estimating the fair value of a liability. When a quoted price in an active market for the identical liability is not available, fair value should be measured using (a) the quoted price of an identical liability when traded as an asset; (b) quoted prices for similar liabilities or similar liabilities when traded as assets; or (c) another valuation technique consistent with the principles of Topic 820 such as an income approach or a market approach. If a restriction exists that prevents the transfer of the liability, a separate adjustment related to the restriction is not required when estimating fair value. The ASU was effective October 1, 2009 for the Company and will have no impact on financial position

or operations.

ASU 2009-12, Fair Value Measurements and Disclosures (Topic 820) - Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent), issued in September, 2009, allows a company to measure the fair value of an investment that has no readily determinable fair market value on the basis of the investee's net asset value per share as provided by the investee. This allowance assumes that the investee has calculated net asset value in accordance with the GAAP measurement principles of Topic 946 as of the reporting entity's measurement date. Examples of such investments include investments in hedge funds, private equity funds, real estate funds and venture capital funds. The update also provides guidance on how the investment should be classified within the fair value hierarchy based on the value for which the investment can be redeemed. The amendment is effective for interim and annual periods ending after December 15, 2009 with early adoption permitted. The Company does not have investments in such entities and, therefore, there will be no impact to our financial statements.

Issued October, 2009, ASU 2009-15, Accounting for Own-Share Lending Arrangements in Contemplation of Convertible Debt Issuance or Other Financing amends ASC Topic 470 and provides guidance for accounting and reporting for own-share lending arrangements issued in contemplation of a convertible debt issuance. At the date of issuance, a share-lending arrangement entered into on an entity's own shares should be measured at fair value in accordance with Topic 820 and recognized as an issuance cost, with an offset to additional paid-in capital. Loaned shares are excluded from basic and diluted earnings per share unless default of the share-lending arrangement occurs. The amendments also require several disclosures including a description and the terms of the arrangement and the reason for entering into the arrangement. The effective dates of the amendments are dependent upon the date the share-lending arrangement was entered into and include retrospective application for arrangements outstanding as of the beginning of fiscal years beginning on or after December 15, 2009. The Company has no plans to issue convertible debt and, therefore, does not expect the update to have an impact on its financial statements.

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Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies that do not require adoption until a future date are not expected to have a material impact on the consolidated financial statements upon adoption.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk.**

Not applicable

**Item 4. Controls and Procedures.**

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures as defined in Exchange Act Rule 13a-15(e). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our current disclosure controls and procedures are effective as of September 30, 2009. There have been no significant changes in

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our internal controls over financial reporting during the fiscal quarter ended September 30, 2009 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

The design of any system of controls and procedures is based in part upon certain assumptions about the likelihood of future events. There can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote.

### **PART II. OTHER INFORMATION**

#### **Item 1. Legal Proceedings.**

There are no material pending legal proceedings to which the company is a party or of which any of its property is the subject.

#### **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

Not applicable

#### **Item 3. Defaults Upon Senior Securities.**

Not applicable

#### **Item 4. Submission of Matters to a Vote of Security Holders.**

Not applicable

#### **Item 5. Other Information.**

Not applicable

#### **Item 6. Exhibits.**

31.1 Rule 13a-14(a) Certification of the Principal Executive Officer.

31.2 Rule 13a-14(a) Certification of the Principal Financial Officer.

32 Section 1350 Certifications.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**SOUTHERN FIRST BANCSHARES, INC.**

Registrant

Date: November 4, 2009

/s/R. Arthur Seaver, Jr.

R. Arthur Seaver, Jr.  
Chief Executive Officer

Date: November 4, 2009

/s/James M. Austin, III

James M. Austin, III  
Chief Financial Officer

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**INDEX TO EXHIBITS**

<b><u>Exhibit Number</u></b>	<b><u>Description</u></b>
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31.1	Rule 13a-14(a) Certification of the Principal Executive Officer.
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31.2 Rule 13a-14(a) Certification of the Principal Financial Officer.

32 Section 1350 Certifications.

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